KOHLS Corp
Form 10-Q
September 07, 2018
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended August 4, 2018

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 1-11084

KOHL'S CORPORATION

(Exact name of registrant as specified in its charter)

Wisconsin	39-1630919
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
N56 W17000 Ridgewood Drive,	
Menomonee Falls, Wisconsin	53051
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (262) 703-7000

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer		Accelerated filer
Non-accelerated filer	* (Do not check if a smaller reporting company)	Smaller reporting company
		Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards pursuant to Section 13(a) of the Exchange Act.

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

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date: September 1, 2018 Common Stock, Par Value $0.01 per Share, 166,712,843 shares outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

KOHL’S CORPORATION

CONSOLIDATED BALANCE SHEETS

(Unaudited)

(Dollars in Millions)	August 4, 2018	February 3, 2018	July 29, 2017
Assets		As Adjusted (a)	As Adjusted (a)
Current assets:			
Cash and cash equivalents	$1,066	$1,308	$552
Merchandise inventories	3,572	3,542	3,853
Other	404	530	381
Total current assets	5,042	5,380	4,786
Property and equipment, net	7,635	7,773	8,068
Other assets	238	236	230
Total assets	$12,915	$13,389	$13,084
Liabilities and Shareholders’ Equity			
Current liabilities:			
Accounts payable	$1,404	$1,271	$1,370
Accrued liabilities	1,174	1,213	1,125
Income taxes payable	70	99	43
Current portion of capital lease and financing obligations	122	126	133
Total current liabilities	2,770	2,709	2,671
Long-term debt	2,273	2,797	2,796
Capital lease and financing obligations	1,537	1,591	1,637
Deferred income taxes	188	211	268
Other long-term liabilities	660	662	691
Shareholders’ equity:			
Common stock	4	4	4
Paid-in capital	3,163	3,078	3,026
Treasury stock, at cost	(10,835)	(10,651)	(10,596)
Accumulated other comprehensive loss	(8)	(11)	(12)
Retained earnings	13,163	12,999	12,599
Total shareholders’ equity	5,487	5,419	5,021
Total liabilities and shareholders’ equity	$12,915	$13,389	$13,084

(a) Refer to Note 2 for details on the adoption of the new revenue recognition accounting standard and the impact on previously reported results.

See accompanying Notes to Consolidated Financial Statements

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KOHL'S CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(Dollars in Millions, Except per Share Data)	Three Months Ended August 4, 2018	July 29, 2017	Six Months Ended August 4, 2018	July 29, 2017
		As Adjusted (a)		As Adjusted (a)
Net sales	$4,310	$ 4,147	$8,263	$ 7,962
Other revenue	260	248	515	498
Total revenue	4,570	4,395	8,778	8,460
Cost of merchandise sold	2,605	2,525	5,101	4,953
Operating expenses:				
Selling, general, and administrative	1,272	1,220	2,532	2,434
Depreciation and amortization	241	243	483	482
Operating income	452	407	662	591
Interest expense, net	65	75	135	150
Loss on extinguishment of debt	—	—	42	—
Income before income taxes	387	332	485	441
Provision for income taxes	95	124	117	167
Net income	$292	$ 208	$368	$ 274
Net income per share:				
Basic	$1.77	$ 1.24	$2.23	$ 1.62
Diluted	$1.76	$ 1.24	$2.21	$ 1.62

(a) Refer to Note 2 for details on the adoption of the new revenue recognition accounting standard and the impact on previously reported results.

See accompanying Notes to Consolidated Financial Statements

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KOHL'S CORPORATION

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

(Unaudited)

	Common Stock		Paid-In	Treasury Stock		Accumulated Other Comprehensive	Retained	
(Dollars in Millions, Except per Share Data)	Shares	Amount	Capital	Shares	Amount	Loss	Earnings	Total
Balance at February 3, 2018 (previously reported)	373	$ 4	$3,078	(205)	$(10,651)	$ (11)	$13,006	$5,426
Change in accounting standard (a)	—	—	—	—	—	—	(7)	(7)
Balance at February 3, 2018 (as adjusted)	373	4	3,078	(205)	(10,651)	(11)	12,999	5,419
Comprehensive income	—	—	—	—	—	3	368	371
Stock options and awards, net of tax	1	—	85	—	(21)	—	—	64
Dividends paid ($1.22 per common share)	—	—	—	—	2	—	(204)	(202)
Treasury stock purchases	—	—	—	(2)	(165)	—	—	(165)
Balance at August 4, 2018	374	$ 4	$3,163	(207)	$(10,835)	$ (8)	$13,163	$5,487

(a) Refer to Note 2 for details on the adoption of the new revenue recognition accounting standard and the impact on previously reported results.

