KROGER CO
Form 10-Q
December 17, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended November 7, 2015

OR

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

For the transition period from to

Commission file number 1-303

(Exact name of registrant as specified in its charter)

Ohio	**31-0345740**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1014 Vine Street, Cincinnati, OH 45202

(Address of principal executive offices)

(Zip Code)

(513) 762-4000

(Registrant s telephone number, including area code)

Unchanged

(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 x No o

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

Large accelerated filer	x	Accelerated filer	o
Non-accelerated filer (do not check if a smaller reporting company)	o	Smaller reporting company	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 .

There were 974,722,765 shares of Common Stock ($1 par value) outstanding as of December 15, 2015.

PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

THE KROGER CO.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in millions, except per share amounts)

(unaudited)

	Third Quarter Ended		Three Quarters Ended	
	November 7, 2015	November 8, 2014	November 7, 2015	November 8, 2014
Sales	$ 25,075	$ 24,987	$ 83,665	$ 83,258
Merchandise costs, including advertising, warehousing, and transportation, excluding items shown separately below	19,478	19,764	65,303	65,965
Operating, general and administrative	4,169	3,954	13,591	13,042
Rent	172	162	542	545
Depreciation and amortization	484	456	1,581	1,481
Operating profit	772	651	2,648	2,225
Interest expense	107	114	369	373
Earnings before income tax expense	665	537	2,279	1,852
Income tax expense	238	172	795	628
Net earnings including noncontrolling interests	427	365	1,484	1,224
Net earnings (loss) attributable to noncontrolling interests	(1)	3	4	14
Net earnings attributable to The Kroger Co.	$ 428	$ 362	$ 1,480	$ 1,210
Net earnings attributable to The Kroger Co. per basic common share	$ 0.44	$ 0.37	$ 1.52	$ 1.22
Average number of common shares used in basic calculation	965	972	966	983
Net earnings attributable to The Kroger Co. per diluted common share	$ 0.43	$ 0.36	$ 1.50	$ 1.20
Average number of common shares used in diluted calculation	979	984	980	995
Dividends declared per common share	$ 0.105	$ 0.093	$ 0.303	$ 0.258

The accompanying notes are an integral part of the Consolidated Financial Statements.

2

THE KROGER CO.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in millions and unaudited)

	Third Quarter Ended		Three Quarters Ended	
	November 7, 2015	**November 8, 2014**	**November 7, 2015**	**November 8, 2014**
Net earnings including noncontrolling interests	$ 427	$ 365	$ 1,484	$ 1,224
Other comprehensive income (loss)				
Unrealized gains on available for sale securities, net of income tax(1)	1	5	8	7
Amortization of amounts included in net periodic pension expense, net of income tax(2)	12	5	41	18
Unrealized gains and losses on cash flow hedging activities, net of income tax(3)	(3)	4	14	4
Total other comprehensive income	10	14	63	29
Comprehensive income	437	379	1,547	1,253
Comprehensive income (loss) attributable to noncontrolling interests	(1)	3	4	14
Comprehensive income attributable to The Kroger Co.	$ 438	$ 376	$ 1,543	$ 1,239

(1) Amount is net of tax of $1 for the third quarter of 2015 and $4 for the third quarter of 2014. Amount is net of tax of $5 for the first three quarters of 2015 and $4 for the first three quarters of 2014.

(2) Amount is net of tax of $8 for the third quarter of 2015 and $3 for the third quarter of 2014. Amount is net of tax of $25 for the first three quarters of 2015 and $11 for the first three quarters of 2014.

(3) Amount is net of tax of $(2) for the third quarter of 2015 and $2 for the third quarter of 2014. Amount is net of tax of $8 for the first three quarters of 2015 and $2 for the first three quarters of 2014.

The accompanying notes are an integral part of the Consolidated Financial Statements.

THE KROGER CO.

