

WILLIAMS SONOMA INC
Form 10-K
April 04, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

(Mark One):

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended February 3, 2013.

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

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

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Common Stock, \$.01 par value
(Title of class)

New York Stock Exchange, Inc.
(Name of each exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act: None

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

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

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

Indicate by check mark whether the registrant has submitted electronically 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 No

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

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

Large accelerated filer 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 Act). Yes No

As of July 29, 2012, the approximate aggregate market value of the registrant's common stock held by non-affiliates was \$3,432,941,000. It is assumed for purposes of this computation that an affiliate includes all persons as of July 29, 2012 listed as executive officers and directors with the Securities and Exchange Commission. This aggregate market value includes all shares held in the Williams-Sonoma, Inc. Stock Fund within the registrant's 401(k) Plan.

As of April 1, 2013, 97,696,301 shares of the registrant's common stock were outstanding.

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DOCUMENTS INCORPORATED BY REFERENCE

Portions of our definitive Proxy Statement for the 2013 Annual Meeting of Stockholders, also referred to in this

Annual Report on Form 10-K as our Proxy Statement, which will be filed with the Securities and Exchange

Commission, or SEC, have been incorporated in Part III hereof.

FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K and the letters to stockholders contained in this Annual Report contain forward-looking statements within the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 that involve risks and uncertainties, as well as assumptions that, if they do not fully materialize or prove incorrect, could cause our business and operating results to differ materially from those expressed or implied by such forward-looking statements. Such forward-looking statements include, without limitation: projections of earnings, revenues or financial items, including future comparable brand revenues, and our ability to achieve new levels of sales and profitability; statements related to enhancing stockholder value; statements related to growth of our business and our brands; statements related to our beliefs about our competitive position and our ability to leverage our competitive advantages; statements related to the plans, strategies, initiatives and objectives of management for future operations; statements related to our brands and our products, including our ability to introduce new brands and new products and product lines; statements related to our belief that our direct-mail catalogs and the Internet act as a cost-efficient means of testing market acceptance of new products and new brands; statements related to our marketing efforts; statements related to our ability to attract new customers; statements related to our belief regarding our competitive advantages; statements related to the seasonal variations in demand; statements related to our belief in the adequacy of our facilities and the availability of suitable additional or substitute space; statements related to our belief in the ultimate resolution of current legal proceedings; statements related to the payment of dividends; statements related to our stock repurchase program; statements related to our global business, including franchising and other third party arrangements in the Middle East and our entry into the Australian market; statements related to our planned use of cash in fiscal 2013; statements related to our compliance with financial covenants; statements related to our belief that our cash on hand and available credit facilities will provide adequate liquidity for our business operations over the next 12 months; statements related to our anticipated investments in the purchase of property and equipment; statements related to our belief regarding the effects of potential losses under our indemnification obligations; statements related to the effects of changes in our inventory reserves; statements related to the impact of new accounting pronouncements; and statements of belief and statements of assumptions underlying any of the foregoing. You can identify these and other forward-looking statements by the use of words such as will, may, should, expects, plans, anticipates, believes, estimates, predicts, intends, potential, continue, or the negative of such comparable terminology.

The risks, uncertainties and assumptions referred to above that could cause our results to differ materially from the results expressed or implied by such forward-looking statements include, but are not limited to, those discussed under the heading Risk Factors in Item 1A hereto and the risks, uncertainties and assumptions discussed from time to time in our other public filings and public announcements. All forward-looking statements included in this document are based on information available to us as of the date hereof, and we assume no obligation to update these forward-looking statements.

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WILLIAMS-SONOMA, INC.
ANNUAL REPORT ON FORM 10-K
FISCAL YEAR ENDED FEBRUARY 3, 2013

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PART I

ITEM 1. BUSINESS OVERVIEW

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

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

In the decades that followed, the quality of our products, our ability to identify new opportunities in the market and our people-first approach to business have facilitated our expansion beyond the kitchen into nearly every area of the home. Additionally, by embracing new technologies and customer-engagement strategies as they emerge, we are able to continually refine our best-in-class approach to multi-channel retailing.

Today, Williams-Sonoma, Inc. is one of the United States' largest e-commerce retailers with some of the best known and most beloved brands in home furnishings. We currently operate retail stores in the United States, Canada and Puerto Rico, and franchise our brands to a third party in a number of countries in the Middle East, including Bahrain, the Kingdom of Saudi Arabia, Kuwait and the United Arab Emirates. Our products are also available to customers through our catalogs and online worldwide.

Williams-Sonoma

From the beginning, our namesake brand, Williams-Sonoma, has been bringing people together around food. A leading specialty retailer of high-quality products for the kitchen and home, the brand seeks to provide world-class service and an engaging customer experience. Williams-Sonoma products include everything for cooking, dining and entertaining, including: cookware, tools, electrics, cutlery, tabletop and bar, outdoor and a vast library of cookbooks.

Pottery Barn

Established in 1949 and acquired by Williams-Sonoma, Inc. in 1986, Pottery Barn is a premier multi-channel home furnishings retailer. The brand was founded on the idea that home furnishings should be exceptional in comfort, quality, style and value. Pottery Barn stores and catalogs are specially designed to make shopping an enjoyable experience, with inspirational lifestyle displays dedicated to every space in the home.

Pottery Barn Kids

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

West Elm

Since its launch in 2002, West Elm has been helping customers express their personal style at home with authentic, affordable and approachable products. West Elm offers a broad range of home furnishing categories including furniture, textiles, decorative accessories, lighting and tabletop items. Each season, West Elm's talented in-house team of designers create a collection that cannot be found anywhere else, and work with artists and independent designers both globally and locally to develop collaborations that are exclusive to the brand. The brand also works closely with organizations that support the development of craft and artisan skills to offer handcrafted and one-of-a-kind discoveries from around the world.

In late 2012, we extended our West Elm brand to include West Elm Market, which offers customers a total home toolkit in four key product categories—kitchen, garden, care and repair and personal care—while focusing on functional design, local production, entrepreneurship and community connections. These products are available in West Elm Market stand-alone stores and select West Elm stores in North America, as well as online through the West Elm website.

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PBteen

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

Rejuvenation

Rejuvenation, founded in 1977 with a passion for old buildings, vintage lighting and house parts and great design, was acquired by Williams-Sonoma, Inc. in 2011. Inspired by history and period authenticity, Rejuvenation's lighting and home-goods product lines span periods back to the 1870s. With manufacturing facilities in Portland, Oregon, Rejuvenation offers a wide assortment of high-quality lights, hardware, furniture and home décor.

Mark and Graham

Launched in late 2012, Mark and Graham is designed to be a premier destination for personalized gift buying. Whether customers are shopping for themselves or for family and friends, they have the opportunity to combine typography and design to make their own unique mark and create something deeply personal. The brand's product lines include men's and women's accessories, small leather goods, jewelry, entertaining and bar, home décor, as well as do-it-yourself wrapping supplies and seasonal items.

DIRECT-TO-CUSTOMER OPERATIONS

As of February 3, 2013, the direct-to-customer segment has seven merchandising concepts (Williams-Sonoma, Pottery Barn, Pottery Barn Kids, PBteen, West Elm, Rejuvenation and Mark and Graham) and sells products through our seven e-commerce websites (williams-sonoma.com, potterybarn.com, potterybarnkids.com, pbteen.com, westelm.com, rejuvenation.com and markandgraham.com) and eight direct-mail catalogs (Williams-Sonoma, Pottery Barn, Pottery Barn Bed and Bath, Pottery Barn Kids, PBteen, West Elm, Rejuvenation and Mark and Graham). We offer shipping from many of our brands to countries worldwide, while our catalogs reach customers across the U.S. Of our seven merchandising concepts, the Pottery Barn brand and its extensions continue to be the major source of revenue in the direct-to-customer segment.

The direct-to-customer business complements the retail business by building brand awareness and acting as an effective advertising vehicle. In addition, we believe that our direct-mail catalogs and our e-commerce websites act as a cost-efficient means of testing market acceptance of new products and new brands. Leveraging these insights and our multi-channel positioning, our marketing efforts, including the circulation of catalogs and the use of e-commerce advertising, are targeted toward driving sales to all of our channels, including retail.

Consistent with our published privacy policies, we send our catalogs to addresses from our proprietary customer list, as well as to addresses from lists of other mail order direct marketers, magazines and companies with which we establish a business relationship. In accordance with prevailing industry practice and our privacy policies, we may also rent our list to select merchandisers. Our customer mailings are continually updated to include new prospects and to eliminate non-responders. In addition, we send email communications only to those customers who have voluntarily provided us with their email addresses.

Detailed financial information about the direct-to-customer segment is found in Note M to our Consolidated Financial Statements.

RETAIL STORES

As of February 3, 2013, the retail segment has five merchandising concepts (Williams-Sonoma, Pottery Barn, Pottery Barn Kids, West Elm and Rejuvenation), operating 560 stores in 44 states, Washington, D.C., and Puerto Rico and 21 stores in Canada. This represents 253 Williams-Sonoma, 192 Pottery Barn, 84 Pottery Barn Kids, 48 West Elm and 4 Rejuvenation stores.

We also have a multi-year franchise agreement with a third party that currently operates 23 franchised stores in a number of countries in the Middle East, including Bahrain, the Kingdom of Saudi Arabia, Kuwait and the United Arab Emirates.

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The retail business complements the direct-to-customer business by building brand awareness and attracting new customers to our brands. Our retail stores serve as billboards for our brands, which we believe inspires confidence in our customers to shop online and through our catalogs.

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

SUPPLIERS

We purchase our merchandise from numerous foreign and domestic manufacturers and importers, the largest of which accounted for approximately 3% of our purchases during fiscal 2012. Approximately 61% of our merchandise purchases in fiscal 2012 were foreign-sourced from vendors in 52 countries, predominantly in Asia and Europe, of which approximately 98% were negotiated and paid for in U.S. dollars.

COMPETITION AND SEASONALITY

The specialty retail business is highly competitive. Our specialty retail stores, direct-mail catalogs and e-commerce websites compete with other retail stores, including large department stores, discount retailers, other specialty retailers offering home-centered assortments, other direct-mail catalogs and other e-commerce websites. The substantial sales growth in the direct-to-customer industry within the last decade, particularly in e-commerce, has encouraged the entry of many new competitors and an increase in competition from established companies. In addition, the more volatile economic environment since 2008 has generated increased competition from discount retailers who, in the past, may not have competed with us or to this degree. We compete on the basis of our brand authority, the quality of our merchandise, service to our customers, our proprietary customer list, our e-commerce websites and our marketing capabilities, as well as the location and appearance of our stores. We believe that we compare favorably with many of our current competitors with respect to some or all of these factors.

Our business is subject to substantial seasonal variations in demand. Historically, a significant portion of our revenues and net earnings have typically 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 anticipation of our peak season, we hire a substantial number of additional temporary employees in our retail stores, customer care centers and distribution centers, and incur significant fixed catalog production and mailing costs.

TRADEMARKS, COPYRIGHTS, PATENTS AND DOMAIN NAMES

We own and/or have applied to register over 75 separate trademarks and service marks. We own and/or have applied to register our key brand names as trademarks in the U.S., Canada and approximately 90 additional jurisdictions. Exclusive rights to the trademarks and service marks are held by Williams-Sonoma, Inc. and are used by our subsidiaries under license. These marks include our core brand names as well as brand names for selected products and services. The core brand names in particular, including Williams-Sonoma, the Williams-Sonoma Grande Cuisine logo, Pottery Barn, pottery barn kids, PBteen, west elm, Williams-Sonoma Home, Rejuvenation and Mark and Graham are of importance to us. Trademarks are generally valid as long as they are in use and/or their registrations are properly maintained, and they have not been found to have become generic. Trademark registrations can generally be renewed indefinitely so long as the marks are in use. We own numerous copyrights and trade dress rights for our products, product packaging, catalogs, books, house publications, website designs and store designs, among other things, which are also used by our subsidiaries under license. We hold patents on certain product functions and product designs. Patents are generally valid for 14 to 20 years as long as their registrations are properly maintained. In addition, we have registered and maintain numerous Internet domain names, including williams-sonoma.com, potterybarn.com, potterybarnkids.com, pbteen.com, westelm.com, wshome.com, williams-sonomainc.com, rejuvenation.com and markandgraham.com. Collectively, the trademarks, copyrights, trade dress rights and domain names that we hold are of material importance to us.

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EMPLOYEES

As of February 3, 2013, we had approximately 26,800 employees of whom approximately 7,200 were full-time. During the fiscal 2012 peak season (defined as the period from October through December), we hired approximately 9,800 temporary employees primarily in our retail stores, customer care centers and distribution centers.

AVAILABLE INFORMATION

We file annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy and information statements and amendments to reports filed or furnished pursuant to Sections 13(a), 14 and 15(d) of the Securities Exchange Act of 1934, as amended. The public may read and copy these materials at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains a website at www.sec.gov that contains reports, proxy and information statements and other information regarding Williams-Sonoma, Inc. and other companies that file materials with the SEC electronically. Our annual reports, Forms 10-K, Forms 10-Q, Forms 8-K and proxy and information statements are also available, free of charge, on our website at www.williams-sonomainc.com.

ITEM 1A. RISK FACTORS

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

The declines in general economic conditions over the past few years, and the resulting impact on consumer confidence and consumer spending, could adversely impact our results of operations.

Our financial performance is subject to declines in general economic conditions and the impact of such economic conditions on levels of consumer confidence and consumer spending. Consumer confidence and consumer spending may deteriorate significantly, and could remain depressed for an extended period of time. Consumer purchases of discretionary items, including our merchandise, generally decline during periods when disposable income is limited, unemployment rates increase or there is economic uncertainty. An uncertain economic environment, such as the one we experienced during the 2008-2009 downturn, could cause our vendors to go out of business or our banks to discontinue lending to us or our vendors, or it could cause us to undergo additional restructurings, any of which would adversely impact our business and operating results.

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

Our business depends on consumer demand for our products and, consequently, is sensitive to a number of factors that influence consumer spending, including general economic conditions, consumer disposable income, fuel prices, recession and fears of recession, unemployment, war and fears of war, inclement weather, such as Hurricane Sandy, availability of consumer credit, consumer debt levels, conditions in the housing market, interest rates, sales tax rates and rate increases, inflation, consumer confidence in future economic conditions and political conditions, and consumer perceptions of personal well-being and security. In particular, the 2008-2009 economic downturn led to decreased discretionary spending, which adversely impacted our business. In addition, a decrease in home purchases has led and may continue to lead to decreased consumer spending on home products. These factors have affected our various brands and channels differently. Adverse changes in factors affecting discretionary consumer spending have reduced and may continue to further reduce consumer demand for our products, thus reducing our sales and harming our business and operating results.

