

FOOT LOCKER INC
Form 10-Q
September 05, 2012

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: July 28, 2012

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: 1-10299

FOOT LOCKER, INC.

(Exact Name of Registrant as Specified in its Charter)

New York

13-3513936

(State or Other Jurisdiction of Incorporation or Organization) (I.R.S. Employer Identification No.)

112 West 34th Street, New York, New York, 10120

(Address of Principal Executive Offices, Zip Code)

(212-720-3700)

(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 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 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 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

Number of shares of Common Stock outstanding at August 24, 2012: 151,018,791

FOOT LOCKER, INC.

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PART I - FINANCIAL INFORMATION**Item 1. Financial Statements****FOOT LOCKER, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(in millions, except shares)**

| | July 28, 2012 (Unaudited) | July 30, 2011 (Unaudited) | January 28, 2012 * |
|---|---------------------------------|---------------------------------|-----------------------------|
| ASSETS | | | |
| Current assets | | | |
| Cash and cash equivalents | \$ 770 | \$ 681 | \$ 851 |
| Short-term investments | 50 | — | — |
| Merchandise inventories | 1,231 | 1,269 | 1,069 |
| Other current assets | 199 | 189 | 159 |
| | 2,250 | 2,139 | 2,079 |
| Property and equipment, net | 447 | 408 | 427 |
| Deferred taxes | 284 | 298 | 284 |
| Goodwill | 143 | 146 | 144 |
| Other intangibles and other assets | 110 | 128 | 116 |
| | \$ 3,234 | \$ 3,119 | \$ 3,050 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | |
| Current liabilities | | | |
| Accounts payable | \$ 391 | \$ 365 | \$ 240 |
| Accrued expenses and other current liabilities | 278 | 255 | 308 |
| | 669 | 620 | 548 |
| Long-term debt | 133 | 136 | 135 |
| Other liabilities | 253 | 248 | 257 |
| | 1,055 | 1,004 | 940 |
| Shareholders' equity | | | |
| Common stock and paid-in capital: 165,819,340, 163,749,566 and 164,460,073 shares, respectively | 819 | 756 | 779 |
| Retained earnings | 1,920 | 1,691 | 1,788 |
| Accumulated other comprehensive loss | (241) | (125) | (204) |
| | (319) | (207) | (253) |

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Less: Treasury stock at cost: 14,959,322, 10,641,938 and 12,840,961 shares,
respectively

| | | | |
|----------------------------|----------|----------|----------|
| Total shareholders' equity | 2,179 | 2,115 | 2,110 |
| | \$ 3,234 | \$ 3,119 | \$ 3,050 |

See Accompanying Notes to Condensed Consolidated Financial Statements.

* The balance sheet at January 28, 2012 has been derived from the previously reported audited financial statements at that date, but does not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended January 28, 2012.

FOOT LOCKER, INC.**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(Unaudited)****(in millions, except per share amounts)**

| | Thirteen weeks ended | | Twenty-six weeks ended | |
|--|-------------------------|---------------------|---------------------------|---------------------|
| | July 28, 2012 | July 30, 2011 | July 28, 2012 | July 30, 2011 |
| Sales | \$ 1,367 | \$ 1,275 | \$ 2,945 | \$ 2,727 |
| Cost of sales | 939 | 887 | 1,980 | 1,864 |
| Selling, general and administrative expenses | 306 | 301 | 612 | 599 |
| Depreciation and amortization | 29 | 28 | 58 | 55 |
| Interest expense, net | 1 | 1 | 2 | 3 |
| Other income | (1) | — | (1) | (1) |
| | 1,274 | 1,217 | 2,651 | 2,520 |
| Income before income taxes | 93 | 58 | 294 | 207 |
| Income tax expense | 34 | 21 | 107 | 76 |
| Net income | \$59 | \$37 | \$187 | \$131 |
| Basic earnings per share: | | | | |
| Net income | \$0.39 | \$0.24 | \$1.23 | \$0.85 |
| Weighted-average common shares outstanding | 151.4 | 153.7 | 151.6 | 154.0 |
| Diluted earnings per share: | | | | |
| Net income | \$0.39 | \$0.24 | \$1.21 | \$0.84 |
| Weighted-average common shares assuming dilution | 153.9 | 155.2 | 154.1 | 155.4 |

See Accompanying Notes to Condensed Consolidated Financial Statements.

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

| | Thirteen weeks ended | | Twenty-six weeks ended | |
|---|----------------------|------------------|------------------------|------------------|
| | July 28, 2012 | July 30, 2011 | July 28, 2012 | July 30, 2011 |
| Net income | \$ 59 | \$ 37 | \$ 187 | \$ 131 |
| Other comprehensive income (loss): | | | | |
| Foreign currency translation adjustment: | | | | |
| Translation adjustment arising during the period, net of tax period | (49) | (18) | (42) | 43 |
| Cash flow hedges: | | | | |
| Change in fair value of derivatives, net of tax | (1) | (1) | (1) | — |
| Available for sale securities: | | | | |
| Unrealized gain | 1 | — | 1 | — |
| Pension and postretirement adjustments: | | | | |
| Amortization of net actuarial gain/loss and prior services included in net periodic benefit costs, net of income tax expense of \$1 million, \$1 million, \$2 million and \$2 million, respectively | 2 | 1 | 4 | 2 |
| Comprehensive income | \$ 12 | \$ 19 | \$ 149 | \$ 176 |

See Accompanying Notes to Condensed Consolidated Financial Statements.

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

| | Twenty-six weeks ended July 28, 2012 | July 30, 2011 |
|---|--|------------------|
| From Operating Activities: | | |
| Net income | \$ 187 | \$ 131 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 58 | 55 |
| Share-based compensation expense | 10 | 8 |
| Qualified pension plan contributions | — | (1) |
| Excess tax benefits on share-based compensation | (6) | (3) |
| Change in assets and liabilities: | | |
| Merchandise inventories | (177) | (195) |
| Accounts payable | 155 | 138 |
| Other accruals | (30) | (21) |
| Other, net | (36) | 15 |
| Net cash provided by operating activities | 161 | 127 |
| From Investing Activities: | | |
| Sales of short-term investments | 7 | — |

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| | | |
|---|--------|--------|
| Purchases of short-term investments | (57) | — |
| Capital expenditures | (87) | (66) |
| Net cash used in investing activities | (137) | (66) |
| From Financing Activities: | | |
| Reduction in long-term debt | (2) | — |
| Purchase of treasury shares | (65) | (59) |
| Dividends paid | (55) | (51) |
| Issuance of common stock | 20 | 8 |
| Treasury stock issued under employee stock plan | 5 | 4 |
| Excess tax benefits on share-based compensation | 7 | 3 |
| Net cash used in financing activities | (90) | (95) |
| Effect of exchange rate fluctuations on Cash and Cash Equivalents | (15) | 19 |
| Net change in Cash and Cash Equivalents | (81) | (15) |
| Cash and Cash Equivalents at beginning of year | 851 | 696 |
| Cash and Cash Equivalents at end of interim period | \$ 770 | \$ 681 |
| Cash paid during the period: | | |
| Interest | \$ 5 | \$ 6 |
| Income taxes | \$ 137 | \$ 81 |

See Accompanying Notes to Condensed Consolidated Financial Statements.

FOOT LOCKER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying condensed consolidated financial statements contained in this report are unaudited. In the opinion of management, the condensed consolidated financial statements include all adjustments, which are of a normal recurring nature, necessary for a fair presentation of the results for the interim periods of the fiscal year ending February 2, 2013 and of the fiscal year ended January 28, 2012. Certain items included in these statements are based on management's estimates. Actual results may differ from those estimates. The results of operations for any interim period are not necessarily indicative of the results expected for the year. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the Notes to Consolidated Financial Statements contained in the Company's Form 10-K for the year ended January 28, 2012, as filed with the Securities and Exchange Commission (the "SEC") on March 26, 2012.

Recent Accounting Pronouncements

During the first quarter of 2012, the Company adopted ASU No. 2011-08, *Testing Goodwill for Impairment*. The revised standard is intended to reduce the cost and complexity of the annual goodwill impairment test by providing entities an option to perform a qualitative assessment to determine whether further impairment testing is necessary. The adoption of this ASU did not have a significant effect on our results of operations or financial position.