CONSOLIDATED BALANCE SHEETS

(in millions, except per share amounts)

(unaudited)

	November 7, 2015	January 31, 2015
ASSETS		
Current assets		
Cash and temporary cash investments	$ 274	$ 268
Store deposits in-transit	962	988
Receivables	1,253	1,266
FIFO inventory	7,626	6,933
LIFO reserve	(1,302)	(1,245)
Prepaid and other current assets	464	701
Total current assets	9,277	8,911
Property, plant and equipment, net	18,926	17,912
Intangibles, net	734	757
Goodwill	2,310	2,304
Other assets	660	613
Total Assets	$ 31,907	$ 30,497
LIABILITIES		
Current liabilities		
Current portion of long-term debt including obligations under capital leases and financing obligations	$ 2,295	$ 1,885
Trade accounts payable	5,866	5,052
Accrued salaries and wages	1,287	1,291
Deferred income taxes	286	287
Other current liabilities	3,218	2,888
Total current liabilities	12,952	11,403
Long-term debt including obligations under capital leases and financing obligations		
Face-value of long-term debt including obligations under capital leases and financing obligations	8,965	9,712
Adjustment to reflect fair-value interest rate hedges	(1)	—
Long-term debt including obligations under capital leases and financing obligations	8,964	9,712
Deferred income taxes	1,096	1,209
Pension and postretirement benefit obligations	1,458	1,463
Other long-term liabilities	1,192	1,268
Total Liabilities	25,662	25,055
Commitments and contingencies (see Note 9)		
SHAREOWNERS EQUITY		
Preferred shares, $100 per share, 5 shares authorized and unissued	—	—
Common shares, $1 par per share, 2,000 shares authorized; 1,918 shares issued in 2015 and 2014	1,918	1,918

Additional paid-in capital		2,948		2,748
Accumulated other comprehensive loss		(749)		(812)
Accumulated earnings		13,554		12,367
Common shares in treasury, at cost, 952 shares in 2015 and 944 shares in 2014		(11,400)		(10,809)
Total Shareowners Equity - The Kroger Co.		6,271		5,412
Noncontrolling interests		(26)		30
Total Equity		6,245		5,442
Total Liabilities and Equity	$	31,907	$	30,497

The accompanying notes are an integral part of the Consolidated Financial Statements.

THE KROGER CO.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions and unaudited)

	Three Quarters Ended November 7, 2015	Three Quarters Ended November 8, 2014
Cash Flows from Operating Activities:		
Net earnings including noncontrolling interests	$ 1,484	$ 1,224
Adjustments to reconcile net earnings including noncontrolling interests to net cash provided by operating activities:		
Depreciation and amortization	1,581	1,481
LIFO charge	58	138
Stock-based employee compensation	130	115
Expense for Company-sponsored pension plans	79	30
Deferred income taxes	(149)	(139)
Other	67	75
Changes in operating assets and liabilities net of effects from acquisitions of businesses:		
Store deposits in-transit	26	19
Receivables	1	(28)
Inventories	(693)	(580)
Prepaid and other current assets	242	302
Trade accounts payable	814	482
Accrued expenses	161	254
Income taxes receivable and payable	45	(32)
Other	(80)	43
Net cash provided by operating activities	3,766	3,384
Cash Flows from Investing Activities:		
Payments for property and equipment, including payments for lease buyouts	(2,532)	(2,070)
Proceeds from sale of assets	34	24
Payments for acquisitions	—	(252)
Other	(82)	—
Net cash used by investing activities	(2,580)	(2,298)
Cash Flows from Financing Activities:		
Proceeds from issuance of long-term debt	58	552
Payments on long-term debt	(547)	(38)
Net borrowings (payments) on commercial paper	100	(355)
Dividends paid	(283)	(247)
Excess tax benefits on stock-based awards	83	39
Proceeds from issuance of capital stock	94	84
Treasury stock purchases	(659)	(1,250)
Investment in the remaining equity of a noncontrolling interest	(26)	—
Other	—	(8)
Net cash used by financing activities	(1,180)	(1,223)
Net increase (decrease) in cash and temporary cash investments	6	(137)
Cash and temporary cash investments:		
Beginning of year	268	401

End of quarter	$	274	$	264
Reconciliation of capital investments:				
Payments for property and equipment, including payments for lease buyouts	$	(2,532)	$	(2,070)
Payments for lease buyouts		16		43
Changes in construction-in-progress payables		(42)		(35)
Total capital investments, excluding lease buyouts	$	(2,558)	$	(2,062)
Disclosure of cash flow information:				
Cash paid during the year for interest	$	397	$	373
Cash paid during the year for income taxes	$	864	$	786

The accompanying notes are an integral part of the Consolidated Financial Statements.