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

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

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

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

In fiscal 2012, we sourced our products from vendors in 52 countries outside of the United States. Approximately 61% of our merchandise purchases were foreign-sourced, predominantly from Asia and Europe. Our dependence on foreign vendors means that we may be affected by changes in the value of the U.S. dollar relative to other foreign currencies. For example, any upward valuation in the Chinese yuan, the euro, the Australian dollar or any other foreign currency against the U.S. dollar may result in higher costs to us for those goods. Although approximately 98% of our foreign purchases of merchandise are negotiated and paid for in U.S. dollars, declines in foreign currencies and currency exchange rates might negatively affect the profitability and business prospects of one or more of our foreign vendors. This, in turn, might cause such foreign vendors to demand higher prices for merchandise in their effort to offset any lost profits associated with any currency devaluation, delay merchandise shipments to us, or discontinue selling to us, any of which could ultimately reduce our sales or increase our costs. In addition, the rising cost of labor in the foreign countries in which our vendors operate has resulted in increases in our costs of doing business. Any further increases in the cost of living in such countries may result in additional increases in our costs or in our vendors going out of business.

We, and our vendors, are also subject to other risks and uncertainties associated with changing economic and political conditions in foreign countries. These risks and uncertainties include import duties and quotas, compliance with anti-dumping regulations, work stoppages, economic uncertainties and adverse economic conditions (including inflation and recession), foreign government regulations, employment matters, wars and fears of war, political unrest, natural disasters, regulations to address climate change and other trade restrictions. We cannot predict whether any of the countries in which our raw materials are sourced from, or our products are currently manufactured or may be manufactured in the future, will be subject to trade restrictions imposed by the

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U.S. or foreign governments or the likelihood, type or effect of any such restrictions. Any event causing a disruption or delay of imports from foreign vendors, including the imposition of additional import restrictions, restrictions on the transfer of funds and/or increased tariffs or quotas, or both, could increase the cost or reduce the supply of merchandise available to us and adversely affect our business, financial condition and operating results. Furthermore, some or all of our foreign vendors' operations may be adversely affected by political and financial instability resulting in the disruption of trade from exporting countries, restrictions on the transfer of funds and/or other trade disruptions. In addition, an economic downturn in or failure of foreign markets may result in financial instabilities for our foreign vendors, which may cause our foreign vendors to decrease production, discontinue selling to us, or cease operations altogether. Our operations in Asia and Europe could also be affected by changing economic and political conditions in foreign countries, any of which could have a negative effect on our business, financial condition and operating results.

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

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

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

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

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

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

Our vendors might not adhere to our quality control standards, and we might not identify the deficiency before merchandise ships to our stores or customers. Our vendors' failure to manufacture or import quality merchandise in a timely and effective manner could damage our reputation and brands, and could lead to an increase in customer litigation against us and an increase in our routine litigation costs. Further, any merchandise that we receive, even if it meets our quality standards, could become subject to a recall, which could damage our reputation and brands, and harm our business. Recently enacted legislation has given the U.S. Consumer Product Safety Commission increased regulatory and enforcement power, particularly with regard to children's safety, among other areas. As a result, companies like ours may be subject to more product recalls and incur higher recall-related expenses. Any recalls or other safety issues could harm our brands' images and negatively affect our business and operating results.

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Our efforts to expand globally may not be successful and could negatively impact the value of our brands, and our increasing global presence presents additional challenges.

We are currently growing our business and increasing our global presence by opening new stores outside of the United States and by offering shipping globally through a third party vendor. We have limited experience with global sales, understanding consumer preferences and anticipating buying trends in different countries, and marketing to customers overseas. Moreover, global awareness of our brands and our products may not be high. Consequently, we may not be able to successfully compete with established brands in these markets and our global sales may not result in the revenues we anticipate. Also, our products may not be accepted, either due to foreign legal requirements or due to different consumer tastes and trends. If our global growth initiatives are not successful, or if we or any of our third party vendors fail to comply with any applicable regulations or laws, the value of our brands may be harmed and negatively affect our future opportunities for global growth. Further, the administration of our global expansion may divert management attention and require more resources than we expect. In addition, we are exposed to foreign currency exchange rate risk with respect to our operations denominated in currencies other than the U.S. dollar. We intend to use instruments in the future to hedge certain foreign currency risks. These programs may not succeed in offsetting the negative impact of foreign currency rate fluctuations on our business and results of operations.

In fiscal 2009, we entered into a franchise agreement with an unaffiliated franchisee to operate stores in the Middle East. Under this agreement, our franchisee operates stores that sell goods purchased from us under our brand names. We have no prior experience directly opening stores outside of North America and we have limited experience opening stores through third party arrangements. The effect of these franchise arrangements on our business and results of operations is uncertain and will depend upon various factors, including the demand for our products in new global markets. In addition, certain aspects of our franchise arrangements are not directly within our control, such as the ability of our franchisee to meet its projections regarding store openings and sales. Moreover, while the agreement we have entered into may provide us with certain termination rights, to the extent that our franchisee does not operate its stores in a manner consistent with our requirements regarding our brand identities and customer experience standards, the value of our brands could be impaired. In addition, in connection with this franchise agreement, we have and will continue to implement certain new processes that may subject us to additional regulations and laws, such as U.S. export regulations. Failure to comply with any applicable regulations or laws could have an adverse effect on our results of operations.

In August 2012, we announced the opening of four stores and our first e-commerce site in Australia. The four stores are currently slated to open simultaneously with the launch of our e-commerce site in May 2013, and are our first locations outside of North America to be owned and operated by us as part of our overall global expansion strategy. While our global expansion to date has been a small part of our business, we plan to continue to increase the number of stores we open directly and through franchise arrangements. Our ability to expand globally is dependent on numerous factors, including the demand for our products in new global markets and the cost of real estate in those markets.

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

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

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

- increased management, infrastructure and legal compliance costs;
- increased financial accounting and reporting requirements and complexities;
- general economic conditions, changes in diplomatic and trade relationships and political and social instability in each country or region;
- economic uncertainty around the world;
- compliance with foreign laws and regulations and the risks and costs of non-compliance with such laws and regulations;
- compliance with U.S. laws and regulations for foreign operations;
- dependence on certain third parties, including vendors and other service providers, with whom we do not have extensive experience;
- fluctuations in currency exchange rates and the related effect on our financial results, and the use of foreign exchange hedging programs to mitigate such risks;
- reduced or varied protection for intellectual property rights in some countries and practical difficulties of enforcing such rights abroad;
- and
- compliance with the laws of foreign taxing jurisdictions and the overlapping of different tax regimes.

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

In addition, as we continue to expand our global operations, we are subject to certain U.S. laws, including the Foreign Corrupt Practices Act, in addition to the laws of the foreign countries in which we operate. We must ensure that our employees comply with these laws. If any of our overseas operations, or our employees or agents, violates such laws, we could become subject to sanctions or other penalties that could negatively affect our reputation, business and operating results.

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

Historically, more than 50% of our net revenues have been generated by our retail stores. Our ability to open additional stores or close existing stores successfully will depend upon a number of factors, including:

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

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

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

The specialty direct-to-customer and retail business is highly competitive. Our e-commerce websites, direct mail catalogs and specialty retail stores compete with other e-commerce websites, other direct mail catalogs and other retail stores that market lines of merchandise similar to ours. We compete with national, regional and local businesses utilizing a similar retail store strategy, as well as traditional furniture stores, department stores and specialty stores. The substantial sales growth in the direct-to-customer industry within the last decade has encouraged the entry of many new competitors, new business models, and an increase in competition from established companies. In addition, the decline in the global economic environment has led to increased competition from discount retailers selling similar products at reduced prices. The competitive challenges facing us include:

- anticipating and quickly responding to changing consumer demands or preferences better than our competitors;
- maintaining favorable brand recognition and achieving customer perception of value;
- effectively marketing and competitively pricing our products to consumers in several diverse market segments;
- effectively managing and controlling our costs;
- developing innovative, high-quality products in colors and styles that appeal to consumers of varying age groups, tastes and regions, and in ways that favorably distinguish us from our competitors; and
- effectively managing our supply chain and distribution strategies in order to provide our products to our consumers on a timely basis and minimize returns, replacements and damaged products.

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

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

The success of our business depends, in part, on our ability to timely and effectively deliver merchandise to our stores and customers. We cannot control all of the various factors that might affect our fulfillment rates in direct-to-customer sales and timely and effective merchandise delivery to our stores. We rely upon third party carriers for our merchandise shipments and reliable data regarding the timing of those shipments, including shipments to our customers and to and from all of our stores. In addition, we are heavily dependent upon two carriers for the delivery of our merchandise to our customers. Accordingly, we are subject to risks, including labor disputes, union organizing activity, inclement weather, natural disasters, the closure of such carriers' offices or a reduction in operational hours due to an economic slowdown, possible acts of terrorism associated with such carriers' ability to provide delivery services to meet our shipping needs, disruptions or increased fuel costs, and costs associated with any regulations to address climate change. Failure to deliver merchandise in a timely and effective manner could damage our reputation and brands. In addition, fuel costs have been volatile and airline and other transportation companies continue to struggle to operate profitably, which could lead to increased fulfillment expenses. Any rise in fulfillment costs could negatively affect our business and operating results by increasing our transportation costs and decreasing the efficiency of our shipments.

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

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

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

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

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

If we are unable to effectively manage our e-commerce business, including effectively managing cybersecurity risks, our reputation and operating results may be harmed.

E-commerce has been our fastest growing business over the last several years and continues to be a significant part of our sales success. The success of our e-commerce business depends, in part, on third parties and factors over which we have limited control. We must successfully respond to changing consumer preferences and buying trends relating to e-commerce usage. Our success in e-commerce has been aided in part by our ability to understand the buying trends of visitors to our websites and to personalize the experience they have with us. We also utilize interest-based advertising to target internet users whose behavior indicates they might be interested in our products. Current or future legislation may reduce or restrict our ability to use these techniques, which could reduce the effectiveness of our advertising spend.

We are also vulnerable to certain additional risks and uncertainties associated with our e-commerce websites, including: changes in required technology interfaces; website downtime and other technical failures; internet connectivity issues; costs and technical issues as we upgrade our website software; computer viruses; changes in applicable federal and state regulations; security breaches; and consumer privacy concerns. In order to function successfully, we rely on communication and transmission of data over both public and private networks. Third parties may have the knowledge or technology to disable, disrupt or interfere with our systems or processes. Although we take the security of our systems seriously, we cannot guarantee that we can prevent all efforts to circumvent our security measures. Any security breach or attack against our networks or systems could slow, hinder, or prevent the proper functioning of our electronic communications. Such a breach or attack could harm our business. In addition, we must keep up to date with competitive technology trends, including the use of new or improved technology, creative user interfaces and other e-commerce marketing tools such as paid search and mobile applications, among others, which may increase our costs and which may not succeed in increasing sales or attracting customers. Our failure to successfully respond to these risks and uncertainties might adversely affect the sales in our e-commerce business, as well as damage our reputation and brands.

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

Catalog mailings are an important component of our business. Postal rate increases, such as the recent increase that went into effect in the U.S. in 2013, affect the cost of our catalog mailings. We rely on discounts from the basic postal rate structure, which could be changed or discontinued at any time. Further, the U.S. Postal Service may raise rates in the future, which could negatively impact our business. The cost of paper, printing and catalog distribution also impacts our catalog business. We recently consolidated all of our catalog printing work with one printer. Our dependence on one vendor subjects us to risks if the vendor fails to perform under our agreement. Paper costs have also fluctuated significantly in the past and may continue to fluctuate in the future. Future increases in postal rates, paper costs or printing costs would have a negative impact on our

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operating results to the extent that we are unable to offset such increases by raising prices, implementing more efficient printing, mailing, delivery and order fulfillment systems, or through the use of alternative direct-mail formats. Also, consolidation within the printing industry has reduced the number of potential suppliers capable of meeting our printing requirements, and further consolidation could limit our ability to obtain favorable terms. In addition, if the performance of our catalogs declines, if we misjudge the correlation between our catalog circulation and net sales, or if our catalog strategy overall does not continue to be successful, our results of operations could be negatively impacted.

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

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

Various factors affect comparable brand revenues, including the number, size and location of stores we open, close, remodel or expand in any period, the overall economic and general retail sales environment, consumer preferences and buying trends, changes in sales mix among distribution channels, our ability to efficiently source and distribute products, changes in our merchandise mix, competition (including competitive promotional activity and discount retailers), current local and global economic conditions, the timing of our releases of new merchandise and promotional events, the success of marketing programs, the cannibalization of existing store sales by our new stores, changes in catalog circulation and in our direct-to-customer business and fluctuations in foreign exchange rates. Among other things, weather conditions can affect comparable brand revenues because inclement weather can alter consumer behavior or require us to close certain stores temporarily and thus reduce store traffic. Even if stores are not closed, many customers may decide to avoid going to stores in bad weather. These factors have caused and may continue to cause our comparable brand revenue results to differ materially from prior periods and from earnings guidance we have provided. For example, the overall economic and general retail sales environment, as well as local and global economic conditions, has caused a significant decline in our comparable brand revenue results in the past.

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

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

We record a reserve for merchandise returns based on historical return trends together with current product sales performance in each reporting period. If actual returns are greater than those projected and reserved for by management, additional sales returns might be recorded in the future. In addition, to the extent that returned

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merchandise is damaged, we often do not receive full retail value from the resale or liquidation of the merchandise. Further, the introduction of new merchandise, changes in merchandise mix, changes in consumer confidence, or other competitive and general economic conditions may cause actual returns to exceed merchandise return reserves. In particular, the recent adverse economic conditions resulted and may continue to result in increased merchandise returns. Any significant increase in merchandise returns that exceeds our reserves could harm our business and operating results.

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

With the expansion of our e-commerce business, new brands, acquired brands, and brand extensions, our overall business has become substantially more complex. The changes in our business have forced us to develop new expertise and face new challenges, risks and uncertainties. For example, we face the risk that our e-commerce business might cannibalize a significant portion of our retail and catalog businesses, and we face the risk of catalog circulation cannibalizing our retail sales. While we recognize that our e-commerce sales cannot be entirely incremental to sales through our retail and catalog channels, we seek to attract as many new customers as possible to our e-commerce websites. We continually analyze the business results of our channels and the relationships among the channels in an effort to find opportunities to build incremental sales.

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

We have in the past and may in the future introduce new brands and brand extensions, reposition brands, close existing brands, or acquire new brands, especially as we continue to expand globally. Our newest brands West Elm, PBteen and Mark and Graham, as well as our recently acquired brand, Rejuvenation and any other new brands, may not grow as we project and plan for. The work involved with integrating new brands into our existing systems and operations could be time consuming, require significant amounts of management time and result in the diversion of substantial operational resources. Further, if we devote time and resources to new brands, acquired brands, brand extensions or brand repositioning, and those businesses are not as successful as we planned, then we risk damaging our overall business results. Alternatively, if our new brands, acquired brands, brand extensions or repositioned brands prove to be very successful, we risk hurting our other existing brands through the potential migration of existing brand customers to the new businesses. In addition, we may not be able to introduce new brands and brand extensions, integrate newly acquired brands, reposition existing brands, or expand our brands globally, in a manner that improves our overall business and operating results and may therefore be forced to close the brands, which may damage our reputation and negatively impact our operating results.