During the first quarter of 2012, the Company also adopted ASU No. 2011-05, *Presentation of Comprehensive Income*, which requires presentation of total comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The implementation of the amended reporting guidance had no effect on our disclosures.

In July 2012, the FASB issued ASU 2012-02, *Testing Indefinite-Lived Intangible Assets for Impairment*, which allows an entity to first assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset, other than goodwill, is impaired. If an entity concludes, based on an evaluation of all relevant qualitative factors, that it is not more likely than not that the fair value of an indefinite-lived intangible asset is less than its carrying amount, it will not be required to perform a quantitative impairment test for that asset. Entities are required to test indefinite-lived assets for impairment at least annually, and more frequently if indicators of impairment exist. This ASU will be effective for the Company on February 3, 2013, with early adoption permitted. The adoption of this ASU is not expected to have a significant effect on our results of operations or financial position.

Other recently issued accounting pronouncements did not, or are not believed by management to, have a material effect on the Company's present or future consolidated financial statements.

FOOT LOCKER, INC.**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****2. Segment Information**

The Company has determined that its reportable segments are those that are based on its method of internal reporting. As of July 28, 2012, the Company has two reportable segments, Athletic Stores and Direct-to-Customers. Sales and division results for the Company's reportable segments for the thirteen weeks and twenty-six weeks ended July 28, 2012 and July 30, 2011 are presented below. Division profit reflects income before income taxes, corporate expense, net interest expense, and net non-operating income.

| | Thirteen weeks ended | | Twenty-six weeks ended | |
|------------------------|----------------------|------------------|------------------------|------------------|
| | July 28, 2012 | July 30, 2011 | July 28, 2012 | July 30, 2011 |
| Sales (in millions) | | | | |
| Athletic Stores | \$ 1,248 | \$ 1,174 | \$ 2,685 | \$ 2,505 |
| Direct-to-Customers | 119 | 101 | 260 | 222 |
| Total sales | \$ 1,367 | \$ 1,275 | \$ 2,945 | \$ 2,727 |

| | Thirteen weeks ended | | Twenty-six weeks ended | |
|-------------------------------------|----------------------|------------------|------------------------|------------------|
| | July 28, 2012 | July 30, 2011 | July 28, 2012 | July 30, 2011 |
| Operating Results (in millions) | | | | |
| Athletic Stores | \$ 107 | \$ 79 | \$ 314 | \$ 241 |
| Direct-to-Customers | 11 | 7 | 29 | 20 |
| Restructuring charge ⁽¹⁾ | — | — | — | (1) |
| Division profit | 118 | 86 | 343 | 260 |
| Less: Corporate expense, net | 25 | 27 | 48 | 51 |
| Operating profit | 93 | 59 | 295 | 209 |
| Other income ⁽²⁾ | 1 | — | 1 | 1 |
| Interest expense, net | 1 | 1 | 2 | 3 |
| Income before income taxes | \$ 93 | \$ 58 | \$ 294 | \$ 207 |

During the first quarter of 2011, the Company increased its 1993 Repositioning and 1991 Restructuring reserve by

(1) \$1 million for repairs necessary to one of the locations comprising this reserve. This amount is included in selling, general and administrative expenses in the Condensed Consolidated Statement of Operations.

(2)

Other income includes non-operating items, such as: gains from insurance recoveries; discounts/premiums paid on the repurchase and retirement of bonds; royalty income; and the changes in fair value, premiums paid, and realized gains associated with foreign currency option contracts. Other income for the thirteen and twenty-six weeks ended July 28, 2012 primarily represents royalty income, partially offset by a premium paid on the repurchase and retirement of bonds. Other income for the twenty-six weeks ended July 30, 2011 primarily represents lease termination gains related to the sale of leasehold interests and royalty income from the Company's franchised operations.

3. Goodwill and Other Intangible Assets

Annually during the first quarter, or more frequently if impairment indicators arise, the Company reviews goodwill and intangible assets with indefinite lives for impairment. The annual review of goodwill and assets with indefinite lives during the first quarters of 2012 and 2011 did not result in impairment charges. The fair value of each of the reporting units substantially exceeds its carrying value for both periods. The following table provides a summary of goodwill by reportable segment. The changes represent foreign exchange fluctuations.

FOOT LOCKER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

3. Goodwill and Other Intangible Assets - (continued)

| (in millions) | July 28, 2012 | July 30, 2011 | January 28, 2012 |
|---------------------|------------------|------------------|---------------------|
| Athletic Stores | \$ 16 | \$ 19 | \$ 17 |
| Direct-to-Customers | 127 | 127 | 127 |
| Goodwill | \$ 143 | \$ 146 | \$ 144 |

The components of finite-lived intangible assets and intangible assets not subject to amortization are as follows:

| (in millions) | July 28, 2012 | | | July 30, 2011 | | | January 28, 2012 | | |
|---|---------------|---------------|--------------|---------------|---------------|--------------|------------------|---------------|--------------|
| | Gross value | Accum. amort. | Net value | Gross Value | Accum. amort. | Net value | Gross Value | Accum. amort. | Net value |
| Finite life intangible assets: | | | | | | | | | |
| Lease acquisition costs | \$152 | \$(131) | \$ 21 | \$184 | \$(157) | \$ 27 | \$171 | \$(149) | \$ 22 |
| Trademark | 21 | (9) | 12 | 21 | (8) | 13 | 21 | (8) | 13 |
| Favorable leases | 5 | (5) | — | 9 | (9) | — | 7 | (7) | — |
| CCS customer relationships | 21 | (16) | 5 | 21 | (11) | 10 | 21 | (13) | 8 |
| | \$199 | \$(161) | \$ 38 | \$235 | \$(185) | \$ 50 | \$220 | \$(177) | \$ 43 |
| Indefinite life intangible assets: | | | | | | | | | |
| Republic of Ireland trademark | | | 1 | | | 2 | | | 1 |
| CCS tradename | | | 10 | | | 15 | | | 10 |
| | | | \$ 11 | | | \$ 17 | | | \$ 11 |
| Net identifiable intangible assets | | | \$ 49 | | | \$ 67 | | | \$ 54 |

For the twenty-six week period ended July 28, 2012, activity included amortization of \$7 million, the effect of the weakening of the U.S. dollar as compared with the euro of \$3 million, partially offset by lease acquisition additions of \$5 million. The lease acquisition additions recorded during the period are being amortized over 10 years.

| | Thirteen weeks ended | | Twenty-six weeks ended | |
|----------------------|----------------------|-----------------|------------------------|-----------------|
| (in millions) | July 28, | July 30, | July 28, | July 30, |
| | 2012 | 2011 | 2012 | 2011 |
| Amortization expense | \$ 3 | \$ 5 | \$ 7 | \$ 9 |

FOOT LOCKER, INC.**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****3. Goodwill and Other Intangible Assets - (continued)**

Future expected amortization expense for finite life intangible assets is estimated as follows:

| | (in millions) |
|-------------------|------------------|
| Remainder of 2012 | \$ 8 |
| 2013 | 9 |
| 2014 | 3 |
| 2015 | 3 |
| 2016 | 2 |
| 2017 | 2 |

4. Accumulated Other Comprehensive Loss

Accumulated other comprehensive loss comprised the following:

| (in millions) | July 28, 2012 | July 30, 2011 | January 28, 2012 |
|--|------------------|------------------|---------------------|
| Foreign currency translation adjustments | \$ 21 | \$ 129 | \$ 63 |
| Cash flow hedges | (2) | 1 | (1) |
| Unrecognized pension cost and postretirement benefit | (259) | (253) | (264) |
| Unrealized loss on available-for-sale security | (1) | (2) | (2) |
| | \$ (241) | \$ (125) | \$ (204) |

5. Financial Instruments

The Company operates internationally and utilizes certain derivative financial instruments to mitigate its foreign currency exposures, primarily related to third-party and intercompany forecasted transactions. As a result of the use of derivative instruments, the Company is exposed to the risk that counterparties will fail to meet their contractual obligations. To mitigate this counterparty credit risk, the Company has a policy of entering into contracts only with major financial institutions selected based upon their credit ratings and other financial factors. The Company monitors the creditworthiness of counterparties throughout the duration of the derivative instrument. Additional information is contained within Note 6, *Fair Value Measurements*.