THE KROGER CO.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREOWNERS EQUITY

(in millions, except per share amounts)

(unaudited)

	Common Stock		Additional Paid-In	Treasury Stock		Accumulated Other Comprehensive	Accumulated	Noncontrolling	
	Shares	**Amount**	**Capital**	**Shares**	**Amount**	**Gain (Loss)**	**Earnings**	**Interest**	**Total**
Balances at February 1, 2014	1,918	$ 1,918	$ 2,590	902	$ (9,641)	$ (464)	$ 10,981	$ 11	$ 5,395
Issuance of common stock:									
Stock options exercised				(8)	84				84
Restricted stock issued			(84)	(4)	38				(46)
Treasury stock activity:									
Treasury stock purchases, at cost				50	(1,129)				(1,129)
Stock options exchanged				6	(121)				(121)
Share-based employee compensation			115						115
Other comprehensive gain net of income tax of $17						29			29
Other			72		(28)				44
Cash dividends declared ($0.258 per common share)							(251)		(251)
Net earnings including noncontrolling interests							1,210	14	1,224
Balances at November 8, 2014	1,918	$ 1,918	$ 2,693	946	$ (10,797)	$ (435)	$ 11,940	$ 25	$ 5,344
Balances at January 31, 2015	1,918	$ 1,918	$ 2,748	944	$ (10,809)	$ (812)	$ 12,367	$ 30	$ 5,442
Issuance of common stock:									
Stock options exercised				(7)	94				94
Restricted stock issued			(113)	(3)	34				(79)
Treasury stock activity:									
Treasury stock purchases, at cost				14	(500)				(500)
Stock options exchanged				4	(159)				(159)
Share-based employee compensation			130						130
Other comprehensive gain net of income tax of $38						63			63
Investment in the remaining equity of a noncontrolling interest			40					(57)	(17)
Other			143		(60)			(3)	80
Cash dividends declared ($0.303 per common share)							(293)		(293)
Net earnings including noncontrolling interests							1,480	4	1,484
Balances at November 7, 2015	1,918	$ 1,918	$ 2,948	952	$ (11,400)	$ (749)	$ 13,554	$ (26)	$ 6,245

The accompanying notes are an integral part of the Consolidated Financial Statements.

6

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

All amounts in the Notes to the Unaudited Consolidated Financial Statements are in millions except per share amounts.

1. ACCOUNTING POLICIES

Basis of Presentation and Principles of Consolidation

The accompanying financial statements include the consolidated accounts of The Kroger Co., its wholly-owned subsidiaries, and the variable interest entities in which the Company is the primary beneficiary. The January 31, 2015 balance sheet was derived from audited financial statements and, due to its summary nature, does not include all disclosures required by generally accepted accounting principles (GAAP). Significant intercompany transactions and balances have been eliminated. References to the Company in these Consolidated Financial Statements mean the consolidated company.

In the opinion of management, the accompanying unaudited Consolidated Financial Statements include all normal, recurring adjustments that are necessary for a fair presentation of results of operations for such periods but should not be considered as indicative of results for a full year. The financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been omitted, pursuant to SEC regulations. Accordingly, the accompanying Consolidated Financial Statements should be read in conjunction with the financial statements in the Company s Annual Report on Form 10-K for the fiscal year ended January 31, 2015.

The unaudited information in the Consolidated Financial Statements for the third quarter and three quarters ended November 7, 2015 and November 8, 2014, includes the results of operations of the Company for the 12 and 40-week periods then ended.

