WILLIAMS SONOMA INC
Form 10-Q
December 10, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended October 31, 2010.

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)

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

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

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

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

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

Large accelerated filer _ü_	Accelerated filer ____
Non-accelerated filer _____ (Do not check if a smaller reporting company)	Smaller reporting company ____

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

As of November 28, 2010, 105,112,709 shares of the registrant s Common Stock were outstanding.

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WILLIAMS-SONOMA, INC.

REPORT ON FORM 10-Q

FOR THE QUARTER ENDED OCTOBER 31, 2010

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PART I. FINANCIAL INFORMATION

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ITEM 1. FINANCIAL STATEMENTS

WILLIAMS-SONOMA, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

Dollars and shares in thousands, except per share amounts	October 31, 2010	January 31, 2010	November 1, 2009
ASSETS			
Current assets			
Cash and cash equivalents	$ 389,627	$ 513,943	$ 228,744
Restricted cash	12,507	0	0
Accounts receivable, net	41,922	44,187	42,182
Merchandise inventories, net	586,256	466,124	545,042
Prepaid catalog expenses	46,767	32,777	42,378
Prepaid expenses	37,887	22,109	42,251
Deferred income taxes	92,265	92,195	90,588
Other assets, net	9,012	8,858	10,415
Total current assets	1,216,243	1,180,193	1,001,600
Property and equipment, net	750,239	829,027	854,478
Non-current deferred income taxes	51,517	53,809	39,312
Other assets	17,173	16,140	16,302
Total assets	$ 2,035,172	$ 2,079,169	$ 1,911,692
LIABILITIES AND SHAREHOLDERS EQUITY			
Current liabilities			
Accounts payable	$ 202,888	$ 188,241	$ 171,904
Accrued salaries, benefits and other	94,033	107,710	75,603
Customer deposits	196,353	195,185	194,689
Income taxes payable	39,025	48,260	0
Current portion of long-term debt	1,714	1,587	14,800
Other liabilities	23,476	22,499	19,741
Total current liabilities	557,489	563,482	476,737
Deferred rent and lease incentives	212,303	241,300	252,888
Long-term debt	7,165	8,672	8,886
Other long-term obligations	58,927	54,120	54,479
Total liabilities	835,884	867,574	792,990
Commitments and contingencies			
Shareholders equity			
Preferred stock, $.01 par value, 7,500 shares authorized, none issued	0	0	0
Common stock, $.01 par value, 253,125 shares authorized, issued and outstanding: 105,422, 106,962 and 105,950 shares at October 31, 2010, January 31, 2010 and November 1, 2009, respectively	1,054	1,070	1,059
Additional paid-in capital	465,937	448,848	431,533
Retained earnings	720,399	751,290	675,842
Accumulated other comprehensive income	11,898	10,387	10,268
Total shareholders equity	1,199,288	1,211,595	1,118,702
Total liabilities and shareholders equity	$ 2,035,172	$ 2,079,169	$ 1,911,692

See Notes to Condensed Consolidated Financial Statements.

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WILLIAMS-SONOMA, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
Dollars and shares in thousands, except per share amounts	October 31, 2010	November 1, 2009	October 31, 2010	November 1, 2009
Net revenues	$ 815,516	$ 729,297	$ 2,308,707	$ 2,013,026
Cost of goods sold	504,235	476,445	1,440,141	1,360,870
Gross margin	311,281	252,852	868,566	652,156
Selling, general and administrative expenses	255,119	243,396	728,746	671,505
Interest (income) expense, net	78	341	329	990
Earnings (loss) before income taxes	56,084	9,115	139,491	(20,339)
Income tax expense (benefit)	19,554	1,788	52,664	(9,360)
Net earnings (loss)	$ 36,530	$ 7,327	$ 86,827	$ (10,979)
Basic earnings (loss) per share	$ 0.34	$ 0.07	$ 0.81	$ (0.10)
Diluted earnings (loss) per share	$ 0.34	$ 0.07	$ 0.79	$ (0.10)
Shares used in calculation of earnings (loss) per share:				
Basic	106,152	105,817	107,216	105,706
Diluted	108,908	108,626	109,782	105,706

See Notes to Condensed Consolidated Financial Statements.

