BIG LOTS INC
Form 10-Q
December 10, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended November 1, 2014
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 1-8897
BIG LOTS, INC.
(Exact name of registrant as specified in its charter)

Ohio	06-1119097
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
300 Phillipi Road, P.O. Box 28512, Columbus, Ohio	43228-5311
(Address of principal executive offices)	(Zip Code)

(614) 278-6800
(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.

Yesþ Noo

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).

Yesþ Noo

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 þ Accelerated filer o Non-accelerated filer 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 Noþ

The number of the registrant’s common shares, $0.01 par value, outstanding as of December 5, 2014, was 53,452,301.

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FORM 10-Q
FOR THE FISCAL QUARTER ENDED NOVEMBER 1, 2014

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Part I. Financial Information

Item 1. Financial Statements

BIG LOTS, INC. AND SUBSIDIARIES
Consolidated Statements of Operations (Unaudited)
(In thousands, except per share amounts)

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	November 1, 2014	November 2, 2013	November 1, 2014	November 2, 2013
Net sales	$1,107,095	$1,104,918	$3,583,729	$3,552,843
Cost of sales (exclusive of depreciation expense shown separately below)	676,153	673,490	2,189,704	2,155,105
Gross margin	430,942	431,428	1,394,025	1,397,738
Selling and administrative expenses	404,732	405,279	1,234,420	1,219,269
Depreciation expense	30,267	29,014	88,535	83,393
Operating (loss) profit	(4,057)	(2,865)	71,070	95,076
Interest expense	(756)	(1,034)	(1,616)	(2,490)
Other income (expense)	—	—	—	(11)
(Loss) income from continuing operations before income taxes	(4,813)	(3,899)	69,454	92,575
Income tax (benefit) expense	(1,698)	(1,951)	26,776	35,514
(Loss) income from continuing operations	(3,115)	(1,948)	42,678	57,061
Loss from discontinued operations, net of tax benefit of $207, $1,704, $13,003 and $1,846, respectively	(326)	(7,569)	(22,833)	(16,119)
Net (loss) income	$(3,441)	$(9,517)	$19,845	$40,942
Earnings per common share - basic:				
Continuing operations	$(0.06)	$(0.03)	$0.77	$0.99
Discontinued operations	(0.01)	(0.13)	(0.41)	(0.28)
	$(0.06)	$(0.17)	$0.36	$0.71
Earnings per common share - diluted:				
Continuing operations	$(0.06)	$(0.03)	$0.76	$0.98
Discontinued operations	(0.01)	(0.13)	(0.41)	(0.28)
	$(0.06)	$(0.17)	$0.35	$0.71
Weighted-average common shares outstanding:				
Basic	54,850	57,461	55,617	57,383
Dilutive effect of share-based awards	—	—	603	550
Diluted	54,850	57,461	56,220	57,933
Cash dividends declared per common share	$0.17	$—	$0.34	$—

The accompanying notes are an integral part of these consolidated financial statements.

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BIG LOTS, INC. AND SUBSIDIARIES
Consolidated Statements of Comprehensive Income (Unaudited)
(In thousands)

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	November 1, 2014	November 2, 2013	November 1, 2014	November 2, 2013
Net (loss) income	$(3,441)	$(9,517)	$19,845	$40,942
Other comprehensive (loss) income:				
Foreign currency translation	—	(224)	5,022	(2,189)
Amortization of pension, net of tax expense of $155, $198, $457, and $535, respectively	208	252	631	751
Valuation adjustment of pension, net of tax benefit (expense) of $198, $(33), $198 and $(33), respectively	(272)	50	(272)	50
Total other comprehensive (loss) income	(64)	78	5,381	(1,388)
Comprehensive (loss) income	$(3,505)	$(9,439)	$25,226	$39,554

The accompanying notes are an integral part of these consolidated financial statements.

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BIG LOTS, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(In thousands, except par value)

	(Unaudited) November 1, 2014	February 1, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$62,488	$68,629
Inventories	1,075,429	914,965
Deferred income taxes	48,553	59,781
Other current assets	126,252	77,686
Total current assets	1,312,722	1,121,061
Property and equipment - net	566,889	569,682
Deferred income taxes	12,512	5,106
Other assets	41,788	43,750
Total assets	$1,933,911	$1,739,599
LIABILITIES AND SHAREHOLDERS’ EQUITY		
Current liabilities:		
Accounts payable	$529,793	$365,772
Property, payroll, and other taxes	81,831	73,334
Accrued operating expenses	72,678	57,167
Insurance reserves	38,325	37,607
Accrued salaries and wages	32,829	29,175
Income taxes payable	868	14,392
Total current liabilities	756,324	577,447
Long-term obligations	283,400	77,000
Deferred rent	68,752	76,364
Insurance reserves	57,091	55,755
Unrecognized tax benefits	17,498	17,975
Other liabilities	37,262	33,631
Shareholders’ equity:		
Preferred shares - authorized 2,000 shares; $0.01 par value; none issued	—	—
Common shares - authorized 298,000 shares; $0.01 par value; issued 117,495 shares; outstanding 52,996 shares and 57,548 shares, respectively	1,175	1,175
Treasury shares - 64,499 shares and 59,947 shares, respectively, at cost	(1,872,431)	(1,670,041)
Additional paid-in capital	571,071	562,447
Retained earnings	2,021,899	2,021,357
Accumulated other comprehensive loss	(8,130)	(13,511)
Total shareholders' equity	713,584	901,427
Total liabilities and shareholders' equity	$1,933,911	$1,739,599

The accompanying notes are an integral part of these consolidated financial statements.

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BIG LOTS, INC. AND SUBSIDIARIES
Consolidated Statements of Shareholders' Equity (Unaudited)
(In thousands)

	Common		Treasury		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
	Shares	Amount	Shares	Amount				
Balance - February 2, 2013	57,269	$1,175	60,226	$(1,677,610)	$551,845	$1,896,062	$(13,330)	$758,142
Comprehensive income	—	—	—	—	—	40,942	(1,388)	39,554
Purchases of common shares	(6)	—	6	(214)	—	—	—	(214)
Exercise of stock options	184	—	(184)	5,114	(1,014)	—	—	4,100
Restricted shares vested	40	—	(40)	1,109	(1,109)	—	—	—
Tax benefit from share-based awards	—	—	—	—	248	—	—	248
Share activity related to deferred compensation plan	—	—	—	—	—	—	—	—
Share-based employee compensation expense	—	—	—	—	11,465	—	—	11,465
Balance - November 2, 2013	57,487	1,175	60,008	(1,671,601)	561,435	1,937,004	(14,718)	813,295
Comprehensive income	—	—	—	—	—	84,353	1,207	85,560
Purchases of common shares	—	—	—	—	—	—	—	—
Exercise of stock options	30	—	(30)	835	(51)	—	—	784
Restricted shares vested	25	—	(25)	696	(696)	—	—	—
Tax charge from share-based awards	—	—	—	—	(125)	—	—	(125)
Share activity related to deferred compensation plan	6	—	(6)	29	166	—	—	195
Share-based employee compensation expense	—	—	—	—	1,718	—	—	1,718
Balance - February 1, 2014	57,548	1,175	59,947	(1,670,041)	562,447	2,021,357	(13,511)	901,427
Comprehensive income	—	—	—	—	—	19,845	5,381	25,226
Dividends declared	—	—	—	—	—	(19,303)	—	(19,303)
Purchases of common shares	(5,896)	—	5,896	(240,462)	—	—	—	(240,462)
Exercise of stock options	1,249	—	(1,249)	35,378	2,174	—	—	37,552
Restricted shares vested	68	—	(68)	1,940	(1,940)	—	—	—
Performance shares vested	25	—	(25)	716	(716)	—	—	—
Tax benefit from share-based awards	—	—	—	—	1,076	—	—	1,076
	2	—	(2)	38	24	—	—	62

Share activity related to deferred compensation plan								
Share-based employee compensation expense	—	—	—	—	8,006	—	—	8,006
Balance - November 1, 2014	52,996	$1,175	64,499	$(1,872,431)	$571,071	$2,021,899	$(8,130)	$713,584

The accompanying notes are an integral part of these consolidated financial statements.