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

We are subject to income taxes in many U.S. and certain foreign jurisdictions, and our domestic and global tax liabilities are subject to the allocation of expenses in differing jurisdictions. Our provision for income taxes is subject to volatility and could be adversely impacted by a number of factors that require significant judgment and estimation. Although we believe our estimates are reasonable, the final tax outcome of these matters may materially differ from our estimates and adversely affect our financial condition or operating results. We record tax expense based on our estimates of future payments, which include reserves for estimates of probable settlements of foreign and domestic tax audits. At any one time, many tax years are subject to audit by various taxing jurisdictions. The results of these audits and negotiations with taxing authorities may affect the ultimate settlement of these issues. As a result, we expect that throughout the year there could be ongoing variability in our quarterly tax rates as taxable events occur and exposures are evaluated.

In addition, our effective tax rate in a given financial statement period may be materially impacted by changes in the mix and level of earnings or losses in countries with differing statutory tax rates or by changes to existing rules or regulations. There could be an adverse impact on our effective tax rate if pending government proposals in the U.S. for fundamental international tax reform are enacted. Further, other pending tax legislation in the U.S. and abroad could negatively impact our current or future tax structure and effective tax rates.

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

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

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

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

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

We are involved in lawsuits, claims and proceedings incident to the ordinary course of our business. Litigation is inherently unpredictable. Any claims against us, whether meritorious or not, could be time consuming, result in costly litigation, require significant amounts of management time and result in the diversion of significant operational resources. There has been a rise in the number of lawsuits against companies like us that gather information in order to market to consumers online or through the mail and, along with other retailers, we have been named in lawsuits for gathering zip code information from our customers. We believe that we have meritorious defenses against these actions, and we will continue to vigorously defend against them. There have also been a growing number of e-commerce-related patent infringement lawsuits and employment-related lawsuits in recent years. From time to time, we have been subject to these types of lawsuits. The cost of defending against all these types of claims against us or the ultimate resolution of such claims, whether by settlement or adverse court decision, may harm our business and operating results. In addition, the increasingly regulated business environment may result in a greater number of enforcement actions and private litigation. This could subject us to increased exposure to stockholder lawsuits.

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

To be successful, we need to manage our operating costs and continue to look for opportunities to reduce costs. We recognize that we may need to increase the number of our employees, especially during peak sales seasons, and incur other expenses to support new brands and brand extensions and the growth of our existing brands, including the opening of new stores. Alternatively, if we are unable to make substantial adjustments to our cost structure during times of uncertainty, such as the 2008-2009 economic downturn, we may incur unnecessary expenses or we may have inadequate resources to properly run our business, and our business and operating results may be negatively impacted. From time to time, we may also experience union organizing activity in

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currently non-union facilities. Union organizing activity may result in work slowdowns or stoppages and higher labor costs. In addition, there appears to be a growing number of wage-and-hour lawsuits and other employment-related lawsuits against retail companies, especially in California.

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

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

Our success depends, in part, on our ability to source and distribute merchandise efficiently through appropriate systems and procedures. We are in the process of substantially modifying our information technology systems, which involves updating or replacing legacy systems with successor systems over the course of several years. There are inherent risks associated with replacing our core systems, including supply chain and merchandising systems disruptions, that could affect our ability to get the correct products into the appropriate stores and delivered to customers. We may not successfully launch these new systems, or the launch of such systems may result in disruptions to our business operations. In addition, changes to any of our software implementation strategies could result in the impairment of software-related assets. We are also subject to the risks associated with the ability of our vendors to provide information technology solutions to meet our needs. Any disruptions could negatively impact our business and operating results.

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

We outsource certain aspects of our business to third party vendors that subject us to risks of disruptions in our business as well as increased costs. For example, we utilize outside vendors for such things as payroll processing, email marketing and various distribution center services. Accordingly, we are subject to the risks associated with their ability to successfully provide the necessary services to meet our needs. If our vendors are unable to adequately protect our data and information is lost, our ability to deliver our services is interrupted, or our vendors' fees are higher than expected, then our business and operating results may be negatively impacted.

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

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

We provide public guidance on our expected operating and financial results for future periods. Although we believe that this guidance provides investors and analysts with a better understanding of management's expectations for the future and is useful to our stockholders and potential stockholders, such guidance is comprised of forward-looking statements subject to the risks and uncertainties described in this report and in our

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

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

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

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

We regularly review and evaluate our liquidity and capital needs. We currently believe that our available cash, cash equivalents and cash flow from operations will be sufficient to finance our operations and expected capital requirements for at least the next 12 months. However, we might experience periods during which we encounter additional cash needs and we might need additional external funding to support our operations. Although we were able to amend our line of credit facility during fiscal 2012 on acceptable terms, in the event we require additional liquidity from our lenders, such funds may not be available to us or may not be available to us on acceptable terms in the future. For example, in the event we were to breach any of our financial covenants, our banks would not be required to provide us with additional funding, or they may require us to renegotiate our existing credit facility on less favorable terms. In addition, we may not be able to renew our letters of credit that we use to help pay our suppliers on terms that are acceptable to us, or at all, as the availability of letter of credit facilities may become limited. Further, the providers of such credit may reallocate the available credit to other borrowers. If we are unable to access credit at the levels we require, or the cost of credit is greater than expected, it could adversely affect our operating results.

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

Disruptions in the global financial markets and banking systems have made credit and capital markets more difficult for companies to access, even for some companies with established revolving or other credit facilities. We have access to capital through our revolving line of credit facility. Each financial institution, which is part of the syndicate for our revolving line of credit facility, is responsible for providing a portion of the loans to be made under the facility. If any participant, or group of participants, with a significant portion of the commitments in our revolving line of credit facility fails to satisfy its obligations to extend credit under the facility and we are unable to find a replacement for such participant or group of participants on a timely basis (if at all), our liquidity and our business may be materially adversely affected.

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

In March 2013, we announced that our Board of Directors had authorized the repurchase of up to \$750,000,000 of our common stock, which we intend to execute over the next three years. In addition, in March 2013, we announced that our Board of Directors had authorized a 41% increase in our quarterly cash dividend from \$0.22 to \$0.31 per common share for an annual cash dividend of \$1.24 per share. The dividend and stock repurchase program may require the use of a significant portion of our cash earnings. As a result, we may not retain a sufficient amount of cash to fund our operations or finance future growth opportunities, new product development initiatives and unanticipated capital expenditures. Further, our Board of Directors may, at its

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discretion, decrease the intended level of dividends or entirely discontinue the payment of dividends at any time. The stock repurchase program does not have an expiration date and may be limited at any time. Our ability to pay dividends and repurchase stock will depend on our ability to generate sufficient cash flows from operations in the future. This ability may be subject to certain economic, financial, competitive and other factors that are beyond our control. Any failure to pay dividends or repurchase stock after we have announced our intention to do so may negatively impact our reputation and investor confidence in us, and may negatively impact our stock price.

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

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

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

Changes to existing accounting rules or regulations may impact our future operating results. A change in accounting rules or regulations may even affect our reporting of transactions completed before the change is effective. The introduction of new accounting rules or regulations and varying interpretations of existing accounting rules or regulations have occurred and may occur in the future. Future changes to accounting rules or regulations, or the questioning of current accounting practices, may adversely affect our operating results.

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

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

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

A significant portion of our customer orders are placed through our e-commerce websites or through our customer care centers. In addition, a significant portion of sales made through our retail channel require the collection of certain customer data, such as credit card information. In order for our sales channel to function and develop successfully, we and other parties involved in processing customer transactions must be able to transmit confidential information, including credit card information, securely over public networks. Third parties may have the technology or knowledge to breach the security of customer transaction data. Although we take the security of our systems and the privacy of our customers' confidential information seriously, we cannot guarantee that our security measures will effectively prevent others from obtaining unauthorized access to our information and our customers' information. Any person who circumvents our security measures could destroy or steal valuable information or disrupt our operations. Any security breach could cause consumers to lose confidence in the security of our websites or stores and choose not to purchase from us. Any security breach could also expose us to risks of data loss, litigation and liability and could seriously disrupt our operations and harm our reputation, any of which could harm our business.

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In addition, states and the federal government are increasingly enacting laws and regulations to protect consumers against identity theft. Also, as our business expands globally, we are subject to data privacy and other similar laws in various foreign jurisdictions. Compliance with these laws will likely increase the costs of doing business and, if we fail to implement appropriate safeguards or to detect and provide prompt notice of unauthorized access as required by some of these new laws, we could be subject to potential claims for damages and other remedies, which could harm our business.

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

Our future success depends to a significant degree on the skills, experience and efforts of key personnel in our senior management, whose vision for our company, knowledge of our business and expertise would be difficult to replace. If any one of our key employees leaves, are seriously injured or unable to work, or fails to perform and we are unable to find a qualified replacement, we may be unable to execute our business strategy.

In addition, our main offices are located in the San Francisco Bay Area, where competition for personnel with retail and technology skills can be intense. If we fail to identify, attract, retain and motivate these skilled personnel, our business may be harmed. Further, in the event we need to hire additional personnel, we may experience difficulties in attracting and successfully hiring such individuals due to competition for highly skilled personnel, as well as the significantly higher cost of living expenses in our market.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We lease store locations, distribution centers, corporate facilities and customer care centers for our U.S. and foreign operations for original terms ranging generally from 3 to 22 years. Certain leases contain renewal options for periods of up to 20 years.

For our store locations, our gross leased store space, as of February 3, 2013, totaled approximately 5,778,000 square feet for 581 stores compared to approximately 5,743,000 square feet for 576 stores as of January 29, 2012.

Leased Properties

The following table summarizes the location and size of our leased distribution centers, customer care centers and corporate facilities occupied as of February 3, 2013:

Location	Occupied Square Footage (Approximate)
<i>Distribution Centers</i>	
Olive Branch, Mississippi	2,105,000
South Brunswick, New Jersey	1,351,000
City of Industry, California	1,180,000
Memphis, Tennessee ¹	1,023,000
Claremont, North Carolina	412,000
Other	278,000
<i>Corporate Facilities</i>	
Brisbane, California	194,000
New York City, New York	93,000
San Francisco, California	13,000
Other	41,000
<i>Customer Care Centers</i>	
Las Vegas, Nevada	36,000
Oklahoma City, Oklahoma	36,000

Other

17,000

¹ See Note F to our Consolidated Financial Statements for more information.

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In addition to the above contracts, we enter into other agreements for offsite storage needs for our distribution centers and our retail store locations. As of February 3, 2013, we had approximately 109,000 square feet of leased space relating to these agreements that is not included in the occupied square footage reported above. This compares to approximately 136,000 square feet of leased space as of January 29, 2012.

Owned Properties

The following table summarizes the location and size of our owned facilities occupied as of February 3, 2013:

Location	Occupied Square Footage (Approximate)
San Francisco, California	412,000
Rocklin, California	42,000
Other	17,000

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

ITEM 3. LEGAL PROCEEDINGS

We are involved in lawsuits, claims and proceedings incident to the ordinary course of our business. These disputes are not currently material. Litigation is inherently unpredictable. 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.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

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

Our common stock is traded on the New York Stock Exchange, or the NYSE, under the symbol WSM. The following table sets forth the high and low selling prices of our common stock on the NYSE for the periods indicated:

Fiscal 2012	High	Low
4 th Quarter	\$ 48.07	\$ 41.99
3 rd Quarter	\$ 48.04	\$ 33.95
2 nd Quarter	\$ 40.76	\$ 32.67
1 st Quarter	\$ 39.88	\$ 34.34
Fiscal 2011	High	Low
4 th Quarter	\$ 39.98	\$ 33.03
3 rd Quarter	\$ 40.07	\$ 27.90
2 nd Quarter	\$ 45.48	\$ 34.40
1 st Quarter	\$ 44.20	\$ 32.03

The closing price of our common stock on the NYSE on April 1, 2013 was \$50.80.

STOCKHOLDERS

The number of stockholders of record of our common stock as of April 1, 2013 was 394. This number excludes stockholders whose stock is held in nominee or street name by brokers.

Table of Contents**PERFORMANCE GRAPH**

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

COMPARISON OF FIVE - YEAR CUMULATIVE TOTAL RETURN*

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

	2/1/08	1/30/09	1/31/10	1/30/11	1/29/12	2/3/13
Williams-Sonoma, Inc.	100.00	29.89	73.78	128.13	141.85	185.88
NYSE Composite Index	100.00	57.57	78.36	93.90	93.97	109.89
S&P Retailing Index	100.00	64.80	102.67	133.34	155.05	196.70

*** Notes:**

- A. The lines represent monthly index levels derived from compounded daily returns that include all dividends.
- B. The indices are re-weighted daily, using the market capitalization on the previous trading day.
- C. If the monthly interval, based on the fiscal year-end, is not a trading day, the preceding trading day is used.

Table of Contents**DIVIDENDS**

In March 2013, we announced that our Board of Directors had authorized a 41% increase in our quarterly cash dividend, from \$0.22 to \$0.31 per common share, subject to capital availability. Total cash dividends declared were approximately \$88,452,000, or \$0.88 per common share, \$76,308,000, or \$0.73 per common share, and \$62,574,000, or \$0.58 per common share, in fiscal 2012, fiscal 2011 and fiscal 2010, respectively. Our quarterly cash dividend may be limited or terminated at any time.

STOCK REPURCHASE PROGRAMS

In January 2012, our Board of Directors authorized a stock repurchase program to purchase up to \$225,000,000 of our common stock. During fiscal 2012, we repurchased 3,962,034 shares of our common stock at an average cost of \$39.14 per share and a total cost of approximately \$155,080,000. In addition, in March 2013, we announced that our Board of Directors had authorized a new stock repurchase program to purchase up to \$750,000,000 of our common stock, which we intend to execute over the next three years.

The following table summarizes our repurchases of shares of our common stock under the January 2012 program during the fourth quarter of fiscal 2012:

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
October 29, 2012	November 25, 2012	193,262	\$45.86	193,262	\$22,421,000
November 26, 2012	December 30, 2012	253,399	\$44.18	253,399	\$11,225,000
December 31, 2012	February 3, 2013	237,295	\$45.21	237,295	\$ 496,000
Total		683,956	\$45.01	683,956	\$ 496,000

Stock repurchases under these programs 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. These stock repurchase programs do not have an expiration date and may be limited or terminated at any time without prior notice.

During fiscal 2011, we repurchased 5,384,036 shares of our common stock at an average cost of \$36.11 per share and a total cost of approximately \$194,429,000. During fiscal 2010, we repurchased 4,263,463 shares of our common stock at an average cost of \$29.32 per share and a total cost of approximately \$125,000,000.