See accompanying Notes to Consolidated Financial Statements

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KOHL’S CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(Dollars in Millions)	Six Months Ended August 4, 2018	July 29, 2017
Operating activities		As Adjusted (a)
Net income	$368	$274
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	483	482
Share-based compensation	50	21
Deferred income taxes	(25)	(2)
Loss on extinguishment of debt	42	—
Other non-cash revenues and expenses	13	(5)
Changes in operating assets and liabilities:		
Merchandise inventories	(24)	(53)
Accrued and other long-term liabilities	(88)	(176)
Accounts payable	133	(137)
Other current and long-term assets	89	36
Income taxes	6	(64)
Net cash provided by operating activities	1,047	376
Investing activities		
Acquisition of property and equipment	(312)	(399)
Other	6	16
Net cash used in investing activities	(306)	(383)
Financing activities		
Treasury stock purchases	(165)	(250)
Shares withheld for taxes on vested restricted shares	(21)	(12)
Dividends paid	(202)	(186)
Reduction of long-term borrowings	(528)	—
Premium paid on redemption of debt	(35)	—
Capital lease and financing obligation activity	(64)	(67)
Proceeds from stock option exercises	32	—
Net cash used in financing activities	(983)	(515)
Net decrease in cash and cash equivalents	(242)	(522)
Cash at beginning of period	1,308	1,074
Cash at end of period	$1,066	$552

Supplemental information		
Interest paid, net of capitalized interest	$ 141	$ 146
Income taxes paid	164	233
Non-cash investing and financing activities		
Property and equipment acquired through additional liabilities	$ 7	$ 37

(a) Refer to Note 2 for details on the adoption of the new revenue recognition accounting standard and the impact on previously reported results.

See accompanying Notes to Consolidated Financial Statements

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KOHL'S CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") for interim financial information. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for fiscal year end consolidated financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. For further information, refer to the consolidated financial statements and related footnotes included in our Annual Report on Form 10-K for the fiscal year ended February 3, 2018 (Commission File No. 1-11084) as filed with the Securities and Exchange Commission.

Due to the seasonality of our business, results for any quarter are not necessarily indicative of the results that may be achieved for a full fiscal year.

We operate as a single business unit.

The following table provides a brief description of issued, but not yet effective, accounting standards:

Standard	Description	Effect on our Financial Statements
Leases (ASC Topic 842) Issued February 2016 Effective Q1 2019	Among other things, the new standard requires us to recognize a right-of-use asset and a lease liability on our balance sheet for each lease. It also changes the presentation and timing of lease-related expenses.	Approximately 5% of our store leases and all of our land leases are not currently recorded on our balance sheet. Recording right-of-use assets and lease liabilities for these and other non-store leases is expected to have a material impact on our balance sheet. We are also evaluating the impact that recording right-of-use assets and lease liabilities will have on our income statement and the financial statement impact that the standard will have on leases which are currently recorded on our balance sheet.

In 2017, we recorded provisional amounts for certain income tax effects of the Tax Cuts & Jobs Act (the "Act"), as addressed in Staff Accounting Bulletin No. 118 ("SAB 118"). During the six months ended August 4, 2018, we made no adjustments to the previously recorded provisional amounts related to the Act. Additional work is needed to finalize the income tax effects of the Act and we do not expect subsequent adjustments to be material. Any such adjustments will be recorded as income tax expense in the period in which the adjustment is finalized.

2. Revenue Recognition

Effective February 4, 2018, we adopted Revenue from Contracts with Customers (ASC Topic 606) as required. We adopted the new standard using the full retrospective method. The standard eliminated the transaction- and industry-specific revenue recognition guidance under prior U.S. GAAP and replaced it with a principles-based approach for revenue recognition and disclosures. Under the standard, revenue is recognized when a customer obtains control of promised goods or services in an amount that reflects the consideration the entity expects to receive in exchange for those goods or services.