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BIG LOTS, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows (Unaudited)
(In thousands)

	Thirty-Nine Weeks Ended	
	November 1, 2014	November 2, 2013
Operating activities:		
Net income	$19,845	$40,942
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization expense	78,287	75,466
Deferred income taxes	3,563	(21,688)
Loss (gain) on disposition of property and equipment	2,033	(3,472)
Non-cash impairment charge	1,424	—
Non-cash share-based compensation expense	8,006	11,465
Excess tax benefit from share-based awards	(3,582)	(248)
Pension expense, net of contributions	1,758	2,402
Change in assets and liabilities, excluding effects of foreign currency adjustments:		
Inventories	(160,424)	(321,859)
Accounts payable	163,997	190,129
Current income taxes	(59,851)	(67,415)
Other current assets	(1,332)	(8,030)
Other current liabilities	10,124	16,098
Other assets	1,402	(2,080)
Other liabilities	(2,872)	17,192
Net cash provided by (used in) operating activities	62,378	(71,098)
Investing activities:		
Capital expenditures	(74,559)	(83,706)
Cash proceeds from sale of property and equipment	2,733	7,084
Other	(82)	14
Net cash used in investing activities	(71,908)	(76,608)
Financing activities:		
Net proceeds from borrowings under bank credit facility	206,400	152,800
Payment of capital lease obligations	(703)	(855)
Dividends paid	(18,823)	—
Proceeds from the exercise of stock options	37,552	4,100
Excess tax benefit from share-based awards	3,582	248
Deferred bank credit facility fees paid	—	(895)
Payment for treasury shares acquired	(229,820)	(214)
Other	62	—
Net cash (used in) provided by financing activities	(1,750)	155,184
Impact of foreign currency on cash	5,139	(333)
(Decrease) increase in cash and cash equivalents	(6,141)	7,145
Cash and cash equivalents:		
Beginning of period	68,629	60,581
End of period	$62,488	$67,726

The accompanying notes are an integral part of these consolidated financial statements.

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BIG LOTS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)

NOTE 1 – BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

All references in this report to "we," "us," or "our" are to Big Lots, Inc. and its subsidiaries. We are a unique, non-traditional, discount retailer operating in the United States of America ("U.S."). At November 1, 2014, we operated 1,496 stores in the U.S. We make available, free of charge, through the "Investor Relations" section of our website (www.biglots.com) under the "SEC Filings" caption, our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended ("Exchange Act"), as soon as reasonably practicable after we file such material with, or furnish it to, the Securities and Exchange Commission ("SEC"). The contents of our websites are not part of this report.

The accompanying consolidated financial statements and these notes have been prepared in accordance with the rules and regulations of the SEC for interim financial information. The consolidated financial statements reflect all normal recurring adjustments which management believes are necessary to present fairly our financial condition, results of operations, and cash flows for all periods presented. These consolidated financial statements, however, do not include all information necessary for a complete presentation of financial condition, results of operations, and cash flows in conformity with accounting principles generally accepted in the United States of America ("GAAP"). Interim results may not necessarily be indicative of results that may be expected for, or actually result during, any other interim period or for the year as a whole. We have historically experienced, and expect to continue to experience, seasonal fluctuations, with a larger percentage of our net sales and operating profit realized in our fourth fiscal quarter. The accompanying consolidated financial statements and these notes should be read in conjunction with the audited consolidated financial statements and notes included in our Annual Report on Form 10-K for the fiscal year ended February 1, 2014 ("2013 Form 10-K").

Fiscal Periods
Our fiscal year ends on the Saturday nearest to January 31, which results in fiscal years consisting of 52 or 53 weeks. Unless otherwise stated, references to years in this report relate to fiscal years rather than calendar years. Fiscal year 2014 ("2014") is comprised of the 52 weeks that began on February 2, 2014 and will end on January 31, 2015. Fiscal year 2013 ("2013") was comprised of the 52 weeks that began on February 3, 2013 and ended on February 1, 2014. The fiscal quarters ended November 1, 2014 ("third quarter of 2014") and November 2, 2013 ("third quarter of 2013") were both comprised of 13 weeks. The year-to-date periods ended November 1, 2014 ("year-to-date 2014") and November 2, 2013 ("year-to-date 2013") were both comprised of 39 weeks.

Selling and Administrative Expenses
Selling and administrative expenses include store expenses (such as payroll and occupancy costs) and costs related to warehousing, distribution, outbound transportation to our stores, advertising, purchasing, insurance, non-income taxes, and overhead. Our selling and administrative expense rates may not be comparable to those of other retailers that include distribution and outbound transportation costs in cost of sales. Distribution and outbound transportation costs included in selling and administrative expenses were $40.9 million and $41.2 million for the third quarter of 2014 and the third quarter of 2013, respectively, and $119.0 million and $117.1 million for the year-to-date 2014 and the year-to-date 2013, respectively.

Advertising Expense
Advertising costs, which are expensed as incurred, consist primarily of television and print advertising, internet marketing and advertising, and in-store presentations. Advertising expenses are included in selling and administrative expenses. Advertising expenses were $16.9 million and $18.2 million for the third quarter of 2014 and the third

quarter of 2013, respectively, and $57.7 million and $61.2 million for the year-to-date 2014 and the year-to-date 2013, respectively.

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Foreign Currency Translation

The functional currency of our former international subsidiary was the local currency of the country in which the subsidiary was located. We had one foreign subsidiary domiciled in Canada. Foreign currency denominated assets and liabilities are translated into U.S. Dollars using the exchange rate in effect at the consolidated balance sheet date. Results of operations and cash flows are translated using the average exchange rates throughout the period. The effect of exchange rate fluctuations on translation of assets and liabilities was included as a component of shareholders' equity in accumulated other comprehensive loss in 2013. Gains and losses from foreign currency transactions are included in discontinued operations because our Canadian subsidiary has ceased operations. There were losses from foreign currency transactions of $0.1 million, $0.1 million, $4.8 million, and $0.4 million for the third quarter of 2014, the third quarter of 2013, the year-to-date 2014, and the year-to-date 2013, respectively. Included in the foreign currency loss in the year-to-date 2014 is a $5.1 million loss related to the realization of the cumulative translation adjustment on our investment in our Canadian operations.

