Ascena Retail Group, Inc.
Form 10-Q
December 01, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended October 29, 2016

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

Commission File Number: 0-11736

ASCENA RETAIL GROUP, INC.
(Exact name of registrant as specified in its charter)

Delaware	30-0641353
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
933 MacArthur Boulevard, Mahwah, New Jersey	07430
(Address of principal executive offices)	(Zip Code)

(551) 777-6700
(Registrant's telephone number, including area code)

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 ý 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 ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.
Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý
The Registrant had 194,764,068 shares of common stock outstanding as of November 29, 2016.

INDEX

PART I. FINANCIAL INFORMATION (Unaudited)

ASCENA RETAIL GROUP, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

	October 29, 2016	July 30, 2016
	(millions, except per share data)	
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$270.7	$371.8
Inventories	807.8	649.3
Prepaid expenses and other current assets	172.1	218.9
Total current assets	1,250.6	1,240.0
Property and equipment, net	1,608.5	1,630.1
Goodwill	1,279.3	1,279.3
Other intangible assets, net	1,263.7	1,268.7
Other assets	86.8	88.2
Total assets	$5,488.9	$5,506.3
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$511.8	$429.4
Accrued expenses and other current liabilities	371.8	420.3
Deferred income	108.8	110.0
Current portion of long-term debt	—	54.0
Total current liabilities	992.4	1,013.7
Long-term debt, less current portion	1,601.0	1,594.5
Lease-related liabilities	380.7	387.1
Deferred income taxes	440.2	442.2
Other non-current liabilities	191.0	205.5
Total liabilities	3,605.3	3,643.0
Commitments and contingencies (Note 13)		
Equity:		
Common stock, par value $0.01 per share; 194.7 million and 194.2 million shares issued and outstanding as of October 29, 2016 and July 30, 2016, respectively	1.9	1.9
Additional paid-in capital	1,056.0	1,050.3
Retained earnings	842.9	828.8
Accumulated other comprehensive loss	(17.2)	(17.7)
Total equity	1,883.6	1,863.3
Total liabilities and equity	$5,488.9	$5,506.3

See accompanying notes.

ASCENA RETAIL GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended	
	October 29, 2016	October 24, 2015
	(millions, except per share data) (unaudited)	
Net sales	$1,678.4	$1,672.0
Cost of goods sold	(664.4)	(769.3)
Gross margin	1,014.0	902.7
Other operating expenses:		
Buying, distribution and occupancy expenses	(320.6)	(303.0)
Selling, general and administrative expenses	(524.4)	(486.7)
Acquisition and integration expenses	(12.0)	(42.5)
Restructuring and other related charges	(11.9)	—
Depreciation and amortization expense	(93.9)	(82.5)
Total other operating expenses	(962.8)	(914.7)
Operating income (loss)	51.2	(12.0)
Interest expense	(25.3)	(20.5)
Interest income and other (expense) income, net	(0.1)	0.6
Income (loss) before (provision) benefit for income taxes	25.8	(31.9)
(Provision) benefit for income taxes	(11.4)	13.8
Net income (loss)	$14.4	$(18.1)
Net income (loss) per common share:		
Basic	$0.07	$(0.10)
Diluted	$0.07	$(0.10)
Weighted average common shares outstanding:		
Basic	194.4	184.8
Diluted	195.3	184.8

See accompanying notes.

ASCENA RETAIL GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	Three Months Ended	
	October 29, 2016	October 24, 2015
	(millions)	
	(unaudited)	
Net income (loss)	$ 14.4	$ (18.1)
Other comprehensive (loss) income, net of tax:		
Net actuarial loss on a defined benefit plan, net of income tax benefit of $0.4 million	(0.7)	—
Foreign currency translation adjustment	(0.8)	1.2
Total other comprehensive (loss) income before reclassification	(1.5)	1.2
Reclassification of settlement charges for ANN's pension plan, net of income tax benefit of $1.3 million	2.0	—
Total comprehensive income (loss)	$ 14.9	$ (16.9)

See accompanying notes.