Derivative Holdings Designated as Hedges

For a derivative to qualify as a hedge at inception and throughout the hedged period, the Company formally documents the nature of the hedged items and the relationships between the hedging instruments and the hedged items, as well as its risk-management objectives, strategies for undertaking the various hedge transactions, and the methods of assessing hedge effectiveness and hedge ineffectiveness. In addition, for hedges of forecasted transactions, the significant characteristics and expected terms of a forecasted transaction must be specifically identified, and it must be probable that each forecasted transaction would occur. If it were deemed probable that the forecasted transaction would not occur, the gain or loss on the derivative instrument would be recognized in earnings immediately. No such gains or losses were recognized in earnings for any of the periods presented. Derivative financial instruments qualifying for hedge accounting must maintain a specified level of effectiveness between the hedging instrument and the item being hedged, both at inception and throughout the hedged period, which management evaluates periodically.

FOOT LOCKER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

5. Financial Instruments – (continued)

The primary currencies to which the Company is exposed are the euro, British pound, Canadian dollar, and Australian dollar. For option and forward foreign exchange contracts designated as cash flow hedges of the purchase of inventory, the effective portion of gains and losses is deferred as a component of Accumulated Other Comprehensive Loss (“AOCL”) and is recognized as a component of cost of sales when the related inventory is sold. The amount reclassified to cost of sales related to such contracts was not significant for any of the periods presented. The ineffective portion of gains and losses related to cash flow hedges recorded to earnings was also not significant for any of the periods presented. When using a forward contract as a hedging instrument, the Company excludes the time value of the contract from the assessment of effectiveness. At each quarter-end, the Company had not hedged forecasted transactions for more than the next twelve months, and the Company expects all derivative-related amounts reported in AOCL to be reclassified to earnings within twelve months.

The net change in the fair value of foreign exchange derivative financial instruments designated as cash flow hedges of the purchase of inventory was \$1 million for both the thirteen weeks ended July 28, 2012 and July 30, 2011, and was \$1 million for the twenty-six weeks ended July 28, 2012. It was not significant for the twenty-six weeks ended July 30, 2011. The notional value of the contracts outstanding at July 28, 2012 was \$57 million and these contracts extend through June 2013.

Derivative Holdings Designated as Non-Hedges

The Company mitigates the effect of fluctuating foreign exchange rates on the reporting of foreign-currency denominated earnings by entering into currency option contracts. Changes in the fair value of these foreign currency option contracts, which are designated as non-hedges, are recorded in earnings immediately within other income. The realized gains, premiums paid and changes in the fair market value recorded in the Condensed Consolidated Statements of Operations were not significant for any of the periods presented. The notional value of the contracts outstanding at July 28, 2012 was \$18 million and these contracts extend through October 2012.

The Company also enters into forward foreign exchange contracts to hedge foreign-currency denominated merchandise purchases and intercompany transactions that are not designated as hedges. Net changes in the fair value

of foreign exchange derivative financial instruments designated as non-hedges were substantially offset by the changes in value of the underlying transactions, which were recorded in selling, general and administrative expenses. The net change in fair value was not significant for any of the periods presented. The notional value of the contracts outstanding at July 28, 2012 was \$27 million and these contracts extend through October 2012.

The Company enters into diesel fuel forward contracts to mitigate a portion of the Company's freight expense due to the variability caused by fuel surcharges imposed by our third-party freight carriers. Changes in the fair value of these contracts are recorded in earnings immediately. The effect was not significant for any of the periods presented. The notional value of the contracts outstanding at July 28, 2012 was \$5 million and these contracts extend through May 2013.

FOOT LOCKER, INC.**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****5. Financial Instruments – (continued)***Fair Value of Derivative Contracts*

The following represents the fair value of the Company's derivative contracts. Many of the Company's agreements allow for a netting arrangement. The following is presented on a gross basis, by type of contract:

| (in millions) | Balance Sheet Caption | July 28, 2012 | July 30, 2011 | January 28, 2012 |
|------------------------------------|--------------------------|------------------|------------------|---------------------|
| Hedging Instruments: | | | | |
| Forward foreign exchange contracts | Current asset | \$ — | \$ 1 | \$ — |
| Forward foreign exchange contracts | Current liability | \$ 2 | \$ — | \$ 2 |
| Non-Hedging Instruments: | | | | |
| Forward foreign exchange contracts | Current liability | \$ 1 | \$ — | \$ — |

Fair Value of Financial Instruments

The carrying value and estimated fair value of long-term debt were as follows:

| (in millions) | July 28, 2012 | July 30, 2011 | January 28, 2012 |
|----------------------|------------------|------------------|---------------------|
| Carrying value | \$ 133 | \$ 136 | \$ 135 |
| Fair value | \$ 143 | \$ 144 | \$ 140 |

During the second quarter of 2012, the Company purchased and retired \$2 million of its 8.50 percent debentures payable in 2022.

The carrying values of cash and cash equivalents, short-term investments, and other current receivables and payables approximate their fair value.

6. Fair Value Measurements

The Company's financial assets recorded at fair value are categorized as follows:

Level 1 Quoted prices for identical instruments in active markets.

Level 2 – Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs or significant value-drivers are observable in active markets.

Level 3 – Model-derived valuations in which one or more significant inputs or significant value-drivers are unobservable.

FOOT LOCKER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

6. Fair Value Measurements – (continued)

The following tables provide a summary of the Company's recognized assets and liabilities that are measured at fair value on a recurring basis:

| (in millions) | At July 28, 2012 | | | At July 30, 2011 | | | At January 28, 2012 | | |
|------------------------------------|------------------|--------------|-------------|------------------|-------------|-------------|---------------------|-------------|-------------|
| | Level 1 | Level 2 | Level 3 | Level 1 | Level 2 | Level 3 | Level 1 | Level 2 | Level 3 |
| Assets | | | | | | | | | |
| Short-term investments | \$ — | \$ 50 | \$ — | \$ — | \$ — | \$ — | \$ — | \$ — | \$ — |
| Auction rate security | — | 6 | — | — | 5 | — | — | 5 | — |
| Forward foreign exchange contracts | — | — | — | — | 1 | — | — | — | — |
| Total Assets | \$ — | \$ 56 | \$ — | \$ — | \$ 6 | \$ — | \$ — | \$ 5 | \$ — |
| Liabilities | | | | | | | | | |
| Forward foreign exchange contracts | — | 3 | — | — | — | — | — | 2 | — |
| Total Liabilities | \$ — | \$ 3 | \$ — | \$ — | \$ — | \$ — | \$ — | \$ 2 | \$ — |

The Company's short-term investments consisted of available-for-sale securities, which are primarily comprised of investments in corporate bonds. Available-for-sale securities are recorded at fair value with unrealized gains and losses reported, net of tax, in other comprehensive income, unless unrealized losses are determined to be other than temporary. As of July 28, 2012, the Company held \$50 million of available-for-sale securities with maturity dates within one year from the purchase date. These securities are valued using quoted prices for similar instruments in active markets and therefore are classified as Level 2 instruments. Level 2 instrument valuations are obtained from readily available pricing sources for comparable instruments.

Interest income related to the short-term investments included within interest expense was not significant for both the thirteen and twenty-six weeks ended July 28, 2012.

The Company's auction rate security is classified as available-for-sale and, accordingly, is reported at fair value. The fair value of the security is determined by review of the underlying security at each reporting period. The Company's

derivative financial instruments are valued using market-based inputs to valuation models. These valuation models require a variety of inputs, including contractual terms, market prices, yield curves, and measures of volatility.

There were no transfers into or out of Level 1, Level 2, or Level 3 assets and liabilities for any of the periods presented.

7. Earnings Per Share

The Company accounts for and discloses net earnings per share using the treasury stock method. The Company's basic earnings per share is computed by dividing the Company's reported net income for the period by the weighted-average number of common shares outstanding at the end of the period. The Company's restricted stock awards, which contain non-forfeitable rights to dividends, are considered participating securities and are included in the calculation of basic earnings per share. Diluted earnings per share reflects the weighted-average number of common shares outstanding during the period used in the basic earnings per share computation plus dilutive common stock equivalents.