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WILLIAMS-SONOMA, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Thirty-Nine Weeks Ended	
	October 31,	November 1,
Dollars in thousands	2010	2009
Cash flows from operating activities:		
Net earnings (loss)	$ 86,827	$ (10,979)
Adjustments to reconcile net earnings (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	108,505	113,584
(Gain) loss on sale/disposal of assets	(1,710)	2,042
Impairment of assets	5,114	21,654
Amortization of deferred lease incentives	(27,895)	(26,367)
Deferred income taxes	(9,049)	(5,452)
Tax benefit from exercise of stock-based awards	8,663	425
Stock-based compensation expense	21,482	14,152
Changes in:		
Accounts receivable	3,204	(4,632)
Merchandise inventories	(119,571)	29,406
Prepaid catalog expenses	(13,990)	(5,953)
Prepaid expenses and other assets	(15,794)	1,925
Accounts payable	14,544	13,490
Accrued salaries, benefits and other current and long-term liabilities	(8,139)	6,952
Customer deposits	933	1,874
Deferred rent and lease incentives	(1,442)	13,576
Income taxes payable	(9,229)	(112)
Net cash provided by operating activities	42,453	165,585
Cash flows from investing activities:		
Purchases of property and equipment	(46,422)	(50,391)
Restricted cash deposits	(12,507)	0
Proceeds from sale of assets	10,756	856
Net cash used in investing activities	(48,173)	(49,535)
Cash flows from financing activities:		
Repayments of long-term obligations	(1,380)	(1,275)
Net proceeds from exercise of stock-based awards	12,812	3,191
Tax withholdings related to stock-based awards	(11,305)	0
Excess tax benefit from exercise of stock-based awards	6,473	98
Payment of dividends	(43,056)	(38,333)
Repurchase of common stock	(80,714)	0
Other	(1,625)	(50)
Net cash used in financing activities	(118,795)	(36,369)
Effect of exchange rates on cash and cash equivalents	199	241
Net (decrease) increase in cash and cash equivalents	(124,316)	79,922
Cash and cash equivalents at beginning of period	513,943	148,822
Cash and cash equivalents at end of period	$ 389,627	$ 228,744

See Notes to Condensed Consolidated Financial Statements.

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WILLIAMS-SONOMA, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Thirty-Nine Weeks Ended October 31, 2010 and November 1, 2009

(Unaudited)

NOTE A. FINANCIAL STATEMENTS - BASIS OF PRESENTATION

These financial statements include Williams-Sonoma, Inc. and its wholly owned subsidiaries (we, us or our). The condensed consolidated balance sheets as of October 31, 2010 and November 1, 2009, the condensed consolidated statements of operations for the thirteen and thirty-nine weeks then ended and the condensed consolidated statements of cash flows for the thirty-nine weeks then ended have been prepared by us, without audit. In our opinion, the financial statements include all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position at the balance sheet dates and the results of operations for the thirteen and thirty-nine weeks then ended. Significant intercompany transactions and accounts have been eliminated. The balance sheet as of January 31, 2010, presented herein, has been derived from our audited balance sheet included in our Annual Report on Form 10-K for the fiscal year ended January 31, 2010.

The results of operations for the thirteen and thirty-nine weeks ended October 31, 2010 are not necessarily indicative of the operating results of the full year.

Certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended January 31, 2010.

NOTE B. BORROWING ARRANGEMENTS

Credit Facility

On September 23, 2010, we entered into the Fifth Amended and Restated Credit Agreement that amends and replaces our existing credit facility and provides for a $300,000,000 unsecured revolving line of credit that may be used for loans or letters of credit. Prior to March 23, 2015, 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. The credit facility contains certain financial covenants, including a maximum leverage ratio (funded debt adjusted for lease and rent expense to earnings before interest, income tax, depreciation, amortization and rent expense EBITDAR), and covenants limiting our ability to dispose of assets, make acquisitions, be acquired (if a default would result from the acquisition), incur indebtedness, grant liens and make investments. The credit facility contains events of default that include, among others, non-payment of principal, interest or fees, violation of covenants, inaccuracy of representations and warranties, bankruptcy and insolvency events, material judgments, cross-defaults to material indebtedness and events constituting a change of control. The occurrence of an event of default will increase the applicable rate of interest by 2.0% and could result in the acceleration of our obligations under the credit facility and an obligation of any or all of our U.S. subsidiaries that have guaranteed the credit facility to pay the full amount of our obligations under the credit facility. As of October 31, 2010, we were in compliance with our financial covenants under the credit facility and, based on current projections, expect to be in compliance throughout fiscal 2010. The credit facility matures on September 23, 2015, at which time all outstanding borrowings must be repaid and all outstanding letters of credit must be cash collateralized.

We may elect interest rates calculated at (i) Bank of America s prime rate (or, if greater, the average rate on overnight federal funds plus one-half of one percent, or a rate based on LIBOR plus one percent) plus a margin based on our leverage ratio or (ii) LIBOR plus a margin based on our leverage ratio. During the thirteen and thirty-nine weeks ended October 31, 2010 and November 1, 2009, we had no borrowings under the credit facility, and no amounts were outstanding as of October 31, 2010 or November 1, 2009. Additionally, as of October 31, 2010, $11,520,000 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.

Restricted Cash

On April 16, 2010, we entered into a Collateral Trust Agreement (the Agreement) to replace a portion of our standby letters of credit, which secure the liabilities associated with our workers compensation and other insurance programs. Under the Agreement, we are obligated to fund the trust with an initial deposit of $12,500,000 and to reinvest interest income up to a maximum of 110% of the initial deposit thereby guaranteeing our obligation for any losses below our insurance deductibles. The Agreement is renewable annually and is cancellable upon 90 days written notice with the insurance provider s and our mutual consent. As of October 31, 2010, restricted cash related to the Agreement was $12,507,000.