ASCENA RETAIL GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended	
	October 29, 2016	October 24, 2015
	(millions) (unaudited)	
Cash flows from operating activities:		
Net income (loss)	$14.4	$ (18.1)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization expense	93.9	82.5
Deferred income tax (benefit) expense	(0.8)	6.1
Deferred rent and other occupancy costs	(16.6)	(12.2)
Amortization of acquisition-related inventory write-up	—	104.2
Stock-based compensation expense	7.0	4.8
Impairments of tangible assets	4.7	1.9
Non-cash interest expense	3.1	2.3
Other non-cash income (expense), net	2.3	(2.9)
Excess tax benefits from stock-based compensation	—	(1.1)
Changes in operating assets and liabilities:		
Inventories	(158.5)	(105.8)
Accounts payable, accrued liabilities and income tax liabilities	67.8	(99.3)
Deferred income	(0.7)	(2.2)
Lease-related liabilities	12.1	14.9
Other balance sheet changes, net	27.3	(21.5)
Net cash provided by (used in) operating activities	56.0	(46.4)
Cash flows from investing activities:		
Cash paid for the acquisition of ANN INC., net of cash acquired (Note 4)	—	(1,494.6)
Capital expenditures	(106.6)	(93.0)
Proceeds from sales and maturities of investments	—	12.7
Net cash used in investing activities	(106.6)	(1,574.9)
Cash flows from financing activities:		
Proceeds from term loan, net of original issue discount	—	1,764.0
Repayments of term loan	(100.0)	—
Proceeds from revolver borrowings	298.3	523.5
Repayments of revolver borrowings	(248.9)	(552.0)
Payment of deferred financing costs	—	(41.4)
Proceeds from stock options exercised and employee stock purchases	0.1	8.4
Excess tax benefits from stock-based compensation	—	1.1
Net cash (used in) provided by financing activities	(50.5)	1,703.6
Net (decrease) increase in cash and cash equivalents	(101.1)	82.3
Cash and cash equivalents at beginning of period	371.8	240.6
Cash and cash equivalents at end of period	$270.7	$ 322.9

See accompanying notes.

ASCENA RETAIL GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Description of Business

ascena retail group, inc., a Delaware corporation (“ascena” or the “Company”), is a leading national specialty retailer of apparel for women and tween girls. On August 21, 2015, the Company acquired ANN INC. ("ANN"), a retailer of women’s apparel, shoes and accessories sold primarily under the Ann Taylor and LOFT brands (the "ANN Acquisition"). The Company operates, through its 100% owned subsidiaries, ecommerce operations and approximately 4,900 stores throughout the United States, Canada and Puerto Rico. The Company had annual revenues for the fiscal year ended July 30, 2016 of approximately $7.0 billion. The Company and its subsidiaries are collectively referred to herein as the “Company,” “ascena,” “we,” “us,” “our” and “ourselves,” unless the context indicates otherwise.

In connection with the Change for Growth program, as more fully described in Note 7, effective with the beginning of Fiscal 2017, the Company reorganized into four operating segments: Premium Fashion, Value Fashion, Plus Fashion and Kids Fashion. All of our segments sell fashion merchandise to the women's and girls' apparel market across a wide range of ages, sizes and demographics. Our segments consist of specialty retail, outlet and ecommerce as well as licensed franchises in international territories at our Kids Fashion segment. Our segment brand-based activities are as follows: our Premium Fashion segment consists of our Ann Taylor and LOFT brands; our Value Fashion segment consists of our maurices and dressbarn brands; our Plus Fashion segment consists of our Lane Bryant and Catherines brands; and our Kids Fashion segment consists of our Justice brand. For a more detailed description of each brand's products and markets in which they serve, see Part I, Item 1 "Business" in our Annual Report on Form 10-K for the fiscal year ended July 30, 2016 (the "Fiscal 2016 10-K").

The Company's brands had the following store counts as of October 29, 2016: Ann Taylor 340 stores; LOFT 683 stores; maurices 1,006 stores; dressbarn 809 stores; Lane Bryant 776 stores; Catherines 370 stores; and Justice 936 stores.

2. Basis of Presentation

Interim Financial Statements

These interim condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”) and are unaudited. In the opinion of management, however, such condensed consolidated financial statements contain all normal and recurring adjustments necessary to present fairly the condensed consolidated financial condition, results of operations, comprehensive income (loss) and cash flows of the Company for the interim periods presented. In addition, certain information and footnote disclosures normally included in financial statements prepared in accordance with the accounting principles generally accepted in the United States of America (“US GAAP”) have been condensed or omitted from this report as permitted by the SEC’s rules and regulations. However, the Company believes that the disclosures herein are adequate to ensure that the information is fairly presented.

The condensed consolidated balance sheet data as of July 30, 2016 is derived from the audited consolidated financial statements included in the Company’s Fiscal 2016 10-K, which should be read in conjunction with these interim financial statements. Reference is made to the Fiscal 2016 10-K for a complete set of financial statements.

Fiscal Period

The Company utilizes a 52-53 week fiscal year ending on the last Saturday in July. Fiscal year 2017 will end on July 29, 2017 and will be a 52-week period (“Fiscal 2017”). Fiscal year 2016 ended on July 30, 2016 and was a 53-week period (“Fiscal 2016”). The three months ended October 29, 2016 and the three months ended October 24, 2015 are both 13-week periods.