The net increase (decrease) in book overdrafts previously reported in financing activities in the Consolidated Statements of Cash Flows is now reported within operating activities. Prior year amounts have been revised to the current year presentation. These revisions were not material to the prior years.

Refer to Note 7 for an additional change to the Consolidated Balance Sheets for a recently adopted accounting standard regarding the presentation of debt issuance costs.

On June 25, 2015, the Company s Board of Directors approved a two-for-one stock split of The Kroger Co. s common shares in the form of a 100% stock dividend, which was effective July 13, 2015. All share and per share amounts in our Consolidated Financial Statements and related notes have been retroactively adjusted to reflect the stock split for all periods presented.

2. MERGER

On August 18, 2014, the Company closed its merger with Vitacost.com, Inc. (Vitacost.com). The Company s purchase price allocation was finalized in the second quarter of 2015 and the changes in the fair values assumed from the preliminary amounts were not material.

Pro forma results of operations, assuming the transaction had taken place at the beginning of 2013, are included in the following table. The pro forma information includes historical results of operations of Vitacost.com and adjustments for interest expense that would have been incurred due to financing the merger, depreciation and amortization of the assets acquired and excludes the pre-merger transaction related expenses incurred by Vitacost.com and the Company. The pro forma information does not include efficiencies, cost reductions or synergies expected to result from the merger. The unaudited pro forma financial information is not necessarily indicative of the results that actually would have occurred had the merger been completed at the beginning of the 2013.

	Third Quarter Ended November 8, 2014	Three Quarters Ended November 8, 2014
Sales	$ 24,987	$ 83,480
Net earnings including noncontrolling interests	365	1,212
Net earnings attributable to noncontrolling interests	3	14
Net earnings attributable to The Kroger Co.	$ 362	$ 1,198

3. STOCK OPTION PLANS

The Company recognized total share-based compensation of $35 and $39 in the third quarters ended November 7, 2015 and November 8, 2014, respectively. The Company recognized total share-based compensation of $130 and $115 in the first three quarters of 2015 and 2014, respectively. These costs were recognized as operating, general and administrative costs in the Company s Consolidated Statements of Operations.

The Company grants options for common shares (stock options) to employees under various plans at an option price equal to the fair market value of a common share on the date of grant. In addition to stock options, the Company awards restricted stock to employees and its non-employee directors under various plans. Equity awards may be made once each quarter on a predetermined date. It has been the Company s practice to make an annual grant to employees, which occurred in the second quarter of 2015. Special grants may be made in the other three quarters. Grants to non-employee directors occur on the same date that the annual grant to employees occurs.

Stock options granted in the first three quarters of 2015 expire 10 years from the date of grant and vest between one year and five years from the date of grant. Restricted stock awards granted in the first three quarters of 2015 have restrictions that lapse between one year and five years from the date of the awards. All grants and awards become immediately exercisable, in the case of options, and restrictions lapse, in the case of restricted stock, upon certain changes in control of the Company.

Changes in equity awards outstanding under the plans are summarized below.

Stock Options

	Shares subject to option	Weighted-average exercise price
Outstanding, January 31, 2015	40.8	$ 15.56
Granted	3.3	$ 38.32
Exercised	(7.0)	$ 13.49
Canceled or Expired	(0.3)	$ 19.76
Outstanding, November 7, 2015	36.8	$ 17.97

Restricted Stock

	Restricted shares outstanding	Weighted-average grant-date fair value
Outstanding, January 31, 2015	10.2	$ 21.04
Granted	3.2	$ 38.30
Vested	(5.0)	$ 21.48
Forfeited	(0.4)	$ 22.53

Outstanding, November 7, 2015	8.0	$	27.61

The weighted-average grant date fair value of stock options granted during the first three quarters of 2015 and 2014, was $9.76 and $5.98, respectively. The fair value of each stock option grant was estimated on the date of grant using the Black-Scholes option-pricing model, based on the assumptions shown in the table below. The Black-Scholes model utilizes accounting judgment and financial estimates, including the term option holders are expected to retain their stock options before exercising them, the volatility of the Company s share price over that expected term, the dividend yield over the term, and the number of awards expected to be forfeited before they vest. Using alternative assumptions in the calculation of fair value would produce fair values for stock option grants that could be different than those used to record share-based compensation expense in the Consolidated Statements of Operations. The increase in the fair value of the stock options granted during the first three quarters of 2015, compared to the first three quarters of 2014, resulted primarily from an increase in the Company s share price, which decreased the expected dividend yield.

