Attorney Docket No. 33127T-004600USUS

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By:
Charlene J. Foster

IN THE UNITED STATES PATENT AND TRADEMARK OFFICE

In re application of:

Williams-Sonoma, Inc.

Serial No.: 76/542,867

Filed: September 8, 2003

Mark: **PEPPERMINT BARK**

TM Attorney: Russ Herman

Law Office: 101

REQUEST FOR REINSTATEMENT

Commissioner for Trademarks
P. O. Box 1451
Alexandria, VA 22313-1451

Madam:

This is in response to the Reconsideration Letter issued on January 26, 2007.

On December 27, 2006 applicant timely submitted a Request for Reconsideration, a Declaration in Support of the Request for Reconsideration, and a Notice of Appeal in response to the final Office Action issued by the Examiner on June 27, 2006. (True and correct copies of the Request for Reconsideration and Notice of Appeal are attached hereto as Exhibits A and B, respectively.)

02-20-2007
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The confirmation postcards mailed with the Request for Reconsideration and Notice of Appeal were stamped and placed in the mail to applicant on December 29, 2006. (True and correct copies of the postcards are attached hereto as Exhibits C and D, respectively.)

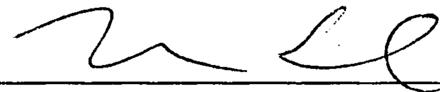
On January 26, 2007, the Examiner issued a denial of the request for reconsideration. The Examiner erroneously stated that a Notice of Appeal was not filed with the Request and declared that the application will be considered abandoned in due course because the time for filing such a Notice had elapsed.

Applicant, having submitted evidence showing that a Notice of Appeal was timely submitted, respectfully requests that the application be reinstated pursuant to TMEP §1712.01, and that the Notice of Appeal be deemed filed.

Dated: February 15, 2007.

Respectfully submitted,

TOWNSEND and TOWNSEND and CREW LLP

By: 

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TRADEMARK

Attorney Docket No. 33127T-004600US

CERTIFICATE OF MAILING

Date of Deposit: **December 27, 2006**

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TOWNSEND AND TOWNSEND AND CREW LLP

By: L Simón

Lois M. Simón

IN THE UNITED STATES PATENT AND TRADEMARK OFFICE

In re application of:

Williams-Sonoma, Inc.

Mark: **PEPPERMINT BARK**

Serial No. 76/542,867

Filed: September 8, 2003

TM Attorney: Russ Herman

Law Office: 101

REQUEST FOR RECONSIDERATION OF FINAL REFUSAL [37 C.F.R. §2.64(b)]

APPEAL DATE: December 27, 2006

Commissioner for Trademarks
P.O. Box 1451
Alexandria, VA 22313-1451

Dear Madam:

This Request for Reconsideration is responsive to the Examining Attorney's final Office Action dated June 27, 2006. That Office Action has been reviewed in depth, and this Response is intended to address the points raised by the Examining Attorney and place the application into condition for publication.

Applicant respectfully submits that the Examining Attorney has not met his

burden of proving that Applicant's mark is generic, whereas Applicant has established a *prima facie* case of acquired distinctiveness. Refusal to register the **PEPPERMINT BARK** mark should be withdrawn and registration should be permitted on the Supplemental Register.

I. PEPPERMINT BARK IS NOT GENERIC

A. The PTO Has Not Met Its Burden Of Proof; There Is No Clear Evidence That The Mark Is Generic

Even if Applicant's arguments and evidence were insufficient (which they are not), registration should issue because the Examining Attorney has failed to meet his evidentiary burden by establishing that the mark sought to be registered is generic for the goods described in the application. *See* In re Merrill Lynch, 4 U.S.P.Q.2d 1141, 1143 (Fed. Cir. 1997). Moreover, the Examining Attorney is required to make a substantial showing that the matter at issue is clearly generic. Id. The evidence relied on by the Examining Attorney is often flawed, and fails to prove Applicant's **PEPPERMINT BARK** mark is generic.

1. References Cited By The Examining Attorney Are Subsequent To, And Result From, Applicant's Long-Standing Use Of PEPPERMINT BARK As A Mark, In Which Applicant Has Established A *Prima Facie* Case Of Acquired Distinctiveness

Applicant first began use of the **PEPPERMINT BARK** mark in commerce at least as early as October 1999. Since then, the mark has consistently appeared in Applicant's catalogs, tens of millions of which are distributed to U.S. consumers every holiday season. *See* Declaration of Christine Amatruda (hereinafter, "Amatruda Decl."), ¶ 1, attached hereto. Since its introduction, Applicant's **PEPPERMINT BARK** product has attained several million dollars of sales each year, all made under the **PEPPERMINT BARK** mark. *Id.* at ¶ 3. Since 1999,

Applicant's **PEPPERMINT BARK** confection has also been prominently featured on Applicant's heavily trafficked website, which includes key placements on Applicant's home page. *Id.* at ¶ 6. Further, the **PEPPERMINT BARK** product has been promoted through large point-of-sale displays in Applicant's stores, of which there are over 250 located in leading shopping destinations throughout the U.S. *Id.* at 1.

In both the present Office Action, and those issued previously in regard to the instant application, the Examining Attorney has referenced the appearance of the phrase "PEPPERMINT BARK" in excerpted articles. However, given the pervasiveness of Applicant's candies it is not clear from the excerpted references whether the cited uses of the "PEPPERMINT BARK" term refer to Applicant's goods (which several references clearly do) or not. The overwhelming majority of references cited by the PTO occur after applicant's adoption, and extensive promotion, of the mark. Given the popularity of Applicant and its goods, the subsequent appearance of references to "PEPPERMINT BARK" cannot be considered convincing evidence of genericness. Thus, the PTO's evidence fails to prove that the cited references to the term Applicant's **PEPPERMINT BARK** do not refer to Applicant's goods and services.

As an example, consider just one reference cited in the June 6, 2005 Office Action, in which the website author refers to paying "$20 for a pound of peppermint bark" in a "fancy store," which she attempts to duplicate. This is clearly an allusion to Applicant's well-known **PEPPERMINT BARK** product, and a lone consumer's attempt to duplicate a product found at Applicant's stores cannot be considered as evidence of the alleged generic nature of Applicant's

mark. Thus, on the face of it, the Examining Attorney has produced no evidence that the mark, when considered in its entirety, is clearly the generic term for Applicant's goods.

2. Several References Relied Upon By The PTO Cannot Serve As Evidence Or Are Redundant

A number of references identified by the PTO to support its claims that **PEPPERMINT BARK** is descriptive and/or generic cannot serve as evidence, since these references appear in foreign publications and refer to use of the term outside of the U.S. Consider, for instance, reference 31 in the June 27, 2006 Office Action (Queensland, Australia), reference 25 in the November 29, 2005 Office Action (Ottawa, Canada), and reference 16 in the November 4, 2004 Office Action (Montreal, Quebec).

Moreover, the number of references identified by the PTO is somewhat misleading, as some articles appear more than once. As just one example, consider references 3 and 4 in the June 27, 2006 Office Action, which refer to the same Tulsa, Oklahoma article.

3. Evidence Cited By The PTO Rarely Considers The Term PEPPERMINT BARK As A Whole

In evaluating alleged genericness, a mark should not be dissected into its component parts but rather should be considered as a whole. *See* Committee for Idaho's High Desert v. Yost, 39 U.S.P.Q.2d 1705, 1710 (9th Cir. 1996) ("Plaintiff's mark is a composite term, and its validity is not judged by an examination of its parts. Rather, the validity of a trademark is to be determined by viewing the trademark as a whole"); Application of Chesapeake Corp. of Virginia, 420 F.2d 754 (C.C.P.A. 1970). It follows, therefore, that even if words are singly descriptive or generic, their combination may create a composite that is nondescriptive. TMEP §1209.01(b)(4). *See* Texas Pig Stands, Inc. v. Hard Rock Café Int'l, Inc., 21 U.S.P.Q.2d 1641 (5th Cir. 1992)

(combination of the two generic terms "pig" and "sandwich" results in a non-generic composite). *See also* Beer Nuts v. Clover Club Foods Co. 711 F.2d 934 (10th Cir. 1983) ("Beer nuts" held not generic); Schmidt v. Quigg, 226 U.S.P.Q. 518 (E.D. Mich 1985) ("Honey baked ham" held not generic).

Although it is permissible to separately view the component parts as a preliminary step, "the ultimate determination is made on the basis of the mark in its entirety." *See* In re Occidental Petroleum Corp., 193 U.S.P.Q. 732 (T.T.A.B. 1976). Applicant notes that the Examining Attorney has collapsed this process, parsing the mark and then finding each part to be generic. The Examining Attorney has seemingly disregarded the anti-dissection rule by looking only at each element of the mark "separated and considered in detail." *See* Estate of P.D. Beckwith, Inc. v. Commissioner of Patents, 252 U.S. 538, 545-46 (1920).

Of the references cited in the most recent Office Action, an overwhelming number refer to the term "bark candy," and not to the term "PEPPERMINT BARK," or even merely the term "bark." For example, consider the following references: 3, 4, 9, 14, 15, 26, 27, 31, 34, 40, 41, 42, 44, 47. As such, this evidence fails to show that the mark, when considered in its entirety, is clearly the generic term for Applicant's goods.

4. Any Doubts Must Be Resolved In Favor Of Applicant

Finally, any doubt on the issue of whether Applicant's mark is generic must be resolved in Applicant's favor. *See* In re Waverly, 27 U.S.P.Q.2d 1620, 1624 (T.T.A.B. 1993). Since the materials submitted by the Examining Attorney are not persuasive that Applicant's mark is generic, registration should be allowed. *See* In re Federated Department Stores, Inc., 3 U.S.P.Q.2d 1541, 1543 (T.T.A.B. 1987) (THE CHILDREN'S OUTLET allowed registration

under 2(f) for retail children's clothing store services).

B. A District Court Has Already Considered This Issue And Declined To Rule That PEPPERMINT BARK Is Generic For Applicant's Goods

In Williams-Somoma, Inc. v. West Coast Confections, Case No. C-03-4716 EDL (N.D. Cal. 2004), United States Magistrate Judge Elizabeth Laporte considered whether Applicant's **PEPPERMINT BARK** mark was generic. In that litigation, the defendant alleged that **PEPPERMINT BARK** was generic, and therefore not entitled to trademark protection. Magistrate Judge Laporte disagreed, and in her Order Denying Defendant's Motion to Dismiss, she found that not only had Applicant sufficiently alleged that **PEPPERMINT BARK** was not generic, but that Applicant's conclusion of non-genericness was "reinforced by the dictionary definitions of which the Court took judicial notice." A copy of the Order is attached as Exhibit A. Magistrate Judge Laporte subsequently denied the defendant's motion to dismiss based on the alleged genericness of Applicant's **PEPPERMINT BARK** mark.

C. The Primary Significance Of PEPPERMINT BARK To The Relevant Public Is As A Source Indicator, Not A Category Of Goods

Applicant's mark is a compound word comprised of the terms "peppermint" and "bark." The Examining Attorney refuses registration on the basis that these terms are generic and have no trademark significance. However, the correct test for genericness, as set forth in Marvin Ginn, is whether (1) the mark sought to be protected in its entirety represents the genus or category of goods in question and (2) that the public refers to Applicant's mark as such. *See* H. Marvin Ginn Corporation v. International Association of Fire Chiefs, 782 F. 2d 987, 989-990 (Fed. Cir. 1986). Further, as the Examining Attorney notes, generic jurisprudence "revolves around the primary significance test, which inquires whether the primary significance of a term

in the minds of the consuming public is the product or the producer." As explained, the Examining Attorney has not provided clear evidence to support that the **PEPPERMINT BARK** mark is generic, or that the primary significance of the term is as a generic indicator of the goods, and not the source.

1. A Compound Word With A Plain Meaning Different From Its Constituent Terms May Not Be Proven Generic

Where a compound word may have a plain meaning different from its constituent terms, the compound word may not be proven generic. *See* In re American Fertility Society, 51 U.S.P.Q.2d 1832, 1836 (Fed. Cir. 1999). Here, the compound word "PEPPERMINT BARK" creates a different commercial impression than the meaning suggested by the Examining Attorney. Even considered separately, neither the PEPPERMINT nor the BARK terms can be seen as merely descriptive—let alone generic—of Applicant's goods.

As set forth in Applicant's prior Office Action responses, the individual terms of the **PEPPERMINT BARK** mark can be interpreted to mean a multitude of things by consumers. "BARK," for instance, can mean any of the following: to speak in a curt loud and usually angry tone; a small sailing ship; the sound made by a barking dog; or the tough exterior covering of a woody root or stem. Notably, the meaning the Examining Attorney proffers for BARK is not generally recognized, as shown in the attached dictionary excerpts in Exhibit B. Presumably, such a little known word could hardly be the "primary significance" of the term, as required under trademark law. Likewise, "PEPPERMINT" also has several possible meanings. Multiple meanings for both words makes it exponentially more difficult for consumers to relate any one particular meaning to the composite term.

If consumers were, however, to ascribe a meaning to the composite term, they would be more than likely to make the same assumption the Examining Attorney did in the initial Office Action, dated March 24, 2004. In that Office Action, the Examining Attorney concluded that if Applicant's goods were "processed from the 'bark' of the 'peppermint plant,'" the mark would be descriptive. As Applicant has already indicated, such is not the case. The Examining Attorney's subsequent identification of references using the term **PEPPERMINT BARK** merely reflects the increased occurrence of the term due to Applicant's long term-use of the mark in conjunction with its goods and Applicant's extensive marketing efforts relating thereto.

2. Contrary To The Examining Attorney's Assertions, There Are Commonly Used Alternatives For the Term PEPPERMINT BARK

The Examining Attorney's conclusion that the **PEPPERMINT BARK** mark is generic relies upon his assumption that there does not appear to be a commonly used alternative that effectively communicates the same functional information. Applicant disagrees on this point, as there are a number of terms, other than **PEPPERMINT BARK**, that refer to the genus of goods similar in nature to Applicant's **PEPPERMINT BARK** product. Just a handful of these terms are shown in the attached evidence in Exhibit C, and include "White Chocolate Mint Candy," "White Chocolate Mint Christmas Candy," "Peppermint Chocolate," "Peppermint Brittle," "Peppermint Candy," and "White Christmas Candy." Therefore, affording Applicant trademark rights in a term in which it has established acquired distinctiveness can hardly serve to prevent others from making and referring to similar goods.

II. IT IS INCONSISTENT AND WRONG TO DENY REGISTRATION OF PEPPERMINT BARK WHEN NUMEROUS "PEPPERMINT" AND "BARK" REGISTRATIONS EXIST FOR LIKE GOODS

Certainly, the decisions of numerous Examining Attorneys to register other "PEPPERMINT" and "BARK" marks for goods akin to those provided by Applicant is convincing evidence that Applicant's mark is not generic. The following chart summarizes examples of relevant registrations, and includes several registrations belonging to Applicant (**bolded**). Notably, Applicant has two existing registrations for **PEPPERMINT BARK** on the Principal Register, Registration Nos. 2758725 and 2785972. *See* Exhibit D, printouts of relevant registrations from the Office's online database.

Mark	Goods	Reg. No.	Register
PEPPERMINT BARK	Candy in Class 30	2758725	Principal
PEPPERMINT BARK	Candy in Class 30	2785972	Principal
PEPPERMINT BURSTS	Candy in Class 30	2946172	Principal
PEPPERMINT CHEWZ	Candy in Class 30	2751398	Principal
PEPPERMINT CREMES	Candy bars, (chocolate); Chips, (chocolate); Chocolate candies; Chocolate chips in Class 30	2945581	Principal
PEPPERMINT PASSION	White mint ice cream with chocolate flakes and mini chocolate mint patties in Class 30	2804152	Principal
PEPPERMINT PONIES	Candy in Class 30	1828450	Principal
PEPPERMINT SNAPS	Candy in Class 30	2743752	Principal
BIRCH BARK	Candy made with birch syrup candy pieces embedded in white chocolate in Class 30	2587962	Principal
CHIPPERS THE BARK WITH A BITE	Confections, namely candy and candy bars in Class 30	3121157	Principal
REINDEER BARK	Chocolate candy in Class 30	2618337	Principal

Mark	Goods	Reg. No.	Register
VANILLA ALMOND BARK	Frozen confections in Class 30	3109102	Principal
YOU CAN'T BITE A BETTER BITE	Candy in Class 30	3039031	Principal

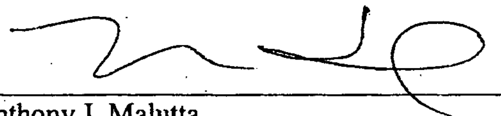
If "PEPPERMINT" and "BARK" are ***repeatedly registrable*** for other products, it is inconsistent and wrong to deny registration of Applicant's **PEPPERMINT BARK** mark for its goods.

III. Conclusion

Based on the above, the Examining Attorney has not met his burden of proving that Applicant's mark is generic. Furthermore, Applicant's mark functions as a trademark as applied to the goods and Applicant has established a *prima facie* case of sufficient distinctiveness for amendment to the Supplemental Register. Accordingly, Applicant respectfully requests that the Examining Attorney withdraw his final refusal and allow the instant application to proceed to publication. If a telephone conversation would be appropriate to further the prosecution of this application, please telephone the undersigned.

Respectfully submitted,

TOWNSEND and TOWNSEND and CREW LLP



Dated: December 27, 2006

By: ______________________

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United States District Court
For the Northern District of California

IN THE UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

WILLIAMS-SONOMA, INC.,

Plaintiff,

v.

WEST COAST CONFECTIONS,

Defendant.

_______________________________/

No. C-03-4716 EDL

ORDER DENYING DEFENDANT'S MOTION TO DISMISS

In this trademark infringement case, Plaintiff Williams-Sonoma, Inc. contends that Defendant West Coast Confections is infringing on Plaintiff's trademark of the term, "Peppermint Bark." Peppermint Bark is a type of holiday candy sold by Plaintiff. Defendant moved to dismiss pursuant to Federal Rule of Civil Procedure 12(b)(6) on the grounds that Plaintiff has failed to state a claim because the term, "Peppermint Bark," is generic and therefore not entitled to trademark protection. On January 6, 2004, the Court held a hearing on Defendant's Motion to Dismiss, at which both parties were represented by counsel.

DISCUSSION

Under the federal notice pleading standard, a court may not dismiss a complaint for failure to state a claim unless "it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitled him to relief." Conley v. Gibson, 355 U.S. 41, 45-46 (1957); Fed. R. Civ. Proc. 8(a). In analyzing a motion to dismiss, a court must accept as true all material allegations in the complaint, and construe them in the light most favorable to the nonmoving party. NL Industries, Inc. v. Kaplan, 792 F.2d 896, 898 (9th Cir. 1986).

To prevail on a trademark infringement claim, a plaintiff must prove the existence of a trademark and the subsequent use of that mark by another in a manner likely to create consumer confusion. See Comedy III Prods., Inc. v. New Line Cinema, 200 F.3d 593, 594 (9th Cir. 2000). Defendant's motion attacks the first element of Plaintiff's trademark infringement claim on the ground that the term "Peppermint Bark" is generic. A generic term refers to the "genus of which the particular product is a species," and can never be protected as a trademark. Committee for Idaho's High Desert v. Yost, 92 F.2d 814, 821 (9th Cir. 1996); see also J. Thomas McCarthy, McCarthy on Trademarks and Unfair Competition, § 12.57 at 12-109 (West Group 2001). By contrast, a descriptive mark may be protected "if the registrant shows that it has acquired secondary meaning, i.e., it has become distinctive of the applicant's goods in commerce." Park N' Fly, Inc. v. Dollar Park and Fly, Inc., 469 U.S. 189, 194 (1985). Whether an alleged mark is generic or descriptive is a question of fact. Committee for Idaho's High Desert, 92 F.3d at 821; Films of Distinction, Inc. v. Allegro Film Prods., Inc., 12 F. Supp. 2d 1068, 1075 (C.D. Cal. 1998).