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

<i>Dollars and amounts in thousands, except percentages,</i>	Fiscal 2012	Fiscal 2011	Fiscal 2010	Fiscal 2009	Fiscal 2008
<i>per share amounts and retail stores data</i>	(53 Weeks)	(52 Weeks)	(52 Weeks)	(52 Weeks)	(52 Weeks)
Results of Operations					
Net revenues	\$ 4,042,870	\$ 3,720,895	\$ 3,504,158	\$ 3,102,704	\$ 3,361,472
Net revenue growth (decline)	8.7%	6.2%	12.9%	(7.7%)	(14.8%)
Comparable brand revenue growth (decline) ¹	6.1%	7.3%	13.9%	(9.3%)	(15.6%)
Gross margin	\$ 1,592,476	\$ 1,459,856	\$ 1,373,859	\$ 1,103,237	\$ 1,135,172
Gross margin as a percent of net revenues	39.4%	39.2%	39.2%	35.6%	33.8%
Operating income ²	\$ 409,163	\$ 381,732	\$ 323,414	\$ 121,442	\$ 42,153
Operating margin ³	10.1%	10.3%	9.2%	3.9%	1.3%
Net earnings	\$ 256,730	\$ 236,931	\$ 200,227	\$ 77,442	\$ 30,024
Basic earnings per share	\$ 2.59	\$ 2.27	\$ 1.87	\$ 0.73	\$ 0.28
Diluted earnings per share	\$ 2.54	\$ 2.22	\$ 1.83	\$ 0.72	\$ 0.28
Weighted average basic shares outstanding during the period	99,266	104,352	106,956	105,763	105,530
Weighted average diluted shares outstanding during the period	101,051	106,582	109,522	107,373	106,880
Financial Position					
Working capital	\$ 659,645	\$ 704,567	\$ 735,878	\$ 616,711	\$ 479,936
Total assets	\$ 2,187,679	\$ 2,060,838	\$ 2,131,762	\$ 2,079,169	\$ 1,935,464
Return on assets	12.0%	11.3%	9.5%	3.9%	1.5%
Net cash provided by operating activities	\$ 364,127	\$ 291,334	\$ 355,989	\$ 490,718	\$ 230,163
Capital expenditures	\$ 205,404	\$ 130,353	\$ 61,906	\$ 72,263	\$ 191,789
Long-term debt and other long-term obligations	\$ 50,216	\$ 52,015	\$ 59,048	\$ 62,792	\$ 62,071
Stockholders' equity	\$ 1,309,138	\$ 1,255,262	\$ 1,258,863	\$ 1,211,595	\$ 1,147,984
Stockholders' equity per share (book value)	\$ 13.39	\$ 12.50	\$ 12.00	\$ 11.33	\$ 10.86
Return on equity	20.0%	18.8%	16.2%	6.6%	2.6%
Annual dividends declared per share	\$ 0.88	\$ 0.73	\$ 0.58	\$ 0.48	\$ 0.48
Direct-to-Customer Net Revenues					
Direct-to-customer net revenue growth (decline)	14.5%	12.4%	18.6%	(12.5%)	(15.9%)
Direct-to-customer net revenues as a percent of net revenues	46.2%	43.9%	41.5%	39.5%	41.6%
E-commerce net revenue growth (decline)	17.4%	17.9%	26.9%	(8.7%)	(6.4%)
E-commerce net revenues as a percent of direct-to-customer net revenues	88.6%	86.4%	82.4%	77.0%	73.9%
Retail Net Revenues					
Retail net revenue growth (decline)	4.1%	1.8%	9.2%	(4.3%)	(14.0%)
Retail net revenues as a percent of net revenues	53.8%	56.1%	58.5%	60.5%	58.4%
Comparable store sales growth (decline) ¹	2.3%	3.5%	9.8%	(5.1%)	(17.2%)
Number of stores at year-end	581	576	592	610	627
Store selling square footage at year-end	3,548,000	3,535,000	3,609,000	3,763,000	3,828,000
Store leased square footage at year-end	5,778,000	5,743,000	5,831,000	6,081,000	6,148,000

¹ Comparable brand revenue and comparable store sales are calculated on a 52-week to 52-week basis, with the exception of fiscal 2012 which was calculated on a 53-week to 53-week basis. See definition of comparable brand revenue and comparable stores within Management's Discussion and Analysis of Financial Condition and Results of Operations.

² Operating income is defined as earnings before net interest income or expense and income taxes.

³ Operating margin is defined as operating income as a percentage of net revenues.

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

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

The following discussion and analysis of our financial condition, results of operations, and liquidity and capital resources for the 53 weeks ended February 3, 2013 (fiscal 2012), the 52 weeks ended January 29, 2012 (fiscal 2011), and the 52 weeks ended January 30, 2011 (fiscal 2010) should be read in conjunction with our consolidated financial statements and notes thereto. As fiscal 2012 was a 53-week year, as opposed to a 52-week year in fiscal 2011, our discussion below includes approximately \$70 million of net revenues and \$0.07 of diluted earnings per share associated with that additional week. All explanations of changes in operational results are discussed in order of magnitude.

OVERVIEW*Fiscal 2012 Financial Results*

Net revenues exceeded four billion dollars for the first time in our history, increasing 8.7% to \$4,042,870,000, including the impact of the additional week in fiscal 2012. This compared to net revenues of \$3,720,895,000 in fiscal 2011. Comparable brand revenues increased 6.1% during fiscal 2012, and diluted earnings per share increased to \$2.54 from \$2.22 in fiscal 2011. We also ended the year with \$424,555,000 in cash.

Direct-to-customer net revenues in fiscal 2012, including the impact of the additional week, increased by \$236,575,000, or 14.5%, compared to fiscal 2011. This increase was driven by growth across all brands, led by Pottery Barn, West Elm, Pottery Barn Kids and Williams-Sonoma. In e-commerce, net revenues increased 17.4% to \$1,656,197,000 in fiscal 2012, compared to \$1,410,236,000 in fiscal 2011. Direct-to-customer net revenues generated 46% of total company net revenues in fiscal 2012 versus 44% in fiscal 2011.

Retail net revenues in fiscal 2012, including the impact of the additional week, increased by \$85,400,000, or 4.1%, compared to fiscal 2011. This increase was primarily driven by Pottery Barn and West Elm, partially offset by a decrease in Williams-Sonoma. Comparable store sales in fiscal 2012 increased 2.3%.

In the Pottery Barn brand, net revenues grew to \$1,752,997,000, and comparable brand revenues increased 8.5%. Throughout the year, we remained focused on selling innovative products at a great value, presented in an inspirational way, across all of our channels. In the Williams-Sonoma brand, net revenues were \$980,709,000, and comparable brand revenues decreased 1.1%. Although the promotional environment intensified during the holiday season, we made progress on our initiatives to introduce exclusive and innovative products, and our strongest performance was in those categories where we had the highest proportion of these products. Although the brand's direct-to-customer channel had the third highest growth rate of any of our brands, there is still progress to be made in our retail stores. In the Pottery Barn Kids brand, net revenues increased to \$557,516,000, and comparable brand revenues increased 5.6%. Textiles and furniture, especially in nursery, drove these results. In the West Elm brand, net revenues increased to \$430,099,000, and comparable brand revenues grew 17.4% in fiscal 2012 on top of 30.3% in fiscal 2011. These results continued to be driven by all categories including furniture, textiles and decorative accessories. In the PBteen brand, net revenues increased to \$220,081,000, and comparable brand revenues increased 1.7%. The brand gained momentum throughout the fiscal year as our in-stock inventory positions improved.

Fiscal 2012 Operational Results

In fiscal 2012, we continued to be focused on our customer, allowing us to deliver increased revenue and profitability, while simultaneously investing in our future growth. Further, we continued to make progress on our long-term strategic initiatives to: successfully execute our brand strategies and launch new businesses; lay the foundation for the expansion of our brands' global presence; invest in our supply chain in order to reduce cost and improve service; and invest in the technologies and infrastructure underlying all of these initiatives in order to enhance our leading multi-channel business.

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While the Williams-Sonoma brand has grown in size to almost one billion dollars, 75% of our revenues now come from our other internally developed brands. In 2012, we broadened the reach and relevance of each of our brands and invested in new businesses. In the Williams-Sonoma brand, we are executing a vision that allows us to be less reliant on branded goods. In all of the Pottery Barn brands, we continued to deliver strong growth, and West Elm, one of our largest growth vehicles, is now approaching 11% of our business. Also, in fiscal 2012, we incubated and launched new businesses, including: Mark and Graham, which specializes in personalized products and gifts; West Elm Market, a brand extension of West Elm that expands the brand to new categories in new settings; and Agrarian, a new category extension of the Williams-Sonoma brand which celebrates homemade and homegrown. Fiscal 2012 also marked Rejuvenation's first full year of operations as a part of our portfolio of brands. We plan to expand on each of these businesses in 2013.

In our global business, our franchise operations continue to grow. In fiscal 2012, an additional 10 stores were opened in the Middle East by our unaffiliated franchisee, including the first PBteen store, and there are now 23 franchise stores at the end of fiscal 2012. In fiscal 2013, we will enter into the Australian market, with four company-owned retail stores, e-commerce websites and distribution operations.

In our supply chain, we focused on reducing costs and improving service through continued network re-design and the in-sourcing of our foreign agent operations, particularly our Vietnam and South China furniture sourcing.

Our technology investments support our initiatives and allow us to elevate our service levels. In fiscal 2012, these investments focused on e-commerce capabilities, global expansion, supply chain and our stores, and enabled us to make our information technology output more scalable, which is critical to our future growth.

Finally, we remain committed to our stockholders and returning excess cash. In fiscal 2012, we returned \$242,927,000 in the form of share repurchases and dividends and, in March 2013, we announced that our Board of Directors had authorized a 41% increase in our quarterly dividend to \$0.31 per share and a new \$750,000,000, three-year stock repurchase program.

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

Net revenues consist of direct-to-customer net revenues and retail net revenues. Direct-to-customer 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, 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.

	Fiscal 2012		Fiscal 2011		Fiscal 2010	
<i>Dollars in thousands</i>	(53 Weeks)	% Total	(52 Weeks)	% Total	(52 Weeks)	% Total
Direct-to-customer net revenues	\$ 1,869,386	46.2%	\$ 1,632,811	43.9%	\$ 1,452,572	41.5%
Retail net revenues	2,173,484	53.8%	2,088,084	56.1%	2,051,586	58.5%
Net revenues	\$ 4,042,870	100.0%	\$ 3,720,895	100.0%	\$ 3,504,158	100.0%

Net revenues in fiscal 2012, including the impact of the additional week of net revenues in fiscal 2012, increased by \$321,975,000, or 8.7%, compared to fiscal 2011. This increase was driven by growth of 6.1% in comparable brand revenue, including e-commerce net revenue growth of 17.4% within the direct-to-customer channel, and a 2.3% increase in comparable store sales. Increased net revenues during fiscal 2012 were driven by the Pottery Barn, West Elm and Pottery Barn Kids brands.

Net revenues in fiscal 2011 increased by \$216,737,000, or 6.2%, compared to fiscal 2010. This increase was driven by growth of 7.3% in comparable brand revenue, including e-commerce net revenue growth of 17.9% within the direct-to-customer channel and a 3.5% increase in comparable store sales. Increased net revenues during fiscal 2011 were driven by the Pottery Barn, West Elm and Pottery Barn Kids brands.

The following table summarizes our net revenues by brand for fiscal 2012, fiscal 2011 and fiscal 2010.

	Fiscal 2012	Fiscal 2011	Fiscal 2010
<i>Dollars in thousands</i>	(53 Weeks)	(52 Weeks)	(52 Weeks)
Pottery Barn	\$ 1,752,997	\$ 1,600,847	\$ 1,511,029
Williams-Sonoma	980,709	994,425	1,006,086
Pottery Barn Kids	557,516	521,565	487,647
West Elm	430,099	335,980	259,936
PBteen	220,081	212,270	197,635
Other	101,468	55,808	41,825
Total	\$ 4,042,870	\$ 3,720,895	\$ 3,504,158

Comparable Brand Revenue

Comparable brand revenue includes retail comparable store sales and direct-to-customer 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. Sales related to our international franchised stores have been excluded as these stores are not operated by us.

Comparable stores are defined as permanent stores in which 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.

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Percentages represent changes in comparable brand revenue compared to the same period in the prior year.

	Fiscal 2012	Fiscal 2011	Fiscal 2010
<i>Comparable brand revenue growth (decline)</i>	<i>(53 Weeks)</i>	<i>(52 Weeks)</i>	<i>(52 Weeks)</i>
Pottery Barn	8.5%	7.6%	17.7%
Williams-Sonoma ¹	(1.1%)	0.0%	5.7%
Pottery Barn Kids	5.6%	7.4%	16.4%
West Elm	17.4%	30.3%	20.8%
PBteen	1.7%	7.4%	21.1%
Total	6.1%	7.3%	13.9%

¹ Williams-Sonoma excludes net revenues from Williams-Sonoma Home merchandise. Including Williams-Sonoma Home, comparable brand revenue growth (decline) for Williams-Sonoma was (1.7%), (0.3%) and 5.0% in fiscal 2012, fiscal 2011 and fiscal 2010, respectively. Williams-Sonoma Home net revenues, however, are included in the total.

DIRECT-TO-CUSTOMER NET REVENUES

	Fiscal 2012	Fiscal 2011	Fiscal 2010
<i>Dollars in thousands</i>	<i>(53 Weeks)</i>	<i>(52 Weeks)</i>	<i>(52 Weeks)</i>
Direct-to-customer net revenues	\$ 1,869,386	\$ 1,632,811	\$ 1,452,572
Direct-to-customer net revenue growth	14.5%	12.4%	18.6%
E-commerce net revenue growth	17.4%	17.9%	26.9%
E-commerce net revenues as a percent of direct-to-customer net revenues	88.6%	86.4%	82.4%

Direct-to-customer net revenues in fiscal 2012, including the impact of the additional week of net revenues in fiscal 2012, increased by \$236,575,000, or 14.5%, compared to fiscal 2011. This increase was driven by growth across all brands, led by Pottery Barn, West Elm, Pottery Barn Kids and Williams-Sonoma. In e-commerce, net revenues increased 17.4% to \$1,656,197,000 in fiscal 2012, compared to \$1,410,236,000 in fiscal 2011. Direct-to-customer net revenues generated 46% of total company net revenues in fiscal 2012 versus 44% in fiscal 2011.

Direct-to-customer net revenues in fiscal 2011 increased by \$180,239,000, or 12.4%, compared to fiscal 2010. This increase was driven by 17.9% growth in e-commerce net revenues in fiscal 2011 compared to fiscal 2010. Increased net revenues during fiscal 2011 were driven by growth across all brands, led by Pottery Barn, West Elm and Pottery Barn Kids.

RETAIL NET REVENUES AND OTHER DATA

	Fiscal 2012	Fiscal 2011	Fiscal 2010
<i>Dollars in thousands</i>	<i>(53 Weeks)</i>	<i>(52 Weeks)</i>	<i>(52 Weeks)</i>
Retail net revenues	\$ 2,173,484	\$ 2,088,084	\$ 2,051,586
Retail net revenue growth	4.1%	1.8%	9.2%
Comparable store sales growth	2.3%	3.5%	9.8%
Number of stores beginning of year	576	592	610
Number of new stores	21	5	4
Number of acquired stores ¹		3	
Number of new stores due to remodeling ²	9	10	7
Number of permanently closed stores	(16)	(27)	(24)
Number of closed stores due to remodeling ²	(9)	(7)	(5)
Number of stores end of year	581	576	592

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Store selling square footage at year-end	3,548,000	3,535,000	3,609,000
Store leased square footage (LSF) at year-end	5,778,000	5,743,000	5,831,000

¹ On November 1, 2011, we acquired Rejuvenation, Inc. See Note N to our Consolidated Financial Statements.

² Remodeled stores are defined as those stores temporarily closed and subsequently reopened during the year due to square footage expansion, store modification or relocation.