Letter of Credit Facilities

As of October 31, 2010, we have three unsecured commercial letter of credit reimbursement facilities for an aggregate of $90,000,000, each of which matures on September 2, 2011. The letter of credit facilities contain covenants and provide for events of default 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 October 31, 2010, an aggregate of $27,910,000 was outstanding under the letter of credit facilities, which represent 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 30, 2012.

Long-Term Debt

As of October 31, 2010, we had $8,879,000 of long-term debt obligations, consisting primarily of the bond-related debt associated with one of our Memphis-based distribution facilities, which accrues interest based on a variable rate. As of October 31, 2010, the carrying value of our long-term debt approximates fair value.

NOTE C. STOCK-BASED COMPENSATION

Equity Award Programs

Our Amended and Restated 2001 Long-Term Incentive Plan (the Plan) provides for grants of incentive stock options, nonqualified stock options, stock-settled stock appreciation rights (collectively, option awards), restricted stock awards, restricted stock units, deferred stock awards (collectively, stock awards) and dividend equivalents up to an aggregate of 18,459,903 shares. 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 now have a maximum term of seven years, as amended. Incentive stock options that may be issued to 10% shareholders, however, have a maximum term of five 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 or not less than 110% of such closing price for an incentive stock option granted to a 10% shareholder. Option awards granted to employees generally vest over a period of four to five years. Stock awards granted to employees generally vest over a period of three to five years for service based awards. 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 shareholders (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

We measure and record stock-based compensation expense in our consolidated financial statements for all employee stock-based awards using a fair value method. During the thirteen and thirty-nine weeks ended October 31, 2010, we recognized total stock-based compensation expense, as a component of selling, general and administrative expenses, of $6,213,000 and $21,482,000, respectively (including stock-based compensation expense of approximately $4,042,000 for the thirty-nine weeks ended October 31, 2010, associated with the retirement of our former Chairman and Chief Executive Officer). During the thirteen and thirty-nine weeks ended November 1, 2009, we recognized total stock-based compensation expense, as a component of selling, general and administrative expenses, of $5,462,000 and $14,152,000, respectively.

Stock Options

The following table summarizes our stock option activity during the thirty-nine weeks ended October 31, 2010:

	Shares
Balance at January 31, 2010	2,613,132
Granted	0
Exercised	(1,034,601)
Canceled	(33,360)
Balance at October 31, 2010	1,545,171
Vested at October 31, 2010	1,544,771
Vested plus expected to vest at October 31, 2010	1,545,159

Stock-Settled Stock Appreciation Rights

The following table summarizes our stock-settled stock appreciation right activity during the thirty-nine weeks ended October 31, 2010:

	Shares
Balance at January 31, 2010	4,547,975
Granted	369,375
Converted	(644,625)
Canceled	(493,400)
Balance at October 31, 2010	3,779,325
Vested at October 31, 2010	679,930
Vested plus expected to vest at October 31, 2010	3,360,721

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Restricted Stock Units

The following table summarizes our restricted stock unit activity during the thirty-nine weeks ended October 31, 2010:

	Shares
Balance at January 31, 2010	1,887,160
Granted	1,330,758
Released	(448,900)
Canceled	(54,248)
Balance at October 31, 2010	2,714,770
Vested plus expected to vest at October 31, 2010	2,320,651

NOTE D. COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) for the thirteen and thirty-nine weeks ended October 31, 2010 and November 1, 2009 was as follows:

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
Dollars in thousands	October 31, 2010	November 1, 2009	October 31, 2010	November 1, 2009
Net earnings (loss)	$ 36,530	$ 7,327	$ 86,827	$ (10,979)
Other comprehensive income (loss)				
Foreign currency translation adjustment	702	841	1,509	4,758
Net unrealized gain on investment	0	2	0	2
Comprehensive income (loss)	$ 37,232	$ 8,170	$ 88,336	$ (6,219)

NOTE E. EARNINGS (LOSS) PER SHARE

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

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

Dollars and amounts in thousands, except per share amounts	Net Earnings (Loss)	Weighted Average Shares	Earnings (Loss) Per Share
Thirteen weeks ended October 31, 2010			
Basic	$ 36,530	106,152	$ 0.34
Effect of dilutive stock-based awards		2,756	
Diluted	$ 36,530	108,908	$ 0.34
Thirteen weeks ended November 1, 2009			
Basic	$ 7,327	105,817	$ 0.07
Effect of dilutive stock-based awards		2,809	
Diluted	$ 7,327	108,626	$ 0.07
Thirty-nine weeks ended October 31, 2010			
Basic	$ 86,827	107,216	$ 0.81
Effect of dilutive stock-based awards		2,566	
Diluted	$ 86,827	109,782	$ 0.79
Thirty-nine weeks ended November 1, 2009			
Basic	$ (10,979)	105,706	$ (0.10)
Effect of dilutive stock-based awards[1]		0	
Diluted	$ (10,979)	105,706	$ (0.10)

[1] *Due to the net loss recognized for the thirty-nine weeks ended November 1, 2009, all stock-based awards were excluded from the calculation of diluted earnings (loss) per share as their inclusion would be anti-dilutive.*

Stock-based awards of 1,576,000 and 2,419,000 for the thirteen weeks ended and 1,613,000 and 10,312,000 for the thirty-nine weeks ended October 31, 2010 and November 1, 2009, respectively, were not included in the computation of diluted earnings (loss) per share, as their inclusion would be anti-dilutive.