Here, Plaintiff alleges that it "distinctively coined" the term "Peppermint Bark," and that it has applied for a trademark registration. See Compl. ¶¶ 6, 12. Plaintiff alleges that since 1999, it has advertised, marketed and sold, through its retail stores, catalogs and websites, its Peppermint Bark products. See Compl. ¶ 7. Plaintiff alleges that "tens of millions" of catalogs are delivered to consumers every holiday season and that the Peppermint Bark products have attained several million dollars of sales each year. Id. Plaintiff further alleges that "as a result of these marketing and sales efforts, consumers have come to strongly and secondarily associate Peppermint Bark trademark with Williams-Sonoma and its high quality candy products." Id. Plaintiff also alleges that Defendant is using the "Peppermint Bark" name to sell candy at another retailer's stores and that those sales are likely to cause consumer confusion. See id. ¶¶ 14, 15.

In light of the liberal standard for notice pleading, Plaintiff's allegations in the complaint are sufficient to state a claim for trademark infringement. See Balistreri v. Pacifica Police Dep't, 901 F.2d 696, 699 (9th Cir. 1990) (finding that a motion to dismiss would be appropriate if a complaint suffered from an "absence of sufficient facts alleged under a cognizable legal theory."). Taking the allegations in the complaint as true, as the Court must do on a motion to dismiss, Plaintiff has sufficiently alleged that Peppermint Bark is not generic, i.e., that it has acquired a secondary meaning and that its primary significance to the relevant public

is to identify Plaintiff as the source of Peppermint Bark. This conclusion is reinforced by the dictionary definitions of which the Court took judicial notice.

Defendant raises a serious issue as to whether "Peppermint Bark" is generic, and has offered some support for that view in the documents that it requested be judicially noticed. Nonetheless, the question is not one that should be decided at the pleading stage. As Defendant conceded at the hearing, it could not locate a single case in which the issue of whether a mark is generic was decided on the pleadings. Accordingly, Defendant's Motion to Dismiss (docket number 8) is denied.

REQUESTS FOR JUDICIAL NOTICE

With its motion, Defendant seeks judicial notice of: (1) Plaintiff's trademark application; (2) results of Google.com search on "Peppermint Bark;" (3) a Peppermint Bark recipe; (4) Plaintiff's website regarding peppermint bark; and (5) Plaintiff's catalog regarding peppermint bark. Plaintiff does not oppose judicial notice of its trademark application, but does oppose the remainder of Defendant's requests. Plaintiff's request for judicial notice of dictionary entries from two dictionaries defining the term "bark" is unopposed.

A judicially noticed fact "must be one not subject to reasonable dispute in that it is either (1) generally known within the territorial jurisdiction of the trial court or (2) capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned." Fed. R. Evid. 201(b). Plaintiff's request for judicial notice is granted because the dictionary definitions Plaintiff provided are not subject to reasonable dispute as provided in Federal Rule of Evidence 201(b). A court may also properly consider material submitted as part of the complaint and take judicial notice of documents referred to in the complaint or which form the basis for the complaint. See Hal Roach Studios v. Richard Feiner & Co., 896 F.2d 1542, 1554 n. 19 (9th Cir.1990) (material submitted as part of the complaint); Mack v. South Bay Beer Distribs., Inc., 798 F.2d 1279, 1282 (9th Cir.1986) (judicial notice), abrogated on other grounds, Astoria Federal Sav. and Loans Ass'n v. Solimino, 501 U.S. 104 (1991). Defendant's request for judicial notice of Plaintiff's trademark application, the Google.com results and the recipe is granted because those documents are not subject to reasonable dispute as provided in Rule 201(b). Defendant's request for judicial notice of Plaintiff's website and catalog is granted because these documents are referred to in Plaintiff's complaint and are central to Plaintiff's allegation that "Peppermint Bark" has acquired a

secondary meaning.

Dated: January 7, 2004

/electronic signature authorized/
ELIZABETH D. LAPORTE
United States Magistrate Judge

United States District Court
For the Northern District of California

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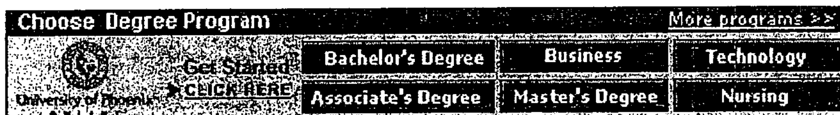

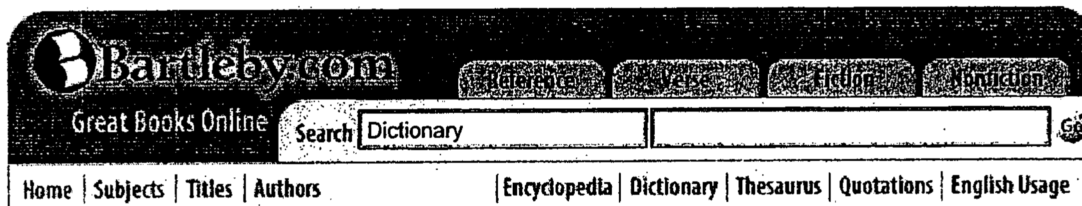

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bark[1]

PRONUNCIATION: bärk

NOUN: **1.** The harsh sound uttered by a dog. **2.** A sound, such as a cough, that is similar to a dog's bark.

VERB: Inflected forms: **barked, bark·ing, barks**

INTRANSITIVE VERB: **1.** To utter a bark. **2.** To make a sound similar to a bark: *"The birds bark softly, sounding almost like young pups"* (Charleston SC News and Courier). **3.** To speak sharply; snap: *"a spot where you can just drop in . . . without anyone's barking at you for failing to plan ahead"* (Andy Birsh, *Gourmet* 5/89). **4.** To work as a barker, as at a carnival.

TRANSITIVE VERB: To utter in a loud, harsh voice: *The quarterback barked out the signals.*

IDIOM: **bark up the wrong tree** To misdirect one's energies or attention.

ETYMOLOGY: From Middle English *berken,* to bark, from Old English *beorcan.*

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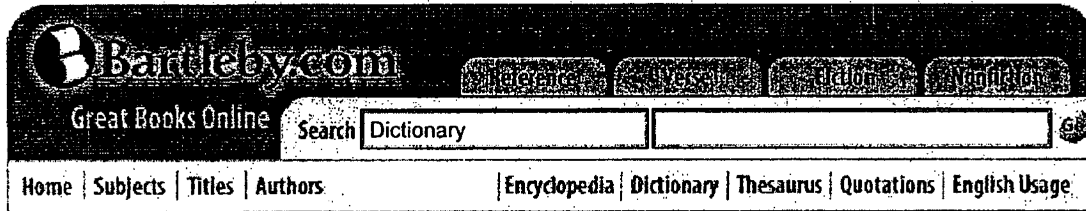

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bark2

PRONUNCIATION: bärk

NOUN: **1.** The tough outer covering of the woody stems and roots of trees, shrubs, and other woody plants. It includes all tissues outside the vascular cambium. **2.** A specific kind of bark used for a special purpose, as in tanning or medicine.

TRANSITIVE VERB: Inflected forms: **barked, bark·ing, barks**
1. To remove bark from (a tree or log). **2.** To rub off the skin of; abrade: *barked my shin on the car door.* **3.** To tan or dye (leather or fabric) by steeping in an infusion of bark. **4.** To treat (a patient) using a medicinal bark infusion.

ETYMOLOGY: Middle English, from Old Norse *börkr.*

OTHER FORMS: **bark'y** —ADJECTIVE

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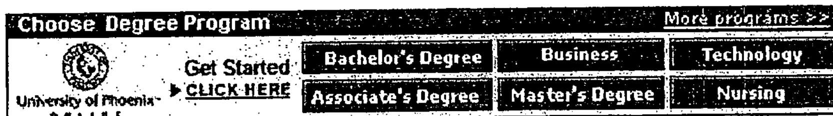

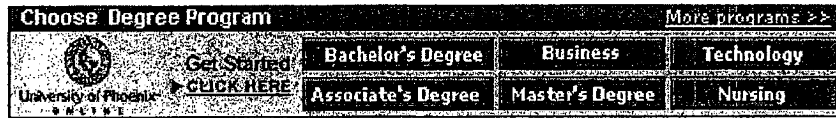

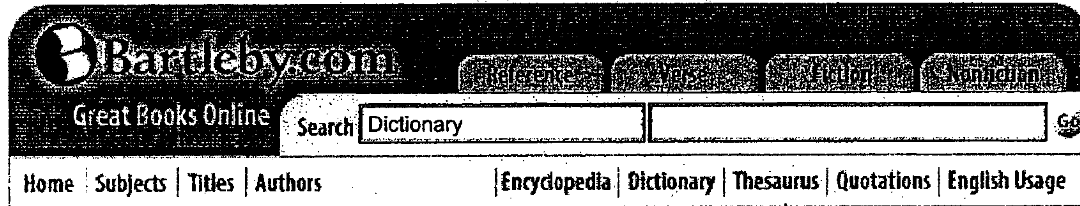

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bark3

PRONUNCIATION: bärk

VARIANT FORMS: also **barque**

NOUN: **1.** A sailing ship with from three to five masts, all of them square-rigged except the after mast, which is fore-and-aft rigged. **2.** A small vessel that is propelled by oars or sails.

ETYMOLOGY: Middle English *barke*, boat, from Old French *barque*, from Old Italian *barca*, from Latin.

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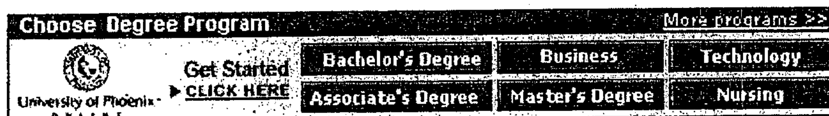

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<u>bark</u> *n.* barks <bârk> 1. The sound made by a dog. 2. A noise resembling the bark of a dog. 3. Tough protective covering of the woody stems and roots of trees and other woody plants. 4. A sailing ship with 3 (or more) masts;

<u>bark</u> *v.* barked ◊ barking ◊ barks <bârk> 1. To cover with bark. 2. To make barking sounds; "The dogs barked at the stranger." 3. To remove the bark of a tree; 4. To speak in an unfriendly tone; "She barked into the dictaphone." 5. To tan (a skin) with bark tannins. [ETYM: **Old Eng. *berken*, AS. *beorcan*; akin to Icel. *berkja*, and prob. to Eng. *break*.**]

- **angostura <u>bark</u>** *n.* The bitter bark of a South American tree; used in medicines and liqueurs and bitters;
- **<u>bark</u> beetle** *n.* <bârk 'bEt&l> Small beetle that bores tunnels in the bark and wood of trees; related to weevils.
- **birch <u>bark</u> canoe** *n.* A canoe made with the bark of a birch tree.
- **cabbage <u>bark</u>** *n.* <'kàbij bârk> Tree with shaggy unpleasant-smelling toxic bark and yielding strong durable wood; bark and seeds used as a purgative and vermifuge and narcotic;
- **Cartagena <u>bark</u>** *n.* <"kârt&'jEn& bârk> Colombian tree; source of Cartagena bark (a cinchona bark); Also called: Cinchona cordifolia, Cinchona lancifolia.
- **cascarilla <u>bark</u>** *n.* <"kàsk&'ril& bârk> Aromatic bark of cascarilla; used as a tonic and for making incense;
- **cassia <u>bark</u>** *n.* <'kà[sh]& bârk> Aromatic bark of the cassia-bark tree; less desirable as a spice than Ceylon cinnamon bark;
- **cinchona <u>bark</u>** *n.* Medicinal bark of cinchona trees; source of quinine and quinidine;

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EASY WHITE CHOCOLATE MINT CANDY

1 lb. white chocolate
1 (5 1/4 oz.) pkg. Starlight peppermints

Crush mints in food processor. Melt chocolate at 50% power in microwave oven for 3 1/2 minutes. Mix melted chocolate and crushed mints. Pour onto wax paper. Cover with wax paper. Use bottom of pie plate to smooth to desired thickness, about 1/4 inch. Score in squares when semi-firm, then break into pieces. Store in airtight container.

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LECHE FLAN

Printer-friendly version

WHITE CHOCOLATE MINT CHRISTMAS CANDY

2 lbs. white chocolate
1 lb. red and green peppermint brickle

Melt chocolate in double boiler or 2 pans that fit inside each other with water in bottom pan. Add peppermint brickle. Pour on cookie sheet lined with foil. Place in refrigerator to harden. Break into bite-size pieces and store in tightly covered container. Makes a nice Christmas gift.

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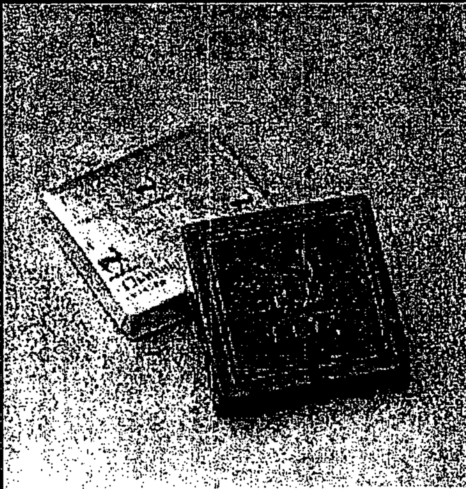

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Chocolate Square Medallions.
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Rich dark chocolate blended with peppermint candy into melt-in-your-mouth squares.

Individually wrapped in embossed Italian foil.

Approximately 250 pieces.
Approximately 1-3/8 inch square and 3/16 inch thick.
54% Cocoa Content Dark Chocolate Peppermint Squares.

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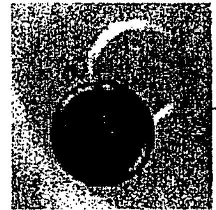

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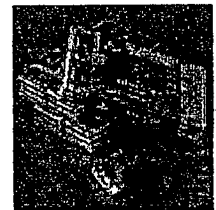

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Peppermint Brittle

2 pounds white chocolate
30 small peppermint candy canes

Line a large jellyroll pan with heavy-duty foil. Place white chocolate in a microwave-safe bowl. Heat in microwave on medium setting for 5 to 6 minutes. Stir occasionally, until chocolate is melted and smooth.

Place candy canes in a plastic bag, or between two pieces of waxed paper. Using a mallet or rolling pin, break the candy canes into chunks. Stir peppermint into melted white chocolate. Spread evenly in pan, and chill until set, about 1 hour. Break into pieces by slamming pan on counter.

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WHITE CHRISTMAS CANDY

2 lbs. white chocolate
1/2 lb. crushed peppermint sticks

Red and green.

Melt chocolate over medium-low heat, stirring until smooth. Remove from heat; stir in candies. Spread on paper-lined cookie sheets. Chill in refrigerator 8 to 10 minutes. Break into small pieces; store in air-tight containers. Yields 2 to 2 1/2 pounds.

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Peppermint Brittle

SUBMITTED BY: Brenda Moore

PHOTO BY: Allrecipes

"A Christmastime treat! This holiday confection is gobbled up quickly by guests, and it is so easy to make. The cool crunch of peppermint with creamy white chocolate is a divine combination." Original recipe yield: 2 1/4 pounds

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PREP TIME 5 Min
COOK TIME 5 Min
READY IN 1 Hr 10 Min

SERVINGS 36 Change About scaling and conversions

INGREDIENTS

- 2 pounds white chocolate
- 30 small peppermint candy canes

DIRECTIONS

1. Line a large jellyroll pan with heavy-duty foil.
2. Place white chocolate in a microwave-safe bowl. Heat in microwave on medium setting for 5 to 6 minutes. Stir occasionally, until chocolate is melted and smooth.
3. Place candy canes in a plastic bag, or between two pieces of waxed paper. Using a mallet or rolling pin, break the candy canes into chunks. Stir peppermint into melted white chocolate. Spread evenly in pan, and chill until set, about 1 hour. Break into pieces by slamming pan on counter.

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Servings Per Recipe: 36
Amount Per Serving
Calories: 159

- Total Fat: 8.9g
- Cholesterol: 5mg
- Sodium: 28mg
- Total Carbs: 18.3g
  - Dietary Fiber: 0g
- Protein: 1.8g

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Goods and Services	IC 030. US 046. G & S: CANDY. FIRST USE: 20011016. FIRST USE IN COMMERCE: 20011016
Mark Drawing Code	(3) DESIGN PLUS WORDS, LETTERS, AND/OR NUMBERS
Design Search Code	03.01.08 - Dogs; Puppies 03.01.24 - Stylized cats, dogs, wolves, foxes, bears
Serial Number	76469120
Filing Date	November 21, 2002
Current Filing Basis	1A
Original Filing Basis	1A
Published for Opposition	June 10, 2003
Registration Number	2758725
Registration Date	September 2, 2003
Owner	(REGISTRANT) Williams-Sonoma, Inc. CORPORATION CALIFORNIA 3250 Van Ness Avenue San Francisco CALIFORNIA 94109
Attorney of Record	Linda Joy Kattwinkel, Esq.
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Register PRINCIPAL
Live/Dead Indicator LIVE

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Word Mark	PEPPERMINT BARK
Goods and Services	IC 030. US 046. G & S: CANDY. FIRST USE: 19991019. FIRST USE IN COMMERCE: 19991019
Mark Drawing Code	(5) WORDS, LETTERS, AND/OR NUMBERS IN STYLIZED FORM
Design Search Code	
Serial Number	76468865
Filing Date	November 21, 2002
Current Filing Basis	1A
Original Filing Basis	1A
Published for Opposition	September 2, 2003
Registration Number	2785972
Registration Date	November 25, 2003

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Word Mark	PEPPERMINT BURSTS
Goods and Services	IC 030. US 046. G & S: CANDY. FIRST USE: 20040410. FIRST USE IN COMMERCE: 20040401
Standard Characters Claimed	
Mark Drawing Code	(4) STANDARD CHARACTER MARK
Design Search Code	
Serial Number	78406315
Filing Date	April 22, 2004
Current Filing Basis	1A
Original Filing Basis	1A
Published for Opposition	February 8, 2005
Registration Number	2946172

Registration Date	May 3, 2005
Owner	(REGISTRANT) SWEET CONCEPTS INC DBA BUTTERFIELDS CORPORATION NORTH CAROLINA 2155 South Old Franklin Road Nashville NORTH CAROLINA 27856
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Goods and Services	IC 030. US 046. G & S: Candy. FIRST USE: 20020301. FIRST USE IN COMMERCE: 20020301
Mark Drawing Code	(3) DESIGN PLUS WORDS, LETTERS, AND/OR NUMBERS
Design Search Code	05.05.25 - Daffodils; Iris (flower); Other flowers
Serial Number	78102713
Filing Date	January 15, 2002
Current Filing Basis	1A
Original Filing Basis	1B
Published for Opposition	July 30, 2002
Registration Number	2751398
Registration Date	August 12, 2003
Owner	(REGISTRANT) Lance Mfg. LLC LTD LIAB CO NORTH CAROLINA 8600 South Boulevard P. O. Box 32368 Charlotte NORTH CAROLINA 282322368
Attorney of Record	Edward H. Schuth
Prior Registrations	2530488;2530489
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Goods and Services	IC 030. US 046. G & S: CANDY. FIRST USE: 20011010. FIRST USE IN COMMERCE: 20011010
Mark Drawing Code	(3) DESIGN PLUS WORDS, LETTERS, AND/OR NUMBERS
Design Search Code	08.03.01 - Candy bars, (chocolate); Chips, (chocolate); Chocolate candies; Chocolate chips
Serial Number	76543619
Filing Date	September 10, 2003
Current Filing Basis	1A
Original Filing Basis	1A
Published for Opposition	February 8, 2005
Registration Number	2945581