FOOT LOCKER, INC.**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****7. Earnings Per Share - (continued)**

The Company's basic and diluted weighted-average number of common shares outstanding as of July 28, 2012 and July 30, 2011, were as follows:

| (in millions) | Thirteen weeks ended | | Twenty-six weeks ended | |
|--|----------------------|------------------|------------------------|------------------|
| | July 28, 2012 | July 30, 2011 | July 28, 2012 | July 30, 2011 |
| Weighted-average common shares outstanding | 151.4 | 153.7 | 151.6 | 154.0 |
| <i>Effect of Dilution:</i> | | | | |
| Stock options and awards | 2.5 | 1.5 | 2.5 | 1.4 |
| Weighted-average common shares assuming dilution | 153.9 | 155.2 | 154.1 | 155.4 |

Options to purchase 0.9 million and 3.9 million shares of common stock were not included in the computation for the thirteen weeks ended July 28, 2012 and July 30, 2011, respectively. Options to purchase 0.7 million and 3.6 million shares of common stock were not included in the computation for the twenty-six weeks ended July 28, 2012 and July 30, 2011, respectively. These options were not included primarily because the exercise prices of the options were greater than the average market price of the common shares and, therefore, the effect would be antidilutive. As of July 28, 2012, contingently issuable shares of 1.0 million have not been included as the vesting conditions have not been satisfied.

8. Pension and Postretirement Plans

The Company has defined benefit pension plans covering certain of its North American employees, which are funded in accordance with the provisions of the laws where the plans are in effect. In addition to providing pension benefits, the Company sponsors postretirement medical and life insurance plans, which are available to most of its retired U.S. employees. These medical and life insurance plans are contributory and are not funded.

The following are the components of net periodic pension benefit cost and net periodic postretirement benefit income:

| (in millions) | Pension Benefits | | | | Postretirement Benefits | | | |
|---------------------------------|----------------------|---------------|------------------------|---------------|-------------------------|---------------|------------------------|---------------|
| | Thirteen weeks ended | | Twenty-six weeks ended | | Thirteen weeks ended | | Twenty-six weeks ended | |
| | July 28, 2012 | July 30, 2011 | July 28, 2012 | July 30, 2011 | July 28, 2012 | July 30, 2011 | July 28, 2012 | July 30, 2011 |
| Service cost | \$4 | \$ 3 | \$ 7 | \$ 6 | \$— | \$ — | \$ — | \$ — |
| Interest cost | 7 | 8 | 14 | 16 | — | — | — | — |
| Expected return on plan assets | (10) | (10) | (20) | (20) | — | — | — | — |
| Amortization of net loss (gain) | 4 | 3 | 8 | 7 | (1) | (1) | (2) | (2) |
| Net benefit expense (income) | \$5 | \$ 4 | \$ 9 | \$ 9 | \$(1) | \$(1) | \$(2) | \$(2) |

No pension contributions to the U.S. or Canadian qualified plans were made during the twenty-six weeks ended July 28, 2012. Additionally, no pension contributions to its U.S. or Canadian qualified plans are required in 2012.

Information regarding U.S. retirement plan litigation is contained in Part II, “Item 1. Legal Proceedings.”

FOOT LOCKER, INC.**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****9. Share-Based Compensation**

The Company uses a Black-Scholes option-pricing model to estimate the fair value of share-based awards. Total compensation expense related to the Company's share-based compensation plans was \$4 million for both the thirteen weeks ended July 28, 2012 and July 30, 2011, and was \$10 million and \$8 million for the twenty-six weeks ended July 28, 2012 and July 30, 2011, respectively. The associated tax benefits recognized for the thirteen weeks ended July 28, 2012 and July 30, 2011 were \$1 million and \$2 million, respectively. The associated tax benefits recognized were \$3 million for both the twenty-six weeks ended July 28, 2012 and July 30, 2011. Tax deductions in excess of the cumulative compensation cost recognized for share-based compensation arrangements were \$7 million and \$3 million for the twenty-six weeks ended July 28, 2012 and July 30, 2011, respectively, and are classified as financing activities within the Condensed Consolidated Statements of Cash Flows.

The Black-Scholes option-pricing model incorporates various and highly subjective assumptions, including expected term and expected volatility. The following table shows the Company's assumptions used to compute the share-based compensation expense:

| | Stock Option Plans | | Stock Purchase Plan | | | |
|---|------------------------|-----------|------------------------|----------|---|---|
| | Twenty-six weeks ended | | Twenty-six weeks ended | | | |
| | July 28, | July 30, | July 28, | July 30, | | |
| | 2012 | 2011 | 2012 | 2011 | | |
| Weighted-average risk free rate of interest | 1.50 | % 2.08 | % 0.21 | % 0.37 | % | % |
| Expected volatility | 43 | % 45 | % 37 | % 37 | % | % |
| Weighted-average expected award life | 5.5 years | 5.0 years | 1.0 year | 1.0 year | | |
| Dividend yield | 2.3 | % 3.5 | % 2.6 | % 3.8 | % | % |
| Weighted-average fair value | \$10.13 | \$5.86 | \$5.52 | \$3.34 | | |

The information in the following table covers options granted under the Company's stock option plans for the twenty-six weeks ended July 28, 2012:

| (in thousands, except weighted-average term and price per share) | Shares | Weighted-Average | Weighted-Average |
|--|--------|------------------|------------------|
|--|--------|------------------|------------------|

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| | | Term | Exercise Price |
|---|---------|------|-------------------|
| Options outstanding at the beginning of the year | 7,227 | | \$ 18.44 |
| Granted | 931 | | 30.92 |
| Exercised | (1,136) | | 18.10 |
| Expired or cancelled | (37) | | 23.27 |
| Options outstanding at July 28, 2012 | 6,985 | 6.18 | \$ 20.13 |
| Options exercisable at July 28, 2012 | 4,564 | 4.78 | \$ 18.82 |
| Options available for future grant at July 28, 2012 | 5,556 | | |

FOOT LOCKER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

9. Share-Based Compensation – (continued)

| | Thirteen weeks ended | | Twenty-six weeks ended | |
|--|-----------------------------|----------|------------------------|----------|
| | July 28, | July 30, | July 28, | July 30, |
| Intrinsic value of stock options (in millions) | 2012 | 2011 | 2012 | 2011 |
| Exercised | \$ 4 | \$ 6 | \$ 15 | \$ 8 |
| Outstanding | | | \$ 94 | \$ 38 |
| Outstanding and exercisable | | | \$ 68 | \$ 23 |

The cash received from option exercises for the thirteen and twenty-six weeks ended July 28, 2012 was \$6 million and \$20 million, respectively. The cash received from option exercises for the thirteen and twenty-six weeks ended July 30, 2011 was \$5 million and \$8 million, respectively. The tax benefit realized from option exercises was \$1 million and \$5 million for the thirteen and twenty-six weeks ended July 28, 2012, respectively, and was \$2 million and \$3 million for the corresponding prior-year periods.

The following table summarizes information about stock options outstanding and exercisable at July 28, 2012:

| Range of Exercise Prices | Options Outstanding | | | Options Exercisable | | |
|---|----------------------------|---|---------------------------------|---------------------|---------------------------------|--|
| | Number Outstanding | Weighted-Average Remaining Contractual Life | Weighted-Average Exercise Price | Number Exercisable | Weighted-Average Exercise Price | |
| (in thousands, except price per share and contractual life) | | | | | | |
| \$9.85 - \$15.10 | 2,450 | 6.56 | \$ 12.48 | 1,955 | \$ 12.07 | |
| \$15.74 - \$23.92 | 2,433 | 6.37 | \$ 20.70 | 1,477 | \$ 21.89 | |
| \$24.04 - \$32.69 | 2,102 | 5.51 | \$ 28.39 | 1,132 | \$ 26.49 | |
| \$9.85 - \$32.69 | 6,985 | 6.18 | \$ 20.13 | 4,564 | \$ 18.82 | |

Changes in the Company's nonvested options for the twenty-six weeks ended July 28, 2012 are summarized as follows:

| (in thousands, except price per share) | Number of Shares | Weighted- Average Grant Date Fair Value per Share |
|---|---------------------|--|
| Nonvested at January 28, 2012 | 2,629 | \$ 16.84 |
| Granted | 931 | 30.92 |
| Vested | (1,102) | 15.89 |
| Expired or cancelled | (37) | 23.27 |
| Nonvested at July 28, 2012 | 2,421 | \$ 22.59 |

Compensation expense related to the Company's stock option and stock purchase plans was \$2 million and \$5 million for the thirteen and twenty-six weeks ended July 28, 2012, respectively, and was \$2 million and \$4 million for the thirteen and twenty-six weeks ended July 30, 2011, respectively. As of July 28, 2012, there was \$9 million of total unrecognized compensation cost, related to nonvested stock options, which is expected to be recognized over a weighted-average period of 1.22 years.