Supplemental Cash Flow Disclosures

The following table provides supplemental cash flow information for the year-to-date 2014 and the year-to-date 2013:

	Thirty-Nine Weeks Ended	
(In thousands)	November 1, 2014	November 2, 2013
Supplemental disclosure of cash flow information:		
Cash paid for interest, including capital leases	$825	$1,858
Cash paid for income taxes, excluding impact of refunds	69,573	122,012
Gross proceeds from borrowings under the bank credit facility	1,131,900	970,000
Gross repayments of borrowings under the bank credit facility	925,500	817,200
Non-cash activity:		
Assets acquired under capital leases	11,317	—
Accrued property and equipment	11,557	9,018
Share repurchases payable	$10,642	$—

Reclassifications

Wholesale Business

During the fourth quarter of 2013, we executed our wind down plan and ceased the operations of our wholesale business. Therefore, we determined that the results of our wholesale business should be reported as discontinued operations. As such, we have reclassified our results for all periods presented. Please see the Wholesale Business section of note 11 and note 12 to the consolidated financial statements for further discussion of the wind down of our wholesale business and the costs we incurred in connection with the wind down during the year-to-date 2014.

Canadian Operations

During the first quarter of 2014, we executed the remainder of our wind down plan and ceased the operations of our former Canadian segment. Therefore, we determined that the results of our former Canadian segment should be reported as discontinued operations. As such, we have reclassified our results for all periods presented. Please see the Canadian Operations section of note 11 and note 12 to the consolidated financial statements for further discussion of the wind down of our Canadian operations and the costs we incurred in connection with the wind down during the year-to-date 2014.

Merchandise Categories

In the fourth quarter of 2013, we realigned select merchandise categories to be consistent with the realignment of our merchandising team and changes to our management reporting. We now use the following merchandise categories, which match our internal management and reporting of merchandise net sales: Food, Consumables, Soft Home, Hard Home, Furniture & Home Décor, Seasonal, and Electronics & Accessories. The Food category includes our beverage

& grocery, candy & snacks, and specialty foods departments. The Consumables category includes our health and beauty, plastics, paper, chemical, and pet departments. The Soft Home category includes the fashion bedding, utility bedding, bath, window, decorative textile, and flooring departments. The Hard Home category includes our small appliances, table top, food preparation, stationery, greeting card, tools, paint, and home maintenance departments. The Furniture & Home Décor category includes our upholstery, mattress, ready-to-assemble, case goods, home décor, and frames departments. The Seasonal category includes our lawn & garden, summer, Christmas, toys, books, sporting goods, and other holiday departments. The Electronics & Accessories category includes the electronics, jewelry, apparel, hosiery, and infant accessories departments. In order to provide comparative information, we have reclassified our net sales by merchandise category into the new alignment for all periods presented in note 9 to the consolidated financial statements.

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We periodically make minor adjustments to our product hierarchy, which can impact the roll-up of our merchandise categories. Our financial reporting process utilizes the most current product hierarchy in reporting net sales by merchandise category for all periods presented. Therefore, there may be minor reclassifications of net sales by merchandise category compared to previously reported amounts.

Recent Accounting Pronouncements
There are currently no new accounting pronouncements with a future effective date that are of significance, or potential significance, to us.

NOTE 2 – BANK CREDIT FACILITY

On July 22, 2011, we entered into a $700 million five-year unsecured credit facility and, on May 30, 2013, we entered into an amendment of the credit facility that extended its expiration from July 22, 2016 to May 30, 2018 (“2011 Credit Agreement”). In connection with our entry into the 2011 Credit Agreement, we paid bank fees and other expenses in the aggregate amount of $3.0 million, which are being amortized over the term of the agreement. In connection with the amendment of the 2011 Credit Agreement, we paid additional bank fees and other expenses in the aggregate amount of $0.9 million, which are being amortized over the term of the amended agreement.

Borrowings under the 2011 Credit Agreement are available for general corporate purposes and working capital. The 2011 Credit Agreement includes a $30 million swing loan sublimit and a $150 million letter of credit sublimit. The interest rates, pricing and fees under the 2011 Credit Agreement fluctuate based on our debt rating. The 2011 Credit Agreement allows us to select our interest rate for each borrowing from multiple interest rate options. The interest rate options are generally derived from the prime rate or LIBOR. We may prepay revolving loans made under the 2011 Credit Agreement. The 2011 Credit Agreement contains financial and other covenants, including, but not limited to, limitations on indebtedness, liens and investments, as well as the maintenance of two financial ratios – a leverage ratio and a fixed charge coverage ratio. A violation of any of the covenants could result in a default under the 2011 Credit Agreement that would permit the lenders to restrict our ability to further access the 2011 Credit Agreement for loans and letters of credit and require the immediate repayment of any outstanding loans under the 2011 Credit Agreement. At November 1, 2014, we had $283.4 million of borrowings outstanding under the 2011 Credit Agreement and $11.2 million was committed to outstanding letters of credit, leaving $405.4 million available under the 2011 Credit Agreement.

NOTE 3 – FAIR VALUE MEASUREMENTS

In connection with our nonqualified deferred compensation plan, we had mutual fund investments of $16.8 million and $21.2 million at November 1, 2014 and February 1, 2014, respectively, which were recorded in other assets. These investments were classified as trading securities and were recorded at their fair value. The fair values of mutual fund investments were Level 1 valuations under the fair value hierarchy because each fund’s quoted market value per share was available in an active market.

The fair values of our long-term obligations are estimated based on the quoted market prices for the same or similar issues and the current interest rates offered for similar instruments. These fair value measurements are classified as Level 2 within the fair value hierarchy. Given the variable rate features and relatively short maturity of the instruments underlying our long-term obligations, the carrying value of these instruments approximates the fair value.

The carrying value of accounts receivable, accounts payable, and accrued expenses approximates fair value because of the relatively short maturity of these items.

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NOTE 4 – SHAREHOLDERS' EQUITY

Earnings per Share
There were no adjustments required to be made to the weighted-average common shares outstanding for purposes of computing basic and diluted earnings per share and there were no securities outstanding at November 1, 2014 or November 2, 2013 which were excluded from the computation of earnings per share other than antidilutive stock options, restricted stock awards, and restricted stock units. For the third quarter of 2014 and the third quarter of 2013, 0.6 million and 2.4 million, respectively, of the stock options outstanding were antidilutive and excluded from the computation of diluted earnings per share. For the year-to-date 2014 and the year-to-date 2013, 1.7 million and 2.8 million, respectively, of the stock options outstanding were antidilutive and excluded from the computation of diluted earnings per share. Antidilutive stock options generally consist of outstanding stock options where the exercise price per share is greater than the weighted-average market price per share for our common shares for each period. Antidilutive stock options, restricted stock awards, and restricted stock units are excluded from the calculation because they decrease the number of diluted shares outstanding under the treasury stock method. The restricted stock awards and restricted stock units that were antidilutive, as determined under the treasury stock method, were immaterial for all periods presented.