Registration Date	May 3, 2005
Owner	(REGISTRANT) Williams-Sonoma, Inc. CORPORATION CALIFORNIA 3250 Van Ness Avenue San Francisco CALIFORNIA 94109
Attorney of Record	ANTHONY J MALUTTA
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Word Mark	PEPPERMINT PASSION
Goods and Services	IC 030. US 046. G & S: WHITE MINT ICE CREAM WITH CHOCOLATE FLAKES AND MINI CHOCOLATE MINT PATTIES. FIRST USE: 20010226. FIRST USE IN COMMERCE: 20010226
Mark Drawing Code	(1) TYPED DRAWING
Design Search Code	
Serial Number	76412890
Filing Date	May 28, 2002
Current Filing Basis	1A
Original Filing Basis	1B
Published for Opposition	October 21, 2003
Registration Number	2804152
Registration Date	January 13, 2004
Owner	(REGISTRANT) Schwan's IP LLC LTD LIAB CO MINNESOTA 115 West College Drive Marshall MINNESOTA 562581796
Attorney of Record	Gregory C. Golla

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Word Mark	PEPPERMINT PONIES
Goods and Services	IC 030. US 046. G & S: candy. FIRST USE: 19921117. FIRST USE IN COMMERCE: 19921117
Mark Drawing Code	(1) TYPED DRAWING
Design Search Code	
Serial Number	74308456
Filing Date	August 28, 1992
Current Filing Basis	1A
Original Filing Basis	1B
Published for Opposition	December 14, 1993
Registration Number	1828450
Registration Date	March 29, 1994
Owner	(REGISTRANT) Harbor Sweets, Inc. CORPORATION MASSACHUSETTS 85 Leavitt St. Salem MASSACHUSETTS 01970
Attorney of Record	Neil F. Markva
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Type of Mark	TRADEMARK
Register	PRINCIPAL
Affidavit Text	SECT 15. SECT 8 (6-YR). SECTION 8(10-YR) 20040325.
Renewal	1ST RENEWAL 20040325
Live/Dead Indicator	LIVE

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Goods and Services	IC 030. US 046. G & S: CANDY. FIRST USE: 20021019. FIRST USE IN COMMERCE: 20021019
Mark Drawing Code	(1) TYPED DRAWING
Design Search Code	
Serial Number	76282956
Filing Date	July 3, 2001
Current Filing Basis	1A
Original Filing Basis	1B
Published for Opposition	January 1, 2002
Registration Number	2743752
Registration Date	July 29, 2003
Owner	(REGISTRANT) Williams-Sonoma, Inc. CORPORATION CALIFORNIA 3250 Van Ness Avenue San Francisco CALIFORNIA 94109
Attorney of Record	Linda Joy Kattwinkel, Esq.
Disclaimer	NO CLAIM IS MADE TO THE EXCLUSIVE RIGHT TO USE "PEPPERMINT" APART FROM THE MARK AS SHOWN
Type of Mark	TRADEMARK
Register	PRINCIPAL
Live/Dead Indicator	LIVE

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Start List At: OR Jump to record: **Record 12 out of 14**

TARR Status | ASSIGN Status | TDR | TTAB Status ***(Use the "Back" button of the Internet Browser to return to TESS)***

Typed Drawing

Word Mark	BIRCH BARK
Goods and Services	IC 030. US 046. G & S: Candy made with birch syrup candy pieces embedded in white chocolate. FIRST USE: 19950101. FIRST USE IN COMMERCE: 19950101
Mark Drawing Code	(1) TYPED DRAWING
Design Search Code	
Serial Number	76217924
Filing Date	March 1, 2001
Current Filing Basis	1A
Original Filing Basis	1A
Published for Opposition	April 9, 2002
Registration Number	2587962
Registration Date	July 2, 2002
Owner	(REGISTRANT) Cameron Birch Syrup & Confections, Inc. CORPORATION ALASKA PO Box 872090 Wasilla ALASKA 996872090
Type of Mark	TRADEMARK
Register	PRINCIPAL-2(F)

Live/Dead Indicator LIVE

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CHIPPERS THE BARK WITH A BITE

Word Mark	CHIPPERS THE BARK WITH A BITE
Goods and Services	IC 030. US 046. G & S: Confections, namely candy and candy bars. FIRST USE: 19950916. FIRST USE IN COMMERCE: 19950916
Standard Characters Claimed	
Mark Drawing Code	(4) STANDARD CHARACTER MARK
Design Search Code	
Serial Number	76530701
Filing Date	July 9, 2003
Current Filing Basis	1A
Original Filing Basis	1A
Published for Opposition	August 17, 2004
Registration Number	3121157

Registration Date	July 25, 2006
Owner	(REGISTRANT) Feitner, Virginia INDIVIDUAL UNITED STATES 355 Sweets Lane Lewisburg PENNSYLVANIA 17837
Type of Mark	TRADEMARK
Register	PRINCIPAL
Live/Dead Indicator	LIVE

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TARR Status | ASSIGN Status | TDR | TTAB Status ***(Use the "Back" button of the Internet Browser to return to TESS)***

Typed Drawing

Word Mark	**REINDEER BARK**
Goods and Services	IC 030. US 046. G & S: CHOCOLATE CANDY. FIRST USE: 19981124. FIRST USE IN COMMERCE: 19981124
Mark Drawing Code	(1) TYPED DRAWING
Design Search Code	
Serial Number	78062451
Filing Date	May 8, 2001
Current Filing Basis	1A
Original Filing Basis	1A
Published for Opposition	June 18, 2002
Registration Number	2618337
Registration Date	September 10, 2002
Owner	(REGISTRANT) TRIFLES, LLC LTD LIAB CO MICHIGAN 9320 ELIZABETH LAKE RD. WHITE LAKE TWP. MICHIGAN 48386
Type of Mark	TRADEMARK
Register	PRINCIPAL
Live/Dead Indicator	LIVE

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VANILLA ALMOND BARK

Word Mark	VANILLA ALMOND BARK
Goods and Services	IC 030. US 046. G & S: Frozen confections. FIRST USE: 19841120. FIRST USE IN COMMERCE: 19841120
Standard Characters Claimed	
Mark Drawing Code	(4) STANDARD CHARACTER MARK
Design Search Code	
Serial Number	78631824
Filing Date	May 17, 2005
Current Filing Basis	1A
Original Filing Basis	1A
Published for Opposition	April 4, 2006
Registration Number	3109102

Registration Date	June 27, 2006
Owner	(REGISTRANT) Tofutti Brands Inc. CORPORATION DELAWARE 50 Jackson Drive Cranford NEW JERSEY 07016
Attorney of Record	Howard Natter
Prior Registrations	1383825
Type of Mark	TRADEMARK
Register	PRINCIPAL-2(F)
Live/Dead Indicator	LIVE

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You Can't Bite a Better Bark

Word Mark	YOU CAN'T BITE A BETTER BARK
Goods and Services	IC 030. US 046. G & S: candy. FIRST USE: 20030701. FIRST USE IN COMMERCE: 20030701
Standard Characters Claimed	
Mark Drawing Code	(4) STANDARD CHARACTER MARK
Design Search Code	
Serial Number	76562810
Filing Date	November 17, 2003
Current Filing Basis	1A
Original Filing Basis	1A
Published for Opposition	October 18, 2005
Registration Number	3039031
Registration Date	January 10, 2006
Owner	(REGISTRANT) Susie's South Forty Confections, Inc. CORPORATION TEXAS 1515 S. Fairgrounds Rd. P. O. Box 4040 Midland TEXAS 79701
Type of Mark	TRADEMARK
Register	PRINCIPAL
Live/Dead Indicator	LIVE

Attorney Docket No. 33127T-004600US

CERTIFICATE OF MAILING

Date of Deposit: December 27, 2006

I hereby certify that this paper or fee is being deposited with the United States Postal Service by "First Class Mail" service under 37 CFR 1.8 on the date indicated above and is addressed to the Commissioner for Trademarks, P.O. Box 1451, Alexandria, VA 22313-1451.

TOWNSEND AND TOWNSEND AND CREW LLP

By: [signature]
Lois M. Simón

IN THE UNITED STATES PATENT AND TRADEMARK OFFICE

In re application of:

Williams-Sonoma, Inc.

Mark: **PEPPERMINT BARK**

Serial No. 76/542,867

Filed: September 8, 2003

TM Attorney: Russ Herman

Law Office: 101

DECLARATION IN SUPPORT OF REQUEST FOR RECONSIDERATION OF FINAL REFUSAL [37 C.F.R. §2.64(b)]

APPEAL DATE: December 27, 2006

Commissioner for Trademarks
P.O. Box 1451
Alexandria, VA 22313-1451

Dear Madam:

I, Christine Amatruda, declare that I am employed by Applicant Williams-Sonoma, Inc., that my title is Associate General Counsel, and that I am authorized to make this Declaration in support of Williams-Sonoma's Request for Reconsideration in response to the final Office Action dated June 27, 2006, as follows:

1. Williams-Sonoma, Inc. ("WSI") is the owner of the Williams-Sonoma® brand ("Williams-Sonoma") as well as other retail brands, such as Pottery Barn®. Williams-Sonoma is a famous retailer of cookware, tableware, fine foods and products for the home, and operates

retail stores as well as thriving catalog and Internet channels. Since the first Williams-Sonoma store opened in 1956, the Williams-Sonoma brand has expanded dramatically, and there are now more than 250 Williams-Sonoma stores in the United States. In 2005, WSI's net revenues for all of its brands exceeded $3.5 billion. Each year, WSI distributes over 50 million catalogs to customers. WSI's 2005 Annual Report is attached hereto as Exhibit 1.

2. Williams-Sonoma has continuously used the **PEPPERMINT BARK** mark in commerce since at least as early as October 1999. Since Williams-Sonoma began selling the **PEPPERMINT BARK** product over seven years ago, the candy has become wildly popular; likewise, the **PEPPERMINT BARK** mark has become widely known by consumers as an indicator of the goods sold by Williams-Sonoma under the mark.

3. While Williams-Sonoma's sales figures are proprietary, it has sold millions of dollars of **PEPPERMINT BARK** product over the last seven years, and it remains a very strong seller in the 2006 holiday season.

4. During the more than seven years that Williams-Sonoma has used **PEPPERMINT BARK** as a trademark, Williams-Sonoma has devoted considerable time, money, and energy into promoting its mark. Williams-Sonoma has promoted the mark **PEPPERMINT BARK** through, among other means, catalogs, its website, signage, and in-store promotions.

5. For the past seven years, for example, Williams-Sonoma featured the **PEPPERMINT BARK** product in its catalogs, as shown in the excerpts from the 1999, 2000, 2001, 2002, 2003, 2004, 2005 and 2006 holiday catalogs, attached as Exhibit 2.

6. The product has also been prominently featured on the Williams-Sonoma website, as shown in the attached Exhibit 3, which shows the product's recent holiday placement on the Williams-Sonoma home page..

Serial No. 76/542,867
Attorney Docket: 33127T-004600US

7. Williams-Sonoma has received further publicity for its **PEPPERMINT BARK** product in various unaffiliated publications, including Newsweek and Money magazines, as shown in the attached Exhibit 3.

8. Because of Williams-Sonoma's substantial, continuous, long-standing, and widespread use, the **PEPPERMINT BARK** mark has become associated with the goods offered by Williams-Sonoma. Therefore, I am informed and believe that when people see the **PEPPERMINT BARK** mark on chocolate pieces with embedded peppermint candy bits, they associate the product with Williams-Sonoma.

9. I aver that all statements made herein of my own knowledge are true and that statements made on information and belief are believed to be true; and further, that these statements were made with the knowledge that willful false statements and the like so made are punishable by fine or imprisonment or both under Section 1001 of Title 18 of the United States Code and that such willful false statements may jeopardize the validity of the application or document or any registration resulting therefrom.

Date: 12-27-06

By: [signature]
Christine Amatruda
Associate General Counsel, Williams-Sonoma, Inc.

60933191 v1

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

FORM 10-K

(Mark One):

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended January 29, 2006.

OR

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

For the transition period from __________ to __________

Commission file number 001-14077

WILLIAMS-SONOMA, INC.

(Exact name of registrant as specified in its charter)

California	**94-2203880**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
3250 Van Ness Avenue, San Francisco, CA	**94109**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (415) 421-7900

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, $.01 par value	New York Stock Exchange, Inc.
(Title of class)	(Name of each exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

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

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐

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

As of July 31, 2005, the approximate aggregate market value of the registrant's common stock held by non-affiliates was $4,245,813,000. It is assumed for purposes of this computation that an affiliate includes all persons as of July 31, 2005 listed as executive officers and directors with the Securities and Exchange Commission. This aggregate market value includes all shares held in the registrant's Williams-Sonoma, Inc. Stock Fund.

As of March 26, 2006, 114,893,520 shares of the registrant's Common Stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of our definitive Proxy Statement for the 2006 Annual Meeting of Shareholders, also referred to in this Annual Report on Form 10-K as our Proxy Statement, which will be filed with the Securities and Exchange Commission, or SEC, on or about April 7, 2006, have been incorporated in Part III hereof.

FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K and the letter to shareholders contained in this annual report contain forward-looking statements within the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995 that involve risks and uncertainties, as well as assumptions that, if they do not fully materialize or prove incorrect, could cause our business and results of operations to differ materially from those expressed or implied by such forward-looking statements. Such forward-looking statements include, without limitation, any projections of earnings, revenues or financial items, statements of the plans, strategies and objectives of management for future operations, statements related to the future performance and growth potential of our brands, statements related to our plans to increase retail leased square footage, statements related to increasing and expanding catalog circulation and increasing catalog page counts, statements related to market acceptance of new products and brands, statements related to litigation matters, statements related to payment of dividends, statements related to introducing new core and seasonal merchandise assortments, statements related to enhancing product quality, statements related to reducing returns, replacements and damages, statements related to implementing new inventory management systems, extending store replenishment programs, new marketing initiatives and expanding electronic direct marketing initiatives, statements related to transportation costs in the furniture delivery network and backroom and offsite storage management in our retail stores, statements related to in-sourcing the management of our east coast furniture hub, statements related to making investments in our emerging brands or transitioning the merchandising strategies of our emerging brands into our other existing brands, statements related to our plans to open new retail stores, statements related to launching new websites and implementing new e-commerce functionality, statements related to future comparable store sales, statements related to our fiscal 2006 income tax provision and effective tax rate, statements related to the use of our available cash, statements related to our projected capital expenditures, statements related to our stock repurchase program, statements related to the impact of new accounting pronouncements, statements related to indemnifications under our agreements, statements related to legal proceedings and statements of belief and statements of assumptions underlying any of the foregoing. You can identify these and other forward-looking statements by the use of words such as "will," "may," "should," "expects," "plans," "anticipates," "believes," "estimates," "predicts," "intends," "potential," "continue," or the negative of such terms, or other comparable terminology.

The risks, uncertainties and assumptions referred to above that could cause our results to differ materially from the results expressed or implied by such forward-looking statements include, but are not limited to, those discussed under the heading "Risk Factors" in Item 1A hereto and the risks, uncertainties and assumptions discussed from time to time in our other public filings and public announcements. All forward-looking statements included in this document are based on information available to us as of the date hereof, and we assume no obligation to update these forward-looking statements.

WILLIAMS-SONOMA, INC.
ANNUAL REPORT ON FORM 10-K
FISCAL YEAR ENDED JANUARY 29, 2006

TABLE OF CONTENTS

		PAGE
	PART I	
Item 1.	Business	3
Item 1A.	Risk Factors	6
Item 1B.	Unresolved Staff Comments	15
Item 2.	Properties	15
Item 3.	Legal Proceedings	16
Item 4.	Submission of Matters to a Vote of Security Holders	16
	PART II	
Item 5.	Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	17
Item 6.	Selected Financial Data	19
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operations	20
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	37
Item 8.	Financial Statements and Supplementary Data	38
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	62
Item 9A.	Controls and Procedures	62
Item 9B.	Other Information	63
	PART III	
Item 10.	Directors and Executive Officers of the Registrant	64
Item 11.	Executive Compensation	64
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	64
Item 13.	Certain Relationships and Related Transactions	64
Item 14.	Principal Accountant Fees and Services	64
	PART IV	
Item 15.	Exhibits and Financial Statement Schedules	65

PART I

ITEM 1. BUSINESS

OVERVIEW

We are a specialty retailer of products for the home. The retail segment of our business sells our products through our six retail store concepts (Williams-Sonoma, Pottery Barn, Pottery Barn Kids, Hold Everything, West Elm and Williams-Sonoma Home). The direct-to-customer segment of our business sells similar products through our eight direct-mail catalogs (Williams-Sonoma, Pottery Barn, Pottery Barn Kids, Pottery Barn Bed + Bath, PBteen, Hold Everything, West Elm and Williams-Sonoma Home) and six e-commerce websites (williams-sonoma.com, potterybarn.com, potterybarnkids.com, pbteen.com, westelm.com and holdeverything.com). The catalogs reach customers throughout the U.S., while the six retail concepts currently operate 570 stores in 43 states, Washington, D.C. and Canada. Based on net revenues in fiscal 2005, retail net revenues accounted for 57.4% of our business and direct-to-customer net revenues accounted for 42.6% of our business. Based on their contribution to our net revenues in fiscal 2005, the core brands in both retail and direct-to-customer are: Pottery Barn, which sells casual home furnishings; Williams-Sonoma, which sells cookware essentials; and Pottery Barn Kids, which sells stylish children's furnishings.

We were founded in 1956 by Charles E. Williams, currently a Director Emeritus, with the opening of our first store in Sonoma, California. Today, the Williams-Sonoma stores offer a wide selection of culinary and serving equipment, including cookware, cookbooks, cutlery, informal dinnerware, glassware, table linens, specialty foods and cooking ingredients. Our direct-to-customer business began in 1972 when we introduced our flagship catalog, "A Catalog for Cooks," which marketed the Williams-Sonoma brand.

In 1983, we internally developed the Hold Everything catalog to offer innovative solutions for household storage needs by providing efficient organization solutions for every room in the house. The first Hold Everything store opened in 1985.

In 1986, we acquired Pottery Barn, a retailer of casual home furnishings, and in 1987 launched the first Pottery Barn catalog. Pottery Barn features a large assortment of home furnishings and furniture that we design internally and source from around the world to create a dynamic look in the home.

In 1989, we developed Chambers, a mail order merchandiser of high quality linens, towels, robes, soaps and accessories for the bed and bath.

In 1999, we launched both our Williams-Sonoma e-commerce website and our Williams-Sonoma bridal and gift registry. In addition, we launched the Pottery Barn Kids catalog.

In 2000, we opened our first Pottery Barn Kids stores across the U.S. In addition, we introduced our Pottery Barn e-commerce website and created Pottery Barn Bed + Bath, a catalog dedicated to bed and bath products.

In 2001, we launched our Pottery Barn Kids e-commerce website, Pottery Barn gift and bridal registry, and Pottery Barn Kids gift registry. Additionally, in 2001, we opened five new retail stores (two Williams-Sonoma, two Pottery Barn and one Pottery Barn Kids) in Toronto, Canada, our first stores operated by us outside of the U.S.

In 2002, we launched our West Elm catalog. The brand targets design conscious consumers looking for a modern aesthetic to furnish and accessorize their living spaces with quality products at accessible price points. West Elm offers a broad range of home furnishing categories including furniture, textiles, decorative accessories, lighting and tabletop items.

In 2003, we launched our West Elm e-commerce website, opened our first West Elm retail store and launched our newest extension of the Pottery Barn brand, PBteen, with the introduction of the PBteen catalog. PBteen offers exclusive collections of home furnishings and decorative accessories that are specifically designed to reflect the personalities of the teenage market. In late 2003, we launched our PBteen e-commerce website.

In 2004, the Chambers brand was retired as a result of the launch of Williams-Sonoma Home, our newest brand. This new premium brand, offering classic home furnishings and decorative accessories, extends the Williams- Sonoma lifestyle beyond the kitchen into every room of the home. In addition, we launched our first Hold Everything e-commerce website and opened three new prototype stores.

