FOOT LOCKER INC
Form 10-Q
December 07, 2007

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended November 3, 2007

Commission file no. 1-10299

FOOT LOCKER, INC.
(Exact name of registrant as specified in its charter)

New York	**13-3513936**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
112 W. 34th Street, New York, New York	**10120**
(Address of principal executive offices)	**(Zip Code)**

Registrant's telephone number: (212) 720-3700

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

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

Large accelerated filer x Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

Number of shares of Common Stock outstanding at December 1, 2007: 154,473,607

FOOT LOCKER, INC.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

FOOT LOCKER, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS
(in millions, except shares)

	November 3, 2007 (Unaudited)	October 28, 2006 (Unaudited- See note 1)	Fe
ASSETS			
Current assets			
Cash and cash equivalents	$ 206	$ 127	$
Short-term investments	126	136	
Merchandise inventories	1,476	1,472	
Other current assets	307	216	
	2,115	1,951	
Property and equipment, net	547	663	
Deferred taxes	183	196	
Goodwill	266	264	
Intangible and other assets	186	200	
	$ 3,297	$ 3,274	$
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities			
Accounts payable	$ 307	$ 356	$
Accrued expenses and other current liabilities	277	252	
Current portion of long-term debt and obligations under capital leases	14	—	
	598	608	
Long-term debt and obligations under capital leases	220	235	
Other liabilities	256	299	
	1,074	1,142	
Shareholders' equity			
Common stock and paid-in capital: 158,996,044, 157,750,905, and 157,810,352 shares, respectively	673	649	

Retained earnings		1,694		1,691	
Accumulated other comprehensive loss		(45)		(161)	
Less: Treasury stock at cost: 4,522,437, 2,105,662, and 2,107,682 shares, respectively		(99)		(47)	
Total shareholders’ equity		2,223		2,132	
	$	3,297	$	3,274	$

See Accompanying Notes to Condensed Consolidated Financial Statements.

* The balance sheet at February 3, 2007 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company’s Annual Report on Form 10-K for the year ended February 3, 2007.

FOOT LOCKER, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(in millions, except per share amounts)

	Thirteen weeks ended		Thirty-nine
	November 3, 2007	**October 28, 2006**	**November 3, 2007**
Sales	$ 1,356	$ 1,430	$ 3,955
Costs and Expenses			
Cost of sales	975	1,008	2,912
Selling, general and administrative expenses	289	284	865
Depreciation and amortization	45	44	132
Impairment charges and store closing program costs	105	—	105
Interest expense, net	—	1	
Other expense (income)	—	(8)	1
	1,414	1,329	4,015
(Loss) income from continuing operations before income taxes	(58)	101	(60)
Income tax (benefit) expense	(24)	36	(25)
(Loss) income from continuing operations	(34)	65	(35)
Income from disposal of discontinued operations, net of income tax of $-	1	—	1
Cumulative effect of accounting change, net of income tax of $-	—	—	—
Net (loss) income	$ (33)	$ 65	$ (34)
Basic (loss) earnings per share:			
(Loss) income from continuing operations	$ (0.22)	$ 0.42	$ (0.22)
Income from discontinued operations	—	—	—
Cumulative effect of accounting change	—	—	—
Net (loss) income	$ (0.22)	$ 0.42	$ (0.22)
Weighted-average common shares outstanding	153.6	155.0	154.1
Diluted (loss) earnings per share:			
(Loss) income from continuing operations	$ (0.22)	$ 0.42	$ (0.22)
Income from discontinued operations	—	—	—
Cumulative effect of accounting change	—	—	—
Net (loss) income	$ (0.22)	$ 0.42	$ (0.22)
Weighted-average common shares assuming dilution	153.6	156.8	154.1

See Accompanying Notes to Condensed Consolidated Financial Statements.

FOOT LOCKER, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME
(Unaudited)
(in millions)

	Thirteen weeks ended		Thirty-nine weeks ende	
	November 3, 2007	**October 28, 2006**	**November 3, 2007**	**October 2 2006**
Net (loss) income	$ (33)	$ 65	$ (34)	$ 1
Other comprehensive income (expense), net of tax				
Foreign currency translation adjustments arising during the period	31	(3)	56	
Pension and postretirement plan adjustments	—	—	1	
Comprehensive (loss) income	$ (2)	$ 62	$ 23	$ 1

See Accompanying Notes to Condensed Consolidated Financial Statements.