Share Repurchase Programs
On March 5, 2014, our Board of Directors authorized a share repurchase program providing for the repurchase of $125 million of our common shares ("March 2014 Repurchase Program"). The March 2014 Repurchase Program was exhausted during the second quarter of 2014.

On August 28, 2014, our Board of Directors authorized a new share repurchase program providing for the repurchase of $125 million of our common shares ("August 2014 Repurchase Program"). Pursuant to the August 2014 Repurchase Program, we may repurchase shares in the open market and/or in privately negotiated transactions at our discretion, subject to market conditions and other factors. Common shares acquired through the August 2014 Repurchase Program will be available to meet obligations under our equity compensation plans and for general corporate purposes.

During the third quarter of 2014, we acquired approximately 2.6 million of our outstanding common shares for $114.8 million. During the year-to-date 2014, we have acquired approximately 5.9 million of our outstanding common shares for $239.8 million, which is comprised of 3.3 million common shares for $125.0 million under the March 2014 Repurchase Program and 2.6 million common shares for $114.8 million under the August 2014 Repurchase Program.

Dividends
In the second quarter of 2014, our Board of Directors commenced a cash dividend program under which we currently expect to pay quarterly dividends on our common shares in the future. The Company declared and paid cash dividends per common share during the periods presented as follows:

	Dividends Per Share	Amount Declared	Amount Paid
2014:		(in thousands)	(in thousands)
Third quarter	$0.17	$9,718	$9,457
Second quarter	0.17	9,585	9,366
Total	$0.34	$19,303	$18,823

The amount of dividends declared may vary from the amount of dividends paid in a period based on certain instruments with restrictions on payment, including restricted stock awards, restricted stock units, and performance share units. Future dividends are subject to declaration by our Board of Directors.

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NOTE 5 – SHARE-BASED PLANS

We have issued nonqualified stock options, restricted stock awards, restricted stock units, and performance share units under our shareholder-approved equity compensation plans. Our restricted stock awards and restricted stock units, as described below and/or in note 7 to the consolidated financial statements in our 2013 Form 10-K, are expensed and reported as nonvested shares. We recognized share-based compensation expense of $3.0 million and $3.7 million in the third quarter of 2014 and the third quarter of 2013, respectively, and $8.0 million and $11.5 million for the year-to-date 2014 and the year-to-date 2013, respectively.

The weighted-average fair value of stock options granted and assumptions used in the model to estimate the fair value of stock options granted during each of the respective periods were as follows:

	Third Quarter 2013	Year-to-Date 2013
Weighted-average fair value of stock options granted	$ 11.83	$ 12.08
Risk-free interest rate	1.1 %	0.7 %
Expected life (years)	4.2	4.2
Expected volatility	39.9 %	42.1 %
Expected annual forfeiture rate	3.0 %	3.0 %

During the year-to-date 2014, we granted no stock options.

The following table summarizes stock option activity for the year-to-date 2014:

	Number of Options	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (000's)
Outstanding stock options at February 1, 2014	3,377,303	$ 34.88		
Exercised	(243,218)	26.90		
Forfeited	(139,850)	38.63		
Outstanding stock options at May 3, 2014	2,994,235	$ 35.35	4.2	$ 16,314
Exercised	(464,400)	36.73		
Forfeited	(50,700)	40.35		
Outstanding stock options at August 2, 2014	2,479,135	$ 35.00	4.1	$ 20,850
Exercised	(541,797)	25.75		
Forfeited	(72,500)	39.15		
Outstanding stock options at November 1, 2014	1,864,838	$ 37.52	4.3	$ 15,162
Vested or expected to vest at November 1, 2014	1,775,684	$ 37.48	4.2	$ 14,515
Exercisable at November 1, 2014	895,774	$ 36.89	3.5	$ 7,845

The stock options granted in prior years vest in equal amounts on the first four anniversaries of the grant date and have a contractual term of seven years. The number of stock options expected to vest was based on our annual forfeiture rate assumption.

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The following table summarizes the non-vested restricted stock awards and restricted stock units activity for the year-to-date 2014:

	Number of Shares	Weighted Average Grant-Date Fair Value Per Share
Outstanding non-vested restricted stock at February 1, 2014	664,101	$38.34
Granted	281,056	37.12
Vested	(13,500)	34.75
Forfeited	(99,200)	40.19
Outstanding non-vested restricted stock at May 3, 2014	832,457	$37.77
Granted	32,987	42.86
Vested	(23,776)	33.65
Forfeited	(22,490)	39.61
Outstanding non-vested restricted stock at August 2, 2014	819,178	$38.04
Granted	2,012	43.87
Vested	(31,000)	34.75
Forfeited	(28,990)	38.84
Outstanding non-vested restricted stock at November 1, 2014	761,200	$38.16

The non-vested restricted stock units granted in the year-to-date 2014 generally vest on a ratable basis over three years from the grant date of the award, if certain threshold financial performance objectives are achieved and the grantee remains employed by us through the vesting dates.

The non-vested restricted stock awards granted in prior years vest if certain financial performance objectives are achieved. If we meet a threshold financial performance objective and the grantee remains employed by us, the restricted stock will vest on the opening of our first trading window five years after the grant date of the award. If we meet a higher financial performance objective and the grantee remains employed by us, the restricted stock will vest on the first trading day after we file our Annual Report on Form 10-K with the SEC for the fiscal year in which the higher objective is met. As of February 1, 2014, we estimated a five-year period for vesting of all non-vested restricted stock awards granted in prior years, as we do not anticipate achieving the higher financial performance objective for any outstanding grants.

In 2013, in connection with his appointment as CEO and President, Mr. David J. Campisi was awarded 37,800 performance share units, which vest based on the achievement of share price performance goals, that had a weighted average grant-date fair value per share of $34.68. The performance share units have a contractual term of seven years. In the second quarter of 2014, Mr. Campisi’s first tranche of 12,600 performance share units vested. In the third quarter of 2014, Mr. Campisi’s second tranche of 12,600 performance share units vested. If the performance goals applicable to the remaining performance share units are not achieved prior to expiration, the awards will be forfeited. A total of 12,600 performance share units remain outstanding at November 1, 2014.

In the year-to-date 2014, we issued 434,124 performance share units, net of forfeitures, to certain members of management, which vest if certain financial performance objectives are achieved over a three-year performance period and the grantee remains employed by us during that period. The financial performance objectives for each fiscal year within the three-year performance period are approved by the Compensation Committee of our Board of Directors during the first quarter of the respective fiscal year. As a result of the process used to establish the financial performance objectives, we will only meet the requirements of establishing a grant date for the performance share units when we communicate the financial performance objectives for the third fiscal year of the award to the award recipients, which will then trigger the service inception date, the fair value of the awards, and the associated expense recognition period. Therefore, we have recognized no expense for these issued performance share units in the year-to-date 2014. If we meet the applicable threshold financial performance objectives over the three-year performance period and the grantee remains employed by us through the end of the performance period, the performance share units will vest on the first trading day after we file our Annual Report on Form 10-K three years after the initial issuance of the award.