Net Sales

Net sales include revenue from the sale of merchandise and shipping revenues. Net sales are recognized when merchandise is received by the customer and we have fulfilled all performance obligations. We do not have any sales that are recorded as commissions.

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KOHL’S CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table summarizes net sales by line of business for the periods ended August 4, 2018 and July 29, 2017:

	Three Months Ended		Six Months Ended	
(Dollars in Millions)	August 4, 2018	July 29, 2017	August 4, 2018	July 29, 2017
Women's	$1,439	$1,398	$2,694	$2,633
Men's	955	890	1,745	1,625
Home	678	679	1,369	1,320
Children's	464	426	919	904
Footwear	445	415	871	815
Accessories	329	339	665	665
Net Sales	$4,310	$4,147	$8,263	$7,962

We maintain various rewards programs whereby customers earn rewards based on their spending and other promotional activities. The rewards are typically in the form of dollar off discounts which can be used on future purchases. These programs create performance obligations which require us to defer a portion of the original sale until the rewards are redeemed. Sales are recorded net of returns. At the end of each reporting period, we record a reserve based on historical return rates and patterns which reverses sales that we expect to be returned in the following period. Revenue from the sale of Kohl's gift cards is recognized when the gift card is redeemed. Liabilities for performance obligations resulting from our rewards programs, return reserves, and unredeemed gift cards and merchandise return cards totaled $358 million as of August 4, 2018, $422 million as of February 3, 2018 and $343 million as of July 29, 2017.

Net sales do not include sales tax as we are considered a pass-through conduit for collecting and remitting sales taxes.

Other Revenue

Other revenue consists primarily of revenue from our credit card operations, unused gift and merchandise return cards (breakage), and other non-merchandise revenues.

Revenue from credit card operations includes our share of the finance charges and interest fees, less charge-offs of the Kohl’s credit card pursuant to the Private Label Credit Card Program Agreement. Expenses related to our credit card operations are reported in SG&A.

Income from unused gift cards and merchandise return cards (breakage) is recorded in proportion and over the time period the cards are actually redeemed.

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KOHL'S CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following tables summarize the impact of adoption of the new standard by financial statement line item:

Three Months Ended July 29, 2017 (Dollars in Millions, Except per Share Data)	As Previously Reported	New Standard Adjustment	Adjusted
Net sales	$ 4,144	$ 3	$ 4,147
Other revenue		248	248
Total revenue		251	4,395
Cost of merchandise sold	2,511	14	2,525
Gross margin	1,633		
Operating expenses:			
Selling, general and administrative	983	237	1,220
Depreciation and amortization	243	-	243
Operating income	407	-	407
Interest expense, net	75	-	75
Income before income taxes	332	-	332
Provision for income taxes	124	-	124
Net income	$ 208	$ -	$ 208
Net income per share:			
Basic	$ 1.24	$ -	$ 1.24
Diluted	$ 1.24	$ -	$ 1.24

Six Months Ended July 29, 2017 (Dollars in Millions, Except per Share Data)	As Previously Reported	New Standard Adjustment	Adjusted
Net sales	$ 7,987	$ (25)	$ 7,962
Other revenue		498	498
Total revenue		473	8,460
Cost of merchandise sold	4,956	(3)	4,953
Gross margin	3,031		
Operating expenses:			
Selling, general and administrative	1,958	476	2,434
Depreciation and amortization	482	-	482
Operating income	591	-	591
Interest expense, net	150	-	150
Income before income taxes	441	-	441
Provision for income taxes	167	-	167
Net income	$ 274	$ -	$ 274
Net income per share:			
Basic	$ 1.62	$ -	$ 1.62

Diluted	$ 1.62	$ -	$ 1.62

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KOHL'S CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