FOOT LOCKER, INC.**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****9. Share-Based Compensation – (continued)***Restricted Stock and Units*

Restricted shares of the Company's common stock and restricted stock units have been may be awarded to officers and certain key employees of the Company. Awards made to executives outside of the United States and to non-employee directors are made in the form of restricted stock units. Each restricted stock unit represents the right to receive one share of the Company's common stock, provided that the vesting conditions are satisfied. As of July 28, 2012, 1,253,075 restricted stock units were outstanding. Compensation expense is recognized using the fair market value at the date of grant and is amortized over the vesting period, provided the recipient continues to be employed by the Company. Generally, awards fully vest after the passage of time, typically three years. However, restricted stock unit grants made after May 19, 2010 in connection with the Company's long-term incentive program vest after the attainment of certain performance metrics and the passage of time. Restricted stock is considered outstanding at the time of grant and the holders have voting rights. Dividends are paid to holders of restricted stock that vest with the passage of time; for performance-based restricted stock granted after May 19, 2010, dividends will be accumulated and paid after the performance criteria are met.

Restricted shares and units activity for the twenty-six weeks ended July 28, 2012 and July 30, 2011 is summarized as follows:

| (in thousands) | Number of Shares and Units | |
|---|----------------------------|---------------|
| | July 28, 2012 | July 30, 2011 |
| Outstanding at beginning of period | 2,068 | 1,759 |
| Granted | 264 | 672 |
| Vested | (482) | (317) |
| Cancelled or forfeited | — | — |
| Outstanding at end of period | 1,850 | 2,114 |
| Aggregate value (in millions) | \$ 33 | \$ 30 |
| Weighted-average remaining contractual life | 1.20 years | 1.65 years |

The weighted-average grant-date fair value per share was \$30.75 and \$20.15 for the twenty-six weeks ended July 28, 2012 and July 30, 2011, respectively. The total value of awards for which restrictions lapsed during the twenty-six weeks ended July 28, 2012 and July 30, 2011 was \$5 million and \$4 million, respectively. As of July 28, 2012, there was \$14 million of total unrecognized compensation cost related to nonvested restricted awards. The Company recorded compensation expense related to restricted stock awards, net of forfeitures, of \$2 million for both the thirteen weeks ended July 28, 2012 and July 30, 2011 and \$5 million and \$4 million for the twenty-six weeks ended July 28, 2012 and July 30, 2011, respectively.

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

BUSINESS OVERVIEW

Foot Locker, Inc., through its subsidiaries, operates in two reportable segments – Athletic Stores and Direct-to-Customers. The Athletic Stores segment is one of the largest athletic footwear and apparel retailers in the world, whose formats include Foot Locker, Lady Foot Locker, Kids Foot Locker, Champs Sports, Footaction, and CCS. The Direct-to-Customers segment is multi-branded and multi-channeled. This segment sells, through its affiliates, directly to customers through its Internet websites, mobile devices, and catalogs. Eastbay, one of the affiliates, is among the largest direct marketers in the United States. The Direct-to-Customers segment operates the website for eastbay.com, final-score.com, and eastbayteamservices.com. Additionally, this segment operates websites aligned with the brand names of its store banners (footlocker.com, ladyfootlocker.com, kidsfootlocker.com, footaction.com, champssports.com, and ccs.com).

STORE COUNT

At July 28, 2012, the Company operated 3,354 stores as compared with 3,369 and 3,407 stores at January 28, 2012 and July 30, 2011, respectively. During the twenty-six weeks ended July 28, 2012, the Company opened 47 stores, remodeled or relocated 109 stores and closed 62 stores.

A total of 37 franchised stores were operating at July 28, 2012, as compared with 34 and 25 stores at January 28, 2012 and July 30, 2011, respectively. Revenue from the franchised stores was not significant for any of the periods presented. These stores are not included in the Company's operating store count above.

SALES AND OPERATING RESULTS

All references to comparable-store sales for a given period relate to sales of stores that are open at the period-end, that have been open for more than one year, and exclude the effect of foreign currency fluctuations. Accordingly, stores opened and closed during the period are not included. Sales from the Direct-to-Customers segment are included in the total Company calculation of comparable-store sales for all periods presented. Division profit reflects income before income taxes, corporate expense, net interest expense, and net non-operating income.

The following table summarizes results by segment:

| | Thirteen weeks ended | | Twenty-six weeks ended | |
|------------------------|----------------------|---------------|------------------------|---------------|
| | July 28, 2012 | July 30, 2011 | July 28, 2012 | July 30, 2011 |
| Sales (in millions) | | | | |
| Athletic Stores | \$1,248 | \$1,174 | \$2,685 | \$2,505 |
| Direct-to-Customers | 119 | 101 | 260 | 222 |
| Total sales | \$1,367 | \$1,275 | \$2,945 | \$2,727 |

| | Thirteen weeks ended | | Twenty-six weeks ended | |
|------------------------------------|----------------------|---------------|------------------------|---------------|
| | July 28, 2012 | July 30, 2011 | July 28, 2012 | July 30, 2011 |
| Operating Results (in millions) | | | | |
| Athletic Stores | \$107 | \$79 | \$314 | \$241 |
| Direct-to-Customers | 11 | 7 | 29 | 20 |

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| | | | | |
|-------------------------------------|------|-------|-------|-------|
| Restructuring charge ⁽¹⁾ | — | — | — | (1) |
| Division profit | 118 | 86 | 343 | 260 |
| Less: Corporate expense, net | 25 | 27 | 48 | 51 |
| Operating profit | 93 | 59 | 295 | 209 |
| Other income ⁽²⁾ | 1 | — | 1 | 1 |
| Interest expense, net | 1 | 1 | 2 | 3 |
| Income before income taxes | \$93 | \$ 58 | \$294 | \$207 |

During the first quarter of 2011, the Company increased its 1993 Repositioning and 1991 Restructuring reserve by (1)\$1 million for repairs necessary to one of the locations comprising this reserve. This amount is included in selling, general and administrative expenses in the Condensed Consolidated Statement of Operations.

Other income includes non-operating items, such as: gains from insurance recoveries; discounts/premiums paid on the repurchase and retirement of bonds; royalty income; and the changes in fair value, premiums paid, and realized gains associated with foreign currency option contracts. Other income for the thirteen and twenty-six weeks ended (2)July 28, 2012 primarily represents royalty income, partially offset by a premium paid on the repurchase and retirement of bonds. Other income for the twenty-six weeks ended July 30, 2011 primarily represents lease termination gains related to the sale of leasehold interests and royalty income from the Company's franchised operations.

Sales increased by \$92 million, or 7.2 percent, to \$1,367 million for the thirteen weeks ended July 28, 2012, from \$1,275 million for the thirteen weeks ended July 30, 2011. For the twenty-six weeks ended July 28, 2012, sales of \$2,945 million increased 8.0 percent from sales of \$2,727 million for the twenty-six week period ended July 30, 2011. Excluding the effect of foreign currency fluctuations, total sales for the thirteen-week and twenty-six week periods increased 10.6 percent and 10.1 percent, respectively, as compared with the corresponding prior-year periods. Comparable-store sales increased by 9.8 percent for both the thirteen and twenty-six weeks ended July 28, 2012.

Gross margin, as a percentage of sales, increased by 90 basis points to 31.3 percent for the thirteen weeks ended July 28, 2012, as compared with the corresponding prior-year period. For the twenty-six weeks ended July 28, 2012, gross margin, as a percentage of sales, increased by 120 basis points to 32.8 percent, as compared with the corresponding prior-year period.

For the thirteen weeks ended July 28, 2012, the occupancy and buyers' salary expense rate decreased by 130 basis points, as a percentage of sales, as compared with the corresponding prior-year periods, reflecting improved leverage. Partially offsetting this improvement was a 40 basis point decrease in the merchandise margin rate. A decline of approximately 30 basis points primarily reflected higher markdowns, mostly in Europe, and the effect of lower initial markups. The additional markdowns in Europe were necessary to ensure that merchandise inventories remained current and aligned with sales. Additionally, 10 basis points of the decline is attributed to the effect of lower shipping and handling income.