FOOT LOCKER, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited, in millions)

	Thirty-nine weeks ended	
	November 3, 2007	**October 28, 2006 (See note 1)**
From Operating Activities:		
Net (loss) income	$ (34)	$ 138
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:		
Income from disposal of discontinued operations, net of tax	(1)	—
Non-cash impairment charges and store closing program costs	103	17
Cumulative effect of accounting change, net of tax	—	(1)
Depreciation and amortization	132	131
Deferred income taxes	(42)	(40)
Share-based compensation expense	8	7
Change in assets and liabilities:		
Merchandise inventories	(137)	(212)
Accounts payable and other accruals	35	(3)
Pension contributions	—	(68)
Other, net	(1)	(43)
Net cash provided by (used in) operating activities of continuing operations	63	(74)
From Investing Activities:		
Lease termination proceeds	—	4
Purchases of short-term investments	(1,314)	(1,379)
Sales of short-term investments	1,437	1,541
Capital expenditures	(117)	(129)
Net cash provided by investing activities of continuing operations	6	37
From Financing Activities:		

Reduction in long-term debt		(2)		(86)
Issuance of common stock, net		9		8
Purchase of treasury stock		(50)		(8)
Excess tax benefit from stock based compensation		1		2
Dividends paid		(58)		(42)
Net cash used in financing activities of continuing operations		(100)		(126)
Net cash provided by operating activities of Discontinued Operations		1		—
Effect of exchange rate fluctuations on Cash and Cash Equivalents		15		1
Net change in Cash and Cash Equivalents		(15)		(162)
Cash and Cash Equivalents at beginning of year		221		289
Cash and Cash Equivalents at end of interim period	$	206	$	127
Cash paid during the period:				
Interest	$	12	$	14
Income taxes	$	41	$	128

See Accompanying Notes to Condensed Consolidated Financial Statements.

FOOT LOCKER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Basis of Presentation. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the Notes to Consolidated Financial Statements contained in the Company’s Form 10-K for the year ended February 3, 2007, as filed with the Securities and Exchange Commission (the “SEC”) on April 2, 2007. Certain items included in these statements are based on management’s estimates. In the opinion of management, all material adjustments, which are of a normal recurring nature, necessary for a fair presentation of the results for the interim periods have been included.

The year-end reporting period for the Company is the Saturday closest to the last day in January. Fiscal year 2007 will comprise 52 weeks, ending on February 2, 2008. Fiscal year 2006 was comprised of 53 weeks and ended on February 3, 2007. The fiscal interim periods ended November 3, 2007 and October 28, 2006 were comprised of 39 weeks. The results for the thirty-nine and thirteen weeks ended November 3, 2007 are not necessarily indicative of the results expected for the year.

In July 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"). Interpretation No. 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes." FIN 48 prescribes a recognition threshold and measurement standard for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

In 2006, in accordance with Staff Accounting Bulletin No. 108, the Company adjusted its opening retained earnings to correct for prior misstatements. Accordingly, the Company has reflected these adjustments in its October 28, 2006 Condensed Consolidated Balance Sheet and Condensed Consolidated Statements of Cash Flows.

2. Income Taxes

The Company adopted the provisions of FIN 48 effective February 4, 2007. Upon the adoption of FIN 48, the Company recognized a $1 million increase to retained earnings to reflect the change to its liability for unrecognized income tax benefits as required. At February 4, 2007, the total amount of gross unrecognized tax benefits was $33 million. The Company recognizes interest and penalties related to unrecognized tax benefits in income tax expense. The amount recognized for the thirteen and thirty-nine weeks ended November 3, 2007 was not significant. The liability for unrecognized tax benefits at February 4, 2007 included $4 million of interest and no penalties.

The Company is subject to taxation in the U.S. and various state, local, and foreign jurisdictions. The Company's U.S. Federal income tax filings have been examined by the Internal Revenue Service (the "IRS") through 2005. The Company participated in the IRS's Compliance Assurance Process ("CAP") for 2006 which concluded during the third quarter 2007. The 2006 return will be subject to a post-filing review by the IRS. The Company does not believe that this post review will result in any changes to the return as filed. The Company has started the CAP for 2007. Due to the recent utilization of net operating loss carryforwards, the Company is subject to state and local tax examinations effectively including years from 1993 to the present. The Company is currently under examination in the Netherlands for tax years 2002-2005. To date, no adjustments have been proposed in any audits that will have a material effect on the Company's financial position or results of operations.