NOTE F. ASSET IMPAIRMENT AND LEASE TERMINATION CHARGES

We review the carrying value of all long-lived assets for impairment, primarily at a store level, whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. We review for impairment all stores for which current or projected cash flows from operations are not sufficient to recover the carrying value of the assets. Impairment results when the carrying value of the assets exceeds the store s undiscounted future cash flows over the remaining life of the lease. Our estimate of undiscounted future cash flows over the store lease term (generally 5 to 22 years) 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 on operating expenses and the overall economics of the retail industry, and are therefore subject to variability and difficult to predict. If a long-lived asset is found to be impaired, the amount recognized for impairment is equal to the difference between the net carrying value and the asset s 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 future cash flows (discounted at a rate that is commensurate with the risk and 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 the thirteen and thirty-nine weeks ended October 31, 2010, we recorded expense of approximately $3,356,000 (of which $3,082,000 is recorded within selling, general and administrative expenses and the remainder within cost of goods sold) and $13,673,000 (of which $12,771,000 is recorded within selling, general and administrative expenses and the remainder within cost of goods sold), respectively, associated with asset impairment and early lease termination charges for underperforming retail stores. We also recorded a net benefit in selling, general and administrative expenses of $403,000 during the thirty-nine weeks ended October 31, 2010 related to the exit of excess distribution capacity.

During the thirteen and thirty-nine weeks ended November 1, 2009, we recorded expense of approximately $12,156,000 (of which $11,036,000 is recorded within selling, general and administrative expenses and the remainder within cost of goods sold) and $25,529,000 (of which $24,250,000 is recorded within selling, general and administrative expenses and the remainder within cost of goods sold), respectively, associated with asset impairment and early lease termination charges for underperforming retail stores. In addition, during the thirteen and thirty-nine weeks ended November 1, 2009, we recorded expense of approximately $6,245,000 (of which $5,665,000 is recorded within selling, general and administrative expenses and the remainder within cost of goods sold) and $7,580,000 (of which $5,981,000 is recorded within selling, general and administrative expenses and the remainder within cost of goods sold), respectively, associated with the exit of excess distribution capacity.

NOTE G. SEGMENT REPORTING

We have two reportable segments, retail and direct-to-customer. The retail segment has five merchandising concepts which sell products for the home (Williams-Sonoma, Pottery Barn, Pottery Barn Kids, West Elm and Williams-Sonoma Home). The five retail merchandising concepts are operating segments, which have been aggregated into one reportable segment, retail. The direct-to-customer segment has six merchandising concepts (Williams-Sonoma, Pottery Barn, Pottery Barn Kids, PBteen, West Elm and Williams-Sonoma Home) and sells similar products through our seven direct mail catalogs (Williams-Sonoma, Pottery Barn, Pottery Barn Kids, Pottery Barn Bed and Bath, PBteen, West Elm and Williams-Sonoma Home) and six e-commerce websites (williams-sonoma.com, potterybarn.com, potterybarnkids.com, pbteen.com, westelm.com and wshome.com). Management s expectation is that the overall economic characteristics of each of our major concepts within each reportable segment will be similar over time based on management s judgment that the operating segments have had similar historical economic characteristics and are expected to have similar long-term financial performance in the future.

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

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

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

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Segment Information

Dollars in thousands	Retail	Direct-to-Customer	Unallocated	Total
Thirteen weeks ended October 31, 2010				
Net revenues[1]	$ 460,933	$ 354,583	$ 0	$ 815,516
Depreciation and amortization expense	21,684	5,127	7,812	34,623
Earnings (loss) before income taxes[2]	40,258	71,802	(55,976)	56,084
Capital expenditures	6,197	4,320	5,016	15,533
Thirteen weeks ended November 1, 2009				
Net revenues[1]	$ 428,292	$ 301,005	$ 0	$ 729,297
Depreciation and amortization expense	25,292	5,177	8,504	38,973
Earnings (loss) before income taxes[2,3]	15,102	49,905	(55,892)	9,115
Capital expenditures	9,827	3,978	3,524	17,329
Thirty-nine weeks ended October 31, 2010				
Net revenues[1]	$ 1,322,589	$ 986,118	$ 0	$ 2,308,707
Depreciation and amortization expense	69,626	15,824	23,055	108,505
Earnings (loss) before income taxes[2,3,4]	97,284	208,757	(166,550)	139,491
Assets[5]	937,466	314,974	782,732	2,035,172
Capital expenditures	19,849	11,141	15,432	46,422
Thirty-nine weeks ended November 1, 2009				
Net revenues[1]	$ 1,185,910	$ 827,116	$ 0	$ 2,013,026
Depreciation and amortization expense	72,893	15,684	25,007	113,584
Earnings (loss) before income taxes[2,3]	3,515	121,737	(145,591)	(20,339)
Assets[5]	992,092	267,578	652,022	1,911,692
Capital expenditures	29,612	10,406	10,373	50,391