July 29, 2017 (Dollars in Millions)	As Previously Reported	New Standard Adjustment	Adjusted
Assets			
Current assets:			
Cash and cash equivalents	$ 552	$ -	$ 552
Merchandise inventories	3,853	-	3,853
Other	335	46	381
Total current assets	4,740	46	4,786
Property and equipment, net	8,068	-	8,068
Other assets	230	-	230
Total assets	$ 13,038	$ 46	$ 13,084
Liabilities and Shareholders' Equity			
Current liabilities:			
Accounts payable	$ 1,370	$ -	$ 1,370
Accrued liabilities	1,069	56	1,125
Income taxes payable	43	-	43
Current portion of capital lease and financing obligations	133	-	133
Total current liabilities	2,615	56	2,671
Long-term debt	2,796	-	2,796
Capital lease and financing obligations	1,637	-	1,637
Deferred income taxes	271	(3)	268
Other long-term liabilities	691	-	691
Total shareholders' equity	5,028	(7)	5,021
Total liabilities and shareholders' equity	$ 13,038	$ 46	$ 13,084

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KOHL'S CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

February 3, 2018 (Dollars in Millions)	As Previously Reported	New Standard Adjustment	Adjusted
Assets			
Current assets:			
Cash and cash equivalents	$ 1,308	$ -	$1,308
Merchandise inventories	3,542	-	3,542
Other	481	49	530
Total current assets	5,331	49	5,380
Property and equipment, net	7,773	-	7,773
Other assets	236	-	236
Total assets	$ 13,340	$ 49	$13,389
Liabilities and Shareholders' Equity			
Current liabilities:			
Accounts payable	$ 1,271	$ -	$1,271
Accrued liabilities	1,155	58	1,213
Income taxes payable	99	-	99
Current portion of capital lease and financing obligations	126	-	126
Total current liabilities	2,651	58	2,709
Long-term debt	2,797	-	2,797
Capital lease and financing obligations	1,591	-	1,591
Deferred income taxes	213	(2)	211
Other long-term liabilities	662	-	662
Total shareholders' equity	5,426	(7)	5,419
Total liabilities and shareholders' equity	$ 13,340	$ 49	$13,389

The adoption of the new standard had no impact on our basic or diluted earnings per share or our net cash provided by (used in) operating, financing, or investing activities.

3. Store Closure and Restructure Reserve

The following table summarizes changes in the store closure and restructure reserve during the six months ended August 4, 2018:

(Dollars in Millions)	
Balance - February 3, 2018	$87
Payments and reversals	(10)

Balance - August 4, 2018	$77

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KOHL'S CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

4. Debt

Long-term debt consists of the following unsecured senior debt:

Maturity (Dollars in Millions)	Effective Rate		Coupon Rate		Outstanding August 4, 2018	February 3, 2018 & July 29, 2017
2021	4.81	%	4.00	%	$413	$ 650
2023	3.25	%	3.25	%	350	350
2023	4.78	%	4.75	%	184	300
2025	4.25	%	4.25	%	650	650
2029	7.36	%	7.25	%	42	99
2033	6.05	%	6.00	%	112	166
2037	6.89	%	6.88	%	101	150
2045	5.57	%	5.55	%	435	450
	4.76	%			$2,287	$ 2,815

Long-term debt is net of unamortized debt discounts and deferred financing costs of $14 million at August 4, 2018, $18 million at February 3, 2018, and $19 million at July 29, 2017.

Our long-term debt is classified as Level 1, financial instruments with unadjusted, quoted prices listed on active market exchanges. The estimated fair value of our long-term debt was $2.3 billion at August 4, 2018 and $2.9 billion at both February 3, 2018 and July 29, 2017.

Year to date, we have reduced our outstanding debt by $528 million, including $500 million which was repurchased pursuant to a cash tender offer in the first quarter and $28 million which was repurchased on the open market during the second quarter. In conjunction with the debt reduction, we recorded a $42 million loss on extinguishment of debt which includes $35 million of premium paid to holders of the debt, $4 million related to an interest rate hedge, and $3 million of deferred financing fees and original issue discounts.

5. Stock-Based Compensation

The following table summarizes our stock-based compensation activity for the six months ended August 4, 2018:

	Stock Options		Nonvested Stock Awards		Performance Share Units	
(Shares and Units in Thousands)	Shares	Weighted Average Exercise Price	Shares	Weighted Average Grant Date Fair Value	Units	Weighted Average Grant Date Fair Value
Balance - February 3, 2018	1,139	$ 50.51	2,811	$ 45.60	660	$ 44.97
Granted	—	—	975	63.63	179	66.30
Exercised/vested	(959)	50.49	(859)	48.13	(38)	78.35
Forfeited/expired	(2)	53.38	(62)	48.60	(5)	46.91
Balance - August 4, 2018	178	$ 51.36	2,865	$ 50.94	796	$ 48.17

6. Contingencies

We are subject to certain legal proceedings and claims arising out of the conduct of our business. In the opinion of management, the outcome of these proceedings and litigation will not have a material adverse impact on our consolidated financial statements.