In 2005, we opened our first Williams-Sonoma Home stores, including a flagship store in Los Angeles, California. In addition, in January 2006, after testing five new prototype stores and several merchandise assortment transitions throughout 2004 and 2005, we decided to transition the merchandising strategies of the Hold Everything brand into our other existing brands by the end of fiscal 2006.

RETAIL STORES

The retail segment has six merchandising concepts (Williams-Sonoma, Pottery Barn, Pottery Barn Kids, Hold Everything, West Elm, and Williams-Sonoma Home). As of January 29, 2006, we operated 570 retail stores, located in 43 states, Washington, D.C. and Canada. This represents 254 Williams-Sonoma, 188 Pottery Barn, 89 Pottery Barn Kids, 8 Hold Everything, 12 West Elm, 3 Williams-Sonoma Home, and 16 Outlet stores (our Outlet stores carry merchandise from all merchandising concepts).

In fiscal 2006, we expect to increase retail leased square footage by approximately 8%, including 28 new stores (10 in West Elm, 5 in Pottery Barn, 4 in Pottery Barn Kids, 4 in Williams-Sonoma Home, 3 in Pottery Barn Bed + Bath and 2 in Williams-Sonoma) and 22 remodeled or expanded stores (13 in Williams-Sonoma, 6 in Pottery Barn, 2 Outlet stores, and 1 in Pottery Barn Kids), offset by the permanent closure of 8 stores (associated with the closure of all of our remaining Hold Everything stores) and the temporary closure of 18 stores (12 in Williams-Sonoma, 4 in Pottery Barn, and 2 Outlet stores). Of the 22 remodeled or expanded stores, four stores (1 Williams-Sonoma, 2 Pottery Barn and 1 Pottery Barn Kids) are in the New Orleans area and are reopening after having been temporarily closed in August 2005 due to Hurricane Katrina. The average leased square footage for new and expanded stores in fiscal 2006 will be approximately 19,300 leased square feet for West Elm, 14,900 leased square feet for Williams-Sonoma Home, 13,000 leased square feet for Pottery Barn, 7,500 leased square feet for Pottery Barn Kids, 7,400 leased square feet for Pottery Barn Bed + Bath, and 6,800 leased square feet for Williams-Sonoma.

The retail business complements the direct-to-customer business by building brand awareness. Our retail stores serve as billboards for our brands, which we believe inspires confidence in our customers to shop via our direct-to-customer channels.

Detailed financial information about the retail segment is found in Note M to our Consolidated Financial Statements.

DIRECT-TO-CUSTOMER OPERATIONS

The direct-to-customer segment has seven merchandising concepts (Williams-Sonoma, Pottery Barn, Pottery Barn Kids, PBteen, Hold Everything, West Elm and Williams-Sonoma Home) and sells products through our eight direct-mail catalogs (Williams-Sonoma, Pottery Barn, Pottery Barn Kids, Pottery Barn Bed + Bath, PBteen, Hold Everything, West Elm and Williams-Sonoma Home) and six e-commerce websites (williams-sonoma.com, potterybarn.com, potterybarnkids.com, pbteen.com, westelm.com, and holdeverything.com). Of these seven merchandising concepts, the Pottery Barn brand and its extensions have been the major source of revenue growth in the direct-to-customer segment for the last several years. We believe that the success of the Pottery Barn brand and its extensions reflect our continuing investment in product design, product quality and multi-channel marketing.

The direct-to-customer channel over the past several years has been strengthened by the continued success of the Pottery Barn Kids brand, the introduction of e-commerce websites in all of our core brands and the launching of our newest brands, West Elm, PBteen and Williams-Sonoma Home. Although the amount of e-commerce revenues that are incremental to our direct-to-customer channel cannot be identified precisely, we estimate that approximately 40% of our company-wide non-gift registry Internet revenues are incremental to the direct-to-customer channel and approximately 60% are driven by customers who recently received a catalog.

We send our catalogs to addresses from our proprietary customer list, as well as to names from lists from other mail order merchandisers, magazines and companies that we receive in exchange for either payment or new addresses, consistent with our published privacy policies. In accordance with prevailing industry practice, we primarily rent our list to select merchandisers. Our customer mailings are continually updated to include new prospects and to eliminate non-responders.

The direct-to-customer business complements the retail business by building brand awareness and acting as an effective advertising vehicle. In addition, we believe that the mail order catalogs and the Internet act as a cost efficient means of testing market acceptance of new products and new brands.

Detailed financial information about the direct-to-customer segment is found in Note M to our Consolidated Financial Statements.

SUPPLIERS

We purchase our merchandise from numerous foreign and domestic manufacturers and importers, the largest of which individually accounted for approximately 2.6% of purchases during fiscal 2005. Approximately 63% of our merchandise purchases in fiscal 2005 were foreign-sourced from manufacturers in 35 countries, primarily from Asia and Europe. Approximately 95% of our foreign purchases of merchandise are negotiated and paid for in U.S. dollars.

COMPETITION AND SEASONALITY

The specialty retail business is highly competitive. Our specialty retail stores, mail order catalogs and e-commerce websites compete with other retail stores, including large department stores, discount stores, other specialty retailers offering home centered assortments, other mail order catalogs and other e-commerce websites. The substantial sales growth in the direct-to-customer industry within the last decade has encouraged the entry of many new competitors and an increase in competition from established companies. We compete on the basis of our brand authority, the quality of our merchandise, service to our customers and our proprietary customer list, as well as location and appearance of our stores. We believe that we compare favorably with many of our current competitors with respect to some or all of these factors.

Our business is subject to substantial seasonal variations in demand. Historically, a significant portion of our revenues and net earnings have been realized during the period from October through December, and levels of net revenues and net earnings have generally been lower during the period from January through September. We believe this is the general pattern associated with the direct-to-customer and retail industries. In anticipation of our peak season, we hire a substantial number of additional employees in our retail stores and direct-to-customer processing and distribution areas, and incur significant fixed catalog production and mailing costs.

PATENTS, TRADEMARKS, COPYRIGHTS AND DOMAIN NAMES

We own and/or have applied to register over 100 trademarks and service marks. We own and/or have applied to register our marks in the U.S., Canada and in approximately 20 additional jurisdictions. Exclusive rights to the trademarks and service marks are held by Williams-Sonoma, Inc. and are used by our subsidiaries under license. These marks include house marks for our subsidiaries and their signature publications and websites as well as brand names for products. The house marks in particular, including "Williams-Sonoma," the Williams-Sonoma Grande Cuisine logo, "Pottery Barn," "pottery barn kids," "PBteen," "west elm" and "Williams-Sonoma Home" are of material importance to us. Trademarks are generally valid as long as they are in use and/or their registrations are properly maintained, and they have not been found to have become generic. Trademark registrations can generally be renewed indefinitely so long as the marks are in use. We own numerous copyrights and trade dress rights for our products, product packaging, catalogs, books, house publications and website designs, among other things, which are also used by our subsidiaries under license. We hold patents on certain product functions and product designs. Patents are generally valid for 20 years as long as their registrations are properly maintained. In addition, we have registered and maintain numerous Internet domain names, including "wsweddings.com," "williams-sonoma.com," "potterybarn.com," "potterybarnkids.com," "pbteen.com,"

"westelm.com," "holdeverything.com," "williamssonomahome.com," and "williams-sonomainc.com." Collectively, the copyrights, trade dress rights, patents and domain names that we hold are of material importance to us.

EMPLOYEES

As of January 29, 2006, we had approximately 37,200 employees, approximately 7,700 of whom were full-time employees. During the fiscal 2005 peak season, we hired approximately 15,500 temporary employees in our stores and in our direct-to-customer processing and distribution centers.

AVAILABLE INFORMATION

We file annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy and information statements and amendments to reports filed or furnished pursuant to Sections 13(a), 14 and 15(d) of the Securities Exchange Act of 1934, as amended. The public may read and copy these materials at the SEC's Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains a website at www.sec.gov that contains reports, proxy and information statements and other information regarding Williams-Sonoma, Inc. and other companies that file materials with the SEC electronically. You may also obtain copies of our annual reports, Forms 10-K, Forms 10-Q and Forms 8-K, free of charge, on our website at www.williams-sonomainc.com.

ITEM 1A. RISK FACTORS

The following information describes certain significant risks and uncertainties inherent in our business. You should carefully consider such risks and uncertainties, together with the other information contained in this Annual Report on Form 10-K and in our other public filings. If any of such risks and uncertainties actually occurs, our business, financial condition or operating results could differ materially from the plans, projections and other forward-looking statements included in the section titled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this report and in our other public filings. In addition, if any of the following risks and uncertainties, or if any other risks and uncertainties, actually occurs, our business, financial condition or operating results could be harmed substantially, which could cause the market price of our stock to decline, perhaps significantly.

We must successfully anticipate changing consumer preferences and buying trends, and manage our inventory commensurate with customer demand.

Our success depends, in large part, upon our ability to anticipate and respond in a timely manner to changing merchandise trends and customer demands. Consumer preferences cannot be predicted with certainty and may change between selling seasons. Changes in customer preferences and buying trends may also affect our brands differently. If we misjudge either the market for our merchandise or our customers' purchasing habits, our sales may decline significantly, and we may be required to mark down certain products to sell the resulting excess inventory or to sell such inventory through our outlet stores or other liquidation channels at prices which are significantly lower than our retail prices, either of which would negatively impact our business and operating results.

In addition, we must manage our inventory effectively and commensurate with customer demand. Much of our inventory is sourced from vendors located outside the U.S. Thus, we usually must order merchandise, and enter into contracts for the purchase and manufacture of such merchandise, up to twelve months in advance of the applicable selling season and frequently before trends are known. The extended lead times for many of our purchases may make it difficult for us to respond rapidly to new or changing trends. Our vendors may also not have the capacity to handle our demands. In addition, the seasonal nature of the specialty home products business requires us to carry a significant amount of inventory prior to peak selling season. As a result, we are vulnerable to demand and pricing shifts and to misjudgments in the selection and timing of merchandise purchases. If we do

not accurately predict our customers' preferences and acceptance levels of our products, our inventory levels will not be appropriate, and our business and operating results may be negatively impacted.

Our business depends, in part, on factors affecting consumer spending that are out of our control.

Our business depends on consumer demand for our products and, consequently, is sensitive to a number of factors that influence consumer spending, including general economic conditions, disposable consumer income, fuel prices, recession and fears of recession, war and fears of war, inclement weather, consumer debt, conditions in the housing market, interest rates, sales tax rates and rate increases, inflation, consumer confidence in future economic conditions and political conditions, health epidemics and consumer perceptions of personal well-being and security. These factors may also affect our various brands and channels differently. Adverse changes in factors affecting discretionary consumer spending could reduce consumer demand for our products, thus reducing our sales and harming our business and operating results. For example, the August 2005 natural disaster caused by Hurricane Katrina will likely continue to affect consumer spending in the vicinity of the disaster.

We face intense competition from companies with brands or products similar to ours.

The specialty retail and direct-to-customer business is highly competitive. Our specialty retail stores, mail order catalogs and e-commerce websites compete with other retail stores, other mail order catalogs and other e-commerce websites that market lines of merchandise similar to ours. We compete with national, regional and local businesses utilizing a similar retail store strategy, as well as traditional furniture stores, department stores and specialty stores. The substantial sales growth in the direct-to-customer industry within the last decade has encouraged the entry of many new competitors and an increase in competition from established companies.

The competitive challenges facing us include:

- anticipating and quickly responding to changing consumer demands better than our competitors;
- maintaining favorable brand recognition and achieving customer perception of value;
- effectively marketing and competitively pricing our products to consumers in several diverse market segments;
- developing innovative, high-quality products in colors and styles that appeal to consumers of varying age groups and tastes, and in ways that favorably distinguish us from our competitors; and
- effectively managing our supply chain and distribution strategies in order to provide our products to our consumers on a timely basis.

In light of the many competitive challenges facing us, we may not be able to compete successfully. Increased competition could harm our sales, operating results and business.

We depend on key domestic and foreign vendors for timely and effective sourcing of our merchandise, and we are subject to various risks and uncertainties that might affect our vendors' ability to produce quality merchandise.

Our performance depends, in part, on our ability to purchase our merchandise in sufficient quantities at competitive prices. We purchase our merchandise from numerous foreign and domestic manufacturers and importers. We have no contractual assurances of continued supply, pricing or access to new products, and any vendor could change the terms upon which they sell to us or discontinue selling to us at any time. We may not be able to acquire desired merchandise in sufficient quantities on terms acceptable to us in the future. Better than expected sales demand may also lead to customer backorders and lower in-stock positions of our merchandise.

Any inability to acquire suitable merchandise on acceptable terms or the loss of one or more key vendors could have a negative effect on our business and operating results because we would be missing products that we felt were important to our assortment, unless and until alternative supply arrangements are secured. We may not be able to develop relationships with new vendors, and products from alternative sources, if any, may be of a lesser quality and/or more expensive than those we currently purchase.

In addition, we are subject to certain risks, including availability of raw materials, labor disputes, union organizing activities, vendor financial liquidity, inclement weather, natural disasters, and general economic and

political conditions, that could limit our vendors' ability to provide us with quality merchandise on a timely basis and at a price that is commercially acceptable. For these or other reasons, one or more of our vendors might not adhere to our quality control standards, and we might not identify the deficiency before merchandise ships to our stores or customers. In addition, our vendors may have difficulty adjusting to our changing demands and growing business. Our vendors' failure to manufacture or import quality merchandise in a timely and effective manner could damage our reputation and brands, and could lead to an increase in customer litigation against us and an attendant increase in our routine litigation costs. Further, any merchandise that does not meet our quality standards could become subject to a recall, which would damage our reputation and brands, and harm our business.

Our dependence on foreign vendors subjects us to a variety of risks and uncertainties.

In fiscal 2005, we sourced our products from manufacturers in 35 countries outside of the United States. Approximately 63% of our merchandise purchases were foreign-sourced, primarily from Asia and Europe. Our dependence on foreign vendors means that we may be affected by declines in the relative value of the U.S. dollar to other foreign currencies. For example, any upward valuation in the Chinese Yuan against the U.S. Dollar may result in higher costs to us for those goods that we source from mainland China. Although approximately 95% of our foreign purchases of merchandise are negotiated and paid for in U.S. dollars, declines in foreign currencies and currency exchange rates might negatively affect the profitability and business prospects of one or more of our foreign vendors. This, in turn, might cause such foreign vendors to demand higher prices for merchandise, delay merchandise shipments to us, or discontinue selling to us, any of which could ultimately reduce our sales or increase our costs.

We are also subject to other risks and uncertainties associated with changing economic and political conditions in foreign countries. These risks and uncertainties include import duties and quotas, concerns over anti-dumping, work stoppages, economic uncertainties (including inflation), foreign government regulations, wars and fears of war, political unrest, health epidemics, natural disasters and other trade restrictions. We cannot predict whether any of the countries in which our products are currently manufactured or may be manufactured in the future will be subject to trade restrictions imposed by the U.S. or foreign governments or the likelihood, type or effect of any such restrictions. Any event causing a disruption or delay of imports from foreign vendors, including the imposition of additional import restrictions, restrictions on the transfer of funds and/or increased tariffs or quotas, or both, could increase the cost or reduce the supply of merchandise available to us and adversely affect our business, financial condition and operating results. Furthermore, some or all of our foreign vendors' operations may be adversely affected by political and financial instability resulting in the disruption of trade from exporting countries, restrictions on the transfer of funds and/or other trade disruptions.

In addition, although we continue to improve our global compliance program, there remains a risk that one or more of our foreign vendors will not adhere to our global compliance standards such as fair labor standards and the prohibition on child labor. Non-governmental organizations might attempt to create an unfavorable impression of our sourcing practices or the practices of some of our vendors that could harm our image. If either of these occurs, we could lose customer goodwill and favorable brand recognition, which could negatively affect our business and operating results.

The growth of our sales and profits depends, in large part, on our ability to successfully open new stores.

In each of the past three fiscal years, the majority of our net revenues have been generated by our retail stores. The growth of our sales and profits depends, in large part, on our ability to successfully open new stores. Our ability to open additional stores successfully will depend upon a number of factors, including:

- our identification and availability of suitable store locations;
- our success in negotiating leases on acceptable terms;
- our ability to secure required governmental permits and approvals;
- our hiring and training of skilled store operating personnel, especially management;
- our timely development of new stores, including the availability of construction materials and labor and the absence of significant construction and other delays in store openings based on weather or other events;

- the availability of financing on acceptable terms, if at all; and
- general economic conditions.

Many of these factors are beyond our control. For example, for the purpose of identifying suitable store locations, we rely, in part, on demographic surveys regarding location of consumers in our target market segments. While we believe that the surveys and other relevant information are helpful indicators of suitable store locations, we recognize that the information sources cannot predict future consumer preferences and buying trends with complete accuracy. In addition, changes in demographics, in the types of merchandise that we sell and in the pricing of our products may reduce the number of suitable store locations. Further, time frames for lease negotiations and store development vary from location to location and can be subject to unforeseen delays. Construction and other delays in store openings could have a negative impact on our business and operating results. We may not be able to open new stores or, if opened, operate those stores profitably.

We must timely and effectively deliver merchandise to our stores and customers.

We cannot control all of the various factors that might affect our fulfillment rates in direct-to-customer sales and timely and effective merchandise delivery to our stores. We rely upon third party carriers for our merchandise shipments and reliable data regarding the timing of those shipments, including shipments to our customers and to and from all of our stores. In addition, we are heavily dependent upon two carriers for the delivery of our merchandise to our customers. Accordingly, we are subject to the risks, including labor disputes, union organizing activity, inclement weather, natural disasters, and possible acts of terrorism associated with such carriers' ability to provide delivery services to meet our shipping needs. Failure to deliver merchandise in a timely and effective manner could damage our reputation and brands. In addition, fuel costs have increased substantially and airline companies struggle to operate profitably, which could lead to increased fulfillment expenses. The increased fulfillment costs could negatively affect our business and operating results by increasing our transportation costs and, therefore, decreasing the efficiency of our shipments.

Our failure to successfully manage our order-taking and fulfillment operations could have a negative impact on our business.

The operation of our direct-to-customer business depends on our ability to maintain the efficient and uninterrupted operation of our order-taking and fulfillment operations and our e-commerce websites. Disruptions or slowdowns in these areas could result from disruptions in telephone service or power outages, inadequate system capacity, system issues, computer viruses, security breaches, human error, changes in programming, union organizing activity, disruptions in our third party labor contracts, natural disasters or adverse weather conditions. These problems could result in a reduction in sales as well as increased selling, general and administrative expenses.

In addition, we face the risk that we cannot hire enough qualified employees, or that there will be a disruption in the labor we hire from our third party providers, especially during our peak season, to support our direct-to-customer operations, due to circumstances that reduce the relevant workforce. The need to operate with fewer employees could negatively impact our customer service levels and our operations.

Our facilities and systems, as well as those of our vendors, are vulnerable to natural disasters and other unexpected events, and any of these events could result in an interruption in our business.

Our retail stores, corporate offices, distribution centers, infrastructure projects and direct-to-customer operations, as well as the operations of vendors from which we receive goods and services, are vulnerable to damage from earthquakes, hurricanes, tornados, fires, floods, power losses, telecommunications failures, computer viruses, and similar events. If any of these events result in damage to our facilities or systems, or those of our vendors, we may experience interruptions in our business until the damage is repaired, resulting in the potential loss of customers and revenues. In addition, we may incur costs in repairing any damage beyond our applicable insurance coverage.

We experience fluctuations in our comparable store sales.