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In the second quarter of 2014, 23,776 common shares underlying the restricted stock awards granted in 2013 to the non-employee members of our Board of Directors vested on the trading day immediately preceding our 2014 Annual Meeting of Shareholders. These awards were part of the annual compensation granted in 2013 to the non-employee members of the Board of Directors. Additionally, in the second quarter of 2014, each non-employee elected to our Board of Directors at our 2014 Annual Meeting of Shareholders received an annual restricted stock award having a grant date fair value of approximately $110,000. The 2014 restricted stock awards will vest on the earlier of (1) the trading day immediately preceding our 2015 Annual Meeting of Shareholders, or (2) the non-employee director's death or disability. However, the restricted stock award will not vest if the non-employee director ceases to serve on our Board of Directors before either vesting event occurs.

The following activity occurred under our share-based plans during the respective periods shown:

	Third Quarter		Year-to-Date	
(In thousands)	2014	2013	2014	2013
Total intrinsic value of stock options exercised	$11,050	$625	$16,980	$2,414
Total fair value of restricted stock vested	1,325	—	2,736	1,434
Total fair value of performance shares vested	585	—	1,143	—

The total unearned compensation cost related to all share-based awards outstanding at November 1, 2014 was approximately $23.8 million. This compensation cost is expected to be recognized through January 2019 based on existing vesting terms with the weighted-average remaining expense recognition period being approximately 2.0 years from November 1, 2014.

NOTE 6 – EMPLOYEE BENEFIT PLANS

We maintain a qualified defined benefit pension plan and a nonqualified supplemental defined benefit pension plan covering certain employees whose hire date occurred before April 1, 1994.

The weighted-average assumptions used to determine net periodic pension cost for our plans were as follows:

	2014	2013
Discount rate	5.0 %	4.6 %
Rate of increase in compensation levels	3.0 %	3.5 %
Expected long-term rate of return	6.0 %	5.1 %

The components of combined net periodic pension cost were as follows:

	Third Quarter		Year-to-Date	
(In thousands)	2014	2013	2014	2013
Service cost - benefits earned in the period	$489	$521	$1,463	$1,564
Interest cost on projected benefit obligation	799	761	2,413	2,281
Expected investment return on plan assets	(804)	(723)	(2,414)	(2,170)
Amortization of actuarial loss	380	423	1,123	1,269
Amortization of prior service cost	(9)	(9)	(26)	(26)
Amortization of transition obligation	—	3	—	9
Settlement loss	164	83	164	83
Net periodic pension cost	$1,019	$1,059	$2,723	$3,010

We currently expect no required contributions to the qualified defined benefit pension plan during 2014. We will contribute to the nonqualified supplemental defined benefit pension plan as benefits are paid to plan participants, if any, because the nonqualified plan is not a funded plan.

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NOTE 7 – INCOME TAXES

In conjunction with the wind down of our former Canadian segment, our Canadian subsidiary was dissolved during the second quarter of 2014 which resulted in a write-off of the net deferred tax assets (including a net operating loss carryforward) for the Canadian jurisdiction and a release of the corresponding valuation allowance.

We have estimated the reasonably possible expected net change in unrecognized tax benefits through October 31, 2015, based on (1) expected cash and noncash settlements or payments of uncertain tax positions, and (2) lapses of the applicable statutes of limitations for unrecognized tax benefits. The estimated net decrease in unrecognized tax benefits for the next 12 months is approximately $4.0 million. Actual results may differ materially from this estimate.

NOTE 8 – CONTINGENCIES

On May 21, May 22 and July 2, 2012, three shareholder derivative lawsuits were filed in the U.S. District Court for the Southern District of Ohio against us and certain of our current and former outside directors and executive officers (Jeffrey Berger, David Kollat, Brenda Lauderback, Philip Mallott, Russell Solt, Dennis Tishkoff, Robert Claxton, Joe Cooper, Steven Fishman, Charles Haubiel, Timothy Johnson, John Martin, Norman Rankin, Paul Schroeder, Robert Segal and Steven Smart). The lawsuits were consolidated, and, on August 13, 2012, plaintiffs filed a consolidated complaint, which generally alleges that the individual defendants traded in our common shares based on material, nonpublic information concerning our guidance for fiscal 2012 and the first quarter of fiscal 2012 and the director defendants failed to suspend our share repurchase program during such trading activity. The consolidated complaint asserts claims under Ohio law for breach of fiduciary duty, unjust enrichment, misappropriation of trade secrets and corporate waste and seeks declaratory relief and disgorgement to us of proceeds from any wrongful sales of our common shares, plus attorneys' fees and expenses. The defendants have filed a motion to dismiss the consolidated complaint, and that motion is fully briefed and awaiting a decision.

We received a letter dated January 28, 2013, sent on behalf of a shareholder demanding that our Board of Directors investigate and take action in connection with the allegations made in the derivative and securities lawsuits described above. The shareholder indicated that he would commence a derivative lawsuit if our Board of Directors failed to take the demanded action. On March 6, 2013, our Board of Directors referred the shareholder's letter to a committee of independent directors to investigate the matter. That committee, with the assistance of independent outside counsel, investigated the allegations in the shareholder's demand letter and, on August 28, 2013, reported its findings to our Board of Directors along with its recommendation that the Board reject the shareholder's demand. Our Board of Directors unanimously accepted the recommendation of the demand investigation committee and, on September 9, 2013, outside counsel for the committee sent a letter to counsel for the shareholder informing the shareholder of the Board's determination. On October 18, 2013, the shareholder filed a derivative lawsuit in the U.S. District Court for the Southern District of Ohio against us and each of the current and former outside directors and executive officers named in the 2012 shareholder derivative lawsuit. The plaintiff's complaint generally alleges that the individual defendants traded in our common shares based on material, nonpublic information concerning our guidance for fiscal 2012 and the first quarter of fiscal 2012 and the director defendants failed to suspend our share repurchase program during such trading activity. The complaint asserts claims under Ohio law for breach of fiduciary duty, unjust enrichment, abuse of control, gross mismanagement, corporate waste and misappropriation of trade secrets and seeks damages, injunctive relief and disgorgement to us of proceeds from any wrongful sales of our common shares, plus attorneys' fees and expenses. The defendants have filed a motion to dismiss the complaint, and that motion is fully briefed and awaiting a decision.

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On February 10, 2014, a shareholder derivative lawsuit was filed in the Franklin County Common Pleas Court in Columbus, Ohio, against us and certain of our current and former outside directors and executive officers (David Campisi, Steven Fishman, Joe Cooper, Charles Haubiel, Timothy Johnson, Robert Claxton, John Martin, Norman Rankin, Paul Schroeder, Robert Segal, Steven Smart, David Kollat, Jeffrey Berger, James Chambers, Peter Hayes, Brenda Lauderback, Philip Mallott, Russell Solt, James Tener and Dennis Tishkoff). The plaintiff's complaint generally alleges that the individual defendants traded in our common shares based on material, nonpublic information concerning our guidance for fiscal 2012 and the first quarter of fiscal 2012 and the director defendants failed to suspend our share repurchase program during such trading activity. The complaint also alleges that we and various individual defendants made false and misleading statements regarding our Canadian operations prior to our announcement on December 5, 2013 that we were exiting the Canadian market. The complaint asserts claims under Ohio law for breach of fiduciary duty, unjust enrichment, waste of corporate assets and misappropriation of insider information and seeks damages, injunctive relief and disgorgement to us of proceeds from any wrongful sales of our common shares, plus attorneys' fees and expenses. At the parties' request, the court has stayed this lawsuit until after the judge in the federal lawsuits discussed in the preceding paragraphs has ruled on the motions to dismiss pending in those federal lawsuits.