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KOHL’S CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

7. Net Income Per Share

Basic net income per share is net income divided by the average number of common shares outstanding during the period. Diluted net income per share includes incremental shares assumed for share-based awards.

The information required to compute basic and diluted net income per share is as follows:

	Three Months Ended	
	August 4,	July 29,
(Dollar and Shares in Millions, Except per Share Data)	2018	2017
Numerator—Net income	$292	$ 208
Denominator—Weighted average shares:		
Basic	165	168
Impact of dilutive stock-based awards	1	—
Diluted	166	168
Antidilutive shares	—	3
Net income per share:		
Basic	$1.77	$ 1.24
Diluted	$1.76	$ 1.24

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Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

For purposes of the following discussion, unless noted, all references to "the quarter" and "the second quarter" are for the three fiscal months (13 weeks) ended August 4, 2018 and July 29, 2017. References to "year to date" and “first half” are for the six fiscal months (26 weeks) ended August 4, 2018 and July 29, 2017.

The following discussion should be read in conjunction with our Consolidated Financial Statements and the related notes included elsewhere in this report, as well as the financial and other information included in our 2017 Annual Report on Form 10-K (our "2017 Form 10-K"). The following discussion may contain forward-looking statements that reflect our plans, estimates and beliefs. Our actual results could materially differ from those discussed in these forward-looking statements. Factors that could cause or contribute to those differences include, but are not limited to, those discussed elsewhere in this report and in our 2017 Form 10-K (particularly in "Risk Factors").

Executive Summary

As of August 4, 2018, we operated 1,158 Kohl's department stores, a website (www.Kohls.com), 12 FILA outlets, and four Off-Aisle clearance centers. Our Kohl's stores and website sell moderately-priced proprietary and national brand apparel, footwear, accessories, beauty and home products. Our Kohl's stores generally carry a consistent merchandise assortment with some differences attributable to local preferences. Our website includes merchandise which is available in our stores, as well as merchandise that is available only on-line.

Key financial results for the quarter included:

- Positive comparable sales results
- 42 basis point increase in gross margin as a percent of net sales
- SG&A as a percentage of total revenue deleveraged 9 basis points
- 8% reduction in inventory per store
- 42% increase in diluted earnings per share ("EPS")

See "Results of Operations" and "Liquidity and Capital Resources" for additional details about our financial results.

Results of Operations

Net Sales

Net sales increased $163 million, or 3.9%, to $4.3 billion for the second quarter of 2018. Year to date, net sales increased $301 million, or 3.8%. On a shifted basis, which adjusts for the 53rd week in 2017 by comparing the periods ended August 4, 2018 and August 5, 2017, comparable sales increased 3.1% for the quarter and 1.8% year to date. On a fiscal basis, which compares the fiscal periods ended August 4, 2018 and July 29, 2017, comparable sales increased 4.3% for the quarter and 4.0% year to date. Kohl’s store sales are included in comparable sales after the store has been open for 12 full months. Digital sales and sales at remodeled and relocated Kohl’s stores are included in comparable sales, unless square footage has changed by more than 10%.

The following results are on a shifted comparable sales basis:

- The increase in comparable sales was driven by higher average transaction value in both periods.
- Our Footwear and Men’s businesses outperformed the Company average in both periods. The Women’s business also outperformed the Company average in the second quarter. Home was challenging in the second quarter, but outperformed the Company average year to date.
- All regions reported positive comparable sales in both periods. The Midwest, South Central and West regions outperformed the Company average in both periods. The MidAtlantic region also outperformed the Company average in the second quarter.

Other Revenue

Other revenue increased $12 million, or 5%, to $260 million for the second quarter of 2018 and $17 million, or 3%, to $515 million year to date. The increases were primarily due to higher credit card revenue and unused gift card and merchandise return card revenue (breakage).