Our success depends, in part, upon our ability to increase sales at our existing stores. Various factors affect comparable store sales, including the number, size and location of stores we open, close, remodel or expand in any period, the general retail sales environment, consumer preferences and buying trends, changes in sales mix between distribution channels, our ability to efficiently source and distribute products, changes in our merchandise mix, competition, current local and global economic conditions, the timing of our releases of new merchandise and promotional events, the success of marketing programs, the cannibalization of existing store sales by our new stores, increased catalog circulation, and continued strength in our Internet business. Among other things, weather conditions can affect comparable store sales because inclement weather can alter consumer behavior or require us to close certain stores temporarily and thus reduce store traffic. Even if stores are not closed, many customers may decide to avoid going to stores in bad weather. These factors have caused and may continue to cause our comparable store sales results to differ materially from prior periods and from earnings guidance we have provided. For example, the August 2005 natural disaster caused by Hurricane Katrina resulted in five store closures, with four stores remaining closed at year-end, and will likely lead to reduced customer traffic in certain other stores.

Our comparable store sales have fluctuated significantly in the past on an annual, quarterly and monthly basis, and we expect that comparable store sales will continue to fluctuate in the future. Our comparable store sales increases for fiscal years 2005, 2004 and 2003 were 4.9%, 3.5% and 4.0%, respectively. Past comparable store sales are no indication of future results, and comparable store sales may decrease in the future. Our ability to maintain and improve our comparable store sales results depends, in large part, on maintaining and improving our forecasting of customer demand and buying trends, selecting effective marketing techniques, providing an appropriate mix of merchandise for our broad and diverse customer base and using effective pricing strategies. Any failure to meet the comparable store sales expectations of investors and security analysts in one or more future periods could significantly reduce the market price of our common stock.

Our failure to successfully manage the costs and performance of our catalog mailings might have a negative impact on our business.

Postal rate increases, paper costs, printing costs and other catalog distribution costs affect the cost of our catalog mailings. We rely on discounts from the basic postal rate structure, which could be changed or discontinued at any time. Our cost of paper has fluctuated significantly during the past three fiscal years, and our paper costs are expected to increase in the future. Future increases in postal rates, paper or printing costs would have a negative impact on our operating results to the extent that we are unable to pass such increases on directly to customers or offset such increases by raising prices or by implementing more efficient printing, mailing, delivery and order fulfillment systems.

We have historically experienced fluctuations in customer response to our catalogs. Customer response to our catalogs is substantially dependent on merchandise assortment, merchandise availability and creative presentation, as well as the selection of customers to whom they are mailed, changes in mailing strategies, and the sizing and timing of delivery of the catalogs. In addition, environmental organizations may attempt to create an unfavorable impression of our paper use in catalogs. The failure to effectively produce or distribute our catalogs could affect the timing of catalog delivery. The timing of catalog delivery has been and can be affected by postal service delays. For example, the August 2005 natural disaster caused by Hurricane Katrina created domestic ground and rail transportation capacity constraints that resulted in late catalog delivery. Any delays in the timing of catalog delivery could cause customers to forego or defer purchases.

We must successfully manage our Internet business.

The success of our Internet business depends, in part, on factors over which we have limited control. In addition to changing consumer preferences and buying trends relating to Internet usage, we are vulnerable to certain additional risks and uncertainties associated with the Internet, including changes in required technology interfaces, website downtime and other technical failures, costs and technical issues as we upgrade our website software, computer viruses, changes in applicable federal and state regulation, security breaches, and consumer

privacy concerns. Our failure to successfully respond to these risks and uncertainties might adversely affect the sales in our Internet business, as well as damage our reputation and brands.

Our failure to successfully anticipate merchandise returns might have a negative impact on our business.

We record a reserve for merchandise returns based on historical return trends together with current product sales performance in each reporting period. If actual returns are greater than those projected by management, additional sales returns might be recorded in the future. Actual merchandise returns may exceed our reserves. In addition, to the extent that returned merchandise is damaged, we often do not receive full retail value from the resale or liquidation of the merchandise. Further, the introduction of new merchandise, changes in merchandise mix, changes in consumer confidence, or other competitive and general economic conditions may cause actual returns to exceed merchandise return reserves. Any significant increase in merchandise returns that exceeds our reserves could harm our business and operating results.

We must successfully manage the complexities associated with a multi-channel and multi-brand business.

During the past few years, with the launch and expansion of our Internet business, new brands and brand extensions, our overall business has become substantially more complex. The changes in our business have forced us to develop new expertise and face new challenges, risks and uncertainties. For example, we face the risk that our Internet business might cannibalize a significant portion of our retail and catalog businesses, and we face the risk of increased catalog circulation cannibalizing our retail sales. While we recognize that our Internet sales cannot be entirely incremental to sales through our retail and catalog channels, we seek to attract as many new customers as possible to our e-commerce websites. We continually analyze the business results of our three channels and the relationships among the channels, in an effort to find opportunities to build incremental sales. However, as our Internet business grows and as we add e-commerce websites for more of our concepts, these increased Internet sales may cannibalize a portion of our retail and catalog businesses.

We may not be able to introduce new brands and brand extensions, or to reposition existing brands, to improve our business.

We have recently introduced three new brands – West Elm, PBteen and Williams-Sonoma Home, and may introduce new brands and brand extensions, or reposition existing brands, in the future. All of these brands, however, may not be successful growth vehicles. For example, in January 2006, we announced our decision to transition the merchandising strategies of our Hold Everything brand into our other existing brands by the end of fiscal 2006. Further, if we devote time and resources to new brands, brand extensions or brand repositioning, and those businesses are not as successful as we planned, then we risk damaging our overall business results. Alternatively, if our new brands, brand extensions or repositioned brands prove to be very successful, we risk hurting our other existing brands through the potential migration of existing brand customers to the new businesses. In addition, we may not be able to introduce new brands, brand extensions or to reposition brands in a manner that improves our overall business and operating results.

Our inability to obtain commercial insurance at acceptable prices or our failure to adequately reserve for self-insured exposures might have a negative impact on our business.

Insurance costs continue to be volatile, affected by natural catastrophes, fear of terrorism and financial irregularities and other fraud at publicly traded companies. We believe that commercial insurance coverage is prudent for risk management, and insurance costs may increase substantially in the future. In addition, for certain types or levels of risk, such as risks associated with earthquakes, hurricanes or terrorist attacks, we may determine that we cannot obtain commercial insurance at acceptable prices. Therefore, we may choose to forego or limit our purchase of relevant commercial insurance, choosing instead to self-insure one or more types or levels of risks. We are primarily self-insured for workers' compensation, employee health benefits and product and general liability claims. If we suffer a substantial loss that is not covered by commercial insurance or our self-insurance reserves, the loss and attendant expenses could harm our business and operating results. In addition, exposures exist for which no insurance may be available and for which we have not reserved.

Our inability or failure to protect our intellectual property would have a negative impact on our business.

Our trademarks, service marks, copyrights, patents, trade dress rights, trade secrets, domain names and other intellectual property are valuable assets that are critical to our success. The unauthorized reproduction or other misappropriation of our intellectual property could diminish the value of our brands or goodwill and cause a decline in our sales. We may not be able to adequately protect our intellectual property. In addition, the costs of defending our intellectual property may adversely affect our operating results.

We have been sued and may be named in additional lawsuits in a growing number of industry-wide business method patent litigation cases relating to our business operations.

There appears to be a growing number of business method patent infringement lawsuits instituted against companies such as ours. The plaintiff in each case claims to hold a patent that covers certain technology or methodologies which are allegedly infringed by the operation of the defendants' business. We are currently a defendant in such patent infringement cases and may be named in others in the future, as part of an industry-wide trend. Even in cases where a plaintiff's claim lacks merit, the defense costs in a patent infringement case can be high. Additional patent infringement claims may be brought against us, and the cost of defending such claims or the ultimate resolution of such claims may harm our business and operating results.

We need to successfully manage our employment, occupancy and other operating costs.

To be successful, we need to manage our operating costs and continue to look for opportunities to reduce costs. We recognize that we may need to increase the number of our employees, especially in peak sales seasons, and incur other expenses to support new brands and brand extensions, as well as the opening of new stores and direct-to-customer growth of our existing brands. From time to time we may also experience union organizing activity in currently non-union distribution facilities, stores and direct-to-customer operations. Union organizing activity may result in work slowdowns or stoppages and higher labor costs. In addition, there appears to be a growing number of wage-and-hour lawsuits against retail companies, especially in California. We are currently a defendant in one such case and may be named in others in the future.

Although we strive to secure long-term contracts with our service providers and other vendors and to otherwise limit our financial commitment to them, we may not be able to avoid unexpected operating cost increases in the future. Further, we incur substantial costs to warehouse and distribute our inventory. Significant increases in our inventory levels may result in increased warehousing and distribution costs. Higher than expected costs, particularly if coupled with lower than expected sales, would negatively impact our business and operating results.

We are undertaking certain systems changes that might disrupt our supply chain operations.

Our success depends on our ability to source and distribute merchandise efficiently through appropriate systems and procedures. We are in the process of substantially modifying our information technology systems supporting the product pipeline, including design, sourcing, merchandise planning, forecasting and purchase order, inventory, distribution, transportation and price management. Modifications will involve updating or replacing legacy systems with successor systems during the course of several years. There are inherent risks associated with replacing our core systems, including supply chain and merchandising systems disruptions that affect our ability to get the correct products into the appropriate stores and delivered to customers. We may not successfully launch these new systems, or the launch may result in supply chain and merchandising systems disruptions. Any such disruptions could negatively impact our business and operating results.

We are implementing changes to our data center information technology infrastructure that might disrupt our business and cost more than expected.

We have engaged IBM to host and manage certain aspects of our data center information technology infrastructure. Accordingly, we are subject to the risks associated with IBM's ability to provide information technology services to meet our needs. Our operations will depend significantly upon IBM's and our ability to make our servers, software

applications and websites available and to protect our data from damage or interruption from human error, computer viruses, intentional acts of vandalism, labor disputes, natural disasters and similar events. If the cost of IBM hosting and managing certain aspects of our data center information technology infrastructure is more than expected, or if IBM or we are unable to adequately protect our data and information is lost or our ability to deliver our services is interrupted, then our business and results of operations may be negatively impacted.

Our operating and financial performance in any given period might not meet the extensive guidance that we have provided to the public.

We provide extensive public guidance on our expected operating and financial results for future periods. Although we believe that this guidance provides investors and analysts with a better understanding of management's expectations for the future, and is useful to our shareholders and potential shareholders, such guidance is comprised of forward-looking statements subject to the risks and uncertainties described in this report and in our other public filings and public statements. Our guidance may not always be accurate. If in the future our operating or financial results for a particular period do not meet our guidance or the expectations of investment analysts or if we reduce our guidance for future periods, the market price of our common stock could significantly decline.

Our quarterly results of operations might fluctuate due to a variety of factors, including seasonality.

Our quarterly results have fluctuated in the past and may fluctuate in the future, depending upon a variety of factors, including shifts in the timing of holiday selling seasons, including Valentine's Day, Easter, Halloween, Thanksgiving and Christmas, and the strategic importance of fourth quarter results. A significant portion of our revenues and net earnings have been realized during the period from October through December. In anticipation of increased holiday sales activity, we incur certain significant incremental expenses, including the hiring of a substantial number of temporary employees to supplement our existing workforce. If, for any reason, we were to realize significantly lower-than-expected revenues or net earnings during the October through December selling season, our business and results of operations would be materially adversely affected.

We may require external funding sources for operating funds.

We regularly review and evaluate our liquidity and capital needs. We currently believe that our available cash, cash equivalents, cash flow from operations and cash available under our existing credit facilities will be sufficient to finance our operations and expected capital requirements for at least the next twelve months. However, as we continue to grow, we might experience peak periods for our cash needs during the course of our fiscal year, and we might need additional external funding to support our operations. Although we believe we would have access to additional debt and/or capital market funding if needed, such funds may not be available to us on acceptable terms. If the cost of such funds is greater than expected, it could adversely affect our expenses and our operating results.

We will require a significant amount of cash to pay quarterly dividends at intended levels and for our stock repurchase programs.

In March 2006, we declared a quarterly cash dividend of $0.10 per common share. In addition, our Board of Directors authorized the repurchase of up to 2,000,000 additional shares of our common stock. The dividend and the share repurchase program may require a significant portion of our cash earnings. As a result, we may not retain a sufficient amount of cash to finance growth opportunities, new product development initiatives, unanticipated capital expenditures or to fund our operations. Our Board of Directors may, at its discretion, decrease the intended level of dividends or entirely discontinue the payment of dividends at any time. The stock repurchase program does not have an expiration date and may be limited or terminated at any time. Our ability to pay dividends and repurchase shares will depend on our ability to generate cash flows from operations in the future. This ability may be subject to certain economic, financial, competitive and other factors that are beyond our control. Any failure to pay dividends or repurchase shares after we have announced our intention to do so may negatively impact our reputation and investor confidence in us and negatively impact our stock price. In addition, we may be subject to lawsuits regarding the use of our cash for dividends or share repurchases.

We are exposed to potential risks from legislation requiring companies to evaluate controls under Section 404 of the Sarbanes-Oxley Act of 2002.

We have evaluated and tested our internal controls in order to allow management to report on, and our registered independent public accounting firm to attest to, our internal controls, as required by Section 404 of the Sarbanes-Oxley Act of 2002. We have incurred, and expect to continue to incur, significant expenses and a diversion of management's time to meet the requirements of Section 404. If we are not able to continue to meet the requirements of Section 404 in a timely manner or with adequate compliance, we would be required to disclose material weaknesses if they develop or are uncovered and we may be subject to sanctions or investigation by regulatory authorities, such as the Securities and Exchange Commission or the New York Stock Exchange. Any such action could negatively impact the perception of us in the financial market and our business. In addition, our internal controls may not prevent or detect all errors and fraud. A control system, no matter how well designed and operated, is based upon certain assumptions and can provide only reasonable assurance that the objectives of the control system will be met.

Changes to accounting rules or regulations may adversely affect our results of operations.

Changes to existing accounting rules or regulations may impact our future results of operations. For example, on December 16, 2004, the Financial Accounting Standards Board ("FASB") issued Statement No. 123R, "Share Based Payment," which requires us, starting in the first quarter of fiscal 2006, to measure compensation costs for all stock-based compensation at fair value and record compensation expense equal to that value over the requisite service period. This accounting rule is estimated to have a negative impact of approximately 10% on our fiscal 2006 diluted earnings per share alone. A change in accounting rules or regulations may even affect our reporting of transactions completed before the change is effective. Other new accounting rules or regulations and varying interpretations of existing accounting rules or regulations have occurred and may occur in the future. Future changes to accounting rules or regulations or the questioning of current accounting practices, may adversely affect our results of operations.

Changes to estimates related to our property and equipment, or operating results that are lower than our current estimates at certain store locations, may cause us to incur impairment charges.

We make certain estimates and projections in connection with impairment analyses for certain of our store locations in accordance with SFAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets." We review for impairment all stores for which current cash flows from operations are negative or the construction costs are significantly in excess of the amount originally expected. An impairment charge is required when the carrying value of the asset exceeds the undiscounted future cash flows over the life of the lease. These calculations require us to make a number of estimates and projections of future results, often up to 20 years into the future. If these estimates or projections change or prove incorrect, we may be, and have been, required to record impairment charges on certain of these store locations. If these impairment charges are significant, our results of operations would be adversely affected.

We must properly account for our unredeemed gift certificates and merchandise credits.

We maintain a liability for unredeemed gift certificates and merchandise credits until the earlier of redemption, escheatment or seven years. After seven years, the remaining unredeemed gift certificate or merchandise credit liability is relieved and recorded within selling, general and administrative expenses. In the event that a state or states were to require that these unredeemed certificates and credits should be escheated to that state or states, then our business and operating results would be harmed.

We may experience fluctuations in our tax obligations and effective tax rate.

We are subject to income taxes in many U.S. and Canadian jurisdictions. We record tax expense based on our estimates of future payments which include reserves for estimates of probable settlements of foreign and domestic tax audits. At any one time, many tax years are subject to audit by various taxing jurisdictions. The results of these audits and negotiations with taxing authorities may affect the ultimate settlement of these issues.

As a result, we expect that throughout the year there could be ongoing variability in our quarterly tax rates as taxable events occur and exposures are re-evaluated. Further, our effective tax rate in a given financial statement period may be materially impacted by changes in the mix and level of earnings.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our gross leased store space, as of January 29, 2006, totaled approximately 5,035,000 square feet for 570 stores compared to approximately 4,637,000 square feet for 552 stores, as of January 30, 2005. All of the existing stores are leased by us with original terms ranging generally from 5 to 22 years. Certain leases contain renewal options for periods of up to 20 years. The rental payment requirements in our store leases are typically structured as either minimum rent, minimum rent plus additional rent based on a percentage of store sales if a specified store sales threshold is exceeded, or rent based on a percentage of store sales if a specified store sales threshold or contractual obligations of the landlord have not been met. See Notes A and E to our Consolidated Financial Statements for more information.

We lease distribution facility space in the following locations:

Location	Square Footage (Approximate)
Olive Branch, Mississippi	2,885,000 square feet
Memphis, Tennessee	1,523,000 square feet
Cranbury, New Jersey	781,000 square feet

During fiscal 2005, we exercised our rights under an option to lease an additional 390,000 square feet of distribution space in connection with one of our Olive Branch, Mississippi distribution center agreements. As of January 29, 2006, however, we had not occupied this space and have thus excluded it from the table above.

Two of our distribution facilities in Memphis, Tennessee are leased from two partnerships whose partners include a Director and a Director Emeritus, both of whom are significant shareholders. Both partnerships were consolidated by us as of February 1, 2004. See Note F to our Consolidated Financial Statements for more information.

Our Cranbury, New Jersey distribution center agreement requires us to lease an additional 219,000 square feet of the facility in the event the current tenant vacates the premises. As of January 29, 2006, the current tenant had not yet vacated the premises.

We contract with a third party who provides furniture delivery and storage facilities in a 662,000 square foot distribution facility in Ontario, California. This distribution square footage is not included in the table above.

In addition to the above long-term contracts, we enter into other agreements to meet our offsite storage needs both for our distribution centers and our retail store locations. As of January 29, 2006, we had approximately 731,000 square feet of leased space relating to these agreements. This square footage is not included in the table above.

We lease call center space in the following locations:

Location	Square Footage (Approximate)
Las Vegas, Nevada	36,000 square feet
Oklahoma City, Oklahoma	36,000 square feet
Camp Hill, Pennsylvania	38,000 square feet

Our corporate facilities are located in San Francisco, California. Our primary headquarters, consisting of 122,000 square feet, was purchased in 1993. In February 2000, we purchased a 204,000 square foot facility in San

Francisco, California for the purpose of consolidating certain headquarters staff and to provide for future growth. In addition, we own a 13,000 square foot data center located in Memphis, Tennessee.

We believe that our facilities are adequate for our current needs and that suitable additional or substitute space will be available in the future to replace our existing facilities, if necessary, or to accommodate the expansion of our operations.

We also lease office, design studio, photo studio, warehouse and data center space in the following locations:

Location	Square Footage (Approximate)
Brisbane, California	194,000 square feet
San Francisco, California	139,000 square feet
New York City, New York	52,000 square feet
Rocklin, California	14,000 square feet

ITEM 3. LEGAL PROCEEDINGS

We are involved in lawsuits, claims and proceedings incident to the ordinary course of our business. These disputes, which are not currently material, are increasing in number as our business expands and our company grows larger. Litigation is inherently unpredictable. Any claims against us, whether meritorious or not, could be time consuming, result in costly litigation, require significant amounts of management time and result in the diversion of significant operational resources. The results of these lawsuits, claims and proceedings cannot be predicted with certainty. However, we believe that the ultimate resolution of these current matters will not have a material adverse effect on our consolidated financial statements taken as a whole.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters submitted to a vote of security holders during the fourth quarter of fiscal 2005.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

MARKET INFORMATION

Our common stock is traded on the New York Stock Exchange, or the NYSE, under the symbol WSM. The following table sets forth the high and low closing prices of our common stock on the NYSE for the periods indicated.