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	Fiscal 2012		Fiscal 2011		Fiscal 2010	
	Store	Avg. LSF	Store	Avg. LSF	Store	Avg. LSF
	Count		Count	Per Store	Count	Per Store
Williams-Sonoma	253	6,600	259	6,500	260	6,400
Pottery Barn	192	13,900	194	13,800	193	13,100
Pottery Barn Kids	84	8,100	83	8,200	85	8,100
West Elm	48	14,900	37	17,100	36	17,100
Rejuvenation	4	13,200	3	17,200		
Outlets ¹					18	19,600
Total	581	9,900	576	10,000	592	9,800

¹ Beginning in fiscal 2011, Outlet stores and their leased square footage have been reclassified into their respective brands.

Retail net revenues in fiscal 2012, including the impact of the additional week of net revenues in fiscal 2012, increased by \$85,400,000, or 4.1%, compared to fiscal 2011. This increase was primarily driven by Pottery Barn and West Elm, partially offset by a decrease in Williams-Sonoma. Comparable store sales in fiscal 2012 increased 2.3%.

Retail net revenues in fiscal 2011 increased by \$36,498,000, or 1.8%, compared to fiscal 2010. This increase was primarily driven by West Elm, Pottery Barn, international franchise operations and Pottery Barn Kids, despite a 1.5% year-over-year reduction in retail leased square footage, due to 16 net fewer stores (including the closure of our Williams-Sonoma Home stores at the end of fiscal 2010). Comparable store sales in fiscal 2011 increased 3.5%.

COST OF GOODS SOLD

	Fiscal 2012		Fiscal 2011		Fiscal 2010	
	(53 Weeks)	% Net Revenues	(52 Weeks)	% Net Revenues	(52 Weeks)	% Net Revenues
<i>Dollars in thousands</i>						
Cost of goods sold ¹	\$ 2,450,394	60.6%	\$ 2,261,039	60.8%	\$ 2,130,299	60.8%

¹ Includes total occupancy expenses of \$517,300,000, \$500,660,000 and \$506,712,000 in fiscal 2012, fiscal 2011 and fiscal 2010, 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 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 direct-to-customer 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 direct-to-customer channel incurs higher customer shipping, damage and replacement costs than the retail channel.

Fiscal 2012 vs. Fiscal 2011

Cost of goods sold increased by \$189,355,000, or 8.4%, in fiscal 2012 compared to fiscal 2011. Cost of goods sold as a percentage of net revenues decreased to 60.6% in fiscal 2012 from 60.8% in fiscal 2011. This decrease was primarily driven by the leverage of fixed occupancy expenses due to increasing net revenues, partially offset by lower selling margins.

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In the direct-to-customer channel, cost of goods sold as a percentage of direct-to-customer net revenues increased approximately 70 basis points during fiscal 2012 compared to fiscal 2011. This increase as a percentage of net revenues was primarily driven by lower selling margins, partially offset by the leverage of fixed occupancy expenses due to increasing net revenues.

In the retail channel, cost of goods sold as a percentage of net revenues decreased 30 basis points during fiscal 2012 compared to fiscal 2011. This decrease as a percentage of net revenues was primarily driven by the leverage of fixed occupancy expenses.

Fiscal 2011 vs. Fiscal 2010

Cost of goods sold increased by \$130,740,000, or 6.1%, in fiscal 2011 compared to fiscal 2010. Cost of goods sold as a percentage of net revenues remained flat at 60.8% in fiscal 2011 compared to fiscal 2010. The leverage of fixed occupancy expenses due to increasing net revenues and a decrease in occupancy expense dollars was offset by lower selling margins due to higher promotional activity (including shipping fees).

In the direct-to-customer channel, cost of goods sold as a percentage of direct-to-customer net revenues increased approximately 70 basis points during fiscal 2011 compared to fiscal 2010. This increase as a percentage of net revenues was primarily driven by lower selling margins due to higher promotional activity (including shipping fees), partially offset by the leverage of fixed occupancy expenses due to increasing net revenues.

In the retail channel, cost of goods sold as a percentage of retail net revenues remained relatively flat during fiscal 2011 compared to fiscal 2010. A decrease in occupancy expense dollars and the leverage of fixed occupancy expenses due to increasing net revenues was offset by lower selling margins due to higher promotional activity.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

	Fiscal 2012	% Net	Fiscal 2011	% Net	Fiscal 2010	% Net
<i>Dollars in thousands</i>	(53 Weeks)	Revenues	(52 Weeks)	Revenues	(52 Weeks)	Revenues
Selling, general and administrative expenses	\$ 1,183,313	29.3%	\$ 1,078,124	29.0%	\$ 1,050,445	30.0%

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 direct-to-customer channels due to their distinct distribution and marketing strategies. Store employment costs represent a greater percentage of retail net revenues than employment costs as a percentage of net revenues within the direct-to-customer channel. However, advertising expenses are higher within the direct-to-customer channel than in the retail channel.

Fiscal 2012 vs. Fiscal 2011

Selling, general and administrative expenses increased by \$105,189,000, or 9.8%, in fiscal 2012 compared to fiscal 2011. Including employee separation charges of \$6,935,000 primarily related to the retirement of our former Executive Vice President, Chief Operating and Chief Financial Officer, and expense of approximately \$6,071,000 from asset impairment charges, selling, general and administrative expenses as a percentage of net revenues increased to 29.3% during fiscal 2012 from 29.0% during fiscal 2011 (which included expense of \$2,819,000 from asset impairment and early lease termination charges). This increase was primarily driven by higher employment costs, including employee separation charges, and increases in other expenses resulting from planned incremental investments to support e-commerce, global expansion and business development growth strategies, partially offset by greater advertising efficiency.

In the direct-to-customer channel, selling, general and administrative expenses as a percentage of net revenues decreased 110 basis points during fiscal 2012 compared to fiscal 2011. This decrease was primarily driven by greater advertising efficiency.

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In the retail channel, selling, general and administrative expenses as a percentage of net revenues increased 80 basis points during fiscal 2012 compared to fiscal 2011. This increase was primarily driven by higher employment costs.

Fiscal 2011 vs. Fiscal 2010

Selling, general and administrative expenses increased by \$27,679,000, or 2.6%, in fiscal 2011 compared to fiscal 2010. Including expense of approximately \$2,819,000 from asset impairment and early lease termination charges for underperforming retail stores, selling, general and administrative expenses as a percentage of net revenues decreased to 29.0% in fiscal 2011 from 30.0% in fiscal 2010 (which included \$16,384,000 from asset impairment and early lease termination charges for underperforming retail stores and \$4,319,000 associated with the retirement of our former Chairman and Chief Executive Officer). This decrease was primarily driven by a decrease in asset impairment and early lease termination charges related to our underperforming retail stores in fiscal 2011, lower incentive compensation costs, greater advertising productivity and reductions in other general expenses. This decrease was partially offset by higher employment which is reflective of our planned incremental investment to support our e-commerce, global expansion and business development growth strategies.

In the direct-to-customer channel, selling, general and administrative expenses as a percentage of direct-to-customer net revenues decreased approximately 120 basis points in fiscal 2011 compared to fiscal 2010. This decrease as a percentage of net revenues was primarily driven by greater advertising productivity and the leverage of other general expenses due to increasing net revenues, partially offset by higher employment.

In the retail channel, selling, general and administrative expenses as a percentage of retail net revenues decreased approximately 60 basis points in fiscal 2011 compared to fiscal 2010. This decrease as a percentage of net revenues was primarily driven by a decrease in asset impairment and early lease termination charges and reductions in other general expenses, partially offset by higher employment.

INCOME TAXES

Our effective income tax rate was 37.4% for fiscal 2012, 37.9% for fiscal 2011, and 38.0% for fiscal 2010. The decrease in the effective income tax rate in fiscal 2012 over fiscal 2011 was primarily driven by certain favorable income tax resolutions and credits.

LIQUIDITY AND CAPITAL RESOURCES

As of February 3, 2013, we held \$424,555,000 in cash and cash equivalent funds, the majority of which are held in money market funds and highly liquid U.S. Treasury bills. As is consistent within our industry, our cash balances are seasonal in nature, with the fourth quarter historically representing a significantly higher level of cash than other periods.

Throughout the fiscal year, we utilize our cash balances to build our inventory levels in preparation for our fourth quarter holiday sales. In fiscal 2013, we plan to use our cash resources to fund our inventory and inventory related purchases, advertising and marketing initiatives, stock repurchases and dividend payments and purchases of property and equipment. In addition to the current cash balances on hand, we have a credit facility that provides for a \$300,000,000 unsecured revolving line of credit that may be used for loans or letters of credit. Prior to December 22, 2016, we may, upon notice to the lenders, request an increase in the credit facility of up to \$200,000,000 to provide for a total of \$500,000,000 of unsecured revolving credit. During fiscal 2012 and fiscal 2011, we had no borrowings under the credit facility, and no amounts were outstanding as of February 3, 2013 or January 29, 2012. However, as of February 3, 2013, \$4,970,000 in issued but undrawn standby letters of credit was outstanding under the credit facility. Additionally, as of February 3, 2013, we had three unsecured letter of credit reimbursement facilities for a total of \$90,000,000, of which an aggregate of \$18,578,000 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 and, based on our current projections, we expect to remain in compliance throughout fiscal 2013. 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.

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Cash Flows from Operating Activities

In fiscal 2012, net cash provided by operating activities was \$364,127,000 compared to \$291,334,000 in fiscal 2011. Net cash provided by operating activities in fiscal 2012 was primarily attributable to net earnings after non-cash adjustments and an increase in accounts payable, partially offset by an increase in merchandise inventories. Net cash provided by operating activities in fiscal 2012 increased compared to fiscal 2011 primarily due to the timing of payments associated with accounts payable and accrued salaries, benefits and other expenses, and an increase in income taxes payable and customer deposits, partially offset by an increase in inventory purchases.

In fiscal 2011, net cash provided by operating activities was \$291,334,000 compared to \$355,989,000 in fiscal 2010. Net cash provided by operating activities in fiscal 2011 was primarily attributable to net earnings. Net cash provided by operating activities in fiscal 2011 decreased compared to fiscal 2010 primarily due to a decrease in accounts payable and accrued liabilities and a decrease in income taxes payable, partially offset by an increase in fiscal 2011 net earnings.

Cash Flows from Investing Activities

Net cash used in investing activities was \$206,815,000 for fiscal 2012 compared to \$157,704,000 in fiscal 2011. Fiscal 2012 purchases of property and equipment were \$205,404,000, comprised of \$76,479,000 for 21 new and 9 remodeled or expanded stores, \$67,077,000 for systems development projects (including e-commerce websites), and \$61,848,000 for distribution center and other infrastructure projects. Net cash used in investing activities for fiscal 2012 increased compared to fiscal 2011 primarily due to an increase in purchases of property and equipment.

Net cash used in investing activities was \$157,704,000 for fiscal 2011 compared to \$63,995,000 in fiscal 2010. Fiscal 2011 purchases of property and equipment were \$130,353,000, comprised of \$53,679,000 for systems development projects (including e-commerce websites), \$42,263,000 for 5 new and 12 remodeled or expanded stores and \$34,411,000 for distribution center and other infrastructure projects. Net cash used in investing activities for fiscal 2011 increased compared to fiscal 2010 primarily due to an increase in purchases of property and equipment, as well as our acquisition of Rejuvenation in the fourth quarter of fiscal 2011.

Cash Flows from Financing Activities

For fiscal 2012, net cash used in financing activities was \$236,445,000 compared to \$259,039,000 in fiscal 2011. Net cash used in financing activities in fiscal 2012 was primarily attributable to repurchases of common stock of \$155,080,000 and the payment of dividends of \$87,847,000. Net cash used in financing activities in fiscal 2012 decreased compared to fiscal 2011 primarily due to a decrease in our repurchase of common stock, partially offset by an increase in the payment of dividends.

For fiscal 2011, net cash used in financing activities was \$259,039,000 compared to \$178,315,000 in fiscal 2010. Net cash used in financing activities in fiscal 2011 was primarily attributable to repurchases of common stock of \$194,429,000 and the payment of dividends of \$68,877,000. Net cash used in financing activities in fiscal 2011 increased compared to fiscal 2010 primarily due to an increase in our repurchase of common stock.

Dividends

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

Stock Repurchase Programs

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

Table of Contents**Contractual Obligations**

The following table provides summary information concerning our future contractual obligations as of

February 3, 2013:

	Fiscal 2013	Payments Due by Period ¹			Total
		to Fiscal 2016	to Fiscal 2018	Thereafter	
<i>Dollars in thousands</i>					
Operating leases ²	\$ 224,579	\$ 555,502	\$ 266,510	\$ 397,662	\$ 1,444,253
Purchase obligations ³	641,266	2,635			643,901
Memphis-based distribution facilities obligation ⁴	1,635	3,753			5,388
Interest ⁵	528	556			1,084
Capital leases	89				89
Total	\$ 868,097	\$ 562,446	\$ 266,510	\$ 397,662	\$ 2,094,715

¹ This table excludes \$11.5 million of liabilities for unrecognized tax benefits associated with uncertain tax positions as we are not able to reasonably estimate when and if cash payments for these liabilities will occur. This amount, however, has been recorded as a liability in the accompanying Consolidated Balance Sheet as of February 3, 2013.

² Projected payments include only those amounts that are fixed and determinable as of the reporting date. See Note E to our Consolidated Financial Statements for discussion of our operating leases.

³ Represents estimated commitments at year-end to purchase inventory and other goods and services in the normal course of business to meet operational requirements.

⁴ Represents bond-related debt pertaining to the consolidation of one of our Memphis-based distribution facilities. See Note F to our Consolidated Financial Statements.

⁵ Represents interest expected to be paid on our long-term debt and our capital leases.

Other Contractual Obligations

We have other liabilities reflected in our Consolidated Balance Sheet. The payment obligations associated with these liabilities are not reflected in the table above due to the absence of scheduled maturities. The timing of these payments cannot be determined, except for amounts estimated to be payable in fiscal 2013, which are included in our current liabilities as of February 3, 2013.

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

Commercial Commitments

The following table provides summary information concerning our outstanding commercial commitments as of February 3, 2013:

	Fiscal 2013	Amount of Outstanding Commitment Expiration By Period ¹			Total
		to Fiscal 2016	to Fiscal 2018	Thereafter	
<i>Dollars in thousands</i>					
Letter of credit facilities	\$ 18,578				\$ 18,578
Standby letters of credit	4,970				4,970

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Credit facility

Total	\$ 23,548	\$ 23,548
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¹ See Note C to our Consolidated Financial Statements for discussion of our borrowing arrangements.

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IMPACT OF INFLATION

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

CRITICAL ACCOUNTING POLICIES

Management's Discussion and Analysis of Financial Condition and Results of Operations is based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosures of contingent assets and liabilities. These estimates and assumptions are evaluated on an ongoing basis and are based on historical experience and various other factors that we believe to be reasonable under the circumstances. Actual results could differ from these estimates.

We believe the following critical accounting policies used in the preparation of our consolidated financial statements include significant estimates and assumptions.