On July 9, 2012, a putative securities class action lawsuit was filed in the U.S. District Court for the Southern District of Ohio on behalf of persons who acquired our common shares between February 2, 2012 and April 23, 2012. This lawsuit was filed against us, Lisa Bachmann, Mr. Cooper, Mr. Fishman and Mr. Haubiel. The complaint in the putative class action generally alleges that the defendants made statements concerning our financial performance that were false or misleading. The complaint asserts claims under sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 and seeks damages in an unspecified amount, plus attorneys' fees and expenses. The lead plaintiff filed an amended complaint on April 4, 2013, which added Mr. Johnson as a defendant, removed Ms. Bachmann as a defendant, and extended the putative class period to August 23, 2012. The defendants have filed a motion to dismiss the putative class action complaint, and that motion is fully briefed and awaiting a decision.

We believe that the shareholder derivative and putative class action lawsuits are without merit, and we intend to defend ourselves vigorously against the allegations levied in these lawsuits. While a loss from these lawsuits is reasonably possible, at this time, we cannot reasonably estimate the amount of any loss that may result or whether the lawsuits will have a material impact on our financial statements.

On June 13, 2013, we received a voluntary document request from the Division of Enforcement of the SEC relating principally to our participation in investor and analyst meetings in the first fiscal quarter of 2012. We have produced documents and are cooperating with the SEC's investigation, which is ongoing.

On October 1, 2013, we received a subpoena from the District Attorney for the County of Alameda, State of California, seeking information concerning our handling of hazardous materials and hazardous waste in the State of California. We have provided information and are cooperating with the authorities from multiple counties and cities in California in connection with this ongoing matter. While a loss related to this matter is reasonably possible, at this time, we cannot reasonably estimate the possible loss or range of loss that may arise from this matter or whether this matter will have a material impact on our financial statements.

We are involved in other legal actions and claims arising in the ordinary course of business. We currently believe that each such action and claim will be resolved without a material effect on our financial condition, results of operations, or liquidity. However, litigation involves an element of uncertainty. Future developments could cause these actions or claims to have a material effect on our financial condition, results of operations, and liquidity.

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NOTE 9 – BUSINESS SEGMENT DATA

We use the following seven merchandise categories, which match our internal management and reporting of merchandise net sales: Food, Consumables, Soft Home, Hard Home, Furniture & Home Décor, Seasonal, and Electronics & Accessories. The Food category includes our beverage & grocery, candy & snacks, and specialty foods departments. The Consumables category includes our health and beauty, plastics, paper, chemical, and pet departments. The Soft Home category includes the fashion bedding, utility bedding, bath, window, decorative textile, and flooring departments. The Hard Home category includes our small appliances, table top, food preparation, stationery, greeting card, tools, paint, and home maintenance departments. The Furniture & Home Décor category includes our upholstery, mattress, ready-to-assemble, case goods, home décor, and frames departments. The Seasonal category includes our lawn & garden, summer, Christmas, toys, books, sporting goods, and other holiday departments. The Electronics & Accessories category includes the electronics, jewelry, apparel, hosiery, and infant accessories departments.

The following table presents net sales data by merchandise category:

	Third Quarter		Year-to-Date	
(In thousands)	2014	2013	2014	2013
Furniture & Home Décor	$270,242	$246,093	$843,952	$796,178
Consumables	230,191	226,420	693,102	671,603
Food	202,352	185,959	584,762	530,216
Hard Home	115,414	132,498	338,187	394,542
Soft Home	110,292	105,286	328,398	305,468
Seasonal	95,942	106,951	549,200	552,349
Electronics & Accessories	82,662	101,711	246,128	302,487
Net sales	$1,107,095	$1,104,918	$3,583,729	$3,552,843

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NOTE 10 – COMPONENTS OF ACCUMULATED OTHER COMPREHENSIVE LOSS

The following table summarizes the components of accumulated other comprehensive loss, net of tax, during 2013 and 2014:

(In thousands)	Foreign currency translation	Pension Plan	Total accumulated other comprehensive loss
Balance at February 2, 2013	$(1,433)	$(11,897)	$(13,330)
Other comprehensive income before reclassifications	(2,189)	50	(2,139)
Amounts reclassified from accumulated other comprehensive loss	—	751	751
Net period change	(2,189)	801	(1,388)
Balance at November 2, 2013	(3,622)	(11,096)	(14,718)
Other comprehensive income before reclassifications	(1,400)	2,302	902
Amounts reclassified from accumulated other comprehensive loss	—	305	305
Net period change	(1,400)	2,607	1,207
Balance at February 1, 2014	(5,022)	(8,489)	(13,511)
Other comprehensive income before reclassifications	(39)	(368)	(407)
Amounts reclassified from accumulated other comprehensive loss	5,061	727	5,788
Net period change	5,022	359	5,381
Balance at November 1, 2014	$—	$(8,130)	$(8,130)

The following table summarizes the components of accumulated other comprehensive loss, net of tax, during the third quarter of 2013:

(In thousands)	Foreign currency translation	Pension Plan	Total accumulated other comprehensive loss
Balance at August 3, 2013	$(3,398)	$(11,398)	$(14,796)
Other comprehensive income before reclassifications	(224)	50	(174)
Amounts reclassified from accumulated other comprehensive loss	—	252	252
Net period change	(224)	302	78
Balance at November 2, 2013	$(3,622)	$(11,096)	$(14,718)

The following table summarizes the components of accumulated other comprehensive loss, net of tax, during the third quarter of 2014:

(In thousands)	Foreign currency translation	Pension Plan	Total accumulated other comprehensive loss
Balance at August 2, 2014	$—	$(8,066)	$(8,066)
Other comprehensive income before reclassifications	—	(368)	(368)
	—	304	304

Amounts reclassified from accumulated other comprehensive loss			
Net period change	—	(64)	(64)
Balance at November 1, 2014	$—	$(8,130)	$(8,130)

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The amounts reclassified from accumulated other comprehensive income associated with our pension plans have been reclassified to selling and administrative expenses in our statements of operations. Please see note 6 to the consolidated financial statements for further information on our pension plans.

The amounts reclassified from accumulated other comprehensive income associated with foreign currency translation have been reclassified to income (loss) from discontinued operations in our statements of operations, as the amounts related to our Canadian operations. Please see note 12 to the consolidated financial statements for further information on our discontinued operations.

NOTE 11 – COSTS ASSOCIATED WITH WIND DOWN ACTIVITIES

Wholesale Business
During the third quarter of 2013, we announced our intention to wind down the operations of our wholesale business during the fourth quarter of 2013. At that time, we recorded a severance charge for this exit activity. During the fourth quarter of 2013, we closed the leased facilities in which we operated our wholesale business, recorded contract termination costs, and fully paid those obligations.