Fiscal 2005	High	Low
1st Quarter	$37.40	$33.49
2nd Quarter	$44.82	$34.08
3rd Quarter	$44.05	$36.46
4th Quarter	$45.09	$39.11
Fiscal 2004	**High**	**Low**
1st Quarter	$34.56	$30.68
2nd Quarter	$32.96	$28.79
3rd Quarter	$38.33	$29.46
4th Quarter	$41.21	$33.55

The closing price of our common stock on the NYSE on March 24, 2006 was $42.20. See Quarterly Financial Information on page 62 of this Annual Report on Form 10-K for the quarter-end closing price of our common stock for each quarter above.

SHAREHOLDERS

The number of shareholders of record of our common stock as of March 24, 2006 was 503. This number excludes shareholders whose stock is held in nominee or street name by brokers.

DIVIDEND POLICY

Prior to March 2006, we had never declared or paid a cash dividend on our common stock. In March 2006, our Board of Directors authorized the initiation of a quarterly cash dividend. The quarterly dividend will be initiated at $0.10 per common share, payable on May 24, 2006, to shareholders of record as of the close of business on April 26, 2006. The aggregate quarterly dividend is estimated at approximately $11,500,000 based on the current number of common shares outstanding. The indicated annual cash dividend, subject to capital availability, is $0.40 per common share, or approximately $46,000,000 in fiscal 2006 based on the current number of common shares outstanding.

Additional information required by Item 5 is contained in Notes H and I to the Consolidated Financial Statements in this Annual Report on Form 10-K.

EQUITY COMPENSATION PLAN INFORMATION

The information required by this Item regarding equity compensation plans is incorporated by reference herein to the information set forth under the heading "Equity Compensation Plan Information" in our Proxy Statement.

STOCK REPURCHASE PROGRAM

In May 2005, our Board of Directors authorized a stock repurchase program to acquire up to 2,000,000 additional shares of our outstanding common stock. During the fourth quarter of fiscal 2005, we repurchased and retired 780,800 shares at a weighted average cost of $41.70 per share and a total cost of approximately $32,556,000.

During fiscal 2005, we repurchased and retired a total of 2,422,300 shares at a weighted average cost of $38.77 per share and a total cost of approximately $93,921,000. As of fiscal year-end, the remaining authorized number of shares eligible for repurchase was 20,000. During the first quarter of fiscal 2006, we repurchased and retired these shares at a weighted average cost of $38.84 per share and a total cost of approximately $777,000, which completed all stock repurchase programs previously authorized by our Board of Directors.

In March 2006, our Board of Directors authorized a stock repurchase program to acquire up to an additional 2,000,000 shares of our outstanding common stock. Stock repurchases under this program may be made through open market and privately negotiated transactions at times and in such amounts as management deems appropriate. The timing and actual number of shares repurchased will depend on a variety of factors, including price, corporate and regulatory requirements, capital availability, and other market conditions. The stock repurchase program does not have an expiration date and may be limited or terminated at any time without prior notice.

The following table summarizes our repurchases of shares of our common stock during the fourth quarter of fiscal 2005:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of a Publicly Announced Repurchase Plan	Maximum Number of Shares that May Yet be Purchased Under the Plan
October 31, 2005 - November 27, 2005	—	—	—	—
November 28, 2005 - December 25, 2005	—	—	—	—
December 26, 2005 - January 29, 2006	780,800	$ 41.70	780,800	20,000
Total	780,800	$ 41.70	780,800	20,000

ITEM 6. SELECTED FINANCIAL DATA

Five-Year Selected Financial Data

Dollars and amounts in thousands, except percentages, per share amounts and retail stores data	Jan. 29, 2006	Jan. 30, 2005	Feb. 1, 2004	Feb. 2, 2003	Feb. 3, 2002[1]
Results of Operations					
Net revenues	$ 3,538,947	$ 3,136,931	$ 2,754,368	$ 2,360,830	$ 2,086,662
Net revenue growth	12.8%	13.9%	16.7%	13.1%	14.1%
Gross margin	$ 1,435,482	$ 1,271,145	$ 1,110,577	$ 951,601	$ 793,989
Earnings before income taxes	$ 348,798	$ 310,205	$ 255,638	$ 202,282	$ 122,106
Net earnings	$ 214,866	$ 191,234	$ 157,211	$ 124,403	$ 75,096
Basic net earnings per share	$ 1.86	$ 1.65	$ 1.36	$ 1.08	$ 0.67
Diluted net earnings per share	$ 1.81	$ 1.60	$ 1.32	$ 1.04	$ 0.65
Gross margin as a percent of net revenues	40.6%	40.5%	40.3%	40.3%	38.1%
Pre-tax operating margin as a percent of net revenues[2]	9.9%	9.9%	9.3%	8.6%	5.9%
Financial Position					
Working capital	$ 492,772	$ 351,608	$ 245,005	$ 200,556	$ 120,060
Total assets	$ 1,981,620	$ 1,745,545	$ 1,470,735	$ 1,264,455	$ 994,903
Return on assets	11.4%	11.9%	11.5%	11.0%	8.3%
Long-term debt and other long-term obligations	$ 29,201	$ 32,476	$ 38,358	$ 23,217	$ 29,307
Shareholders' equity	$ 1,125,318	$ 957,662	$ 804,591	$ 643,978	$ 532,531
Shareholders' equity per share (book value)	$ 9.80	$ 8.30	$ 6.95	$ 5.63	$ 4.65
Return on equity	20.6%	21.7%	21.7%	21.1%	15.6%
Debt-to-equity ratio	3.0%	4.4%	4.6%	4.0%	6.0%
Retail Revenues					
Retail revenue growth	12.3%	11.6%	13.9%	15.1%	18.3%
Retail revenues as a percent of net revenues	57.4%	57.7%	58.9%	60.3%	59.3%
Comparable store sales growth	4.9%	3.5%	4.0%	2.7%	1.7%
Store count					
Williams-Sonoma:	254	254	237	236	214
Grande Cuisine	*243*	*238*	*215*	*204*	*176*
Classic	*11*	*16*	*22*	*32*	*38*
Pottery Barn:	188	183	174	159	145
Design Studio	*188*	*181*	*168*	*153*	*137*
Classic	—	*2*	*6*	*6*	*8*
Pottery Barn Kids	89	87	78	56	27
Hold Everything	8	9	8	13	15
West Elm	12	4	1	—	—
Williams-Sonoma Home	3	—	—	—	—
Outlets	16	15	14	14	14
Number of stores at year-end	570	552	512	478	415
Store selling area at fiscal year-end (sq. ft.)	3,140,000	2,911,000	2,624,000	2,356,000	2,012,000
Store leased area at fiscal year-end (sq. ft.)	5,035,000	4,637,000	4,163,000	3,725,000	3,179,000
Direct-to-Customer Revenues					
Direct-to-customer revenue growth	13.6%	17.1%	20.8%	10.2%	8.4%
Direct-to-customer revenues as a percent of net revenues	42.6%	42.3%	41.1%	39.7%	40.7%
Catalogs circulated during the year	385,158	368,210	328,355	279,724	245,224
Percent growth in number of catalogs circulated	4.6%	12.1%	17.4%	14.1%	5.2%
Percent growth in number of pages circulated	9.7%	19.5%	16.8%	16.1%	1.4%

[1] *The fiscal year ended February 3, 2002 included 53 weeks.*

[2] *Pre-tax operating margin is defined as earnings before income taxes.*

The information set forth above is not necessarily indicative of future operations and should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Consolidated Financial Statements and notes thereto in this Annual Report on Form 10-K.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

Fiscal 2005 Financial Results

In fiscal 2005, our net revenues increased 12.8% to $3,538,947,000 from $3,136,931,000 in fiscal 2004, primarily driven by increases in the Pottery Barn, Pottery Barn Kids, Williams-Sonoma, and West Elm concepts. In fiscal 2005, our diluted earnings per share increased by 13.1% to $1.81 from $1.60 in fiscal 2004, including a $13,500,000 (pre-tax), or $0.07 per diluted share, Hold Everything charge discussed below.

In our retail channel, net revenues increased 12.3% during fiscal 2005 versus fiscal 2004. This increase was primarily driven by a year-over-year increase in retail leased square footage of 8.6%, including 18 net new stores, and a comparable store sales increase of 4.9%. Net revenues generated in the Pottery Barn, Williams-Sonoma, West Elm and Pottery Barn Kids brands were the primary contributors to this year-over-year net revenues increase.

In our direct-to-customer channel, net revenues increased 13.6% during fiscal 2005 versus fiscal 2004. This year-over-year increase was primarily driven by net revenues generated in the Pottery Barn, Pottery Barn Kids, West Elm and Williams-Sonoma brands due to increased catalog and page circulation and continued strength in our Internet business. Internet revenues increased 36.5% during fiscal 2005 versus fiscal 2004, primarily resulting from our expanded efforts associated with our electronic direct marketing initiatives and strategic e-commerce partnerships, and the incremental net revenues generated by the late 2004 launch of our Hold Everything e-commerce website. All of our brands in the direct-to-customer channel delivered positive growth during the fiscal year with the exception of the Hold Everything brand.

In our core brands, net revenues increased 10.9% in fiscal 2005, primarily driven by low double-digit and low-teen net revenue increases in the Pottery Barn and Pottery Barn Kids brands, respectively, and a high single-digit net revenue increase in the Williams-Sonoma brand.

In our emerging brands, including Hold Everything, PBteen, West Elm and Williams-Sonoma Home, net revenues increased 35.6%, primarily driven by the strong performance of the West Elm and Williams-Sonoma Home brands. In West Elm, the strong growth in e-commerce from the re-launch of the brand's website to enhance the customer's on-line experience and the opening of eight new stores across the country (at an average size of 17,000 square feet) drove these results. In addition, we continued to broaden the brand's appeal by expanding its product assortment, softening the color palate, and presenting the merchandise in a lifestyle setting in all three channels. In Williams-Sonoma Home, the increased catalog circulation and the opening of three new prototype stores in September and October (including an 18,000 square foot flagship store in Los Angeles) drove these results. In addition, throughout the year, we saw a positive consumer response to our expanded merchandise assortment, with particular strength in furniture and bedding.

In January 2006, we decided to transition the merchandising strategies of our Hold Everything brand into our other existing brands by the end of fiscal 2006. In connection with this transition, we incurred a pre-tax charge of approximately $13,500,000, or $0.07 per diluted share, in the fourth quarter of fiscal 2005. These costs primarily included the initial asset impairment and lease termination costs associated with the shutdown of the Hold Everything retail stores, the asset impairment of the e-commerce website, and the write-down of impaired merchandise inventories. Of this pre-tax charge, approximately $4,500,000 is included in cost of goods sold and approximately $9,000,000 is included in selling, general, and administrative expenses. We expect to incur an additional after-tax charge of $0.03 per diluted share in the first half of fiscal 2006.

Fiscal 2005 Operational Results

Operationally, in fiscal 2005, we continued to reduce customer shipping costs, driven by the ongoing refining of our furniture delivery network; we continued to reduce employee benefit costs as a percentage of net revenues, driven by cost containment strategies in fringe benefits and proactive workers' compensation initiatives; and we continued to reduce corporate overhead expenses as a percentage of net revenues, due to strong expense management initiatives.

During fiscal 2005, we also made significant progress in building our infrastructure to support the growth of our core and emerging brands. In the information technology area, we continued to make important progress on our 5-year strategic plan. We transitioned the majority of our data center operations to IBM while continuing to evaluate the long-term strategy for our e-commerce websites. We also continued to invest in our direct-to-customer order management and inventory management systems, which are currently in beta testing. In fiscal 2006, we will begin implementing a new retail inventory management system. These multi-phase, multi-year technology initiatives are at the heart of our long-term efforts to drive increased sales and reduce costs through increased productivity and operational efficiency.

In the area of supply chain operations, we successfully implemented "Daily Store Replenishment" in the retail channel and began testing an in-sourcing strategy for our furniture hub operations on the east coast. We also added to our distribution network by increasing distribution leased square footage by approximately 10%.

On our "Weeks of Supply" inventory management initiative, we made gradual progress throughout the year in optimizing the flow of our merchandise through the supply chain. We improved our order fulfillment rates and reduced customer back-orders. The full benefit of this initiative, however, will not be realized until we have fully implemented our new inventory management system.

Fiscal 2006

In fiscal 2006, in an effort to enhance shareholder value, we will continue to focus on our long-term strategic initiatives of driving profitable top-line sales growth and increasing our pre-tax operating margin.

To drive profitable top-line sales growth, we expect to increase retail leased square footage, increase comparable store sales, and increase catalog and page circulation.

In our core brands, we expect to add 11 new retail stores, reopen four stores associated with Hurricane Katrina, open three new Pottery Barn Bed + Bath test stores and remodel or expand 18 existing stores. In the direct-to-customer channel, we expect to increase catalog circulation and electronic direct marketing across all brands and intensify the marketing support behind our e-commerce channel.

In our emerging brands (PBteen, West Elm and Williams-Sonoma Home), we expect to add 14 new retail stores and plan to continue to focus on building brand awareness and enhancing customer access to the brands. In PBteen, we will continue to expand our core merchandising categories, increase catalog circulation and expand our on-line marketing initiatives. We will also be investing in a number of marketing programs to continue to grow our teen affinity database. In West Elm, we will continue to broaden the appeal of the brand by expanding the merchandise assortment, including new classifications previously offered in Hold Everything, and further softening the fabric and finishing choices. We also plan to increase catalog and page circulation, expand our on-line marketing initiatives, open ten new retail stores, ranging from 15,000 to 25,000 square feet, and continue to expand our retail-only assortment to support the increased square footage. In Williams-Sonoma Home, in addition to increasing both catalog and page circulation, we are planning to launch a Williams-Sonoma Home e-commerce website in the third quarter of fiscal 2006. We also plan to expand both our retail and direct-to-customer assortments in addition to opening four new retail stores, ranging from 13,000 to 16,000 square feet. Operationally, in this brand, our focus will be on product development, sourcing, and supply chain customization, in response to the operational challenges we experienced in our distribution network that resulted in higher than expected returns, replacements, and damages in fiscal 2005.

To increase our pre-tax operating margin, we plan to improve the supply chain cost structure in the areas of customer returns, replacements, and damages, transportation costs in the furniture delivery network, and backroom and offsite storage management in our retail stores. We also plan to leverage our general overhead expenses as we continue our efforts to reduce our fixed and variable cost structure.

Operationally, our key initiatives for fiscal 2006 include: implementing operational disciplines throughout the supply chain to reduce returns, replacements and damages; testing an extension to our daily store replenishment program in high-density urban locations whereby both customer delivery and store replenishment operations can be efficiently combined; improving our furniture sourcing and inventory management disciplines; and

in-sourcing the management of our east coast furniture hub to further develop a "gold standard" in customer service and improve the overall operational efficiency of the furniture supply chain process.

In addition, in fiscal 2006, we will issue our first ever quarterly cash dividend. The quarterly dividend will be initiated at $0.10 per common share, payable on May 24, 2006, to shareholders of record as of the close of business on April 26, 2006. The aggregate quarterly dividend is estimated at approximately $11,500,000 based on the current number of common shares outstanding. The indicated annual cash dividend, subject to capital availability, is $0.40 per common share, or approximately $46,000,000 in fiscal 2006 based on the current number of common shares outstanding.

Further, in March 2006, our Board of Directors authorized a stock repurchase program to acquire up to an additional 2,000,000 shares of our outstanding common stock.

Results of Operations

NET REVENUES

Net revenues consist of retail sales, direct-to-customer sales and shipping fees. Retail sales include sales of merchandise to customers at our retail stores. Direct-to-customer sales include sales of merchandise to customers through our catalogs and the Internet. Shipping fees consist of revenue received from customers for delivery of merchandise.

The following table summarizes our net revenues for the 52 weeks ended January 29, 2006 ("fiscal 2005"), January 30, 2005 ("fiscal 2004") and February 1, 2004 ("fiscal 2003").

Dollars in thousands	Fiscal 2005	% Total	Fiscal 2004	% Total	Fiscal 2003	% Total
Retail revenues	$2,032,907	57.4%	$1,810,979	57.7%	$1,622,383	58.9%
Direct-to-customer revenues	1,506,040	42.6%	1,325,952	42.3%	1,131,985	41.1%
Net revenues	$3,538,947	100.0%	$3,136,931	100.0%	$2,754,368	100.0%

Net revenues for fiscal 2005 increased by $402,016,000, or 12.8%, over fiscal 2004. The increase was primarily due to an increase in store leased square footage of 8.6% (including 30 new store openings and the remodeling or expansion of an additional 8 stores) and comparable stores sales growth of 4.9% in fiscal 2005. The increase was further driven by increased catalog and page circulation (4.6% and 9.7%, respectively) and continued strength in our Internet business, primarily due to our expanded efforts associated with electronic direct marketing initiatives and strategic e-commerce partnerships, and the incremental net revenues generated by the late 2004 launch of our Hold Everything e-commerce website. These increases were partially offset by the temporary closure of 12 stores and the permanent closure of 8 stores in fiscal 2005.

Net revenues for fiscal 2004 increased by $382,563,000, or 13.9%, over fiscal 2003. The increase was primarily due to an increase in store leased square footage of 11.4% (including 43 new store openings and the remodeling or expansion of an additional 17 stores) and comparable stores sales growth of 3.5% in fiscal 2004. The increase was further driven by increased catalog and page circulation (12.1% and 19.5%, respectively) and continued strength in our Internet business, primarily due to our expanded efforts associated with electronic direct marketing initiatives and the incremental net revenues generated by the late 2003 and 2004 launches of our PBteen, West Elm, and Hold Everything e-commerce websites. These increases were partially offset by the temporary closure of 15 stores and the permanent closure of 5 stores in fiscal 2004.

RETAIL REVENUES AND OTHER DATA

Dollars in thousands	Fiscal 2005	Fiscal 2004	Fiscal 2003
Retail revenues	$2,032,907	$1,810,979	$1,622,383
Percent growth in retail revenues	12.3%	11.6%	13.9%
Percent growth in comparable store sales	4.9%	3.5%	4.0%
Number of stores – beginning of year	552	512	478
Number of new stores	30	43	46
Number of new stores due to remodeling[1]	8	17	19
Number of closed stores due to remodeling[1,2]	(12)	(15)	(21)
Number of permanently closed stores	(8)	(5)	(10)
Number of stores – end of year	570	552	512
Store selling square footage at year-end	3,140,000	2,911,000	2,624,000
Store leased square footage ("LSF") at year-end	5,035,000	4,637,000	4,163,000

[1] *Remodeled stores are defined as those stores temporarily closed and subsequently reopened during the year due to square footage expansion, store modification or relocation.*

[2] *Fiscal 2005 store closing numbers include 2 Williams-Sonoma, 2 Pottery Barn and 1 Pottery Barn Kids temporary store closures in the New Orleans area due to Hurricane Katrina. One Williams-Sonoma store subsequently reopened before fiscal year-end and one Williams-Sonoma, one Pottery Barn, and one Pottery Barn Kids store reopened subsequent to fiscal year-end; the remaining Pottery Barn store is scheduled to reopen in fiscal 2006.*

	Fiscal 2005		Fiscal 2004		Fiscal 2003	
	Store Count	Avg. LSF Per Store	Store Count	Avg. LSF Per Store	Store Count	Avg. LSF Per Store
Williams-Sonoma	254	5,700	254	5,700	237	5,400
Pottery Barn	188	12,100	183	11,900	174	11,700
Pottery Barn Kids	89	7,800	87	7,800	78	7,700
Hold Everything[1]	8	7,600	9	6,100	8	4,300
West Elm	12	16,100	4	14,500	1	9,500
Williams-Sonoma Home	3	13,900	—	—	—	—
Outlets	16	20,200	15	15,500	14	14,200
Total	570	8,800	552	8,400	512	8,100

[1] *Subsequent to fiscal 2005 year-end, the Company closed all 8 of its Hold Everything stores.*

Retail revenues in fiscal 2005 increased by $221,928,000, or 12.3%, over fiscal 2004 primarily due to an increase in store leased square footage of 8.6% (including 30 new store openings and the remodeling or expansion of an additional 8 stores) and a comparable store sales increase of 4.9%. These increases were partially offset by the temporary closure of 12 stores and the permanent closure of 8 stores during fiscal 2005. Net revenues generated in the Pottery Barn, Williams-Sonoma, West Elm and Pottery Barn Kids brands were the primary contributors to the year-over-year revenue increase. Pottery Barn and Pottery Barn Kids accounted for 50.0% of the growth in retail revenues from fiscal 2004 to fiscal 2005.