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Cost of Merchandise Sold and Gross Margin

(Dollars in Millions)	Quarter 2018	2017	Change	Year to Date 2018	2017	Change
Net sales	$ 4,310	$ 4,147	$ 163	$ 8,263	$ 7,962	$ 301
Cost of merchandise sold	2,605	2,525	80	5,101	4,953	148
Gross margin	$ 1,705	$ 1,622	$ 83	$ 3,162	$ 3,009	$ 153
Gross margin as a percent of net sales	39.5 %	39.1 %	42 bp	38.3 %	37.8 %	46 bp

Cost of merchandise sold includes the total cost of products sold, including product development costs, net of vendor payments other than reimbursement of specific, incremental and identifiable costs; inventory shrink; markdowns; freight expenses associated with moving merchandise from our vendors to our distribution centers; shipping expenses for on-line sales; and terms cash discount. Our cost of merchandise sold may not be comparable with that of other retailers because we include distribution center and buying costs in selling, general and administrative expenses while other retailers may include these expenses in cost of merchandise sold.

The increase in gross margin as a percent of net sales reflects the benefits of our inventory management initiatives which contributed to less permanent and promotional markdowns and our operational efficiency initiative, which positively impacted shipping costs.

Selling, General and Administrative Expenses ("SG&A")

(Dollars in Millions)	Quarter 2018	2017	Change	Year to Date 2018	2017	Change
SG&A	$ 1,272	$ 1,220	$ 52	$ 2,532	$ 2,434	$ 98
As a percent of total revenue	27.8 %	27.8 %	9 bp	28.8 %	28.8 %	7 bp

SG&A expenses include compensation and benefit costs (including stores, headquarters, buying, and distribution centers); occupancy and operating costs of our retail, distribution and corporate facilities; freight expenses associated with moving merchandise from our distribution centers to our retail stores and among distribution and retail facilities; marketing expenses, offset by vendor payments for reimbursement of specific, incremental and identifiable costs; expenses related to our credit card operations; and other administrative revenues and expenses. We do not include depreciation and amortization in SG&A. The classification of these expenses varies across the retail industry.

The following table summarizes the increases in SG&A by expense type:

(Dollars in Millions)	Quarter	Year to Date
Technology	$ 21	$ 36
Store expenses	13	14
Leadership changes & other corporate costs	9	36
Marketing	6	7

Distribution costs	3	5
Total increase	$ 52	$ 98

Many of our expenses, including store payroll and distribution costs, are variable in nature. These costs generally increase as sales increase and decrease as sales decrease. We measure both the change in these variable expenses and the expense as a percent of sales. If the expense as a percent of sales decreased from the prior year, the expense "leveraged". If the expense as a percent of sales increased over the prior year, the expense "deleveraged".

For the quarter, all major expenses leveraged, except technology where we're making deliberate investments in the cloud and other technology initiatives. Year to date, our corporate expenses deleveraged primarily due to expenses associated with recent executive leadership changes.

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Other Expenses

(Dollars in Millions)	Quarter 2018	2017	Change	Year to Date 2018	2017	Change
Depreciation and amortization	$ 241	$ 243	$ (2)	$ 483	$ 482	$ 1
Interest expense, net	65	75	(10)	135	150	(15)
Loss on extinguishment of debt	—	—	—	42	—	42

Depreciation and amortization decreased for the quarter as lower depreciation on our maturing store portfolio more than offset higher depreciation and amortization on our fifth E-commerce fulfillment center which opened in August 2017 and technology investments.

Interest expense, net decreased due to the benefits of this year’s debt tender transaction, as well as increased interest income due to higher yield and investment balances.

We recognized a $42 million loss on extinguishment of debt in the first quarter of 2018 related to our $500 million cash tender offer.

Income Taxes

(Dollars in Millions)	Quarter 2018	2017	Change	Year to Date 2018	2017	Change
Provision for income taxes	$ 95	$ 124	$ (29)	$ 117	$ 167	$ (50)
Effective tax rate	24.5 %	37.4 %		24.2 %	37.9 %	

The decreases in the provision for income taxes and the effective tax rate were primarily due to tax reform.