The following table reflects the weighted-average assumptions used for grants awarded to option holders:

	2015	2014
Risk-free interest rate	2.12%	2.06%
Expected dividend yield	1.20%	1.51%
Expected volatility	24.07%	25.29%
Expected term	7.2 Years	6.6 Years

4. DEBT OBLIGATIONS

Long-term debt consists of:

	November 7, 2015	January 31, 2015
0.76% to 8.00% Senior Notes due through 2043	$ 8,734	$ 9,224
5.00% to 12.75% Mortgages due in varying amounts through 2027	67	73
0.37% Commercial paper borrowings due through November 2015	1,375	1,275
Other	500	454
Total debt, excluding capital leases and financing obligations	10,676	11,026
Less current portion	(2,253)	(1,844)
Total long-term debt, excluding capital leases and financing obligations	$ 8,423	$ 9,182

5. BENEFIT PLANS

The following table provides the components of net periodic benefit cost for the Company-sponsored defined benefit pension plans and other post-retirement benefit plans for the third quarters of 2015 and 2014.

	Third Quarter Ended			
	Pension Benefits		Other Benefits	
	November 7, 2015	November 8, 2014	November 7, 2015	November 8, 2014
Components of net periodic benefit cost:				
Service cost	$ 15	$ 14	$ 2	$ 3
Interest cost	37	41	2	3
Expected return on plan assets	(52)	(56)		
Amortization of:				
Prior service cost			(2)	(1)
Actuarial loss (gain)	23	11	(1)	(2)
Net periodic benefit cost	$ 23	$ 10	$ 1	$ 3

The following table provides the components of net periodic benefit cost for the Company-sponsored defined benefit pension plans and other post-retirement benefit plans for the first three quarters of 2015 and 2014.

	Three Quarters Ended			
	Pension Benefits		Other Benefits	
	November 7, 2015	November 8, 2014	November 7, 2015	November 8, 2014
Components of net periodic benefit cost:				
Service cost	$ 50	$ 38	$ 8	$ 9
Interest cost	127	139	8	10
Expected return on plan assets	(176)	(186)		
Amortization of:				
Prior service cost			(8)	(5)
Actuarial loss (gain)	78	39	(4)	(5)
Net periodic benefit cost	$ 79	$ 30	$ 4	$ 9

The Company contributed $5 to its Company-sponsored defined benefit pension plans in the first three quarters of 2015. The Company is not required and does not expect to make any additional contributions in 2015.

The Company contributed $152 and $144 to employee 401(k) retirement savings accounts in the first three quarters of 2015 and 2014, respectively.

The Company also contributes to various multi-employer pension plans based on obligations arising from most of its collective bargaining agreements. These plans provide retirement benefits to participants based on their service to contributing employers. The Company recognizes expense in connection with these plans as contributions are funded.

During the third quarter of 2015, the Company contributed $80 to the United Food and Commercial Workers International Union (UFCW) Consolidated Pension Plan, which was recognized as expense. The Company also incurred a charge of $87 due to commitments and withdrawal liabilities arising from the restructuring of certain multi-employer pension plan obligations during the first quarter of 2014.