In the fourth quarter of 2013 we established a liability of $0.5 million for severance related cost associated with the wind down of our wholesale business. During the six months ended August 2, 2014 we paid $0.5 million in severance cost reducing the liability to zero at August 2, 2014. We anticipate no additional charges associated with the wind down of the operations of our wholesale business.

As the operations of the wholesale business had ceased as of February 1, 2014, the results of operations of the wholesale business were reclassified to discontinued operations. Please see the Wholesale Business section of note 12 to the consolidated financial statements for further information regarding this discontinued operation.

Canadian Operations
During the fourth quarter of 2013, we announced our intention to wind down the operations of our former Canadian segment. We conducted detailed evaluations of our long range strategic objectives and performed a preliminary review of our 2014 financial plan. As a result of this evaluation and review, we determined our Canadian operations did not fit into our strategic plan for maximizing long-term shareholder returns based on our expectations of the required investments necessary to improve our Canadian operations' financial performance, both in the near and long-term. During the fourth quarter of 2013, we began a markdown strategy with the intent to liquidate our inventory prior to closing our stores. At February 1, 2014, we revalued our inventory at our net realizable value based on estimated cash proceeds prior to closing, which represents our estimate of its market value. During the fourth quarter of 2013, we also conducted a review of our long lived assets. We determined that the elimination of future cash flows from our operations beyond the first quarter of 2014 resulted in the impairment of our property and equipment and our tradename intangible assets. Additionally, we conducted an impairment review of our goodwill associated with our Canadian operations, determined that the goodwill had been fully impaired, and we recorded an impairment charge.

The wind down of our Canadian operations was separated into two phases: our distribution centers and our stores. During the fourth quarter of 2013, we ceased the operations of our Canadian distribution centers, as receiving, processing, and distributing activities were completed. We recorded a severance charge of approximately $2.7 million relating to the closure of our distribution centers and certain administrative activities. Additionally, with the closure of certain leased distribution centers, we recorded contract termination costs of approximately $1.3 million.

During the first quarter of 2014, we closed all of our stores, ceased their operations, and closed our Canadian corporate office. We recorded severance and contract termination costs of approximately $2.2 million and $23.0 million relating to the closure of our stores and our remaining administrative activities, respectively. In addition, in connection with the substantial completion of the wind down activities, we recorded a foreign currency translation loss of $5.1 million, which related to the realization of the cumulative translation adjustment on our investment in our Canadian operations.

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The following table summarizes the components of our wind down activities associated with our Canadian operations and the activities within the related liabilities during 2014:

(In thousands)	Severance	Contract Termination Costs	Total
Balance at February 1, 2014	$2,420	$1,276	$3,696
Charges	2,206	22,984	25,190
Adjustments	—	553	553
Payments	(3,997)	(15,577)	(19,574)
Foreign currency translation	(38)	74	36
Period change	(1,829)	8,034	6,205
Balance at May 3, 2014	$591	$9,310	$9,901
Charges	—	28	28
Adjustments	—	(335)	(335)
Payments	(591)	(7,942)	(8,533)
Foreign currency translation	—	95	95
Period change	(591)	(8,154)	(8,745)
Balance at August 2, 2014	$—	$1,156	$1,156
Charges	—	114	114
Adjustments	—	—	—
Payments	—	(1,012)	(1,012)
Foreign currency translation	—	(8)	(8)
Period change	—	(906)	(906)
Balance at November 1, 2014	$—	$250	$250

During February 2014, we closed all of our Canadian stores, terminated all remaining Canadian employees, and accrued an obligation for the associated severance and contract termination costs. As of November 1, 2014, we anticipate any future charges associated with the wind down of our Canadian operations will be immaterial. As our Canadian operations had ceased as of May 3, 2014, the results of our Canadian operations were reclassified to discontinued operations. Please see the Canadian Operations section of note 12 to the consolidated financial statements for further information regarding this discontinued operation.

NOTE 12 – DISCONTINUED OPERATIONS

Our discontinued operations for the third quarter and year-to-date of 2014 and 2013 were comprised of the following:

	Third Quarter		Year-to-Date	
(In thousands	2014	2013	2014	2013
Canadian operations	$(475)	$(4,977)	$(35,629)	$(13,269)
Wholesale business	(58)	(4,296)	(216)	(4,697)
KB Toys matters	—	—	9	—
Other	—	—	—	1
Total loss from discontinued operations, pretax	$(533)	$(9,273)	$(35,836)	$(17,965)

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Canadian Operations

During the fourth quarter of 2013, we announced our intention to wind down our Canadian operations. We began the wind down activities during the fourth quarter of 2013, which included the closing of our Canadian distribution centers, and completed the wind down activities during the first quarter of 2014, which included the closing of our Canadian stores and corporate offices. Therefore, we determined the results of our Canadian operations should be reported as discontinued operations for all periods presented. The results of our Canadian operations have historically consisted of sales of product to retail customers, the costs associated with those products, and selling and administrative expenses, including personnel, purchasing, warehousing, distribution, occupancy and overhead costs. During the year-to-date 2014, the results of our Canadian operations also included significant contract termination costs associated with the wind down of the operations. Please see the Canadian Operations section of note 11 to the consolidated financial statements for additional details regarding the costs we incurred in connection with the wind down of our Canadian operations during the year-to-date 2014.

In addition to the costs associated with our Canadian operations, we reclassified to discontinued operations the direct expenses incurred by our U.S. operations to facilitate the wind down. These costs primarily consist of professional fees. We also reclassified the income tax benefit that we expect our U.S. operations to generate as a result of the wind down of our Canadian operations, based on our ability to recover a worthless stock deduction in the foreseeable future. During the third quarter of 2014 and the year-to-date 2014, the amount of this income tax benefit that we recognized was approximately $0.2 million and $12.9 million, respectively.

Wholesale Business

During the third quarter of 2013, we announced our intention to wind down the operations of our wholesale business, within our U.S. segment. During the fourth quarter of 2013, we executed our wind down plan and ceased the operations of our wholesale business. Therefore, we determined that the results of our wholesale business should be reported as discontinued operations for all periods presented. The results of operations of our wholesale business primarily consisted of sales of product to wholesale customers, the costs associated with those products, and selling and administrative expenses, including personnel, purchasing, warehousing, distribution, occupancy and overhead costs. Please see the Wholesale Business section of note 11 to the consolidated financial statements for additional details regarding the costs we incurred in connection with the wind down of our wholesale business during the year-to-date 2014.

KB Toys Matters

We acquired the KB Toys business from Melville Corporation (now known as CVS New York, Inc., and, together with its subsidiaries, “CVS”) in May 1996. As part of that acquisition, we provided, among other things, an indemnity to CVS with respect to any losses resulting from KB Toys' failure to pay all monies due and owing under any KB Toys lease or mortgage obligation. While we controlled the KB Toys business, we provided guarantees with respect to a limited number of additional KB Toys store leases. We sold the KB Toys business to KB Acquisition Corp. (“KBAC”), an affiliate of Bain Capital, pursuant to a Stock Purchase Agreement. KBAC similarly agreed to indemnify us with respect to all lease and mortgage obligations. On January 14, 2004, KBAC and certain affiliated entities (collectively referred to as “KB-I”) filed for bankruptcy protection pursuant to Chapter 11 of title 11 of the United States Code. On August 30, 2005, in connection with the acquisition by an affiliate of Prentice Capital Management of majority ownership of KB-I, KB-I emerged from its 2004 bankruptcy (the KB Toys business that emerged from bankruptcy is hereinafter referred to as “KB-II”). On December 11, 2008, KB-II filed for bankruptcy protection pursuant to Chapter 11 of title 11 of the United States Code.