[1] *Includes net revenues in the retail channel of approximately $28.2 million and $19.7 million for the thirteen weeks ended October 31, 2010 and November 1, 2009, respectively, and $73.8 million and $49.9 million for the thirty-nine weeks ended October 31, 2010 and November 1, 2009, respectively, related to our foreign operations.*

[2] *Includes expenses in the retail channel of approximately $3.4 million and $12.2 million for the thirteen weeks ended October 31, 2010 and November 1, 2009, respectively, and $13.7 million and $25.5 million for the thirty-nine weeks ended October 31, 2010 and November 1, 2009, respectively, related to asset impairment and early lease termination charges for underperforming retail stores.*

[3] *Unallocated costs before income taxes include a net benefit of $0.4 million for the thirty-nine weeks ended October 31, 2010 and expense of $6.2 million and $7.6 million for the thirteen and thirty-nine weeks ended November 1, 2009, respectively, related to the exit of excess distribution capacity.*

[4] *Unallocated costs before income taxes includes $4.3 million for the thirty-nine weeks ended October 31, 2010 related to the retirement of our former Chief Executive Officer.*

[5] *Includes $27.4 million and $29.7 million of long-term assets as of October 31, 2010 and November 1, 2009, respectively, related to our foreign operations.*

NOTE H: RETIREMENT AND CONSULTING AGREEMENT

On January 25, 2010, the independent members of the Board of Directors (the Board) of Williams-Sonoma, Inc. (the Company) approved the Company s entry into a Retirement and Consulting Agreement (the Agreement) with W. Howard Lester, the Company s former Chairman and Chief Executive Officer. Pursuant to the terms of the Agreement, Mr. Lester retired as Chairman and Chief Executive Officer and as a member of the Board on May 26, 2010. Upon his retirement and in recognition of his contributions to the Company, Mr. Lester received, among other things, accelerated vesting of his outstanding stock options, stock-settled stock appreciation rights and restricted stock units. The total expense recorded in the thirty-nine weeks ended October 31, 2010 associated with Mr. Lester s retirement, consisting primarily of stock-based compensation expense, was approximately $4,319,000. As a result of Mr. Lester s death on November 15, 2010, the Agreement terminated and all unvested stock units and cash payments granted under the Agreement were forfeited.

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NOTE I. CONSOLIDATION OF 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 W. Howard Lester, our former Chairman Emeritus, and James A. McMahan, a Director Emeritus and a significant shareholder. 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.

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 W. Howard Lester, James A. 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.

Both partnerships financed the construction of the distribution facilities and related addition through the sale of industrial development bonds. Quarterly interest and annual principal payments on the bonds are required through maturity and the terms of the lease automatically renew on an annual basis until the bonds are fully repaid. The two partnerships described above qualify as variable interest entities (VIEs) due to their related party relationship with us and our obligation to renew the leases until the bonds are fully repaid. Accordingly, the two related party VIE partnerships, from which we lease our Memphis-based distribution facilities, are consolidated by us. As of October 31, 2010, our consolidated balance sheet includes $15,310,000 in assets (primarily buildings), $8,513,000 in debt and $6,797,000 in other long-term liabilities related to these leases. We have no other VIE relationships which meet the criteria for consolidation.

NOTE J. COMMITMENTS AND CONTINGENCIES

We are involved in lawsuits, claims and proceedings incident to the ordinary course of our business. These disputes, which are not currently material, are increasing in number as our business expands and our company grows larger. 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.

NOTE K. STOCK REPURCHASE PROGRAM

Consistent with our objective to offset dilution from equity compensation programs on an on-going basis, in May 2010, our Board of Directors authorized a stock repurchase program to purchase up to $60,000,000 of our common stock through open market and privately negotiated transactions, at times and in such amounts as management deems appropriate. We completed the $60,000,000 stock repurchase program by repurchasing 599,812 shares of our common stock at a weighted average cost of $26.17 per share and a total cost of approximately $15,694,000 during the third quarter.

In September 2010, our Board of Directors authorized a new stock repurchase program to purchase up to $65,000,000 of our common stock through open market and privately negotiated transactions, at times and in such amounts as management deems appropriate. During the quarter, we repurchased 654,863 shares under this new program at a weighted average cost of $31.63 per share and a total cost of approximately $20,714,000. There remains an aggregate of approximately $44,286,000 available for repurchases under the $65,000,000 stock repurchase program.