Merchandise Inventories

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

Reserves for shrinkage are estimated and recorded throughout the year, at the concept and channel level, as a percentage of net sales based on historical shrinkage results, expectations of future shrinkage and current inventory levels. Actual shrinkage is recorded at year-end based on the results of our physical inventory count and can vary from our estimates due to such factors as changes in operations within our distribution centers, the mix of our inventory (which ranges from large furniture to small tabletop items) and execution against loss prevention initiatives in our stores, distribution centers, off-site storage locations, and with our third party transportation providers. Accordingly, there is no shrinkage reserve at year-end.

Due to these factors, our obsolescence and shrinkage reserves contain uncertainties. Both estimates include calculations that require management to make assumptions and to apply judgment regarding a number of factors, including market conditions, the selling environment, historical results and current inventory trends. If actual obsolescence or shrinkage estimates change from our original estimate, we will adjust our reserves accordingly throughout the year. Management does not believe that changes in the assumptions used in these estimates would have a significant effect on our inventory balances. We have made no material changes to our assumptions included in the calculations of the obsolescence and shrinkage reserves throughout the year. In addition, we do not believe a 10% change in our inventory reserves would have a material effect on net earnings. As of February 3, 2013 and January 29, 2012, our inventory obsolescence reserves were \$12,273,000 and \$12,026,000, respectively.

Advertising and Prepaid Catalog Expenses

Advertising expenses consist of media and production costs related to catalog mailings, e-commerce advertising and other direct marketing activities. All advertising costs are expensed as incurred, or upon the release of the initial advertisement, with the exception of prepaid catalog expenses. Prepaid catalog expenses consist primarily of third party incremental direct costs, including creative design, paper, printing, postage and mailing costs for all of our direct response catalogs. Such costs are capitalized as prepaid catalog expenses and are amortized over their expected period of future benefit. Such amortization is based upon the ratio of estimated direct-to-customer revenues for the period to the total estimated direct-to-customer revenues over the life of the catalog on an

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individual catalog basis. Estimated direct-to-customer revenues over the life of the catalog are based upon various factors such as the total number of catalogs and pages circulated, the probability and magnitude of consumer response and the assortment of merchandise offered. Each catalog is generally fully amortized over a six to nine month period, with the majority of the amortization occurring within the first four to five months. Prepaid catalog expenses are evaluated for realizability on a monthly basis by comparing the carrying amount associated with each catalog to the estimated probable remaining future profitability (remaining net revenues less merchandise cost of goods sold, selling expenses and catalog-related costs) associated with that catalog. If the catalog is not expected to be profitable, the carrying amount of the catalog is impaired accordingly.

Property and Equipment

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

We review the carrying value of all long-lived assets for impairment, primarily at a store level, whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. Our impairment analyses determine whether projected cash flows from operations are sufficient to recover the carrying value of these assets. Impairment may result when the carrying value of the asset exceeds the estimated undiscounted future cash flows over its remaining useful life. For store impairment, our estimate of undiscounted future cash flows over the store lease term is based upon our experience, historical operations of the stores and estimates of future store profitability and economic conditions. The future estimates of store profitability and economic conditions require estimating such factors as sales growth, gross margin, employment rates, lease escalations, inflation and the overall economics of the retail industry, and are therefore subject to variability and difficult to predict. Actual future results may differ from those estimates. If a long-lived asset is found to be impaired, the amount recognized for impairment is equal to the difference between the asset's net carrying value and its fair value. Long-lived assets are measured at fair value on a nonrecurring basis using Level 3 inputs as defined in the fair value hierarchy. The fair value is estimated based upon the present value of estimated future cash flows (discounted at a rate commensurate with the risk and that approximates our weighted average cost of capital).

Goodwill

Goodwill is not amortized, but rather is subject to impairment testing annually (on the first day of the fourth quarter), or between annual tests whenever events or changes in circumstances indicate that the fair value of a reporting unit may be below its carrying amount. The first step of the impairment test requires determining the fair value of the reporting unit. We use the income approach, whereby we estimate the fair value based on the present value of estimated future cash flows. The process of evaluating the potential impairment of goodwill is subjective and requires significant estimates and assumptions such as estimates for sales growth, gross margins, employment rates, inflation and future economic and market conditions. Actual future results may differ from those estimates. If the carrying value of the reporting unit's assets and liabilities, including goodwill, is in excess of its fair value, goodwill may be impaired, and we must perform a second step of comparing the implied fair value of the goodwill to its carrying value to determine the impairment charge, if any. At February 3, 2013 and January 29, 2012, we had goodwill of \$18,951,000 and \$19,301,000, respectively, included in other assets, primarily related to our fiscal 2011 acquisition of Rejuvenation. We did not recognize any goodwill impairment in fiscal 2012 or fiscal 2011.

Self-Insured Liabilities

We are primarily self-insured for workers' compensation, employee health benefits and product and general liability claims. We record self-insurance liabilities based on claims filed, including the development of those claims, and an estimate of claims incurred but not yet reported. Factors affecting this estimate include future inflation rates, changes in severity, benefit level changes, medical costs and claim settlement patterns. Should a different amount of claims occur compared to what was estimated, or costs of the claims increase or decrease beyond what was anticipated, reserves may need to be adjusted accordingly. We determine our workers' compensation liability and product and general liability claims reserves based on an actuarial analysis of historical claims data. Self-insurance reserves for employee health benefits, workers' compensation and product

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and general liability claims were \$20,275,000 and \$19,103,000 as of February 3, 2013 and January 29, 2012, respectively, and are recorded within accrued salaries, benefits and other within our Consolidated Balance Sheets.

Stock-Based Compensation

We account for stock-based compensation arrangements by measuring and recognizing compensation expense in our consolidated financial statements for all stock-based awards using a fair value based-method. For stock options and stock-settled stock appreciation rights (option awards), fair value is determined using the Black-Scholes valuation model, while restricted stock units are valued using the closing price of our stock on the date prior to the date of grant. Significant factors affecting the fair value of option awards include the estimated future volatility of our stock price and the estimated expected term until the option award is exercised, converted or cancelled. The fair value of each stock-based award is amortized over the requisite service period.

Income Taxes

Income taxes are accounted for using the asset and liability method. Under this method, deferred income taxes arise from temporary differences between the tax basis of assets and liabilities and their reported amounts in the consolidated financial statements. We record reserves for estimates of probable settlements of foreign and domestic tax audits. At any one time, many tax years are subject to audit by various taxing jurisdictions. The results of these audits and negotiations with taxing authorities may affect the ultimate settlement of these issues. Additionally, our effective tax rate in a given financial statement period may be materially impacted by changes in the mix and level of our earnings.

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risks, which include significant deterioration of the U.S. and foreign markets, changes in U.S. interest rates, foreign currency exchange rates, including the devaluation of the U.S. dollar, and the effects of uncertain economic forces 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

As of February 3, 2013, our line of credit facility was the only instrument we held with a variable interest rate which could, if drawn upon, subject us to risks associated with changes in that interest rate. As of February 3, 2013, there were no amounts outstanding under our credit facility.

In addition, we have fixed and variable income investments consisting of short-term investments classified as cash and cash equivalents, which are also affected by changes in market interest rates. As of February 3, 2013, our investments, made primarily in money market funds, interest-bearing demand deposit accounts and highly liquid U.S. Treasury bills, 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 2% of our international purchase transactions are in currencies other than the U.S. dollar, primarily the euro. Any currency risks related to these international purchase transactions were not significant to us during fiscal 2012 and fiscal 2011. 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, as of February 3, 2013, our retail stores in Canada and our limited operations in Asia, Europe and Australia, expose us to market risk associated with foreign currency exchange rate fluctuations. Although these exchange rate fluctuations have not been material to us in the past, we intend to enter into foreign currency contracts beginning in fiscal 2013 to minimize the currency remeasurement risk associated with the transactions of our foreign subsidiaries. We did not enter into any foreign currency contracts during fiscal 2012 or fiscal 2011.

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

	<i>Fiscal Year Ended</i>		
	Feb. 3, 2013	Jan. 29, 2012	Jan. 30, 2011
	(53 Weeks)	(52 Weeks)	(52 Weeks)
<i>Dollars and shares in thousands, except per share amounts</i>			
Net revenues	\$ 4,042,870	\$ 3,720,895	\$ 3,504,158
Cost of goods sold	2,450,394	2,261,039	2,130,299
Gross margin	1,592,476	1,459,856	1,373,859
Selling, general and administrative expenses	1,183,313	1,078,124	1,050,445
Operating income	409,163	381,732	323,414
Interest (income) expense, net	(793)	(98)	354
Earnings before income taxes	409,956	381,830	323,060
Income taxes	153,226	144,899	122,833
Net earnings	\$ 256,730	\$ 236,931	\$ 200,227
Basic earnings per share	\$ 2.59	\$ 2.27	\$ 1.87
Diluted earnings per share	\$ 2.54	\$ 2.22	\$ 1.83
Shares used in calculation of earnings per share:			
Basic	99,266	104,352	106,956
Diluted	101,051	106,582	109,522

See Notes to Consolidated Financial Statements.

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

	<i>Fiscal Year Ended</i>		
	Feb. 3, 2013	Jan. 29, 2012	Jan. 30, 2011
	(53 Weeks)	(52 Weeks)	(52 Weeks)
<i>Dollars in thousands</i>			
Net earnings	\$ 256,730	\$ 236,931	\$ 200,227
Other comprehensive income (loss), net of tax:			
Foreign currency translation adjustment	1,043	(400)	2,603
Comprehensive income	\$ 257,773	\$ 236,531	\$ 202,830

See Notes to Consolidated Financial Statements.

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

<i>Dollars and shares in thousands, except per share amounts</i>	Feb. 3, 2013	Jan. 29, 2012
ASSETS		
Current assets		
Cash and cash equivalents	\$ 424,555	\$ 502,757
Restricted cash	16,055	14,732
Accounts receivable, net	62,985	45,961
Merchandise inventories, net	640,024	553,461
Prepaid catalog expenses	37,231	34,294
Prepaid expenses	26,339	24,188
Deferred income taxes, net	99,764	91,744
Other assets	9,819	9,229
Total current assets	1,316,772	1,276,366
Property and equipment, net	812,037	734,672
Non-current deferred income taxes, net	12,398	12,382
Other assets, net	46,472	37,418
Total assets	\$ 2,187,679	\$ 2,060,838
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	\$ 259,162	\$ 218,329
Accrued salaries, benefits and other	120,632	111,774
Customer deposits	207,415	190,417
Income taxes payable	41,849	22,435
Current portion of long-term debt	1,724	1,795
Other liabilities	26,345	27,049
Total current liabilities	657,127	571,799
Deferred rent and lease incentives	171,198	181,762
Long-term debt	3,753	5,478
Other long-term obligations	46,463	46,537
Total liabilities	878,541	805,576
Commitments and contingencies See Note J		
Stockholders' equity		
Preferred stock: \$.01 par value; 7,500 shares authorized; none issued	0	0
Common stock: \$.01 par value; 253,125 shares authorized; 97,734 and 100,451 shares issued and outstanding at		
February 3, 2013 and January 29, 2012, respectively	977	1,005
Additional paid-in capital	503,616	478,720
Retained earnings	790,912	762,947
Accumulated other comprehensive income	13,633	12,590
Total stockholders' equity	1,309,138	1,255,262
Total liabilities and stockholders' equity	\$ 2,187,679	\$ 2,060,838

See Notes to Consolidated Financial Statements.

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

	Common Stock		Additional Paid-in	Retained	Accumulated Other Comprehensive	Total
<i>Dollars and shares in thousands</i>	Shares	Amount	Capital	Earnings	Income	Equity
Balance at January 31, 2010	106,962	\$ 1,070	\$ 448,848	\$ 751,290	\$ 10,387	\$ 1,211,595
Net earnings				200,227		200,227
Foreign currency translation adjustment					2,603	2,603
Exercise of stock-based awards and related tax effect	983	10	23,290			23,300
Conversion/release of stock-based awards	1,206	12	(17,930)			(17,918)
Repurchase and retirement of common stock	(4,263)	(43)	(13,945)	(111,012)		(125,000)
Stock-based compensation expense			26,622	8		26,630
Dividends declared				(62,574)		(62,574)
Balance at January 30, 2011	104,888	\$ 1,049	\$ 466,885	\$ 777,939	\$ 12,990	\$ 1,258,863
Net earnings				236,931		236,931
Foreign currency translation adjustment					(400)	(400)
Exercise of stock-based awards and related tax effect	430	4	17,921			17,925
Conversion/release of stock-based awards	517	5	(11,661)			(11,656)
Repurchase and retirement of common stock	(5,384)	(53)	(18,757)	(175,619)		(194,429)
Stock-based compensation expense			24,332	4		24,336
Dividends declared				(76,308)		(76,308)
Balance at January 29, 2012	100,451	\$ 1,005	\$ 478,720	\$ 762,947	\$ 12,590	\$ 1,255,262
Net earnings				256,730		256,730
Foreign currency translation adjustment					1,043	1,043
Exercise of stock-based awards and related tax effect	506	5	27,225			27,230
Conversion/release of stock-based awards	739	7	(18,644)			(18,637)
Repurchase and retirement of common stock	(3,962)	(40)	(14,741)	(140,299)		(155,080)
Stock-based compensation expense			31,056	(14)		31,042
Dividends declared				(88,452)		(88,452)
Balance at February 3, 2013	97,734	\$ 977	\$ 503,616	\$ 790,912	\$ 13,633	\$ 1,309,138

See Notes to Consolidated Financial Statements.

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

	Feb. 3, 2013 (53 Weeks)	Fiscal Year Ended	
		Jan. 29, 2012 (52 Weeks)	Jan. 30, 2011 (52 Weeks)
<i>Dollars in thousands</i>			
Cash flows from operating activities:			
Net earnings	\$ 256,730	\$ 236,931	\$ 200,227
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:			
Depreciation and amortization	134,453	130,553	144,630
(Gain)/loss on sale/disposal of assets	2,317	2,040	(1,139)
Impairment of assets	6,071	840	5,453
Amortization of deferred lease incentives	(26,694)	(27,547)	(37,115)
Deferred income taxes	(9,029)	14,210	23,566
Tax benefit from exercise of stock-based awards	12,725	8,515	10,450
Excess tax benefit from exercise of stock-based awards	(12,683)	(8,021)	(11,239)
Stock-based compensation expense	31,042	24,336	26,630
Other	0	17	0
Changes in:			
Accounts receivable	(16,408)	(4,763)	3,477
Merchandise inventories	(85,981)	(34,853)	(46,464)
Prepaid catalog expenses	(2,937)	2,559	(4,048)
Prepaid expenses and other assets	(12,204)	(2,065)	(1,729)
Accounts payable	22,461	(21,154)	35,946
Accrued salaries, benefits and other current and long-term liabilities	9,147	(16,030)	19,314
Customer deposits	16,962	(2,242)	(3,112)
Deferred rent and lease incentives	18,803	7,570	(2,550)
Income taxes payable	19,352	(19,562)	(6,308)
Net cash provided by operating activities	364,127	291,334	355,989
Cash flows from investing activities:			
Purchases of property and equipment	(205,404)	(130,353)	(61,906)
Restricted cash deposits	(1,323)	(2,220)	(12,512)
Proceeds from sale of assets	182	81	10,823
Proceeds from insurance reimbursement	115	751	0
Acquisition of Rejuvenation Inc., net of cash received	0	(25,363)	0
Other	(385)	(600)	(400)
Net cash used in investing activities	(206,815)	(157,704)	(63,995)
Cash flows from financing activities:			
Repurchase of common stock	(155,080)	(194,429)	(125,000)
Payment of dividends	(87,847)	(68,877)	(59,160)
Tax withholdings related to stock-based awards	(18,637)	(11,656)	(17,918)
Net proceeds from exercise of stock-based awards	14,637	9,614	15,736
Excess tax benefit from exercise of stock-based awards	12,683	8,021	11,239
Repayments of long-term obligations	(1,796)	(1,626)	(1,587)
Other	(405)	(86)	(1,625)
Net cash used in financing activities	(236,445)	(259,039)	(178,315)
Effect of exchange rates on cash and cash equivalents	931	(237)	781
Net increase (decrease) in cash and cash equivalents	(78,202)	(125,646)	114,460
Cash and cash equivalents at beginning of year	502,757	628,403	513,943
Cash and cash equivalents at end of year	\$ 424,555	\$ 502,757	\$ 628,403
Supplemental disclosure of cash flow information:			

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Cash paid during the year for:

Interest	\$ 1,651	\$ 1,952	\$ 2,381
Income taxes, net of refunds	131,440	150,657	98,617

See Notes to Consolidated Financial Statements.

