FOOT LOCKER INC
Form 10-Q
June 12, 2007

UNITED STATES
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 May 5, 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 May 31, 2007: 155,331,252

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)

	May 5, 2007 (Unaudited)	April 29, 2006 (Unaudited- See note 1)	February 3, 2007 *
ASSETS			
Current assets:			
Cash and cash equivalents	$ 197	$ 140	$ 221
Short-term investments	221	230	249
Total cash, cash equivalents and short-term investments	418	370	470
Merchandise inventories	1,490	1,399	1,303
Other current assets	265	176	261
	2,173	1,945	2,034
Property and equipment, net	659	674	654
Deferred taxes	118	159	109
Goodwill	265	264	264
Intangible and other assets	190	208	188
	$ 3,405	$ 3,250	$ 3,249

LIABILITIES AND SHAREHOLDERS’ EQUITY			
Current liabilities:			
Accounts payable	$ 403	$ 380	$ 256
Accrued expenses and other current liabilities	238	232	246
Current portion of long-term debt and obligations under capital leases	14	—	14
	655	612	516
Long-term debt and obligations under capital leases	221	272	220
Other liabilities	234	301	218
	1,110	1,185	954
Shareholders’ equity:			
Common stock and paid-in capital: 158,717,407, 157,534,348 and 157,810,352 shares, respectively	663	640	653
Retained earnings	1,784	1,640	1,785
Accumulated other comprehensive loss	(77)	(166)	(96)
Less: Treasury stock at cost: 3,387,894, 2,227,661 and 2,107,682 shares, respectively	(75)	(49)	(47)
Total shareholders’ equity	2,295	2,065	2,295
	$ 3,405	$ 3,250	$ 3,249

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	
	May 5, 2007	**April 29, 2006**
Sales	$ 1,316	$ 1,365
Costs and Expenses		
Cost of sales	956	946
Selling, general and administrative expenses	290	283
Depreciation and amortization	43	43
Interest expense, net	—	1
	1,289	1,273
Income before income taxes and cumulative effect of accounting change	27	92
Income tax expense	10	34
Income before cumulative effect of accounting change	17	58
Cumulative effect of accounting change, net of income tax of $-	—	1
Net income	$ 17	$ 59
Basic earnings per share:		
Income before cumulative effect of accounting change	$ 0.11	$ 0.37

Cumulative effect of accounting change	—	0.01
Net income	$ 0.11	$ 0.38
Weighted-average common shares outstanding	154.8	154.7
Diluted earnings per share:		
Income before cumulative effect of accounting change	$ 0.11	$ 0.37
Cumulative effect of accounting change	—	0.01
Net income	$ 0.11	$ 0.38
Weighted-average common shares assuming dilution	156.5	156.7

See Accompanying Notes to Condensed Consolidated Financial Statements.

FOOT LOCKER, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)
(in millions)

	Thirteen weeks ended	
	May 5, 2007	**April 29, 2006**
Net income	$ 17	$ 59
Other comprehensive income (expense), net of tax:		
Foreign currency translation adjustments arising during the period	20	5
Pension and postretirement plan adjustments	1	—
Comprehensive income	$ 38	$ 64

See Accompanying Notes to Condensed Consolidated Financial Statements.

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

	Thirteen week ended	
	May 5, 2007	**Apri 29, 200 (See note**
From Operating Activities:		

Net income	$	17	$	5
Adjustments to reconcile net income to net cash provided by (used in) operating activities of continuing operations:				
Cumulative effect of accounting change, net of tax		—		
Depreciation and amortization		43		4
Share-based compensation expense		3		
Change in assets and liabilities:				
Merchandise inventories		(174)		(14
Accounts payable and other accruals		125		
Qualified pension plan contributions		—		(6
Income tax payable		5		
Other, net		8		(1
Net cash provided by (used in) operating activities of continuing operations		27		(11
From Investing Activities:				
Purchases of short-term investments		(423)		(59
Sales of short-term investments		451		66
Capital expenditures		(43)		(3
Net cash (used in) provided by investing activities of continuing operations		(15)		3
From Financing Activities:				
Reduction in long-term debt		—		(5
Issuance of common stock		5		
Purchase of treasury stock		(26)		
Excess tax benefit from share-based compensation		1		
Dividends paid		(19)		(1
Net cash used in financing activities of continuing operations		(39)		(6
Net cash used in operating activities of Discontinued Operations		—		
Effect of exchange rate fluctuations on Cash and Cash Equivalents		3		
Net change in Cash and Cash Equivalents		(24)		(14
Cash and Cash Equivalents at beginning of year		221		28
Cash and Cash Equivalents at end of interim period	$	197	$	14
Cash paid during the period:				
Interest	$	3	$	
Income taxes	$	12	$	2

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 is comprised of 52 weeks which will end on February 2, 2008. Fiscal year 2006 was comprised of 53 weeks and ended on February 3, 2007. The fiscal interim periods ended May 5, 2007 and April 29, 2006 were comprised of 13 weeks. The results for the thirteen weeks ended May 5, 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 SAB 108 the Company adjusted its opening retained earnings to correct for prior misstatements. Accordingly, the Company has reflected these adjustments in its April 29, 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 weeks ended May 5, 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 is participating in the IRS’s Compliance Assurance Process (“CAP”) for 2006, which is expected to conclude during 2007. 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 statutes of limitations will materially affect the financial position, results of operations or cash flows prior to May 3, 2008. However, actual results could differ from those currently anticipated.

3. 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.