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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.

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

FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties, as well as assumptions that, if they do not fully materialize or are proven incorrect, could cause our business and results of operations to differ materially from those expressed or implied by such forward-looking statements. Such forward-looking statements include statements related to: our projected earnings, revenues and sales; the impact of accounting changes; our expected effective tax rate; our plans to shift our merchandising and marketing strategies for the Williams-Sonoma Home brand to an e-commerce and limited store-in-store strategy; the expansion of our international business, including expectations regarding the opening of additional franchised stores and the launch of international shipments through our e-commerce channel; our expectations regarding business trends, our performance in the fourth quarter and the success of our e-marketing and clienteling initiatives; our plans for using our cash resources; our compliance with our bank covenants; our belief that our cash on-hand, in addition to our available credit facilities, will provide adequate liquidity for our business operations over the next 12 months; our planned investments; our stock repurchase program; the future payment of dividends; and our plans to enter into foreign currency contracts, as well as statements of belief and statements of assumptions underlying any of the foregoing. You can identify these and other forward-looking statements by the use of words such as may, should, expects, plans, anticipates, believes, estimates, predicts, intends, potential, continue, or the negative o 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 those discussed under the heading Risk Factors in this document 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.

OVERVIEW

We are a specialty retailer of products for the home. The retail segment of our business sells our products through our five retail store concepts (Williams-Sonoma, Pottery Barn, Pottery Barn Kids, West Elm and Williams-Sonoma Home). The direct-to-customer segment of our business sells similar products through our seven direct-mail catalogs (Williams-Sonoma, Pottery Barn, Pottery Barn Kids, Pottery Barn Bed and Bath, PBteen, West Elm and Williams-Sonoma Home) and six e-commerce websites (williams-sonoma.com, potterybarn.com, potterybarnkids.com, pbteen.com, westelm.com and wshome.com). Based on their contribution to our net revenues, the core brands in both the retail and direct-to-customer channels are: Pottery Barn, which sells casual home furnishings; Williams-Sonoma, which sells cooking and entertaining essentials; and Pottery Barn Kids, which sells stylish children s furnishings.

The following discussion and analysis of financial condition, results of operations, and liquidity and capital resources for the thirteen weeks ended October 31, 2010 (third quarter of fiscal 2010), as compared to the thirteen weeks ended November 1, 2009 (third quarter of fiscal 2009) and the thirty-nine weeks ended October 31, 2010 (year-to-date 2010), as compared to the thirty-nine weeks ended November 1, 2009 (year-to-date 2009), should be read in conjunction with our condensed consolidated financial statements and the notes thereto.

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

Third Quarter of Fiscal 2010 Financial Results

During the third quarter of fiscal 2010, our net revenues increased 11.8% to $815,516,000 from $729,297,000 in the third quarter of fiscal 2009. Diluted earnings per share in the third quarter of fiscal 2010 increased to $0.34, the highest third quarter earnings per share in our history, compared to $0.07 in the third quarter of fiscal 2009, including a $0.02 and $0.09 charge from unusual business events, respectively. Innovative merchandise at compelling price points, supported by a superior customer experience and a highly targeted multi-channel marketing strategy, drove these results. We also ended the quarter with cash and cash equivalents of $389,627,000 after returning $136,569,000 to shareholders through share repurchases and dividends over the past 12 months.

Retail net revenues in the third quarter of fiscal 2010 increased $32,641,000, or 7.6%, compared to the third quarter of fiscal 2009. This increase was driven by growth of 8.1% in comparable store sales, partially offset by a 3.2% year-over-year reduction in retail leased square footage, including 21 net fewer stores. Increased net revenues during the quarter were driven by the Pottery Barn, West Elm, Pottery Barn Kids and Williams-Sonoma brands.

Direct-to-customer net revenues in the third quarter of fiscal 2010 increased $53,578,000, or 17.8%, compared to the third quarter of fiscal 2009. This increase was driven by growth in the Pottery Barn, Pottery Barn Kids, PBteen, West Elm and Williams-Sonoma brands. Internet net revenues, our fastest growing channel, increased 28.5% to $295,804,000 in the third quarter of fiscal 2010 compared to $230,112,000 in the third quarter of fiscal 2009.

In our core brands, net revenues in the third quarter of fiscal 2010 increased 10.6% compared to the third quarter of fiscal 2009. Pottery Barn saw the greatest increase, followed by Pottery Barn Kids and Williams-Sonoma. In the Pottery Barn brand, net revenues in the third quarter increased 14.4% and comparable store sales increased 11.6%. In the Pottery Barn Kids brand, net revenues increased 8.2% despite a 7% year-over-year decline in retail leased square footage. Comparable store sales increased 10.3%. In the direct-to-customer channel in both the Pottery Barn and Pottery Barn Kids brands, we continued to identify new opportunities to drive growth and enhanced customer acquisition through both expanded e-marketing and increased catalog circulation. In the Williams-Sonoma brand, third quarter net revenues increased 2.1% and comparable stores sales increased 1.4%. Product exclusivity and traffic-generating promotions were key drivers of growth during the quarter.