For the twenty-six weeks ended July 28, 2012, the occupancy and buyers' salary expense rate decreased by 120 basis points, as a percentage of sales, as compared with the corresponding prior-year periods, reflecting improved leverage. The cost of merchandise rate for the twenty-six weeks ended July 28, 2012 did not change from the corresponding prior-year period.

The effect of vendor allowances was not significant for any of the periods presented.

Segment Analysis

Athletic Stores

Athletic Stores sales increased by 6.3 percent and 7.2 percent for the thirteen and twenty-six weeks ended July 28, 2012, respectively, as compared with the corresponding prior-year periods. Excluding the effect of foreign currency fluctuations, sales from athletic stores increased 10.0 percent and 9.6 percent for the thirteen and twenty-six

weeks ended July 28, 2012, respectively, as compared with the corresponding prior-year periods. Comparable-store sales increased by 9.1 percent and 9.2 percent for the thirteen and twenty-six weeks ended July 28, 2012, respectively. For the thirteen weeks and twenty-six weeks ended July 28, 2012, most divisions, led by Kids Foot Locker and Champs Sports, posted strong comparable-store gains. Total footwear sales gains were led by the basketball category. The running category was essentially flat reflecting an assortment shift to lower-priced running styles. Apparel sales continued to improve, although lower apparel sales in Foot Locker Europe reduced the overall improvement.

Foot Locker Europe experienced a small decline for both the quarter and year-to-date periods reflecting primarily the macroeconomic conditions in that region. Total sales for Foot Locker Europe were higher than the corresponding prior-year periods for both the quarter and year-to-date periods as a result of new store openings.

Lady Foot Locker experienced a modest comparable-store decrease for the quarter but a slight comparable-store increase for the year-to-date period. Lady Foot Locker has experienced success with certain initiatives, such as closing underperforming stores and improving apparel offerings. Lady Foot Locker's total sales declined principally due to lower store count. Management has continued to review the women's business and is developing and implementing various initiatives, such as expanded apparel offerings and a new store design, which is currently being tested.

Athletic Stores division profit for the thirteen weeks ended July 28, 2012 increased to \$107 million, or 8.6 percent, as a percentage of sales, as compared with division profit of \$79 million, or 6.7 percent, as a percentage of sales, for the thirteen weeks ended July 30, 2011. For the twenty-six weeks ended July 28, 2012 division profit increased to \$314 million, or 11.7 percent, as a percentage of sales, as compared with division profit of \$241 million, or 9.6 percent, as a percentage of sales, for the twenty-six weeks ended July 30, 2011. These increases were mainly attributable to improved sales, as well as a higher gross margin rate driven by improved leverage of the fixed expenses within gross margin. Also contributing to the improvement was continued expense control.

Direct-to-Customers

Direct-to-Customers sales increased by 17.8 percent to \$119 million for the thirteen weeks ended July 28, 2012, as compared with the corresponding prior-year period of \$101 million. For the twenty-six weeks ended July 28, 2012, sales increased by 17.1 percent to \$260 million, as compared with the corresponding prior-year period of \$222 million. These increases were primarily a result of the continued strong sales performance of Company's store banner websites and Eastbay, both of which benefited from improved and fresh product offerings. The Company continues to experience the migration of catalog sales to internet sales; therefore providing the breakdown between catalog and internet sales is no longer meaningful.

Direct-to-Customers division profit increased 57.1 percent to \$11 million, and increased 45.0 percent to \$29 million, for the thirteen and twenty-six weeks ended July 28, 2012, respectively, as compared with the corresponding prior-year periods. Division profit, as a percentage of sales, increased to 9.2 percent and 11.2 percent for the thirteen and twenty-six weeks ended July 28, 2012, respectively, as compared with 6.9 percent and 9.0 percent, respectively, in the corresponding prior-year periods. These increases primarily reflect the improvement in sales.

Corporate Expense

Corporate expense consists of unallocated general and administrative expenses, as well as depreciation and amortization related to the Company's corporate headquarters, centrally managed departments, unallocated insurance and benefit programs, certain foreign exchange transaction gains and losses, and other items. Corporate expense for the thirteen weeks ended July 28, 2012 decreased by \$2 million to \$25 million from the corresponding prior-year period. Corporate expense for the twenty-six weeks ended July 28, 2012 decreased by \$3 million to \$48 million from the corresponding prior-year period. The decline primarily reflected the prior-year costs associated with certain management changes that occurred last year, consisting of relocation costs.

Selling, General and Administrative

Selling, general and administrative expenses (“SG&A”) of \$306 million increased by \$5 million or 1.7 percent, for the thirteen weeks ended July 28, 2012 as compared with the corresponding prior-year period. SG&A, as a percentage of sales, decreased to 22.4 percent for the thirteen weeks ended July 28, 2012, as compared with 23.6 percent in the corresponding prior-year period. For the twenty-six weeks ended July 28, 2012, SG&A increased by \$13 million, or 2.2 percent, as compared with the corresponding prior-year period. SG&A, as a percentage of sales, decreased to 20.8 percent for the twenty-six weeks ended July 28, 2012, as compared with 22.0 percent in the corresponding prior-year period. Excluding the effect of foreign currency fluctuations, SG&A increased by \$15 million and \$27 million for the thirteen and twenty-six weeks ended July 28, 2012, respectively, as compared with the corresponding prior-year periods. This increase principally represents increased variable costs to support sales, such as store wages and banking expenses. Variable costs, while higher than the prior year, were managed efficiently resulting in the decline in the SG&A rate. Additionally, marketing expenses increased \$2 million and \$4 million for the thirteen week and twenty-six weeks ended July 28, 2012, respectively, as the Company continues to invest in marketing campaigns specific to each banner.

Depreciation and Amortization

Depreciation and amortization increased by \$1 million for the thirteen weeks ended July 28, 2012 to \$29 million, as compared with the corresponding prior-year period. For the twenty-six weeks ended July 28, 2012, depreciation and amortization increased by \$3 million to \$58 million as compared with \$55 million for the twenty-six weeks ended July 30, 2011. Excluding the effect of foreign currency fluctuations, primarily related to the euro, depreciation and amortization increased by \$3 million and \$5 million for the thirteen weeks and twenty-six weeks ended July 28, 2012, respectively, as compared with the corresponding prior-year periods, reflecting additional depreciation and amortization associated with increased capital spending.

Interest Expense

| | Thirteen weeks ended | | Twenty-six weeks ended | |
|-----------------------|----------------------|---------------|------------------------|---------------|
| | July 28, 2012 | July 30, 2011 | July 28, 2012 | July 30, 2011 |
| (in millions) | | | | |
| Interest expense | \$2 | \$3 | \$5 | \$7 |
| Interest income | (1) | (2) | (3) | (4) |
| Interest expense, net | \$1 | \$1 | \$2 | \$3 |

The decrease in net interest expense for the twenty-six weeks ended July 28, 2012, as compared with the corresponding prior-year period, primarily reflects lower expenses associated with the Company's revolving credit facility, which was amended at the end of 2011 with lower annual fees. The decline in interest income reflects lower interest rates on cash and cash equivalents.

Income Taxes

The Company recorded income tax provisions of \$34 million and \$107 million, which represent an effective tax rate of 36.7 percent and 36.5 percent, for the thirteen weeks and twenty-six weeks ended July 28, 2012, respectively. For the thirteen weeks and twenty-six weeks ended July 30, 2011, the Company recorded income tax provisions of \$21 million and \$76 million, which represent an effective tax rate of 36.0 percent and 36.6 percent, respectively. The Company's interim provision for income taxes is measured using an annual effective tax rate, adjusted for discrete items that occur within the periods presented. The significant factors that affect the effective tax rate are the level and mix of earnings by tax jurisdiction and the difference between the U.S. federal statutory rate and the rates in foreign jurisdictions.

As required by the authoritative guidance on accounting for income taxes, the Company records the effect on the recognition of deferred tax assets and liabilities related to changes in tax laws or rates when enacted. The effective tax rate for the thirteen weeks ended July 28, 2012 included a tax benefit related to a Canadian provincial tax rate change that resulted in a \$1 million increase in the value of the Company's net deferred tax assets. The Company does not expect this change to have a significant effect on future periods.