The Company does not anticipate that any adjustments to unrecognized benefits due to settlement of audits and expiration of statute of limitations will materially affect the financial position or operations prior to November 1, 2008. However, actual results could differ from those currently anticipated.

3. Impairment of Long-Lived Assets and Store Closing Program

In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," ("SFAS No. 144") the Company recognizes an impairment loss when circumstances indicate that the carrying value of long-lived tangible and intangible assets with finite lives may not be recoverable. Management's policy in determining whether an impairment indicator exists, a triggering event, comprises measurable operating performance criteria at the division level as well as qualitative measures. The Company considers historical performance and future estimated results, which are predominately identified from the Company's three-year strategic plans, in its evaluation of potential impairment. The calculation of fair value is based on estimated expected future cash flows by store. If the carrying amount of the asset exceeds the estimated expected undiscounted future cash flows, the Company measures the amount of the impairment by comparing the carrying amount of the asset with its estimated fair value. The estimation of fair value is measured by discounting expected future cash flows at the Company's weighted-average cost of capital. The Company estimates fair value based on the best information available using estimates, judgments and projections as considered necessary.

During the third quarter of 2007, the Company concluded that triggering events had occurred at its U.S. retail store divisions, comprising Foot Locker, Lady Foot Locker, Kids Foot Locker, Footaction, and Champs Sports. Accordingly, the Company recorded a non-cash impairment charge of $95 million primarily to write-down long-lived assets such as store fixtures and leasehold improvements for 1,004 stores at the Company's U.S. store operations pursuant to SFAS No. 144.

Additionally in the third quarter of 2007, the Company identified 66 unproductive stores for closure. Accordingly, the Company evaluated the recoverability of long-lived assets considering the revised estimated future cash flows. The Company recorded an additional non-cash impairment charge of $7 million as a result of this analysis. Exit costs related to 13 stores which closed during the third quarter of 2007, comprising lease terminations costs of $2 million and $1 million in other non-cash charges, were recognized in accordance with SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." During the fourth quarter of 2007, the Company currently expects to close an additional 142 unproductive stores. Approximately 53 of the stores are expected to close prior to normal lease expiration, depending on the Company's success in negotiating agreements with its landlords. The lease exit costs associated with these additional closures is expected to total $10 million to $15 million. These charges will be recorded during the fourth quarter of 2007 in accordance with SFAS No. 146. The cash impact of the 2007 store closings is expected to be minimal, as the related cash lease costs are expected to be offset by associated inventory reductions. Under SFAS No. 144, store closings may constitute discontinued operations if migration of customers and cash flows are not expected. The Company has concluded that no store closings have met the criteria for discontinued operations treatment.

4. Goodwill and Intangible Assets

The Company accounts for goodwill and other intangibles in accordance with SFAS No. 142, “Goodwill and Other Intangible Assets,” which requires that goodwill and intangible assets with indefinite lives be reviewed for impairment if impairment indicators arise and, at a minimum, annually. During the first quarters of 2007 and 2006, the Company completed its annual reviews of goodwill, which did not result in an impairment charge. Additionally, during the third quarter of 2007 the Company performed a review of its U.S. Athletic Stores’ goodwill, as a result of the SFAS No. 144 recoverability analysis. This analysis did not result in an impairment charge.

Goodwill (in millions)	**November 3, 2007**	**October 28, 2006**	**February 3, 2007**
Athletic Stores	$ 186	$ 184	$ 184
Direct-to-Customers	80	80	80
	$ 266	$ 264	$ 264

The effect of foreign exchange fluctuations on goodwill at November 3, 2007 was $2 million resulting from the strengthening of the euro as compared with the U.S. dollar.

	November 3, 2007			**October 28, 2006**			**February 3, 2007**		
(in millions)	**Gross value**	**Accum. amort.**	**Net value**	**Gross value**	**Accum. amort.**	**Net value**	**Gross value**	**Accum. amort.**	**Net value**
Indefinite life intangible assets	$ 3	$ —	$ 3	$ 4	$ —	$ 4	$ 3	$ —	$ 3
Finite life intangible assets									
Lease acquisition costs	$ 194	$ (118)	$ 76	$ 173	$ (92				