In our emerging brands, including West Elm, PBteen and Williams-Sonoma Home, net revenues in the third quarter of fiscal 2010 increased 18.6% compared to the third quarter of fiscal 2009 driven by increasing net revenues in the West Elm and PBteen brands. PBteen net revenues in the third quarter increased 17.1% driven by innovative product at a great value.

In the Williams-Sonoma Home brand, we continued to focus on our retail restructuring and now expect to have all stand-alone stores closed by the end of this fiscal year. At the same time, we are developing new merchandising and marketing strategies for fiscal 2011, as we transition the brand to e-commerce and a limited store-in-store strategy within the Williams-Sonoma brand.

Third Quarter of Fiscal 2010 Operational Results

In supply chain, we continue to see ongoing benefits from our hub distribution strategies and continue to focus on our initiatives including packaging optimization, domestic transportation, network redesign and refinements in our sourcing base.

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In our international business, we are pleased with the performance of our first four franchised stores in Dubai and Kuwait. We see this as a strategic first step toward a longer term international growth plan and are currently planning to see an additional 7 franchised stores opened in fiscal 2011. We are also planning to begin shipping internationally through our e-commerce channel next year.

Fiscal 2010

As we look forward to the fourth quarter, we continue to be encouraged by the sales and margin trends that we are seeing in our business today, particularly in our home furnishings brands, and are operationally poised for an exceptional holiday season. We are also well-positioned to drive significant multi-channel traffic through newly launched e-marketing and clienteling initiatives. As a result of these strong business trends, we now expect net revenue growth of 11% to 12% and diluted earnings per share of $1.61 to $1.66 in fiscal 2010 versus $0.72 in fiscal 2009.

Lastly, in May 2010, our Board of Directors authorized a share repurchase program to purchase up to $60,000,000 of our common stock. During the third quarter, we completed all remaining share repurchases under this program. In September 2010, our Board of Directors authorized a new share repurchase program to purchase up to $65,000,000 of the Company s outstanding common stock. The authorization of these stock repurchase programs reflect the Board of Director s objective to offset dilution from equity compensation programs on an ongoing basis. For year-to-date 2010, we have repurchased $80,714,000 under these programs and have $44,286,000 available for repurchase under the $65,000,000 stock repurchase program.

Results of Operations

NET REVENUES

Net revenues consist of retail revenues and direct-to-customer revenues, both of which include shipping fees. Retail revenues include sales of merchandise to customers at our retail stores, as well as shipping fees on any retail products shipped to our customers homes. Direct-to-customer revenues include sales of merchandise to customers through our catalogs and the internet, as well as shipping fees. 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.

The following table summarizes our net revenues for the third quarter of fiscal 2010 and fiscal 2009, and year-to-date 2010 and 2009:

	Thirteen Weeks Ended				Thirty-Nine Weeks Ended			
Dollars in thousands	October 31, 2010	% Total	November 1, 2009	% Total	October 31, 2010	% Total	November 1, 2009	% Total
Retail revenues	$ 460,933	56.5%	$ 428,292	58.7%	$ 1,322,589	57.3%	$ 1,185,910	58.9%
Direct-to-customer revenues	354,583	43.5%	301,005	41.3%	986,118	42.7%	827,116	41.1%
Net revenues	$ 815,516	100.0%	$ 729,297	100.0%	$ 2,308,707	100.0%	$ 2,013,026	100.0%

Net revenues in the third quarter of fiscal 2010 increased by $86,219,000 or 11.8%, compared to the third quarter of fiscal 2009. This increase was driven by growth of 8.1% in comparable store sales and growth of 28.5% in our e-commerce revenues primarily driven by increased internet advertising, partially offset by a 3.2% year-over-year reduction in retail leased square footage, including 21 net fewer stores. Increased net revenues during the quarter were driven by Pottery Barn and West Elm brands.

Net revenues for year-to-date 2010 increased by $295,681,000, or 14.7%, compared to year-to-date 2009. This increase was driven by growth of 12.6% in comparable store sales and growth of 26.7% in our e-commerce revenues primarily driven by increased internet advertising, partially offset by a 3.2% year-over-year reduction in

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retail leased square footage, including 21 net fewer stores. Increased net revenues during year-to-date 2010 were driven by Pottery Barn, Pottery Barn Kids, West Elm and Williams-Sonoma brands.