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Williams-Sonoma, Inc.

Notes to Consolidated Financial Statements

Note A: Summary of Significant Accounting Policies

We are a specialty retailer of high-quality products for the home. The direct-to-customer segment of our business sells our products through our seven e-commerce websites (williams-sonoma.com, potterybarn.com, potterybarnkids.com, pbteen.com, westelm.com, rejuvenation.com and markandgraham.com) and eight direct-mail catalogs (Williams-Sonoma, Pottery Barn, Pottery Barn Bed and Bath, Pottery Barn Kids, PBteen, West Elm, Rejuvenation and Mark and Graham). We offer shipping from many of our brands to countries worldwide, while our catalogs reach customers across the U.S. The retail segment of our business sells similar products through our five retail store concepts (Williams-Sonoma, Pottery Barn, Pottery Barn Kids, West Elm and Rejuvenation). As of February 3, 2013, we operate 581 stores in 44 states, Washington, D.C., Canada and Puerto Rico.

Intercompany transactions and accounts have been eliminated.

Fiscal Year

Our fiscal year ends on the Sunday closest to January 31, based on a 52 or 53-week year. Fiscal 2012, a 53-week year, ended on February 3, 2013; fiscal 2011, a 52-week year, ended on January 29, 2012; and fiscal 2010, a 52-week year, ended on January 30, 2011.

Use of Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosures of contingent assets and liabilities. These estimates and assumptions are evaluated on an ongoing basis and are based on historical experience and various other factors that we believe to be reasonable under the circumstances. Actual results could differ from these estimates.

Cash Equivalents

Cash equivalents include highly liquid investments with an original maturity of three months or less. As of February 3, 2013, we were invested primarily in money market funds, interest-bearing demand deposit accounts and highly liquid U.S. Treasury bills. Book cash overdrafts issued, but not yet presented to the bank for payment, are reclassified to accounts payable.

Restricted Cash

Restricted cash represents deposits held in trusts to secure our liabilities associated with our workers' compensation and other insurance programs.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are stated at their carrying values, net of an allowance for doubtful accounts. Accounts receivable consist primarily of credit card, franchisee and landlord receivables for which collectability is reasonably assured. Other miscellaneous receivables are evaluated for collectability on a regular basis and an allowance for doubtful accounts is recorded, if necessary. Our allowance for doubtful accounts was not material to our financial statements as of February 3, 2013 and January 29, 2012.

Merchandise Inventories

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

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Reserves for shrinkage are estimated and recorded throughout the year, at the concept and channel level, as a percentage of net sales based on historical shrinkage results, expectations of future shrinkage and current inventory levels. Actual shrinkage is recorded at year-end based on the results of our physical inventory count and can vary from our estimates due to such factors as changes in operations within our distribution centers, the mix of our inventory (which ranges from large furniture to small tabletop items) and execution against loss prevention initiatives in our stores, distribution centers, off-site storage locations, and with our third party transportation providers. Accordingly, there is no shrinkage reserve at year-end.

Due to these factors, our obsolescence and shrinkage reserves contain uncertainties. Both estimates include calculations that require management to make assumptions and to apply judgment regarding a number of factors, including market conditions, the selling environment, historical results and current inventory trends. If actual obsolescence or shrinkage estimates change from our original estimate, we will adjust our reserves accordingly throughout the year. Management does not believe that changes in the assumptions used in these estimates would have a significant effect on our inventory balances. We have made no material changes to our assumptions included in the calculations of the obsolescence and shrinkage reserves throughout the year. In addition, we do not believe a 10% change in our inventory reserves would have a material effect on net earnings. As of February 3, 2013 and January 29, 2012, our inventory obsolescence reserves were \$12,273,000 and \$12,026,000, respectively.

Advertising and Prepaid Catalog Expenses

Advertising expenses consist of media and production costs related to catalog mailings, e-commerce advertising and other direct marketing activities. All advertising costs are expensed as incurred, or upon the release of the initial advertisement, with the exception of prepaid catalog expenses. Prepaid catalog expenses consist primarily of third party incremental direct costs, including creative design, paper, printing, postage and mailing costs for all of our direct response catalogs. Such costs are capitalized as prepaid catalog expenses and are amortized over their expected period of future benefit. Such amortization is based upon the ratio of estimated direct-to-customer revenues for the period to the total estimated direct-to-customer revenues over the life of the catalog on an individual catalog basis. Estimated direct-to-customer revenues over the life of the catalog are based upon various factors such as the total number of catalogs and pages circulated, the probability and magnitude of consumer response and the assortment of merchandise offered. Each catalog is generally fully amortized over a six to nine month period, with the majority of the amortization occurring within the first four to five months. Prepaid catalog expenses are evaluated for realizability on a monthly basis by comparing the carrying amount associated with each catalog to the estimated probable remaining future profitability (remaining net revenues less merchandise cost of goods sold, selling expenses and catalog-related costs) associated with that catalog. If the catalog is not expected to be profitable, the carrying amount of the catalog is impaired accordingly.

Total advertising expenses (including catalog advertising, e-commerce advertising and all other advertising costs) were approximately \$318,338,000, \$301,316,000 and \$293,623,000 in fiscal 2012, fiscal 2011 and fiscal 2010, respectively.

Property and Equipment

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

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

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

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

During fiscal 2012, we recorded expense of approximately \$6,071,000 associated with asset impairment charges, primarily related to underperforming retail stores, all of which is recorded within selling, general and administrative expenses.

During fiscal 2011, we recorded expense of approximately \$3,194,000 associated with asset impairment and early lease termination charges for underperforming retail stores, substantially all of which is recorded within selling, general and administrative expenses.

During fiscal 2010, we recorded expense of approximately \$17,525,000 associated with asset impairment and early lease termination charges for underperforming retail stores, substantially all of which is recorded within selling, general and administrative expenses. We also recorded a net benefit of \$403,000 associated with the exit of excess distribution capacity, which is recorded within selling, general and administrative expenses.

Goodwill

Goodwill is not amortized, but rather is subject to impairment testing annually (on the first day of the fourth quarter), or between annual tests whenever events or changes in circumstances indicate that the fair value of a reporting unit may be below its carrying amount. The first step of the impairment test requires determining the fair value of the reporting unit. We use the income approach, whereby we estimate the fair value based on the present value of estimated future cash flows. The process of evaluating the potential impairment of goodwill is subjective and requires significant estimates and assumptions such as estimates for sales growth, gross margins, employment rates, inflation and future economic and market conditions. Actual future results may differ from those estimates. If the carrying value of the reporting unit's assets and liabilities, including goodwill, is in excess of its fair value, goodwill may be impaired, and we must perform a second step of comparing the implied fair value of the goodwill to its carrying value to determine the impairment charge, if any. At February 3, 2013 and January 29, 2012, we had goodwill of \$18,951,000 and \$19,301,000, respectively, included in other assets, primarily related to our fiscal 2011 acquisition of Rejuvenation. We did not recognize any goodwill impairment in fiscal 2012 or fiscal 2011.

Self-Insured Liabilities

We are primarily self-insured for workers' compensation, employee health benefits and product and general liability claims. We record self-insurance liabilities based on claims filed, including the development of those claims, and an estimate of claims incurred but not yet reported. Factors affecting this estimate include future inflation rates, changes in severity, benefit level changes, medical costs and claim settlement patterns. Should a different amount of claims occur compared to what was estimated, or costs of the claims increase or decrease beyond what was anticipated, reserves may need to be adjusted accordingly. We determine our workers

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compensation liability and product and general liability claims reserves based on an actuarial analysis of historical claims data. Self-insurance reserves for employee health benefits, workers' compensation and product and general liability claims were \$20,275,000 and \$19,103,000 as of February 3, 2013 and January 29, 2012, respectively, and are recorded within accrued salaries, benefits and other.

Customer Deposits

Customer deposits are primarily comprised of unredeemed gift cards and merchandise credits and deferred revenue related to undelivered merchandise. We maintain a liability for unredeemed gift cards and merchandise credits until the earlier of redemption, escheatment or four years as we have concluded that the likelihood of our gift cards being redeemed beyond four years from the date of issuance is remote.

Deferred Rent and Lease Incentives

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

Fair Value of Financial Instruments

The carrying values of cash and cash equivalents, restricted cash, accounts receivable, accounts payable and debt approximate their estimated fair values.

Revenue Recognition

We recognize revenues and the related cost of goods sold (including shipping costs) at the time the products are delivered to our customers. Revenue is recognized for retail sales (excluding home-delivered merchandise) at the point of sale in the store and for home-delivered merchandise and direct-to-customer sales when the merchandise is delivered to the customers. Discounts provided to customers are accounted for as a reduction of sales. We record a reserve for estimated product returns in each reporting period. Shipping and handling fees charged to the customer are recognized as revenue at the time the products are delivered to the customer. Revenues are presented net of any taxes collected from customers and remitted to governmental authorities.

Sales Returns Reserve

Our customers may return purchased items for an exchange or refund. We record a reserve for estimated product returns, net of cost of goods sold, based on historical return trends together with current product sales performance. A summary of activity in our sales returns reserve is as follows:

	Fiscal 2012 ¹	Fiscal 2011 ¹	Fiscal 2010 ¹
<i>Dollars in thousands</i>	(53 Weeks)	(52 Weeks)	(52 Weeks)
Balance at beginning of year	\$ 14,151	\$ 12,502	\$ 11,839
Provision for sales returns	270,156	245,815	221,289
Actual sales returns	(269,910)	(244,166)	(220,626)
Balance at end of year	\$ 14,397	\$ 14,151	\$ 12,502

¹ Amounts are shown net of cost of goods sold.

Vendor Allowances

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

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Cost of Goods Sold

Cost of goods sold includes cost of goods, occupancy expenses and shipping costs. Cost of goods consists of cost of merchandise, inbound freight expenses, freight-to-store expenses and other inventory related costs such as shrinkage, damages and replacements. Occupancy expenses consist of rent, depreciation and other occupancy costs, including common area maintenance and utilities. Shipping costs consist of third party delivery services and shipping materials.

Selling, General and Administrative Expenses

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

Stock-Based Compensation

We account for stock-based compensation arrangements by measuring and recognizing compensation expense in our consolidated financial statements for all stock-based awards using a fair value based-method. For stock options and stock-settled stock appreciation rights (option awards), fair value is determined using the Black-Scholes valuation model, while restricted stock units are valued using the closing price of our stock on the date prior to the date of grant. Significant factors affecting the fair value of option awards include the estimated future volatility of our stock price and the estimated expected term until the option award is exercised, converted or cancelled. The fair value of each stock-based award is amortized over the requisite service period.

Foreign Currency Translation

As of February 3, 2013, our retail stores in Canada and our limited operations in Asia, Europe and Australia expose us to market risk associated with foreign currency exchange rate fluctuations.

Additionally, some of our foreign operations have a functional currency different than the U.S. dollar, such as those in Canada (Canadian dollar), Europe (euro or Great British pound) and Australia (Australian dollar). Assets and liabilities are translated into U.S. dollars using the current exchange rates in effect at the balance sheet date, while revenues and expenses are translated at the average exchange rates during the period. The resulting translation adjustments are recorded as other comprehensive income within stockholders' equity. Gains and losses resulting from foreign currency transactions have not been significant and are included in selling, general and administrative expenses.

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 for the period plus common stock equivalents. Common stock equivalents consist of shares subject to option awards with exercise prices less than or equal to the average market price of our common stock for the period, as well as restricted stock units, to the extent their inclusion would be dilutive.

Income Taxes

Income taxes are accounted for using the asset and liability method. Under this method, deferred income taxes arise from temporary differences between the tax basis of assets and liabilities and their reported amounts in the consolidated financial statements. We record reserves for estimates of probable settlements of foreign and domestic tax audits. At any one time, many tax years are subject to audit by various taxing jurisdictions. The results of these audits and negotiations with taxing authorities may affect the ultimate settlement of these issues. Additionally, our effective tax rate in a given financial statement period may be materially impacted by changes in the mix and level of our earnings.

New Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*. This guidance revises the manner

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in which entities present comprehensive income in their financial statements. The new guidance removes the presentation options in previous guidance and requires entities to report components of comprehensive income in either (1) a continuous statement of comprehensive income or (2) two separate but consecutive statements. The new guidance does not change the items that must be reported in other comprehensive income. We adopted ASU 2011-05 in the first quarter of fiscal 2012 and have included two separate but consecutive statements for all periods presented.

Note B: Property and Equipment

Property and equipment consists of the following:

<i>Dollars in thousands</i>	Feb. 3, 2013	Jan. 29, 2012
Leasehold improvements	\$ 812,451	\$ 812,701
Fixtures and equipment	643,366	597,453
Capitalized software	366,509	310,761
Land and buildings	180,806	137,943
Corporate systems projects in progress ¹	66,839	72,924
Construction in progress ²	24,971	2,695
Total	2,094,942	1,934,477
Accumulated depreciation	(1,282,905)	(1,199,805)
Property and equipment, net	\$ 812,037	\$ 734,672

¹ Corporate systems projects in progress as of February 3, 2013 and January 29, 2012 includes approximately \$39.7 million and \$48.2 million, respectively, for the portion of our new inventory and order management system currently under development and not ready for its intended use.

² Construction in progress is primarily comprised of leasehold improvements and furniture and fixtures related to new, expanded or remodeled retail stores where construction had not been completed as of year-end.

Note C: Borrowing Arrangements

Long-term debt consists of the following:

<i>Dollars in thousands</i>	Feb. 3, 2013	Jan. 29, 2012
Memphis-based distribution facilities obligation	\$ 5,388	\$ 6,924
Capital leases	89	349
Total debt	5,477	7,273
Less current maturities	(1,724)	(1,795)
Total long-term debt	\$ 3,753	\$ 5,478

Memphis-Based Distribution Facilities Obligation

As of February 3, 2013 and January 29, 2012, total debt of \$5,388,000 and \$6,924,000, respectively, consists entirely of bond-related debt pertaining to the consolidation of one of our Memphis-based distribution facilities due to its related party relationship and our obligation to renew the lease until the bonds are fully repaid (see Note F).