The Company regularly assesses the adequacy of the Company's provisions for income tax contingencies in accordance with the applicable authoritative guidance on accounting for income taxes. As a result, the Company may adjust the reserves for unrecognized tax benefits for the impact of new facts and developments, such as changes to interpretations of relevant tax law, assessments from taxing authorities, settlements with taxing authorities, and lapses of statutes of limitation. The changes in the tax reserves for the thirteen weeks ended July 28, 2012 and July 30, 2011 were not significant. Included in the twenty-six weeks ended July 28, 2012 are tax benefits of \$3 million from reserve releases due to the settlements of federal, state, and foreign tax examinations.

Excluding the Canadian provincial tax rate change and the reserve releases, the effective tax rate for the thirteen weeks and twenty-six ended July 28, 2012 increased as compared with the corresponding prior-year periods, due primarily to a higher proportion of income earned in the United States, which bears a higher tax rate.

The Company currently expects its full year tax rate to approximate 37 percent, excluding the effect of any additional nonrecurring items that may occur. We expect the third and fourth quarter tax rates to be slightly higher than 37 percent due the higher proportion of U.S. income. The actual rate will primarily depend on the percentage of income earned in the United States as compared with its international operations.

Reconciliation of Non-GAAP Measures

The Company provides non-GAAP information to assist investors with the comparison of the Company's results period over period. In 2009, the Company excluded from its non-GAAP results the effect of a Canadian provincial tax rate change that resulted in a \$4 million reduction in the value of the Company's deferred tax assets. In the second quarter of 2012, the Company recorded a benefit of \$1 million, or \$0.01 per diluted share, to reflect the repeal of the last two stages of the Canadian provincial tax rate changes. Accordingly, consistent with prior periods, the Company has excluded this benefit to arrive at its non-GAAP results. The non-GAAP financial measure is provided in addition to, and not as an alternative to, the Company's reported results prepared in accordance with GAAP.

Net Income

For the thirteen weeks and twenty-six weeks ended July 28, 2012, net income increased by \$22 million or 59.5 percent and \$56 million or 42.7 percent, respectively, as compared with the corresponding prior-year periods. Presented below are GAAP and non-GAAP results, as more fully described above.

| | Thirteen weeks ended | | Twenty-six weeks ended | |
|------------------------|-------------------------|---------------------|---------------------------|---------------------|
| | July 28, 2012 | July 30, 2011 | July 28, 2012 | July 30, 2011 |
| (in millions) | | | | |
| Net income | \$59 | \$37 | \$187 | \$131 |
| Diluted EPS | \$0.39 | \$0.24 | \$1.21 | \$0.84 |
| Net income (non-GAAP) | \$58 | \$37 | \$186 | \$131 |
| Diluted EPS (non-GAAP) | \$0.38 | \$0.24 | \$1.20 | \$0.84 |

This represents a 39.9 percent flow-through of increased sales to pre-tax income, reflecting leveraging of fixed costs and controlling operating expenses.

LIQUIDITY AND CAPITAL RESOURCES

The Company's primary source of liquidity has been cash flow from operations, while the principal uses of cash have been to: fund inventory and other working capital requirements; finance capital expenditures related to store openings, store remodelings, Internet and mobile sites, information systems, and other support facilities; make retirement plan contributions, quarterly dividend payments, and interest payments; and fund other cash requirements to support the development of its short-term and long-term operating strategies. The Company generally finances real estate with operating leases. Management believes its cash, cash equivalents, short-term investments, future cash flow from operations, and the Company's current revolving credit facility will be adequate to fund these requirements.

The Company may also from time to time repurchase its common stock or seek to retire or purchase outstanding debt through open market purchases, privately negotiated transactions, or otherwise. Such repurchases, if any, will depend on prevailing market conditions, liquidity requirements, contractual restrictions, and other factors. The amounts involved may be material.

Any material adverse change in customer demand, fashion trends, competitive market forces, or customer acceptance of the Company's merchandise mix and retail locations, uncertainties related to the effect of competitive products and pricing, the Company's reliance on a few key vendors for a significant portion of its merchandise purchases and risks associated with global product sourcing, economic conditions worldwide, the effects of currency fluctuations, as well as other factors listed under the heading "Disclosure Regarding Forward-Looking Statements," could affect the ability of the Company to continue to fund its needs from business operations.

On May 16, 2012, the Company's Board of Directors approved an overall increase of \$10 million to the 2012 capital expenditure and lease acquisition plan to \$170 million, representing capital expenditures of \$163 million and lease acquisition costs related to the Company's operations in Europe of \$7 million. Separately, in May 2012 the Company purchased from its U.S. pension trust an investment in real estate for \$8 million.

Operating Activities

Net cash provided by operating activities was \$161 million and \$127 million for the twenty-six weeks ended July 28, 2012 and July 30, 2011, respectively. These amounts reflect net income adjusted for non-cash items and seasonal working capital changes. The increase in operating cash flow is primarily the result of strong sales during the first two quarters, and improved working capital management. Other changes reflect the timing of income tax payments as well as the prior year's receipt of a \$46 million IRS income tax refund resulting from a loss carryback.

Investing Activities

Net cash used in investing activities was \$137 million and \$66 million for the twenty-six weeks ended July 28, 2012 and July 30, 2011, respectively, reflecting the Company's net purchases of \$50 million of short-term investments as well as capital expenditures. The Company's current full year forecast for capital expenditures is \$163 million, of which \$124 million relates to the modernizations of existing stores and new store openings and \$39 million for the development of information systems and infrastructure. The Company expects to open 84 new stores as well modernize 180 stores during the year. Capital expenditures for the twenty-six weeks ended July 28, 2012 also includes \$8 million to purchase land and buildings from the Company's U.S. pension trust.

Financing Activities

Net cash used in financing activities was \$90 million and \$95 million for the twenty-six weeks ended July 28, 2012 and July 30, 2011, respectively. During the twenty-six weeks ended July 28, 2012, the Company repurchased and

retired \$2 million of its 8.50 percent debentures payable in 2022. Additionally in 2012, the Company repurchased 2,120,261 shares of its common stock for \$65 million, compared with \$59 million purchased during the corresponding prior-year period. The Company declared and paid dividends during the first two quarters of 2012 and 2011 of \$55 million and \$51 million, respectively. This represents a quarterly rate of \$0.18 and \$0.165 per share for 2012 and 2011, respectively. The Company received proceeds from the issuance of common stock in connection with employee stock programs of \$25 million and \$12 million for the twenty-six weeks ended July 28, 2012 and July 31, 2011, respectively. In connection with stock option exercises and share-based compensation programs, the Company recorded excess tax benefits of \$7 million as a financing activity during the twenty-six week period ended July 28, 2012 as compared with \$3 million in the corresponding prior-year period, primarily reflecting higher stock option exercises in the current year.

Recent Accounting Pronouncements

During the first quarter of 2012, the Company adopted ASU No. 2011-08, *Testing Goodwill for Impairment*. The revised standard is intended to reduce the cost and complexity of the annual goodwill impairment test by providing entities an option to perform a qualitative assessment to determine whether further impairment testing is necessary. The adoption of this ASU did not have a significant effect on our results of operations or financial position.

During the first quarter of 2012, the Company also adopted ASU No. 2011-05, *Presentation of Comprehensive Income*, which requires presentation of total comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The implementation of the amended reporting guidance had no effect on our disclosures.

In July 2012, the FASB issued ASU 2012-02, *Testing Indefinite-Lived Intangible Assets for Impairment*, which allows an entity to first assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset, other than goodwill, is impaired. If an entity concludes, based on an evaluation of all relevant qualitative factors, that it is not more likely than not that the fair value of an indefinite-lived intangible asset is less than its carrying amount, it will not be required to perform a quantitative impairment test for that asset. Entities are required to test indefinite-lived assets for impairment at least annually, and more frequently if indicators of impairment exist. This ASU will be effective for the Company on February 3, 2013, with early adoption permitted. The adoption of this ASU is not expected to have a significant effect on our results of operations or financial position.

Other recently issued accounting pronouncements did not, or are not believed by management to, have a material effect on the Company's present or future consolidated financial statements.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

There have been no significant changes to the Company's critical accounting policies and estimates from the information provided in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," included in the Annual Report on Form 10-K for the fiscal year ended January 28, 2012.

DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements within the meaning of the federal securities laws. Other than statements of historical facts, all statements which address activities, events, or developments that the Company anticipates will or may occur in the future, including, but not limited to, such things as future capital expenditures, expansion, strategic plans, financial objectives, dividend payments, stock repurchases, growth of the Company's business and operations, including future cash flows, revenues, and earnings, and other such matters, are forward-looking statements. These forward-looking statements are based on many assumptions and factors which are detailed in the Company's filings with the Securities and Exchange Commission, including the effects of currency fluctuations, customer demand, fashion trends, competitive market forces, uncertainties related to the effect of competitive products and pricing, customer acceptance of the Company's merchandise mix and retail locations, the Company's reliance on a few key vendors for a majority of its merchandise purchases (including a significant portion

from one key vendor), pandemics and similar major health concerns, unseasonable weather, further deterioration of global financial markets, economic conditions worldwide, further deterioration of business and economic conditions, any changes in business, political and economic conditions due to the threat of future terrorist activities in the United States or in other parts of the world and related U.S. military action overseas, the ability of the Company to execute its business and strategic plans effectively with regard to each of its business units, and risks associated with global product sourcing, including political instability, changes in import regulations, and disruptions to transportation services and distribution.

For additional discussion on risks and uncertainties that may affect forward-looking statements, see “Risk Factors” disclosed in the 2011 Annual Report on Form 10-K. Any changes in such assumptions or factors could produce significantly different results. The Company undertakes no obligation to update forward-looking statements, whether as a result of new information, future events, or otherwise.

Item 4. Controls and Procedures

The Company's management performed an evaluation under the supervision and with the participation of the Company's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), and completed an evaluation as of July 28, 2012 of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as that term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")). Based on that evaluation, the Company's CEO and CFO concluded that the Company's disclosure controls and procedures were effective to ensure that information relating to the Company that is 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 in the SEC rules and forms, and is accumulated and communicated to management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

During the quarter ended July 28, 2012, there were no changes in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) of the Exchange Act) that materially affected or are reasonably likely to affect the Company's internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

Legal proceedings pending against the Company or its consolidated subsidiaries consist of ordinary, routine litigation, including administrative proceedings, incidental to the business of the Company or businesses that have been sold or disposed of by the Company in past years. These legal proceedings include commercial, intellectual property, customer, environmental, and labor-and-employment-related claims.

Certain of the Company's subsidiaries are defendants in a number of lawsuits filed in state and federal courts containing various class action allegations under federal or state wage and hour laws, including allegations concerning unpaid overtime, meal and rest breaks, and uniforms.

The Company is a defendant in one such case in which plaintiff alleges that the Company permitted unpaid off-the-clock hours in violation of the Fair Labor Standards Act and state labor laws. The case, *Pereira v. Foot Locker*, was filed in the U.S. District Court for the Eastern District of Pennsylvania in 2007. In his complaint, in addition to unpaid wage and overtime allegations, plaintiff seeks compensatory and punitive damages, injunctive relief, and attorneys' fees and costs. In 2009, the Court conditionally certified a nationwide collective action. During

the course of 2010, notices were sent to approximately 81,888 current and former employees of the Company offering them the opportunity to participate in the class action, and approximately 5,027 have opted in.

The Company is a defendant in additional purported wage and hour class actions that assert claims similar to those asserted in *Pereira* and seek similar remedies. With the exception of *Hill v. Foot Locker* filed in state court in Illinois, and *Cortes v. Foot Locker* filed in federal court of New York, all of these actions were consolidated by the United States Judicial Panel on Multidistrict Litigation with *Pereira*. The consolidated cases are in the discovery stages of proceedings. In *Hill v. Foot Locker*, in May 2011, the court granted plaintiffs' motion for certification of an opt-out class covering certain Illinois employees only. The Company's motion for leave to appeal was denied. The Company is currently engaged in mediation with plaintiff's counsel in *Pereira* in an attempt to determine whether it will be possible to resolve the consolidated cases and *Hill*. Meanwhile, the Company is vigorously defending these class actions. Due to the inherent uncertainties of such matters, and because fact and expert discovery have not been completed, the Company is currently unable to make an estimate of the range of loss.

The Company and the Company’s U.S. retirement plan are defendants in a purported class action (*Osberg v. Foot Locker*, filed in the U.S. District Court for the Southern District of New York) in which the plaintiff alleges that, in connection with the 1996 conversion of the retirement plan to a defined benefit plan with a cash balance formula, the Company and the retirement plan failed to properly advise plan participants of the “wear-away” effect of the conversion. Plaintiff asserts claims for breach of fiduciary duty under the Employee Retirement Income Security Act of 1974 (ERISA) and violation of the statutory provisions governing the content of the Summary Plan Description. Claims for alleged violations of the notice provision of Section 204(h) of ERISA and ERISA’s age discrimination provisions were dismissed by the court. The Company is currently engaged in mediation with plaintiff’s counsel in an attempt to determine whether it will be possible to resolve this case. Because of the inherent uncertainties of such matters, because plaintiff is attempting to extend discovery on certain issues, and because certain motions relating to key portions of the case are currently pending with the court, the Company is currently unable to make an estimate of loss or range of loss for this case.

Management does not believe that the outcome of any such legal proceedings pending against the Company or its consolidated subsidiaries, including the *Pereira* consolidated cases, *Hill*, and *Osberg*, as described above, would have a material adverse effect on the Company’s consolidated financial position, liquidity, or results of operations, taken as a whole.

Item 1A. Risk Factors

There were no material changes to the risk factors disclosed in the 2011 Annual Report on Form 10-K.

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

The following table provides information with respect to shares of the Company’s common stock that the Company repurchased during the thirteen weeks ended July 28, 2012.

| Date Purchased | Total Number of Shares Purchased ⁽¹⁾ | Average Price Paid per Share ⁽¹⁾ | Total Number of Shares Purchased as Part of Publicly Announced Program ⁽²⁾ | Approximate Dollar Value of Shares that may yet be Purchased Under the Program |
|----------------|---|---|---|--|
|----------------|---|---|---|--|

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| | | | | |
|-------------------------------------|-----------|----------|-----------|-----------------------|
| April 29, 2012 through May 26, 2012 | 29,900 | \$ 32.57 | 29,900 | (2) \$ 371,980,663 |
| May 27, 2012 through June 30, 2012 | 1,149,018 | \$ 30.12 | 1,149,018 | \$ 337,366,524 |
| July 1, 2012 through July 28, 2012 | 62,643 | \$ 31.20 | 62,643 | \$ 335,412,259 |
| | 1,241,561 | \$ 30.24 | 1,241,561 | |

(1) The calculation of the average price paid per share includes all fees, commissions, and other costs associated with the repurchase of such shares.

(2) On February, 14, 2012, the Company's Board of Directors approved a new 3-year, \$400 million share repurchase program extending through January 2015.

Item 6. Exhibits

(a) Exhibits

The exhibits that are in this report immediately follow the index.

SIGNATURE

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

FOOT LOCKER, INC.

Date: September 5, 2012 (Company)

/s/ Lauren B. Peters

LAUREN B. PETERS

Executive Vice President and Chief Financial Officer

FOOT LOCKER, INC.

INDEX OF EXHIBITS REQUIRED BY ITEM 6(a) OF FORM 10-Q

AND FURNISHED IN ACCORDANCE WITH ITEM 601 OF REGULATION S-K

| Exhibit No. in Item 601 | Description |
|----------------------------|---|
| 12 | Computation of Ratio of Earnings to Fixed Charges. |
| 15 | Accountants' Acknowledgement. |
| 31.1 | Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 99 | Report of Independent Registered Public Accounting Firm. |
| 101 | The following materials from Foot Locker, Inc.'s Quarterly Report on Form 10-Q for the quarter ended July 28, 2012, formatted in XBRL (Extensible Business Reporting Language) and furnished electronically herewith: (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Operations, (iii) the Condensed Consolidated Statements of Comprehensive Income, (iv) the Condensed Consolidated Statements of Cash Flows, and (v) Notes to Condensed Consolidated Financial Statements, tagged as blocks of text. This exhibit will not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934 (15 U.S.C. 78r), or otherwise subject to the liability of that section. Such exhibit will not be deemed to be incorporated by reference into any filing under the Securities Act or Securities Exchange Act, except to the extent that the Company specifically incorporates it by reference. |

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