6. EARNINGS PER COMMON SHARE

Net earnings attributable to The Kroger Co. per basic common share equal net earnings attributable to The Kroger Co. less income allocated to participating securities divided by the weighted-average number of common shares outstanding. Net earnings attributable to The Kroger Co. per diluted common share equal net earnings attributable to The Kroger Co. less income allocated to participating securities divided by the weighted-average number of common shares outstanding, after giving effect to dilutive stock options. The following table provides a reconciliation of net earnings attributable to The Kroger Co. and shares used in calculating net earnings attributable to The Kroger Co. per basic common share to those used in calculating net earnings attributable to The Kroger Co. per diluted common share:

	Third Quarter Ended November 7, 2015			Third Quarter Ended November 8, 2014		
	Earnings (Numerator)	**Shares (Denominator)**	**Per Share Amount**	**Earnings (Numerator)**	**Shares (Denominator)**	**Per Share Amount**
Net earnings attributable to The Kroger Co. per basic common share	$ 424	965	$ 0.44	$ 358	972	$ 0.37
Dilutive effect of stock options		14			12	
Net earnings attributable to The Kroger Co. per diluted common share	$ 424	979	$ 0.43	$ 358	984	$ 0.36

	Three Quarters Ended November 7, 2015			Three Quarters Ended November 8, 2014		
	Earnings (Numerator)	**Shares (Denominator)**	**Per Share Amount**	**Earnings (Numerator)**	**Shares (Denominator)**	**Per Share Amount**
Net earnings attributable to The Kroger Co. per basic common share	$ 1,466	966	$ 1.52	$ 1,198	983	$ 1.22
Dilutive effect of stock options		14			12	
Net earnings attributable to The Kroger Co. per diluted common share	$ 1,466	980	$ 1.50	$ 1,198	995	$ 1.20

The Company had combined undistributed and distributed earnings to participating securities totaling $4 in the third quarters of 2015 and 2014. For the first three quarters of 2015 and 2014, the Company had combined undistributed and distributed earnings to participating securities of $14 and $12, respectively.

The Company had options outstanding for approximately 3 million and 8 million shares during the third quarters of 2015 and 2014, respectively, that were excluded from the computations of net earnings per diluted common share because their inclusion would have had an anti-dilutive effect on net earnings per share. The Company had options outstanding for approximately 1 million shares in the first three quarters of 2015 and 4 million shares in the first three quarters of 2014 that were excluded from the computations of net earnings per diluted common share because their inclusion would have had an anti-dilutive effect on earnings per share.

7. RECENTLY ADOPTED ACCOUNTING STANDARDS

In 2015, the Financial Accounting Standards Board (FASB) amended Accounting Standards Codification 835, Interest-Imputation of Interest. The amendment simplifies the presentation of debt issuance costs related to a recognized debt liability by requiring it be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. This amendment became effective for the Company beginning February 1, 2015, and was adopted retrospectively in accordance with the standard. The adoption of this amendment resulted in amounts previously reported in other assets to now be reported within long-term debt including obligations under capital leases and financing obligations in the Consolidated Balance Sheets. These amounts were not material to the prior year. The adoption of this amendment did not have an effect on the Company s Consolidated Statements of Operations.

8. RECENTLY ISSUED ACCOUNTING STANDARDS

In May 2014, the FASB issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers, which provides guidance for revenue recognition. The standard s core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. Per ASU 2015-14, Deferral of Effective Date, this guidance will be effective for the Company in the first quarter of its fiscal year ending February 2, 2019. Early adoption is permitted as of the first quarter of the Company s fiscal year ending February 3, 2018. The Company is currently in the process of evaluating the effect of adoption of this ASU on the Company s Consolidated Financial Statements.

In April 2015, the FASB issued ASU 2015-04, Retirement Benefits (Topic 715): Practical Expedient for the Measurement Date of an Employer s Defined Benefit Obligation and Plan Assets. This amendment permits an entity to measure defined benefit plan assets and obligations using the month end that is closest to the entity s fiscal year end for all plans. This guidance will be effective for the Company in the fiscal year ending January 28, 2017. The implementation of this amendment will not have an effect on the Company s Consolidated Statements of Operations, and will not have a significant effect on the Company s Consolidated Balance Sheets.