	May 5,	**April 29,**	**February 3,**

Goodwill (in millions)	**2007**	**2006**	**2007**
Athletic Stores	$ 185	$ 184	$ 184
Direct-to-Customers	80	80	80
	$ 265	$ 264	$ 264

The effect of foreign exchange fluctuations on goodwill for the thirteen weeks ended May 5, 2007 was $1 million resulting from the strengthening of the euro as compared with the U.S. dollar.

	May 5, 2007			**April 29, 2006**			
(in millions)	**Gross value**	**Accum. amort.**	**Net value**	**Gross value**	**Accum. amort.**	**Net value**	
Indefinite life intangible assets	$ 3	$ —	$ 3	$ 4	$ —	$ 4	$
Finite life intangible assets							
Lease acquisition costs	$ 184	$ (105)	$ 79	$ 169	$ (83)	$ 86	$
Trademark	21	(3)	18	21	(2)	19	
Loyalty program	1	(1)	—	1	(1)	—	
Favorable leases	9	(6)	3	9	(4)	5	
Total finite life intangible assets	$ 215	$ (115)	$ 100	$ 200	$ (90)	$ 110	$
Total intangible assets	$ 218	$ (115)	$ 103	$ 204	$ (90)	$ 114	$

Intangible assets not subject to amortization at May 5, 2007, April 29, 2006, and February 3, 2007 include the trademark of $3 million related to the 11 stores acquired in the Republic of Ireland. The additional intangible asset of $1 million at April 29, 2006 was eliminated in 2006 with the adoption of SFAS No. 158.

Lease acquisition costs represent amounts that are required to secure prime lease locations and other lease rights, primarily in Europe. Included in finite life intangibles is the trademark for the Footaction name, amounts paid for leased locations with rents below their fair value for the acquisitions of both the Footaction stores and the stores in the Republic of Ireland and amounts paid to obtain names of members of the Footaction loyalty program.

The weighted-average amortization period as of May 5, 2007 was approximately 12.3 years. Amortization expense was $5 million for the quarters ended May 5, 2007 and April 29, 2006. Additionally, the net intangible activity for the thirteen-week period ended May 5, 2007, primarily reflects the effect of the strengthening of the Euro as compared with the U.S dollar of $3 million. Annual estimated amortization expense is expected to be approximately $15 million for the remainder of 2007, $18 million for 2008, $15 million for 2009, $13 million for 2010 and $11 million for 2011.

4. Derivative Financial Instruments

Derivative Holdings Designated as Hedges

Net changes in the fair value of foreign exchange derivative financial instruments designated as cash flow hedges, and income/losses recognized in the income statement related to settled contracts, were not significant for the thirteen weeks ended May 5, 2007 and April 29, 2006.

The Company has numerous investments in foreign subsidiaries, and the net assets of those subsidiaries are exposed to foreign currency exchange-rate volatility. The Company has entered into two net investment hedges for its European and Canadian subsidiaries. Gains and losses in the net investments in the Company's subsidiaries due to foreign exchange volatilities will be partially offset by losses and gains related to these transactions, which will be recorded within the foreign currency translation adjustment included in accumulated other comprehensive loss on the Condensed Consolidated Balance Sheet. The amount recorded within the foreign currency translation adjustment related to these net investment hedges during the first quarter of 2007 and 2006 decreased shareholders’ equity by $10 million and $2 million, net of tax, respectively.

Derivative Holdings Designated as Non-Hedges

The Company had foreign currency option contracts with a total USD equivalent notional amount of $75 million outstanding at the end of the first quarter 2007 to mitigate the effect of fluctuating foreign exchange rates on the reporting of a portion of its expected 2007 foreign currency denominated earnings. Changes in the fair value of these foreign currency option contracts, which are designated as non-hedges, are recorded in earnings immediately. The premiums paid and changes in the fair market value were not significant for the thirteen weeks ended May 5, 2007 and April 29, 2006, respectively.

In addition, the Company entered into forward foreign exchange contracts to hedge foreign-currency denominated merchandise purchases and intercompany transactions. At May 5, 2007, the USD equivalent notional amount for outstanding forward foreign exchange contracts totaled $41 million. Net changes in the fair value of foreign exchange derivative financial instruments designated as non-hedges were substantially offset by the changes in value of the underlying transactions, which were recorded in selling, general and administrative expenses in the current period.

During the first quarter of 2007, the Company entered into a series of monthly diesel fuel forward contracts to mitigate a portion of the Company’s freight expense due the variability caused by fuel surcharges charged by our third-party freight carriers. The notional values of these contracts were less than $1 million and extend through November 2007. Changes in the fair value of these contracts are recorded in earnings immediately. The effect was not significant for the thirteen weeks ended May 5, 2007. In May 2007, subsequent to the end of the first quarter, the Company entered into an additional series of monthly contracts, bringing the total notional value to approximately $1 million.

Interest Rate Management

The Company has employed various interest rate swaps to minimize its exposure to interest rate fluctuations. These swaps, which mature in 2022, have been designated as a fair value hedge of the changes in fair value of $100 million of the Company’s 8.50 percent debentures payable in 2022 attributable to changes in interest rates and effectively convert the interest rate on the debentures from 8.50 percent to a 1-month variable rate of LIBOR plus 3.45 percent which totaled 8.77 percent and 8.49 percent at May 5, 2007 and April 29, 2006.

Fair Value

The following represents the fair value of foreign exchange derivative contracts and interest rate swaps:

(in millions)	**May 5, 2007**	**April 29, 2006**	**February 3, 2007**
Current assets	$ 1	$ 1	$ 1
Current liabilities	1	1	2
Non-current liabilities	19		