Retail revenues in fiscal 2004 increased by $188,596,000, or 11.6%, over fiscal 2003 primarily due to an increase in store leased square footage of 11.4% (including 43 new store openings and the remodeling or expansion of an additional 17 stores) and a comparable store sales increase of 3.5%. These increases were partially offset by the temporary closure of 15 stores and the permanent closure of 5 stores during fiscal 2004. Net revenues generated in the Pottery Barn, Williams-Sonoma and Pottery Barn Kids brands were the primary contributors to the year-over-year revenue increase, partially offset by the transitional impact of our Hold Everything brand realignment strategy. Pottery Barn and Pottery Barn Kids accounted for 65.8% of the growth in retail revenues from fiscal 2003 to fiscal 2004.

Comparable Store Sales

Comparable stores are defined as those stores in which gross square footage did not change by more than 20% in the previous 12 months and which have been open for at least 12 consecutive months without closure for seven or more consecutive days. Comparable stores exclude new retail concepts until such time as we believe that comparable store results in those concepts are meaningful to evaluating the performance of the retail strategy. For fiscal 2005, our total comparable store sales exclude the West Elm concept, which, at year-end, had only four stores operating for more than one year. One West Elm store was excluded in fiscal 2004. By measuring the year-over-year sales of merchandise in the stores that have a history of being open for a full comparable 12 months or more, we can better gauge how the core store base is performing since it excludes store remodelings, expansions and closings.

Percentages represent changes in comparable store sales versus the same period in the prior year.

Percent increase (decrease) in comparable store sales	Fiscal 2005	Fiscal 2004	Fiscal 2003
Williams-Sonoma	2.8%	0.5%	6.7%
Pottery Barn	5.7%	4.6%	2.3%
Pottery Barn Kids	5.2%	4.1%	0.4%
Hold Everything	(10.7%)	2.1%	(5.2%)
Outlets	14.7%	18.1%	6.7%
Total	4.9%	3.5%	4.0%

Various factors affect comparable store sales, including the number, size and location of stores we open, close, remodel or expand in any period, the general retail sales environment, consumer preferences and buying trends,

changes in sales mix between distribution channels, our ability to efficiently source and distribute products, changes in our merchandise mix, competition, current local and global economic conditions, the timing of our releases of new merchandise and promotional events, the success of marketing programs, the cannibalization of existing store sales by our new stores, increased catalog circulation, and continued strength in our Internet business. Among other things, weather conditions can affect comparable store sales because inclement weather can alter consumer behavior or require us to close certain stores temporarily and thus reduce store traffic. Even if stores are not closed, many customers may decide to avoid going to stores in bad weather. These factors have caused our comparable store sales to fluctuate significantly in the past on an annual, quarterly and monthly basis and, as a result, we expect that comparable store sales will continue to fluctuate in the future.

DIRECT-TO-CUSTOMER REVENUES

Dollars in thousands	Fiscal 2005	Fiscal 2004	Fiscal 2003
Catalog revenues[1]	$ 739,734	$ 764,703	$ 742,018
Internet revenues[1]	766,306	561,249	389,967
Total direct-to-customer revenues[1]	$1,506,040	$1,325,952	$1,131,985
Percent growth in direct-to-customer revenues	13.6%	17.1%	20.8%
Percent growth in number of catalogs circulated	4.6%	12.1%	17.4%
Percent growth in number of pages circulated	9.7%	19.5%	16.8%

[1] *Approximately 60% of our company-wide non-gift registry Internet revenues are driven by customers who recently received a catalog and approximately 40% are incremental to the direct-to-customer channel.*

Direct-to-customer revenues in fiscal 2005 increased by $180,088,000, or 13.6%, over fiscal 2004. This increase was primarily driven by revenues generated in the Pottery Barn, Pottery Barn Kids, West Elm and Williams-Sonoma brands due to increased catalog and page circulation (4.6% and 9.7%, respectively) and continued strength in our Internet business, primarily resulting from our expanded efforts associated with our electronic direct marketing initiatives and strategic e-commerce partnerships, and the incremental revenues generated by the late 2004 launch of our Hold Everything e-commerce website. All of our brands in the direct-to-customer channel delivered positive growth during the fiscal year with the exception of the Hold Everything brand.

Direct-to-customer revenues in fiscal 2004 increased by $193,967,000, or 17.1%, over fiscal 2003. This increase was primarily driven by revenues generated in the Pottery Barn, PBteen, Pottery Barn Kids and West Elm brands. All of our brands in the direct-to-customer channel delivered positive growth during the fiscal year with the exception of the Chambers brand, which was closed in the second quarter of 2004 in anticipation of the launch of the Williams-Sonoma Home brand in the third quarter of 2004.

COST OF GOODS SOLD

Dollars in thousands	Fiscal 2005	% Net Revenues	Fiscal 2004	% Net Revenues	Fiscal 2003	% Net Revenues
Total cost of goods sold	$2,103,465	59.4%	$1,865,786	59.5%	$1,[illegible]	[illegible]

Cost of goods sold includes cost of goods, occupancy expenses and shipping costs. Cost of goods consists of cost of merchandise, inbound freight expenses, freight-to-store expenses and other inventory related costs such as shrinkage, damages and replacements. Occupancy expenses consist of rent, depreciation and other occupancy costs, including common area maintenance and utilities. Shipping costs consist of third-party delivery services and shipping materials.

Our classification of expenses in cost of goods sold may not be comparable to other public companies, as we do not include non-occupancy related costs associated with our distribution network in cost of goods sold. These costs, which include distribution network employment, third-party warehouse management, and other distribution-related administrative expenses, are recorded in selling, general and administrative expenses.

Within our reportable segments, the direct-to-customer channel does not incur freight-to-store or store occupancy expenses, and typically operates with lower markdowns and inventory shrinkage than the retail channel. However, the direct-to-customer channel incurs higher shipping, damage and replacement costs than the retail channel.

Fiscal 2005 vs. Fiscal 2004
Cost of goods sold increased by $237,679,000, or 12.7%, in fiscal 2005 over fiscal 2004. Including an approximate $4,500,000 charge associated with transitioning the merchandising strategies of our Hold Everything brand into our other existing brands, cost of goods sold as a percentage of net revenues decreased 10 basis points in fiscal 2005 from fiscal 2004, primarily driven by rate reductions in shipping and occupancy costs, partially offset by a rate increase in cost of goods. The rate reduction in shipping costs was primarily due to the successful refining of our furniture delivery network, including the late 2004 in-sourcing of our line-haul management and cost efficiencies gained from our east coast distribution center, partially offset by a year-over-year increase in fuel surcharges. The rate reduction in occupancy expenses was primarily due to sales leverage in the retail channel, partially offset by increased distribution leased square footage in the direct-to-customer channel and lease termination costs associated with transitioning the merchandising strategies of our Hold Everything brand into our other existing brands. The rate increase in cost of goods was primarily due to the costs associated with the implementation of the daily store replenishment program in April and May of 2005 and a higher percentage of total company net revenues being driven by furniture, which generates a lower than average gross margin rate, as well as the write-down of impaired merchandise inventories associated with transitioning the merchandising strategies of our Hold Everything brand into our other existing brands.

In the retail channel, cost of goods sold as a percentage of retail net revenues decreased 20 basis points during fiscal 2005 compared to fiscal 2004. This was primarily due to sales leverage in fixed occupancy expenses, despite the lease termination costs associated with the merchandising transition in the Hold Everything brand into our other existing brands. Although cost of goods as a percentage of retail net revenues remained relatively flat compared to fiscal 2004, we saw a rate decrease in cost of merchandise driven by increased full-price selling in the Pottery Barn and Williams-Sonoma brands, partially offset by the write-down of impaired merchandise inventories associated with transitioning the merchandising strategies of our Hold Everything brand into our other existing brands and increased costs associated with the 2005 daily store replenishment program.

In the direct-to-customer channel, cost of goods sold as a percentage of direct-to-customer net revenues remained relatively flat in fiscal 2005 compared to fiscal 2004. This was primarily due to rate increases in cost of goods and occupancy expenses, offset by a rate reduction in shipping costs. The rate increase in cost of goods was primarily due to a furniture-driven rate increase, as well as the write-down of impaired merchandise inventories associated with transitioning the merchandising strategies of our Hold Everything brand into our other existing brands. The rate increase in occupancy expenses was primarily a function of higher distribution occupancy expenses resulting from increased distribution leased square footage versus fiscal 2004. The rate reduction in shipping costs was primarily due to the successful refining of our furniture delivery network, including the late 2004 in-sourcing of our line-haul management and cost efficiencies gained from our east coast distribution center, partially offset by a year-over-year increase in fuel surcharges.

Fiscal 2004 vs. Fiscal 2003
Cost of goods sold increased by $221,995,000, or 13.5%, in fiscal 2004 over fiscal 2003. As a percentage of net revenues, cost of goods sold decreased 20 basis points in fiscal 2004 from fiscal 2003, primarily driven by a rate reduction in occupancy expenses and shipping costs, partially offset by an increase in cost of goods. The rate reduction in occupancy expenses was primarily due to a greater percentage of total company net revenues being generated in the direct-to-customer channel, which does not incur store occupancy expenses. The rate improvement in shipping costs was primarily due to a full-year benefit of expense reductions in 2004 associated with the mid-2003 consolidation of freight providers, the in-sourcing of our line-haul management in the furniture delivery network, and reductions in furniture delivery costs driven by efficiencies gained from the new east coast distribution center. This rate improvement was partially offset by additional cost earlier in the year as we overcame initial challenges of balancing inventory allocations between the coastal distribution centers and a

need to ship merchandise out of market to our customers in order to fill backorders. The rate increase in cost of goods was primarily due to a higher percentage of total company net revenues being driven by furniture, which generates a lower than average gross margin rate, in addition to higher returns, replacements and damages.

In the retail channel, cost of goods sold as a percentage of retail net revenues remained relatively flat in fiscal 2004 compared to fiscal 2003. This was primarily driven by a year-over-year rate decrease in merchandise cost of goods, offset by an increase in our store occupancy expense rate.

In the direct-to-customer channel, cost of goods sold as a percentage of direct-to-customer net revenues increased 10 basis points during fiscal 2004 compared to fiscal 2003. This rate increase was primarily the result of a higher cost of merchandise due to a higher percentage of net revenues being driven by furniture, which generates a lower than average gross margin, in addition to higher replacements and damages. This was partially offset by an improvement in shipping costs in fiscal 2004 and a rate reduction in occupancy expenses. The improvement in shipping costs was due to the full-year benefit of expense reductions in 2004 associated with the mid-2003 consolidation of freight providers, the in-sourcing of our line-haul management in the furniture delivery network, and reductions in furniture delivery costs driven by efficiencies gained from the new east coast distribution center. The rate reduction in occupancy expenses was primarily due to the continued leveraging of sales.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses consist of non-occupancy related costs associated with our retail stores, distribution warehouses, customer care centers, supply chain operations (buying, receiving and inspection), and corporate administrative functions. These costs include employment, advertising, third party credit card processing, and other general expenses.

Due to their distinct distribution and marketing strategies, we experience differing employment and advertising costs as a percentage of net revenues within the retail and direct-to-customer segments. Store employment costs represent a greater percentage of retail net revenues than employment costs as a percentage of net revenues within the direct-to-customer segment. However, catalog advertising expenses are greater within the direct-to-customer channel than the retail channel.

Fiscal 2005 vs. Fiscal 2004
Selling, general and administrative expenses increased by $129,216,000, or 13.4%, to $1,090,392,000 in fiscal 2005 from $961,176,000 in fiscal 2004. Including an approximate $9,000,000 charge associated with transitioning the merchandising strategies of our Hold Everything brand into our other existing brands, selling, general and administrative expenses expressed as a percentage of net revenues increased to 30.8% in fiscal 2005 from 30.6% in fiscal 2004. This 20 basis point increase as a percentage of net revenues was primarily due to higher catalog advertising expenses and other general expenses, partially offset by rate reductions in employee benefit costs. Increased paper costs across all brands drove the majority of the catalog advertising expense increase. The increase in other general expenses was primarily due to asset impairment costs associated with the early shutdown of our Hold Everything stores as a result of transitioning the merchandising strategies of our Hold Everything brand into our other existing brands.

In the retail channel, selling, general and administrative expenses as a percentage of retail net revenues increased approximately 50 basis points in fiscal 2005 versus fiscal 2004, primarily driven by an increase in other general expenses due to asset impairment costs associated with the early shutdown of our Hold Everything stores as a result of transitioning the merchandising strategies of our Hold Everything brand into our other existing brands, in addition to higher catalog advertising expenses. Increased paper costs drove the majority of the catalog advertising expense increase. This rate increase was partially offset by rate reductions in employee benefit costs.

In the direct-to-customer channel, selling, general and administrative expenses as a percentage of direct-to-customer net revenues increased by approximately 40 basis points in fiscal 2005 compared to fiscal 2004. This rate increase was primarily driven by higher catalog advertising expenses resulting from increased paper costs across all brands, and an increase in other general expenses, including asset impairment costs as a result of transitioning the merchandising strategies of our Hold Everything brand into our other existing brands.

Fiscal 2004 vs. Fiscal 2003

Selling, general and administrative expenses increased by $105,386,000, or 12.3%, to $961,176,000 in fiscal 2004 from $855,790,000 in fiscal 2003. Selling, general and administrative expenses expressed as a percentage of net revenues decreased to 30.6% in fiscal 2004 from 31.1% in fiscal 2003. This 50 basis point improvement as a percentage of net revenues was primarily due to a rate reduction in year-over-year employment expenses. Contributing to the employment rate decrease were year-over-year reductions in workers' compensation and other employment-related costs.

In the retail channel, selling, general and administrative expenses as a percentage of retail net revenues increased approximately 30 basis points in fiscal 2004 versus fiscal 2003, primarily driven by increases in employment and advertising costs. The increase in the employment rate was due in part to the up front investment required in the emerging brands prior to the opening of our new store locations.

In the direct-to-customer channel, selling, general and administrative expenses as a percentage of direct-to-customer net revenues decreased by approximately 90 basis points in fiscal 2004 compared to fiscal 2003. This improvement was primarily driven by a rate reduction in catalog advertising and employment costs. The rate reduction in catalog advertising costs was driven by lower catalog circulation in the emerging brands coupled with continued sales generation by our e-commerce sites. This decrease was partially offset by growth in the rate of other general expenses primarily due to third party outsourcing of distribution services.

INTEREST INCOME AND EXPENSE

Interest income was $5,683,000 in fiscal 2005, $1,939,000 in fiscal 2004, and $873,000 in fiscal 2003, comprised primarily of income from short-term investments classified as cash and cash equivalents. The increase in interest income during fiscal 2005 resulted from an increase in the interest rates associated with these short-term investments as well as higher cash balances during fiscal 2005 compared to fiscal 2004.

Interest expense was $1,975,000 (net of capitalized interest of $1,200,000), $1,703,000 (net of capitalized interest of $1,689,000), and $22,000 (net of capitalized interest of $2,142,000) for fiscal 2005, fiscal 2004 and fiscal 2003, respectively. Interest expense increased by $272,000 to $1,975,000 in fiscal 2005, primarily due to interest expense associated with our Mississippi industrial development bonds issued in June 2004, partially offset by lower interest expense incurred on our senior notes as a result of the repayment of our outstanding balance in August 2005.

Interest expense increased by $1,681,000 to $1,703,000 in fiscal 2004, primarily due to additional interest expense of $1,525,000 associated with the consolidation of our Memphis-based distribution facilities. Prior to the adoption of Financial Accounting Standards Board ("FASB") Interpretation No. ("FIN") 46R, "Consolidation of Variable Interest Entities" in fiscal 2004, this expense would have been classified as occupancy expense.

INCOME TAXES

Our effective tax rate was 38.4% for fiscal 2005 and fiscal 2004, and 38.5% for fiscal 2003. We currently expect our fiscal 2006 effective tax rate to be in the range of 38.6% to 38.8%.

LIQUIDITY AND CAPITAL RESOURCES

As of January 29, 2006, we held $360,982,000 in cash and cash equivalent funds. As is consistent with our industry, our cash balances are seasonal in nature, with the fourth quarter representing a significantly higher level of cash than other periods. Throughout the fiscal year, we utilize our cash balances to build our inventory levels in preparation for our fourth quarter holiday sales. In fiscal 2006, we plan to utilize our cash resources to fund our inventory and inventory related purchases, catalog advertising and marketing initiatives, current store development and infrastructure strategies, share repurchases and issuance of dividends. In addition to the current cash balances on-hand, we have a $300,000,000 credit facility available as of January 29, 2006 that may be used for loans or letters of credit. No amounts were borrowed by us under the credit facility in either fiscal 2005 or fiscal 2004. However, as of January 29, 2006, $36,073,000 in issued but undrawn standby letters of credit were

outstanding under the credit facility. We believe our cash on-hand, in addition to our available credit facilities, will provide adequate liquidity for our business operations and growth opportunities over the following twelve-month period.

In fiscal 2005, net cash provided by operating activities was $348,373,000 as compared to net cash provided by operating activities of $304,437,000 in fiscal 2004. Cash provided by operating activities in fiscal 2005 was primarily attributable to net earnings, an increase in deferred rent and lease incentives due to new store openings, and an increase in customer deposits due to growth in unredeemed gift certificates. This was partially offset by an increase in merchandise inventories in order to support the increase in sales in our core and emerging brands and an increase in our leased and selling square footage of 8.6% and 7.9%, respectively.

In fiscal 2004, net cash provided by operating activities was $304,437,000 as compared to net cash provided by operating activities of $209,351,000 in fiscal 2003. The cash provided by operating activities in fiscal 2004 was primarily attributable to net earnings, an increase in our deferred rent and lease incentives due to an increase in retail store openings, an increase in customer deposits due to an increase in unredeemed gift certificates and an increase in accounts payable due to an increase in accrued freight and the timing of expenditures, offset primarily by an increase in merchandise inventories. Our merchandise inventories increased in fiscal 2004 in order to support the increase in sales in our core and emerging brands and an increase in our leased and selling square footage of 11.4% and 10.9%, respectively.

Net cash used in investing activities was $151,788,000 for fiscal 2005 as compared to $181,453,000 in fiscal 2004. Fiscal 2005 purchases of property and equipment were $151,788,000, comprised of $90,602,000 for 30 new and 8 remodeled stores, $39,602,000 for systems development projects (including e-commerce websites) and $21,584,000 for distribution, facility infrastructure and other projects.

In fiscal 2006, we anticipate investing $170,000,000 to $190,000,000 in the purchase of property and equipment, primarily for the construction of 28 new stores and 22 remodeled or expanded stores, systems development projects (including e-commerce websites), and distribution, facility infrastructure and other projects.

Net cash used in investing activities was $181,453,000 for fiscal 2004 as compared to $211,979,000 in fiscal 2003. Fiscal 2004 purchases of property and equipment were $181,453,000, comprised of $83,272,000 for 43 new and 17 remodeled or expanded stores, $53,830,000 for systems development projects (including e-commerce websites) and $44,351,000 for distribution, facility infrastructure and other projects (including the purchase of a corporate aircraft for approximately $11,500,000, previously leased under an operating lease).