Our Premium Fashion segment, which represents the results of Ann Taylor and LOFT for the post-acquisition period from August 22, 2015 to October 31, 2015 have been included herein for the ascena three-month period ended October 24, 2015, resulting in a one-week reporting lag for the first quarter of Fiscal 2016. The effect of this one-week reporting period difference is not material to the condensed consolidated financial statements for the three months ended October 24, 2015. As of the end of Fiscal 2016, our Premium Fashion segment is on the same fiscal calendar as the rest of the Company's operating segments.

ASCENA RETAIL GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Reclassification

During the third quarter of Fiscal 2016, the Company determined that, for the first six months of Fiscal 2016, an expense for our Premium Fashion segment, which should have been classified as Buying, distribution and occupancy expenses, had been incorrectly classified as Cost of goods sold. As a result, the Company restated its prior period information by reclassifying $6.6 million of these costs for the first quarter of Fiscal 2016 to Buying, distribution and occupancy expenses from Cost of goods sold, thereby increasing Gross margin. This change had no effect on the previously reported Operating loss or Net loss.

3. Recently Issued Accounting Standards

In March 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-09, "Improvements to Employee Share-Based Payment Accounting." The guidance simplifies the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, statutory tax withholding requirements and the classification in the statement of cash flows. The guidance is effective for fiscal years beginning after December 15, 2016 and interim periods therein, with early adoption permitted. The Company is currently evaluating the guidance and its impact on the Company's condensed consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases." The guidance requires the lessee to recognize the assets and liabilities for the rights and obligations created by leases with terms of 12 months or more. The guidance is effective for fiscal years beginning after December 15, 2018 and interim periods therein, with early adoption permitted. The Company is currently evaluating the guidance and its impact on the Company's condensed consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers," which supersedes the revenue recognition requirements in FASB Accounting Standards Codification ("ASC"), "Revenue Recognition (Topic 605)." The guidance requires that an entity recognize revenue in a way that depicts the transfer of promised goods or services to customers in the amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods and services. The guidance, which was deferred in July 2015, is effective for annual reporting periods beginning after December 15, 2017 and interim periods therein. The guidance may be applied retrospectively to each period presented or with the cumulative effect recognized as of the initial date of application. The Company is currently evaluating the guidance and its impact on the Company's condensed consolidated financial statements.

4. Acquisition of ANN INC.

On August 21, 2015, the Company acquired 100% of the outstanding common stock of ANN for an aggregate purchase price of approximately $2.1 billion. The purchase price consisted of approximately $1.75 billion in cash and the issuance of 31.2 million shares of the Company's common stock valued at approximately $345 million, based on the Company's stock price on the date of the acquisition. The cash portion of the purchase price was funded with borrowings under a $1.8 billion seven-year, variable-rate term loan described in Note 8. The acquisition is intended to diversify our portfolio of brands that serve the needs of women of different ages, sizes and demographics.

The Company expensed $20.5 million of transaction costs during the first quarter of Fiscal 2016, which are included within Acquisition and integration expenses in the condensed consolidated statements of operations. In addition, as a result of the write-up of ANN's assets and liabilities to fair value, the Company expensed $11.0 million and $110.7

million during the three months ended October 29, 2016 and October 24, 2015, respectively. The expenses in the three months ended October 29, 2016 reflect $7.8 million of depreciation and amortization expense associated with the write-up of ANN's customer relationships and property and equipment and $3.2 million of other purchase accounting adjustments which are primarily lease-related. The expenses in the three months ended October 24, 2015 reflect $104.2 million recorded to Cost of goods sold related to the write-up of ANN's inventory and $6.5 million of depreciation and amortization.

ASCENA RETAIL GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

There were no measurement-period adjustments recorded during the first quarter of Fiscal 2017 and the allocation of the purchase price is final. The following table summarizes the final allocation of fair values of the identifiable assets acquired and liabilities assumed in the ANN Acquisition.

	Final Allocation, as of October 29, 2016
	(millions)
Cash and cash equivalents	$ 257.6
Inventories	398.3
Prepaid expenses and other current assets	118.5
Property and equipment	453.3
Goodwill	959.6
Other intangible assets:	
Trade names	815.0
Customer relationships	51.5
Favorable leases	38.4
Other assets	3.5
Total assets acquired	3,095.7
Accounts payable	155.6
Accrued expenses and other current liabilities	209.0
Deferred income	46.0
Lease-related liabilities	175.0
Deferred income taxes	374.1
Other non-current liabilities	38.8
Total liabilities assumed	998.5
Total net assets acquired	$ 2,097.2

The following pro forma information has been prepared as if the ANN Acquisition and the issuance of stock and debt to finance the acquisition had occurred as of the beginning of Fiscal 2015:

	Three Months Ended October 24, 2015