Associated with the KB-I and KB-II bankruptcies, we believed we had exposure to certain lease obligations for which we had recorded estimated liabilities in prior years. During the fourth quarter of 2013, we received a final distribution from the KB-I bankruptcy estate. Additionally, in the fourth quarter of 2013, we reduced the amount of our estimated obligation associated with the KB-II bankruptcy to zero in our consolidated balance sheet. We based this reversal on the following factors: (1) we had not received any new demand letters from landlords during the past two years; (2) all prior demands against us by landlords had been settled or paid or the landlords had stopped pursuing their demands; (3) the KB-II bankruptcy occurred more than five years prior to the end of 2008 and most of the lease rejections occurred more than two years prior to the end of 2013; and (4) we believed that the likelihood of new claims against us was remote and, if incurred, the amount would be immaterial.

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

CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS FOR PURPOSES OF THE SAFE HARBOR PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

The Private Securities Litigation Reform Act of 1995 (“Act”) provides a safe harbor for forward-looking statements to encourage companies to provide prospective information, so long as those statements are identified as forward-looking and are accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those discussed in the statements. We wish to take advantage of the “safe harbor” provisions of the Act.

Certain statements in this report are forward-looking statements within the meaning of the Act, and such statements are intended to qualify for the protection of the safe harbor provided by the Act. The words “anticipate,” “estimate,” “expect,” “objective,” “goal,” “project,” “intend,” “plan,” “believe,” “will,” “should,” “may,” “target,” “forecast,” “guidance,” expressions generally identify forward-looking statements. Similarly, descriptions of our objectives, strategies, plans, goals or targets are also forward-looking statements. Forward-looking statements relate to the expectations of management as to future occurrences and trends, including statements expressing optimism or pessimism about future operating results or events and projected sales, earnings, capital expenditures and business strategy. Forward-looking statements are based upon a number of assumptions concerning future conditions that may ultimately prove to be inaccurate. Forward-looking statements are and will be based upon management's then-current views and assumptions regarding future events and operating performance, and are applicable only as of the dates of such statements. Although we believe the expectations expressed in forward-looking statements are based on reasonable assumptions within the bounds of our knowledge, forward-looking statements, by their nature, involve risks, uncertainties and other factors, any one or a combination of which could materially affect our business, financial condition, results of operations or liquidity.

Forward-looking statements that we make herein and in other reports and releases are not guarantees of future performance and actual results may differ materially from those discussed in such forward-looking statements as a result of various factors, including, but not limited to, the current economic and credit conditions, the cost of goods, our inability to successfully execute strategic initiatives, competitive pressures, economic pressures on our customers and us, the availability of brand name closeout merchandise, trade restrictions, freight costs, the risks discussed in the Risk Factors section of our most recent Annual Report on Form 10-K, and other factors discussed from time to time in our other filings with the SEC, including Quarterly Reports on Form 10-Q and Current Reports on Form 8-K. This report should be read in conjunction with such filings, and you should consider all of these risks, uncertainties and other factors carefully in evaluating forward-looking statements.

Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date they are made. We undertake no obligation to publicly update forward-looking statements whether as a result of new information, future events or otherwise. Readers are advised, however, to consult any further disclosures we make on related subjects in our public announcements and SEC filings.

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OVERVIEW

The discussion and analysis presented below should be read in conjunction with the accompanying consolidated financial statements and related notes. Each term defined in the notes has the same meaning in this item and the balance of this report.

The following are the results from the third quarter of 2014 that we believe are key indicators of our operating performance when compared to our operating performance from the third quarter of 2013:

- Net sales increased $2.2 million, or 0.2%.
- Comparable store sales for stores open at least fifteen months increased $14.2 million, or 1.4%.
- Gross margin dollars decreased $0.5 million, and gross margin rate decreased 10 basis points from 39.0% to 38.9% of sales.
- Selling and administrative expenses decreased $0.6 million. As a percentage of net sales, selling and administrative expenses decreased 10 basis points to 36.6% of net sales.
- Operating loss rate increased 10 basis points to 0.4%.
- Diluted loss per share from continuing operations increased from $(0.03) per share to $(0.06) per share.
- Inventory decreased by 13.1% or $162.7 million to $1,075.4 million from the third quarter of 2013.
- We acquired 2.6 million of our outstanding common shares for $114.8 million under our August 2014 Repurchase Program.
- We declared and paid a quarterly cash dividend in the amount of $0.17 per common share.

See the discussion and analysis below for additional details regarding our operating results.

STORES

During the first quarter of 2014, we ceased our Canadian operations and closed all Canadian stores. The following table presents stores opened and closed in the U.S. during the year-to-date 2014 and the year-to-date 2013:

	2014	2013
Stores open at the beginning of the fiscal year	1,493	1,495
Stores opened during the period	24	52
Stores closed during the period	(21)	(22)
Stores open at the end of the period	1,496	1,525

We have opened 24 stores in the year-to-date and do not expect to open any additional stores during the balance of the year. We expect to close 57 stores in the U.S. during 2014, which will result in more than the 20 net closings that we originally anticipated, but is fewer than the 60 to 65 net closings that we anticipated in our Quarterly Report on Form 10-Q for the quarterly period ended August 2, 2014. The increase in net closings from our original expectations is primarily due to (1) fewer anticipated openings driven by both the timing and availability of acceptable locations and (2) more anticipated closings based on management decisions relating to store level performance and renewal option negotiations.

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RESULTS OF OPERATIONS

The following table compares components of our consolidated statements of operations as a percentage of net sales at the end of each period:

	Third Quarter		Year-to-Date	
	2014	2013	2014	2013
Net sales	100.0 %	100.0 %	100.0 %	100.0 %
Cost of sales (exclusive of depreciation expense shown separately below)	61.1	61.0	61.1	60.7
Gross margin	38.9	39.0	38.9	39.3
Selling and administrative expenses	36.6	36.7	34.4	34.3
Depreciation expense	2.7	2.6	2.5	2.3
Operating (loss) profit	(0.4)	(0.3)	2.0	2.7
Interest expense	(0.1)	(0.1)	(0.0)	(0.1)
Other income (expense)	0.0	0.0	0.0	(0.0)
(Loss) income from continuing operations before income taxes	(0.4)	(0.4)	1.9	2.6
Income tax (benefit) expense	(0.2)	(0.2)	0.7	1.0
(Loss) income from continuing operations	(0.3)	(0.2)	1.2	1.6
Loss from discontinued operations	(0.0)	(0.7)	(0.6)	(0.5)
Net (loss) income	(0.3)%	(0.9)%	0.6	