RETAIL REVENUES AND OTHER DATA

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
Dollars in thousands	October 31, 2010	November 1, 2009	October 31, 2010	November 1, 2009
Retail revenues	$ 460,933	$ 428,292	$ 1,322,589	$ 1,185,910
Percent increase (decrease) in retail revenues	7.6%	0.9%	11.5%	(10.2%)
Percent increase (decrease) in comparable store sales	8.1%	1.7%	12.6%	(11.6%)
Number of stores - beginning of period	609	629	610	627
Number of new stores	0	1	3	8
Number of new stores due to remodeling[1]	1	1	6	6
Number of closed stores due to remodeling[1]	(1)	(1)	(4)	(6)
Number of permanently closed stores	0	0	(6)	(5)
Number of stores - end of period	609	630	609	630
Store selling square footage at period-end	3,747,000	3,880,000	3,747,000	3,880,000
Store leased square footage (LSF) at period-end	6,054,000	6,251,000	6,054,000	6,251,000

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

	Store Count				Store Count	Avg. LSF Per Store	Avg. LSF Per Store
	August 1, 2010	Openings	Closings	October 31, 2010	November 1, 2009	October 31, 2010	November 1, 2009
Williams-Sonoma	260	0	(1)	259	263	6,300	6,300
Pottery Barn	197	1	0	198	204	13,000	12,900
Pottery Barn Kids	85	0	0	85	93	8,100	8,000
West Elm	37	0	0	37	40	17,000	17,300
Williams-Sonoma Home	11	0	0	11	11	13,200	13,200
Outlets	19	0	0	19	19	19,100	19,500
Total	609	1	(1)	609	630	9,900	9,900

Retail net revenues in the third quarter of fiscal 2010 increased $32,641,000, or 7.6%, compared to the third quarter of fiscal 2009. This increase was driven by growth of 8.1% in comparable store sales, partially offset by a 3.2% year-over-year reduction in retail leased square footage, including 21 net fewer stores. Increased net revenues during the quarter were driven by the Pottery Barn, West Elm, Pottery Barn Kids and Williams-Sonoma brands.

Retail net revenues for year-to-date 2010 increased $136,679,000, or 11.5%, compared to year-to-date 2009. This increase was driven by growth of 12.6% in comparable store sales, partially offset by a 3.2% year-over-year reduction in retail leased square footage, including 21 net fewer stores. Increased net revenues during year-to-date 2010 were driven by the Pottery Barn, West Elm and Williams-Sonoma brands.

Comparable Store Sales

Comparable stores are defined as those 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. By measuring the year-over-year sales of merchandise in the stores that have a history of being open for a full comparable 12 months or more, we can better gauge how the core store base is performing since it excludes new store openings, store remodelings and expansions. Comparable stores exclude new retail

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concepts until such time as we believe that comparable store results in those concepts are of sufficient size to evaluate the performance of the retail strategy. Therefore, in both fiscal 2010 and fiscal 2009, total comparable store sales exclude the West Elm and Williams-Sonoma Home concepts.

Percentages represent changes in comparable store sales compared to the same period in the prior year.

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
Percent increase (decrease) in comparable store sales	October 31, 2010	November 1, 2009	October 31, 2010	November 1, 2009
Williams-Sonoma	1.4%	(2.1%)	6.6%	(9.4%)
Pottery Barn	11.6%	7.6%	16.9%	(10.6%)
Pottery Barn Kids	10.3%	(3.1%)	16.8%	(16.8%)
Outlets	14.1%	(6.7%)	6.6%	(17.5%)
Total	8.1%	1.7%	12.6%	(11.6%)

Various factors affect comparable store sales, including the overall economic and general retail sales environment as well as current local and global economic conditions, each of which were significant factors in our comparable store sales results for the thirteen and thirty-nine weeks ended October 31, 2010 and November 1, 2009, respectively. Additional factors have affected our comparable store sales results in the past and may continue to affect them in the future, such as the number, size and location of stores we open, close, remodel or expand in any period, 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), 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, the benefits of closing underperforming stores in multi-store markets, 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 store sales 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 our comparable store sales to fluctuate significantly in the past on an annual, quarterly and monthly basis and, as a result, we expect that comparable store sales will continue to fluctuate in the future.

DIRECT-TO-CUSTOMER REVENUES

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
Dollars in thousands	October 31, 2010	November 1, 2009	October 31, 2010	November 1, 2009
Catalog revenues	$ 58,779	$ 70,893	$ 182,855	$ 193,287
Internet revenues	295,804	230,112	803,263	633,829
Total direct-to-customer revenues	$ 354,583	$ 301,005	$ 986,118	$ 827,116
Percent increase (decrease) in direct-to-customer revenues	17.8%	(8.1%)	19.2%	(19.9%)
Percent increase (decrease) in number of catalogs circulated	3.8%	(18.1%)	0.5%	(18.0%)
Percent increase (decrease) in number of pages circulated	1.6%	(20.6%)	(1.3%)	(22.8%)

Direct-to-customer net revenues in the third quarter of fiscal 2010 increased $53,578,000, or 17.8%, compared to the third quarter of fiscal 2009. This increase was driven by growth in the Pottery Barn, Pottery Barn Kids, PBteen, West Elm and Williams-Sonoma brands. Internet net revenues, our fastest growing channel, increased 28.5% to $295,804,000 in the third quarter of fiscal 2010 compared to $230,112,000 in the third quarter of fiscal 2009.

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Direct-to-customer net revenues for year