Income before Income Taxes, Net Income and Earnings Per Diluted Share

(Dollars in Millions, Except per Share Data)	2018 Income before Income Taxes	Net Income	Earnings Per Diluted Share	2017 Income before Income Taxes	Net Income	Earnings Per Diluted Share
Quarter:						
GAAP	$ 387	$ 292	$ 1.76	$ 332	$ 208	$ 1.24
Loss on extinguishment of debt	—	—	—	—	—	—
Adjusted (Non-GAAP)	$ 387	$ 292	$ 1.76	$ 332	$ 208	$ 1.24
Year to Date:						
GAAP	$ 485	$ 368	$ 2.21	$ 441	$ 274	$ 1.62

Loss on extinguishment of debt	42	31	0.19	—	—	—
Adjusted (Non-GAAP)	$ 527	$ 399	$ 2.40	$ 441	$ 274	$ 1.62

We believe the adjusted results in the table above are useful because they provide enhanced visibility into our results excluding the loss on extinguishment of debt. However, these non-GAAP financial measures are not intended to replace the comparable GAAP measures.

Seasonality and Inflation

Our business, like that of most retailers, is subject to seasonal influences, with the major portion of sales and income typically realized during the second half of each fiscal year, which includes the back-to-school and holiday seasons. Approximately 15% of annual sales typically occur during the back-to-school season and 30% during the holiday season. Because of the seasonality of our business, results for any quarter are not necessarily indicative of the results that may be achieved for a full fiscal year.

Although we expect that our operations will be influenced by general economic conditions, including food, fuel and energy prices, and by costs to source our merchandise, we do not believe that inflation has had a material

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effect on our results of operations for the periods covered by this report. However, there can be no assurance that our business will not be impacted by such factors in the future.

Liquidity and Capital Resources

The following table presents our primary uses and sources of cash.

Cash Uses	Cash Sources
•Operational needs, including salaries, rent, taxes and other costs of running our business	•Cash flow from operations
•Capital expenditures	•Short-term trade credit, in the form of extended payment terms
•Inventory	•Line of credit under our revolving credit facility
•Dividend payments	
•Share repurchases	
•Debt reduction	

Our working capital and inventory levels typically build throughout the fall, peaking during the November and December holiday selling season.

(Dollars in Millions)	2018	2017	Increase/(Decrease) in Cash $	%
Net cash provided by (used in):				
Operating activities	$ 1,047	$ 376	$ 671	178 %
Investing activities	(306)	(383)	77	20 %
Financing activities	(983)	(515)	(468)	(91)%

Operating Activities

Operating activities generated $1.0 billion of cash in the first half of 2018, an increase of $671 million over the first half of 2017. The increase was primarily due to changes in accounts payable.

Investing Activities

Investing activities used cash of $306 million in the first half of 2018 and $383 million in the first half of 2017. The decrease was primarily due to lower spending on E-commerce fulfillment centers and timing of technology spending.

Financing Activities

Financing activities used cash of $983 million in the first half of 2018, an increase of $468 million over the first half of 2017.

In the first six months of 2018, we reduced our outstanding debt by $528 million, including $500 million which was repurchased pursuant to a cash tender offer in the first quarter and $28 million which was repurchased on the open market during the second quarter. We may again seek to retire or purchase our outstanding debt through open market cash purchases, privately negotiated transactions or otherwise. Such repurchases, if any, will depend on prevailing market conditions, our liquidity requirements, contractual restrictions and other factors.

We paid cash for treasury stock purchases of $165 million in the first half of 2018 and $250 million in the first half of 2017. Share repurchases are discretionary in nature. The timing and amount of repurchases is based upon available cash balances, our stock price and other factors.

We paid cash dividends of $202 million ($1.22 per share) in the first half of 2018 and $186 million ($1.10 per share) in the first half of 2017. On August 14, 2018, our Board of Directors declared a quarterly cash dividend on our common stock of $0.61 per share. The dividend is payable on September 26, 2018 to shareholders of record at the close of business on September 12, 2018.