The aggregate maturities of long-term debt at February 3, 2013 were as follows:

<i>Dollars in thousands</i>	
Fiscal 2013	\$ 1,724
Fiscal 2014	1,785

Fiscal 2015	1,968
Total	\$ 5,477

Table of Contents*Credit Facility*

We have a credit facility that provides for a \$300,000,000 unsecured revolving line of credit that may be used for loans or letters of credit. Prior to December 22, 2016, we may, upon notice to the lenders, request an increase in the credit facility of up to \$200,000,000, to provide for a total of \$500,000,000 of unsecured revolving credit. As of February 3, 2013, we were in compliance with our financial covenants under the credit facility and, based on current projections, we expect to remain in compliance throughout fiscal 2013. The credit facility matures on June 22, 2017, 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 fiscal 2012 and fiscal 2011, we had no borrowings under the credit facility, and no amounts were outstanding as of February 3, 2013 or January 29, 2012. Additionally, as of February 3, 2013, \$4,970,000 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 \$90,000,000, each of which matures on August 30, 2013. 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 February 3, 2013, an aggregate of \$18,578,000 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 27, 2014.

Note D: Income Taxes

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

	Feb. 3, 2013	<i>Fiscal Year Ended</i>	
		Jan. 29, 2012	Jan. 30, 2011
<i>Dollars in thousands</i>	(53 Weeks)	(52 Weeks)	(52 Weeks)
United States	\$ 401,542	\$ 367,620	\$ 308,033
Foreign	8,414	14,210	15,027
Total earnings before income taxes	\$ 409,956	\$ 381,830	\$ 323,060

The provision for income taxes consists of the following:

	Feb. 3, 2013	<i>Fiscal Year Ended</i>	
		Jan. 29, 2012	Jan. 30, 2011
<i>Dollars in thousands</i>	(53 Weeks)	(52 Weeks)	(52 Weeks)
Current			
Federal	\$ 136,742	\$ 104,370	\$ 79,719
State	22,072	22,275	15,576
Foreign	3,441	4,044	3,972
Total current	162,255	130,689	99,267
Deferred			
Federal	(7,827)	15,650	20,429
State	(1,202)	(1,427)	3,047
Foreign	(0)	(13)	90
Total deferred	(9,029)	14,210	23,566
Total provision	\$ 153,226	\$ 144,899	\$ 122,833

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Except where required by U.S. tax law, we have historically elected not to provide for U.S. income taxes with respect to the undistributed earnings of our foreign subsidiaries as we intended to utilize those earnings in our foreign operations for an indefinite period of time. As of February 3, 2013, the accumulated undistributed earnings of all foreign subsidiaries were approximately \$35,600,000 and are sufficient to support our anticipated future cash needs for our foreign operations. We currently intend to utilize the remainder of those undistributed earnings for an indefinite period of time and will only repatriate such earnings when it is tax effective to do so. It is currently not practical to estimate the tax liability that might be payable if these foreign earnings were to be repatriated.

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

	Feb. 3, 2013	<i>Fiscal Year Ended</i> Jan. 29, 2012	Jan. 30, 2011
	(53 Weeks)	(52 Weeks)	(52 Weeks)
Federal income taxes at the statutory rate	35.0%	35.0%	35.0%
State income tax rate	3.3%	3.5%	3.8%
Other	(0.9%)	(0.6%)	(0.8%)
Effective tax rate	37.4%	37.9%	38.0%

Significant components of our deferred tax accounts are as follows:

<i>Dollars in thousands</i>	Feb. 3, 2013	Jan. 29, 2012
Current:		
Compensation	\$ 9,255	\$ 8,638
Merchandise inventories	23,413	21,923
Accrued liabilities	19,462	15,438
Customer deposits	55,321	53,638
Prepaid catalog expenses	(13,971)	(12,869)
Other	6,284	4,976
Total current	99,764	91,744
Non-current:		
Depreciation	(11,142)	(9,008)
Deferred rent	16,205	15,824
Deferred lease incentives	(29,931)	(28,353)
Stock-based compensation	23,245	20,211
Executive deferral plan	4,562	4,563
Uncertainties	3,907	4,856
Other	5,552	4,289
Total non-current	12,398	12,382
Total deferred tax assets, net	\$ 112,162	\$ 104,126

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

<i>Dollars in thousands</i>	Feb. 3, 2013	Jan. 29, 2012	Jan. 30, 2011
Balance at beginning of year	\$ 10,023	\$ 11,619	\$ 15,866
Increases related to current year tax positions	2,188	1,329	821
Increases related to prior years tax positions	936	379	0
Decreases related to prior years tax positions	(171)	(370)	(560)
Settlements	(1,069)	(2,070)	(1,701)
Lapses in statute of limitations	(2,917)	(864)	(2,807)

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Balance at end of year	\$	8,990	\$	10,023	\$	11,619
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As of February 3, 2013, January 29, 2012 and January 30, 2011, we had \$8,990,000, \$10,023,000, and \$11,619,000, respectively, of gross unrecognized tax benefits, of which \$6,101,000, \$6,738,000, and \$7,812,000, respectively, would, if recognized, affect the effective tax rate.

We accrue interest and penalties related to unrecognized tax benefits in the provision for income taxes. As of February 3, 2013 and January 29, 2012, our accruals, entirely for the payment of interest, totaled \$2,508,000 and \$3,983,000, respectively.

Due to the potential resolution of state issues, it is reasonably possible that the balance of our gross unrecognized tax benefits could decrease within the next twelve months by a range of zero to \$3,100,000.

We file income tax returns in the U.S. federal jurisdiction and various states and foreign jurisdictions. We have concluded all U.S. federal income tax examinations through fiscal 2008. Substantially all material state, local and foreign income tax examinations have been concluded through fiscal 2001.

Note E: Accounting for Leases*Operating Leases*

We lease store locations, distribution centers, customer care centers, corporate facilities and certain equipment for original terms ranging generally from 3 to 22 years. Certain leases contain renewal options for periods up to 20 years. The rental payment requirements in our store leases are typically structured as either: minimum rent; minimum rent plus additional rent based on a percentage of store sales; rent based on a percentage of store sales; or rent based on a percentage of store sales if a specified store sales threshold or contractual obligation of the landlord has not been met. Contingent rental payments, including rental payments that are based on a percentage of sales, cannot be predicted with certainty at the onset of the lease term. Accordingly, such contingent rental payments are recorded as incurred each period and are excluded from our calculation of deferred rent liability.

Total rental expense for all operating leases was as follows:

	Feb. 3, 2013	Fiscal Year Ended	
		Jan. 29, 2012	Jan. 30, 2011
	(53		
<i>Dollars in thousands</i>	Weeks)	(52 Weeks)	(52 Weeks)
Rent expense	\$ 189,060	\$ 186,346	\$ 185,979
Contingent rent expense	35,634	34,390	34,856
Rent expense before deferred lease incentive income	224,694	220,736	220,835
Deferred lease incentive income	(26,694)	(27,547)	(37,115)
Less: sublease rental income	(535)	(382)	(329)
Total rent expense ¹	\$ 197,465	\$ 192,807	\$ 183,391

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

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The aggregate future minimum annual cash rental payments under non-cancelable operating leases (excluding the Memphis-based distribution facility consolidated by us, see Note F) in effect at February 3, 2013 were as follows:

<i>Dollars in thousands</i>	Lease Commitments ^{1,2}
Fiscal 2013	\$ 224,579
Fiscal 2014	207,696
Fiscal 2015	181,233
Fiscal 2016	166,573
Fiscal 2017	142,769
Thereafter	521,403
Total	\$1,444,253

¹ Represents future projected cash payments and, therefore, is not necessarily representative of future expected rental expense.

² Projected cash payments include only those amounts that are fixed and determinable as of the reporting date. We currently pay rent for certain store locations based on a percentage of store sales. Projected payments for these locations are based on minimum rent, which is generally higher than rent based on a percentage of store sales, as future store sales cannot be predicted with certainty. We incur other lease obligation expenses, such as common area charges and other executory costs, which are not fixed in nature and are thus not included in the future projected cash payments reflected above. In addition, projected cash payments do not include any benefit from deferred lease incentive income, which is reflected within Total rent expense above.

Note F: Memphis-Based Distribution Facilities

Our Memphis-based distribution facilities include an operating lease entered into in July 1983 for a distribution facility in Memphis, Tennessee. The lessor is a general partnership (Partnership 1) comprised of the estate of W. Howard Lester (Mr. Lester), our former Chairman of the Board and Chief Executive Officer, and the estate of James A. McMahan (Mr. McMahan), a former Director Emeritus and significant stockholder. Partnership 1 does not have operations separate from the leasing of this distribution facility and does not have lease agreements with any unrelated third parties. The terms of the lease automatically renewed until the bonds that financed the construction of the facility were fully repaid in December 2010, at which time we continued to rent the facility on a month-to-month basis. We subsequently agreed to lease the facilities from Partnership 1 through June 2013. We made annual rental payments in fiscal 2012, fiscal 2011 and fiscal 2010 of approximately \$618,000, plus interest on the bonds.

Our other Memphis-based distribution facility includes an operating lease entered into in August 1990 for another distribution facility that is adjoined to the Partnership 1 facility in Memphis, Tennessee. The lessor is a general partnership (Partnership 2) comprised of the estate of Mr. Lester, the estate of Mr. McMahan and two unrelated parties. Partnership 2 does not have operations separate from the leasing of this distribution facility and does not have lease agreements with any unrelated third parties. The term of the lease automatically renews on an annual basis until the bonds that financed the construction of the facility are fully repaid in August 2015. As of February 3, 2013, \$5,388,000 was outstanding under the Partnership 2 bonds. We made annual rental payments of approximately \$2,473,000, \$2,516,000 and \$2,567,000 plus applicable taxes, insurance and maintenance expenses in fiscal 2012, fiscal 2011 and fiscal 2010, respectively.

As of February 3, 2013, Partnership 2 qualifies as a variable interest entity and is consolidated by us due to its related party relationship and our obligation to renew the lease until the bonds are fully repaid. As such, as of February 3, 2013, our consolidated balance sheet includes \$11,535,000 in assets (primarily buildings), \$5,388,000 in debt and \$6,147,000 in other long-term liabilities related to the consolidation of the Partnership 2 distribution facility.

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

<i>Dollars and amounts in thousands, except per share amounts</i>	Net Earnings	Weighted Average Shares	Earnings Per Share
2012 (53 Weeks)			
Basic	\$ 256,730	99,266	\$ 2.59
Effect of dilutive stock-based awards		1,785	
Diluted	\$ 256,730	101,051	\$ 2.54
2011 (52 Weeks)			
Basic	\$ 236,931	104,352	\$ 2.27
Effect of dilutive stock-based awards		2,230	
Diluted	\$ 236,931	106,582	\$ 2.22
2010 (52 Weeks)			
Basic	\$ 200,227	106,956	\$ 1.87
Effect of dilutive stock-based awards		2,566	
Diluted	\$ 200,227	109,522	\$ 1.83

Stock-based awards of 1,313,000, 1,743,000 and 1,488,000 shares in fiscal 2012, fiscal 2011 and fiscal 2010, respectively, were not included in the computation of diluted earnings per share, as their inclusion would be anti-dilutive.

Note H: 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, deferred stock awards (collectively, *stock awards*) and dividend equivalents up to an aggregate of 25,759,903 shares. As of February 3, 2013, there were approximately 7,563,315 shares available for future grant. Awards may be granted under the Plan to officers, employees and non-employee Board members of the company or any parent or subsidiary. Annual grants are limited to 1,000,000 shares covered by option awards and 400,000 shares covered by stock awards on a per person basis. All grants of option awards made under the Plan 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 and stock awards granted to employees generally vest over a period of four years. Certain option awards, stock awards and other agreements contain vesting acceleration clauses resulting from events including, but not limited to, retirement, merger or a similar corporate event. Option and 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). Shares issued as a result of award exercises will be funded with the issuance of new shares.

Stock-Based Compensation Expense

During fiscal 2012, fiscal 2011 and fiscal 2010, we recognized total stock-based compensation expense, as a component of selling, general and administrative expenses, of \$31,042,000 (including stock-based compensation expense of \$3,019,000 associated with the retirement of our former Executive Vice President, Chief Operating and Chief Financial Officer), \$24,336,000, and \$26,630,000, respectively. As of February 3, 2013, there was \$48,351,000 of unrecognized stock-based compensation expense (net of estimated forfeitures), which we expect to recognize on a straight-line basis over a weighted average remaining service period of approximately two years. At each reporting period, all compensation expense attributable to vested awards has been fully recognized.

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The following table summarizes our stock option activity during fiscal 2012:

	Shares	Weighted Average Exercise Price	Weighted Average Contractual Term Remaining (Years)	Intrinsic Value ¹
Balance at January 29, 2012	934,696	\$ 31.76		
Granted	0	0.00		
Exercised	(505,566)	28.95		
Cancelled	(200)	38.84		
Balance at February 3, 2013 (100% vested)	428,930	\$ 35.07	1.95	\$ 4,266,000

¹ Intrinsic value for outstanding and vested options is based on the excess, if any, of the market value of our common stock on the last business day of the fiscal year (or \$45.02) over the exercise price.

No stock options were granted in fiscal 2012, fiscal 2011 or fiscal 2010. The total intrinsic value of stock options exercised was \$5,497,000 for fiscal 2012, \$7,343,000 for fiscal 2011 and \$15,788,000 for fiscal 2010. Intrinsic value for options exercised is based on the excess of the market value over the exercise price on the date of exercise.

Stock-Settled Stock Appreciation Rights

A stock-settled stock appreciation right is an award that allows the recipient to receive common stock equal to the appreciation in the fair market value of our common stock between the date the award was granted and the conversion date for the number of shares vested.

The following table summarizes our stock-settled stock appreciation right activity during fiscal 2012:

	Shares	Weighted Average Conversion Price ¹	Weighted Average Contractual Term Remaining (Years)	Intrinsic Value ²
Balance at January 29, 2012	3,941,642	\$ 24.13		
Granted	0	0.00		
Converted into common stock	(1,183,951)	13.79		
Cancelled	(229,907)	32.48		
Balance at February 3, 2013	2,527,784	\$ 28.21	5.42	\$ 42,497,000
Vested at February 3, 2013	1,466,023	\$ 20.37	5.44	\$ 36,133,000
Vested plus expected to vest at February 3, 2013	2,205,070	\$ 26.47	5.45	\$ 40,899,000

¹ Conversion price is equal to the market value on the date of grant.

² Intrinsic value for outstanding and vested rights is based on the excess of the market value of our common stock on the last business day of the fiscal year (or \$45.02) over the conversion price.

The following table summarizes additional information about stock-settled stock appreciation rights:

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	Fiscal 2012	Fiscal 2011	Fiscal 2010
Weighted average grant date fair value per share of awards granted	\$ 0.00	\$ 14.27	\$ 10.21
Intrinsic value of awards converted into common stock ¹	\$ 31,569,000	\$ 18,969,000	\$ 20,252,000

¹ Intrinsic value for conversions is based on the excess of the market value over the conversion price on the date of the conversion.