In April 2015, the FASB issued ASU 2015-07, Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent). This amendment removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share. This guidance will be effective for the Company in the fiscal year ending January 28, 2017. The implementation of this amendment will have an effect on the Company s Notes to the Consolidated Financial Statements and will not have an effect on the Company s Consolidated Statements of Operations or Consolidated Balance Sheets.

In September 2015, the FASB issued ASU 2015-16, Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments. This amendment eliminates the requirement to retrospectively account for adjustments made to provisional amounts recognized in a business combination. This guidance will be effective for the Company in its fiscal year ending January 28, 2017. The implementation of this amendment is not expected to have a significant effect on the Company s Consolidated Financial Statements.

In November 2015, the FASB issued ASU 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes. This amendment requires deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. This guidance will be effective for the fiscal year ending January 28, 2017. Early adoption is permitted. The implementation of this amendment will not have an effect on the Company s Consolidated Statements of Operations and will not have a significant effect on the Company s Consolidated Balance Sheets.

9. COMMITMENTS AND CONTINGENCIES

The Company continuously evaluates contingencies based upon the best available evidence.

The Company believes that allowances for loss have been provided to the extent necessary and that its assessment of contingencies is reasonable. To the extent that resolution of contingencies results in amounts that vary from the Company s estimates, future earnings will be charged or credited.

Litigation Various claims and lawsuits arising in the normal course of business, including suits charging violations of certain antitrust, wage and hour, or civil rights laws, as well as product liability cases, are pending against the Company. Some of these suits purport or have been determined to be class actions and/or seek substantial damages. Any damages that may be awarded in antitrust cases will be automatically trebled. Although it is not possible at this time to evaluate the merits of all of these claims and lawsuits, nor their likelihood of success, the Company is of the belief that any resulting liability will not have a material effect on the Company s financial position, results of operations, or cash flows.

The Company continually evaluates its exposure to loss contingencies arising from pending or threatened litigation and believes it has made provisions where it is reasonably possible to estimate and where an adverse outcome is probable. Nonetheless, assessing and predicting the outcomes of these matters involve substantial uncertainties. Management currently believes that the aggregate range of loss for the Company s exposure is not material to the Company. It remains possible that despite management s current belief, material differences in actual outcomes or changes in management s evaluation or predictions could arise that could have a material adverse effect on the Company s financial condition, results of operations, or cash flows.

10. FAIR VALUE MEASUREMENTS

GAAP establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The three levels of the fair value hierarchy defined in the standards are as follows:

Level 1 Quoted prices are available in active markets for identical assets or liabilities;

Level 2 Pricing inputs are other than quoted prices in active markets included in Level 1, which are either directly or indirectly observable;

Level 3 Unobservable pricing inputs in which little or no market activity exists, therefore requiring an entity to develop its own assumptions about the assumptions that market participants would use in pricing an asset or liability.

For items carried at (or adjusted to) fair value in the Consolidated Financial Statements, the following tables summarize the fair value of these instruments at November 7, 2015 and January 31, 2015:

November 7, 2015 Fair Value Measurements Using

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Trading Securities	$ 50	$	$	$ 50
Available-for-Sale Securities	48			48
Warrants		39		39
Long-Lived Assets			5	5
Interest Rate Hedges		(1)		(1)
Total	$ 98	$ 38	$ 5	$ 141

January 31, 2015 Fair Value Measurements Using

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Trading Securities	$ 47	$	$	$ 47
Available-for-Sale Securities	36			36
Warrants		26		26

Long-Lived Assets						22		22
Interest Rate Hedges				(39)				(39)
Total	$	83	$	(13)	$	22	$	92

In the first three quarters of 2015, unrealized gains on the Level 1 available-for-sale securities totaled $13.

The Company values warrants using the Black-Scholes option-pricing model. The Black-Scholes option-pricing model is classified as a Level 2 input.

The Company values interest rate hedges using observable forward yield curves. These forward yield curves are classified as Level 2 inputs.