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As of August 4, 2018, our credit ratings were as follows:

	Moody's	Standard & Poor's	Fitch
Long-term debt	Baa2	BBB-	BBB

Key Financial Ratios

Key financial ratios that provide certain measures of our liquidity are as follows:

(Dollars in Millions)	August 4, 2018	July 29, 2017
Working capital	$ 2,272	$ 2,115
Current ratio	1.82	1.79
Debt/capitalization	41.7 %	47.6 %

The increases in our working capital and current ratio include a $514 million increase in cash despite $528 million in debt reductions during the first six months of 2018. The increases were attributable to cash, but were partially offset by a $281 million reduction in inventory as a result of our inventory management initiatives. The debt/capitalization ratio reflects the benefit of lower debt outstanding.

Inventory per store as of August 4, 2018 decreased 8% from July 29, 2017. Accounts payable as a percent of inventory increased 375 basis points to 39.3% at August 4, 2018. Both were driven by our inventory management initiatives.

Debt Covenant Compliance

As of August 4, 2018, we were in compliance with all debt covenants and expect to remain in compliance during the remainder of fiscal 2018.

Contractual Obligations

Aside from the $528 million reduction in outstanding debt and the resulting decline in our interest expense, there have been no significant changes in the contractual obligations disclosed in our 2017 Form 10-K.

Off-Balance Sheet Arrangements

We have not provided any financial guarantees as of August 4, 2018.

We have not created, and are not party to, any special-purpose or off-balance sheet entities for the purpose of raising capital, incurring debt or operating our business. We do not have any arrangements or relationships with entities that are not consolidated into our financial statements that are reasonably likely to materially affect our financial condition, liquidity, results of operations or capital resources.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect reported amounts. Management has discussed the development, selection and disclosure of its estimates and assumptions with the Audit Committee of our Board of Directors. There have been no significant changes in the critical accounting policies and estimates discussed in our 2017 Form 10-K.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no significant changes in the market risks described in our 2017 Form 10-K.

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Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (the “Evaluation”) at a reasonable assurance level as of the last day of the period covered by this report.

Based upon the Evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective at the reasonable assurance level. Disclosure controls and procedures are defined by Rule 13a-15(e) of the Securities Exchange Act of 1934 (the "Exchange Act") as controls and other procedures that are designed to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosures.

It should be noted that the design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving our stated goals under all potential future conditions, regardless of how remote.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended August 4, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1A. Risk Factors

There have been no significant changes in the risk factors described in our 2017 Form 10-K.

This Form 10-Q contains "forward-looking statements" made within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as "believes," “anticipates,” “plans,” "may," "intends," "will," "should," “expects” and similar expressions are intended to identify forward-looking statements. Forward-looking statements may include comments about our future sales or financial performance and our plans, performance, and other objectives, expectations or intentions, such as statements regarding our liquidity, debt service requirements, planned capital expenditures, future store initiatives, and adequacy of capital resources and reserves. Forward-looking statements are based on our management’s then current views and assumptions and, as a result, are subject to certain risks and uncertainties that could cause actual results to differ materially from those projected. Any such forward-looking statements are qualified by the important risk factors described in Part I, Item 1A of our 2017 Form 10-K or disclosed from time to time in our filings with the SEC, that could cause actual results to differ materially from those predicted by the forward-looking statements. Forward-looking statements relate to the date initially made, and we undertake no obligation to update them.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

We did not sell any securities during the quarter ended August 4, 2018, which were not registered under the Securities Act of 1933, as amended.

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The following table contains information for shares of common stock repurchased and shares acquired from employees in lieu of amounts required to satisfy minimum tax withholding requirements upon the vesting of the employees' stock-based compensation during the three fiscal months ended August 4, 2018:

	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (In Millions)
May 6 - June 2, 2018	523,302	$ 63.18	444,969	$ 1,505
June 3 - July 7, 2018	501,341	74.51	499,235	1,467
July 8 - August 4, 2018	421,978	72.08	419,848	1,437
Total	1,446,621	$ 70.10	1,364,052	$ 1,437

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Item 6. Exhibits

Exhibit	Description
10.1	Employment agreement between Kohl's Department Stores, Inc. and Kohl's Corporation and Doug Howe effective as of May 14, 2018.*
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase

*A management contract or compensatory plan or arrangement.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	Kohl's Corporation
	(Registrant)
Date: September 7, 2018	/s/ Bruce Besanko Bruce Besanko
	On behalf of the Registrant and as Chief Financial Officer
	(Principal Financial Officer)