Fair value measurements of non-financial assets and non-financial liabilities are primarily used in the impairment analysis of goodwill, other intangible assets, and long-lived assets, and in the valuation of store lease exit costs. The Company reviews goodwill and other intangible assets for impairment annually, during the fourth quarter of each fiscal year, and as circumstances indicate the possibility of impairment. See Note 3 to the Consolidated Financial Statements in the Annual Report on Form 10-K for the fiscal year ended January 31, 2015 for further discussion related to the Company s carrying value of goodwill. Long-lived assets and store lease exit costs were measured at fair value on a nonrecurring basis using Level 3 inputs as defined in the fair value hierarchy. See Note 1 to the Consolidated Financial Statements in the Annual Report on Form 10-K for the fiscal year ended January 31, 2015 for further discussion of the Company s policies regarding the valuation of long-lived assets and store lease exit costs. For the first three quarters of 2015, long-lived assets with a carrying amount of $38 were written down to their fair value of $5 resulting in an impairment charge of $33. For the first three quarters of 2014, long-lived assets with a carrying amount of $42 were written down to their fair value of $13 resulting in an impairment charge of $29. In fiscal year 2014, long-lived assets with a carrying amount of $59 were written down to their fair value of $22, resulting in an impairment charge of $37.

Fair Value of Other Financial Instruments

Current and Long-term Debt

The fair value of the Company s long-term debt, including current maturities, was estimated based on the quoted market prices for the same or similar issues adjusted for illiquidity based on available market evidence. If quoted market prices were not available, the fair value was based upon the net present value of the future cash flow using the forward interest rate yield curve in effect at November 7, 2015 and January 31, 2015. At November 7, 2015, the fair value of total debt was $10,695 compared to a carrying value of $10,676. At January 31, 2015, the fair value of total debt was $12,319 compared to a carrying value of $11,026. The reduction in the fair value of total debt from January 31, 2015, compared to November 7, 2015, is primarily due to a decrease in the forward interest rate yield curve.

Cash and Temporary Cash Investments, Store Deposits In-Transit, Receivables, Prepaid and Other Current Assets, Trade Accounts Payable, Accrued Salaries and Wages and Other Current Liabilities

The carrying amounts of these items approximated fair value.

Other Assets

The fair values of these investments were estimated based on quoted market prices for those or similar investments, or estimated cash flows, if appropriate. At November 7, 2015 and January 31, 2015, the carrying and fair value of long-term investments for which fair value is determinable was $132 and $133, respectively. At November 7, 2015 and January 31, 2015, the carrying value of notes receivable for which fair value is determinable was $135 and $98, respectively.

11. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following table represents the changes in AOCI by component for the first three quarters of 2014 and 2015:

	Cash Flow Hedging Activities(1)	Available for sale Securities(1)	Pension and Postretirement Defined Benefit Plans(1)	Total(1)
Balance at February 1, 2014	$ (25)	$ 12	$ (451)	$ (464)
OCI before reclassifications(2)	4	7		11
Amounts reclassified out of AOCI(3)			18	18
Net current-period OCI	4	7	18	29
Balance at November 8, 2014	$ (21)	$ 19	$ (433)	$ (435)
Balance at January 31, 2015	$ (49)	$ 17	$ (780)	$ (812)
OCI before reclassifications(2)	14	8		22
Amounts reclassified out of AOCI(3)			41	41
Net current-period OCI	14	8	41	63
Balance at November 7, 2015	$ (35)	$ 25	$ (739)	$ (749)

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(1) All amounts are net of tax.

(2) Net of tax of $2 and $4 for cash flow hedging activities and available for sale securities, respectively, for the first three quarters of 2014. Net of tax of $8 and $5 for cash flow hedging activities and available for sale securities, respectively, for the first three quarters of 2015.

(3) Net of tax of $11 for pension and postretirement defined benefit plans for the first three quarters of 2014 and $25 for pension and postretirement defined benefit plans for the first three quarters of 2015.

The following table represents the items reclassified out of AOCI and the related tax effects for the third quarter and first three quarters of 2015 and 2014:

	Third Quarter Ended		Three Quarters Ended
	November 7, 2015	November 8, 2014	