For fiscal 2005, cash used in financing activities was $75,808,000, comprised primarily of $93,921,000 for the repurchase of common stock and $9,235,000 for the repayment of long-term obligations, including capital leases and long-term debt, partially offset by $28,002,000 in proceeds from the exercise of stock options.

For fiscal 2004, cash used in financing activities was $48,207,000, comprised primarily of $79,320,000 for the repurchase of common stock and $9,789,000 for the repayment of long-term obligations, including capital leases and long-term debt, partially offset by $26,190,000 in proceeds from the exercise of stock options and $15,000,000 in proceeds from the issuance of our Mississippi industrial development bonds associated with the Mississippi Debt Transaction. See Note C to our Consolidated Financial Statements.

Stock Repurchase Program

In May 2005, our Board of Directors authorized a stock repurchase program to acquire up to 2,000,000 additional shares of our outstanding common stock. During the fourth quarter of fiscal 2005, we repurchased and retired 780,800 shares at a weighted average cost of $41.70 per share and a total cost of approximately $32,556,000. During fiscal 2005, we repurchased and retired a total of 2,422,300 shares at a weighted average cost of $38.77 per share and a total cost of approximately $93,921,000. As of fiscal year-end, the remaining authorized number of shares eligible for repurchase was 20,000. During the first quarter of fiscal 2006, we repurchased and retired these shares at a weighted average cost of $38.84 per share and a total cost of approximately $777,000, which completed all stock repurchase programs previously authorized by our Board of Directors.

In March 2006, our Board of Directors authorized a stock repurchase program to acquire up to an additional 2,000,000 shares of our outstanding common stock. Stock repurchases under this program may be made through open market and privately negotiated transactions at times and in such amounts as management deems appropriate. The timing and actual number of shares repurchased will depend on a variety of factors, including price, corporate and regulatory requirements, capital availability, and other market conditions. The stock repurchase program does not have an expiration date and may be limited or terminated at any time without prior notice.

Contractual Obligations

The following table provides summary information concerning our future contractual obligations as of January 29, 2006.

	Payments Due by Period				
Dollars in thousands	Fiscal 2006	Fiscal 2007 to Fiscal 2009	Fiscal 2010 to Fiscal 2011	Thereafter	Total
Memphis-based distribution facilities obligation	$ 1,369	$ 4,527	$ 2,875	$ 6,925	$ 15,696
Industrial development bonds	14,200	—	—	—	14,200
Capital leases	3,295	163	—	—	3,458
Interest[1]	2,156	5,130	2,255	1,549	11,090
Operating leases[2,3]	178,846	507,500	281,918	539,533	1,507,797
Purchase obligations[4]	588,051	8,248	—	—	596,299
Total	$ 787,917	$ 525,568	$ 287,048	$ 548,007	$2,148,540

[1] Represents interest expected to be paid on our long-term debt, industrial development bonds and capital leases.

[2] See discussion on operating leases in the "Off Balance Sheet Arrangements" section and Note E to our Consolidated Financial Statements.

[3] Projected payments include only those amounts that are fixed and determinable as of the reporting date.

[4] Represents estimated commitments at year-end to purchase inventory and other goods and services in the normal course of business to meet operational requirements.

Memphis-Based Distribution Facilities Obligation

At January 29, 2006, long-term debt of $15,696,000 consisted of bond-related debt pertaining to the consolidation of our Memphis-based distribution facilities in accordance with FIN 46R. See discussion of the consolidation of our Memphis-based distribution facilities at Note F to our Consolidated Financial Statements.

Industrial Development Bonds

In June 2004, in an effort to utilize tax incentives offered to us by the state of Mississippi, we entered into an agreement whereby the Mississippi Business Finance Corporation issued $15,000,000 in long-term variable rate industrial development bonds, the proceeds, net of debt issuance costs, of which were loaned to us to finance the acquisition and installation of leasehold improvements and equipment located in our newly leased Olive Branch distribution center (the "Mississippi Debt Transaction"). The bonds are marketed through a remarketing agent and are secured by a letter of credit issued under our $300,000,000 line of credit facility. The bonds mature on June 1, 2024. The bond rate resets each week based upon current market rates. The rate in effect at January 29, 2006 was 4.5%.

The bond agreement allows for each bondholder to tender their bonds to the trustee for repurchase, on demand, with seven days advance notice. In the event the remarketing agent fails to remarket the bonds, the trustee will draw upon the letter of credit to fund the purchase of the bonds. As of January 29, 2006, $14,200,000 remained outstanding on these bonds and was classified as current debt. The bond proceeds are restricted for use in the acquisition and installation of leasehold improvements and equipment located in our Olive Branch distribution center. As of January 29, 2006, we had acquired and installed approximately $14,700,000 of leasehold improvements and equipment associated with the facility.

Capital Leases
Our $3,458,000 of capital lease obligations consist primarily of in-store computer equipment leases with a term of 60 months. The in-store computer equipment leases include an early purchase option at 54 months for $2,496,000, which is approximately 25% of the acquisition cost. We have an end of lease purchase option to acquire the equipment at the greater of fair market value or 15% of the acquisition cost.

Subsequent to year-end, we exercised the early purchase option on three of these leases and expect to exercise this option on the remaining computer equipment leases during fiscal 2006.

Other Contractual Obligations
We have other long-term liabilities reflected in our consolidated balance sheets, including deferred income taxes and insurance accruals. The payment obligations associated with these liabilities are not reflected in the table above due to the absence of scheduled maturities. The timing of these payments cannot be determined, except for amounts estimated to be payable in fiscal 2006 which are included in our current liabilities as of January 29, 2006.

Commercial Commitments

The following table provides summary information concerning our outstanding commercial commitments as of January 29, 2006.

	Amount of Outstanding Commitment Expiration By Period				
Dollars in thousands	Fiscal 2006	Fiscal 2007 to Fiscal 2009	Fiscal 2010 to Fiscal 2011	Thereafter	Total
Credit facility	—	—	—	—	—
Letter of credit facilities	$105,260	—	—	—	$105,260
Standby letters of credit	36,073	—	—	—	36,073
Total	$141,333	—	—	—	$141,333

Credit Facility
As of January 29, 2006, we have a credit facility that provides for a $300,000,000 unsecured revolving line of credit that may be used for loans or letters of credit and contains certain financial covenants, including a maximum leverage ratio (funded debt adjusted for lease and rent expense to EBITDAR), and a minimum fixed charge coverage ratio. Prior to August 22, 2009, we may, upon notice to the lenders, request an increase in the credit facility of up to $100,000,000, to provide for a total of $400,000,000 of unsecured revolving credit. The credit facility contains events of default that include, among others, non-payment of principal, interest or fees, inaccuracy of representations and warranties, violation of covenants, bankruptcy and insolvency events, material judgments, cross defaults to certain other indebtedness and events constituting a change of control. The occurrence of an event of default will increase the applicable rate of interest by 2.0% and could result in the acceleration of our obligations under the credit facility, and an obligation of any or all of our U.S. subsidiaries to pay the full amount of our obligations under the credit facility. The credit facility matures on February 22, 2010, at which time all outstanding borrowings must be repaid and all outstanding letters of credit must be cash collateralized.

We may elect interest rates calculated at Bank of America's prime rate (or, if greater, the average rate on overnight federal funds plus one-half of one percent) or LIBOR plus a margin based on our leverage ratio. No amounts were borrowed under the credit facility during fiscal 2005 or fiscal 2004. However, as of January 29, 2006, $36,073,000 in issued but undrawn standby letters of credit were outstanding under the credit facility. The standby letters of credit were issued to secure the liabilities associated with workers' compensation, other insurance programs and certain debt transactions. As of January 29, 2006, we were in compliance with our financial covenants under the credit facility.

Letter of Credit Facilities
We have three unsecured commercial letter of credit reimbursement facilities for an aggregate of $145,000,000, each of which expires on September 9, 2006. As of January 29, 2006, an aggregate of $105,260,000 was

outstanding under the letter of credit facilities. Such letters of credit represent only a future commitment to fund inventory purchases to which we have not taken legal title as of January 29, 2006. The latest expiration possible for any future letters of credit issued under the agreements is February 6, 2007.

OFF BALANCE SHEET ARRANGEMENTS

Operating Leases

We lease store locations, warehouses, corporate facilities, call centers and certain equipment under operating and capital leases for original terms ranging generally from 3 to 22 years. Certain leases contain renewal options for periods up to 20 years. The rental payment requirements in our store leases are typically structured as either minimum rent, minimum rent plus additional rent based on a percentage of store sales if a specified store sales threshold is exceeded, or rent based on a percentage of store sales if a specified store sales threshold or contractual obligations of the landlord have not been met. See Notes A and E to our Consolidated Financial Statements.

We have an operating lease for a 1,002,000 square foot retail distribution facility located in Olive Branch, Mississippi. The lease has an initial term of 22.5 years, expiring January 2022, with two optional five-year renewals. The lessor, an unrelated party, is a limited liability company. The construction and expansion of the distribution facility was financed by the original lessor through the sale of $39,200,000 Taxable Industrial Development Revenue Bonds, Series 1998 and 1999, issued by the Mississippi Business Finance Corporation. The bonds are collateralized by the distribution facility. As of January 29, 2006, approximately $31,249,000 was outstanding on the bonds. During fiscal 2005, we made annual rental payments of approximately $3,753,000, plus applicable taxes, insurance and maintenance expenses.

We have an operating lease for an additional 1,103,000 square foot retail distribution facility located in Olive Branch, Mississippi. The lease has an initial term of 22.5 years, expiring January 2023, with two optional five-year renewals. The lessor, an unrelated party, is a limited liability company. The construction of the distribution facility was financed by the original lessor through the sale of $42,500,000 Taxable Industrial Development Revenue Bonds, Series 1999, issued by the Mississippi Business Finance Corporation. The bonds are collateralized by the distribution facility. As of January 29, 2006, approximately $34,396,000 was outstanding on the bonds. During fiscal 2005, we made annual rental payments of approximately $4,181,000, plus applicable taxes, insurance and maintenance expenses.

In December 2003, we entered into an agreement to lease 780,000 square feet of a distribution facility located in Olive Branch, Mississippi. The lease has an initial term of six years, with two optional two-year renewals. The agreement includes an option to lease an additional 390,000 square feet of the same distribution center. We exercised this option during fiscal 2005, however, as of January 29, 2006, we had not occupied this space. During fiscal 2005, we made annual rental payments of approximately $1,927,000, plus applicable taxes, insurance and maintenance expenses.

On February 2, 2004, we entered into an agreement to lease 781,000 square feet of a distribution center located in Cranbury, New Jersey. The lease has an initial term of seven years, with three optional five-year renewals. The agreement requires us to lease an additional 219,000 square feet of the facility in the event the current tenant vacates the premises. As of January 29, 2006, the current tenant had not yet vacated the premises. During fiscal 2005, we made annual rental payments of approximately $3,339,000, plus applicable taxes, insurance and maintenance expenses.

On August 18, 2004, we entered into an agreement to lease a 500,000 square foot distribution facility located in Memphis, Tennessee. The lease has an initial term of four years, with one optional three-year and nine-month renewal. During fiscal 2005, we made annual rental payments of approximately $913,000, plus applicable taxes, insurance and maintenance expenses.

In addition, we are party to a variety of contractual agreements under which we may be obligated to indemnify the other party for certain matters. These contracts primarily relate to our commercial contracts, operating leases, trademarks, intellectual property, financial agreements and various other agreements. Under these contracts, we

may provide certain routine indemnifications relating to representations and warranties or personal injury matters. The terms of these indemnifications range in duration and may not be explicitly defined. Historically, we have not made significant payments for these indemnifications. We believe that if we were to incur a loss in any of these matters, the loss would not have a material effect on our financial condition or results of operations.

CONSOLIDATION OF MEMPHIS-BASED DISTRIBUTION FACILITIES

Our Memphis-based distribution facilities include an operating lease entered into in July 1983 for a distribution facility in Memphis, Tennessee. The lessor is a general partnership ("Partnership 1") comprised of W. Howard Lester, Chairman of the Board of Directors and a significant shareholder, and James A. McMahan, a Director Emeritus and a significant shareholder. Partnership 1 does not have operations separate from the leasing of this distribution facility and does not have lease agreements with any unrelated third parties.

Partnership 1 financed the construction of this distribution facility through the sale of a total of $9,200,000 of industrial development bonds in 1983 and 1985. Annual principal payments and monthly interest payments are required through maturity in December 2010. The Partnership 1 industrial development bonds are collateralized by the distribution facility and the individual partners guarantee the bond repayments. As of January 29, 2006, $1,887,000 was outstanding under the Partnership 1 industrial development bonds.

During fiscal 2005, we made annual rental payments of approximately $618,000 plus interest on the bonds calculated at a variable rate determined monthly (3.5% in January 2006), applicable taxes, insurance and maintenance expenses. Although the current term of the lease expires in August 2006, we are obligated to renew the operating lease on an annual basis until these bonds are fully repaid.

Our other Memphis-based distribution facility includes an operating lease entered into in August 1990 for another distribution facility that is adjoined to the Partnership 1 facility in Memphis, Tennessee. The lessor is a general partnership ("Partnership 2") comprised of W. Howard Lester, James A. McMahan and two unrelated parties. Partnership 2 does not have operations separate from the leasing of this distribution facility and does not have lease agreements with any unrelated third parties.

Partnership 2 financed the construction of this distribution facility and related addition through the sale of a total of $24,000,000 of industrial development bonds in 1990 and 1994. Quarterly interest and annual principal payments are required through maturity in August 2015. The Partnership 2 industrial development bonds are collateralized by the distribution facility and require us to maintain certain financial covenants. As of January 29, 2006, $13,809,000 was outstanding under the Partnership 2 industrial development bonds.

During fiscal 2005, we made annual rental payments of approximately $2,600,000, plus applicable taxes, insurance and maintenance expenses. This operating lease has an original term of 15 years expiring in August 2006, with three optional five-year renewal periods. We are, however, obligated to renew the operating lease on an annual basis until these bonds are fully repaid.

As of February 1, 2004, the Company adopted FIN 46R, which requires existing unconsolidated variable interest entities to be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among parties involved. The two partnerships described above qualify as variable interest entities under FIN 46R due to their related party relationship and our obligation to renew the leases until the bonds are fully repaid. Accordingly, the two related party variable interest entity partnerships from which we lease our Memphis-based distribution facilities were consolidated by us as of February 1, 2004. As of January 29, 2006, the consolidation resulted in increases to our consolidated balance sheet of $18,250,000 in assets (primarily buildings), $15,696,000 in debt, and $2,554,000 in other long-term liabilities. Consolidation of these partnerships did not have an impact on our net income. However, the interest expense associated with the partnerships' debt, shown as occupancy expense in fiscal 2003, is now recorded as interest expense. In fiscal 2005 and fiscal 2004, this interest expense approximated $1,462,000 and $1,525,000, respectively.

IMPACT OF INFLATION

The impact of inflation on our results of operations for the past three fiscal years has not been significant.

CRITICAL ACCOUNTING POLICIES

Management's Discussion and Analysis of Financial Condition and Results of Operations is based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosures of contingent assets and liabilities. These estimates and assumptions are evaluated on an on-going basis and are based on historical experience and various other factors that we believe to be reasonable under the circumstances. Actual results could differ from these estimates.

We believe the following critical accounting policies affect the significant estimates and assumptions used in the preparation of our consolidated financial statements.

Merchandise Inventories
Merchandise inventories, net of an allowance for excess quantities and obsolescence, are stated at the lower of cost (weighted average method) or market. We estimate a provision for damaged, obsolete, excess and slow-moving inventory based on inventory aging reports and specific identification. We generally reserve, based on inventory aging reports, for 50% of the cost of all inventory between one and two years old and 100% of the cost of all inventory over two years old. If actual obsolescence is different from our estimate, we will adjust our provision accordingly. Specific reserves are also recorded in the event the cost of the inventory exceeds the fair market value. In addition, on a monthly basis, we estimate a reserve for expected shrinkage at the concept and channel level based on historical shrinkage factors and our current inventory levels. Actual shrinkage is recorded at year-end based on the results of our physical inventory count and can vary from our estimates due to such factors as changes in operations within our distribution centers, the mix of our inventory (which ranges from large furniture to small tabletop items) and execution against loss prevention initiatives in our stores, off-site storage locations, and our third party transportation providers.

Prepaid Catalog Expenses
Prepaid catalog expenses consist of third party incremental direct costs, including creative design, paper, printing, postage and mailing costs for all of our direct response catalogs. Such costs are capitalized as prepaid catalog expenses and are amortized over their expected period of future benefit. Such amortization is based upon the ratio of actual revenues to the total of actual and estimated future revenues on an individual catalog basis. Estimated future revenues are based upon various factors such as the total number of catalogs and pages circulated, the probability and magnitude of consumer response and the assortment of merchandise offered. Each catalog is generally fully amortized over a six to nine month period, with the majority of the amortization occurring within the first four to five months. Prepaid catalog expenses are evaluated for realizability on a monthly basis by comparing the carrying amount associated with each catalog to the estimated probable remaining future profitability (remaining net revenues less merchandise cost of goods sold, selling expenses and catalog related-costs) associated with that catalog. If the catalog is not expected to be profitable, the carrying amount of the catalog is impaired accordingly.

Property and Equipment
Property and equipment is stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. The decision to close, relocate, remodel or expand a store prior to the end of its lease term can result in accelerated depreciation over the revised useful life of the long-lived assets. For any store closures where a lease obligation still exists, we record the estimated future liability associated with the rental obligation on the date the store is closed in accordance with Statement of Financial Accounting Standards ("SFAS") No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." However, most store closures occur upon the lease expiration.

We review the carrying value of all long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," we review for impairment all

stores for which current cash flows from operations are negative, or the construction costs are significantly in excess of the amount originally expected. Impairment results when the carrying value of the assets exceeds the undiscounted future cash flows over the life of the lease. Our estimate of undiscounted future cash flows over the lease term (typically 5 to 22 years) is based upon our experience, historical operations of the stores and estimates of future store profitability and economic conditions. The future estimates of store profitability and economic conditions require estimating such factors as sales growth, employment rates, lease escalations, inflation on operating expenses and the overall economics of the retail industry for up to 20 years in the future, and are therefore subject to variability and difficult to predict. If a long-lived asset is found to be impaired, the amount recognized for impairment is equal to the difference between the carrying value and the asset's fair value. The fair value is estimated based upon future cash flows (discounted at a rate that approximates our weighted average cost of capital) or other reasonable estimates of fair market value. See Note A to the Consolidated Financial Statements for additional information regarding Property and Equipment.

Self-Insured Liabilities
We are primarily self-insured for workers' compensation, employee health benefits and product and general liability claims. We record self-insurance liabilities based on claims filed, including the development of those claims, and an estimate of claims incurred but not yet reported. Factors affecting this estimate include future inflation rates, changes in severity, benefit level changes, medical costs and claim settlement patterns. Should a different amount of claims occur compared to what was estimated, or costs of the claims increase or decrease beyond what was anticipated, reserves may need to be adjusted accordingly. We determine our workers' compensation liability and general liability claims reserves based on an actuarial analysis. Reserves for self-insurance liabilities are recorded within accrued salaries, benefits and other on our consolidated balance sheet.

Revenue Recognition
We recognize revenues and the related cost of goods sold (including shipping costs) at the time the products are received by customers in accordance with the provisions of Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition in Financial Statements" as amended by SAB No. 104, "Revenue Recognition." Revenue is recognized for retail sales (excluding home-delivered merchandise) at the point of sale in the store and for home-delivered merchandise and direct-to-customer sales when the merchandise is delivered to the customer. Discounts provided to customers are accounted for as a reduction of sales. We record a reserve for estimated product returns in each reporting period. Shipping and handling fees charged to the customer are recognized as revenue at the time the products are delivered to the customer.

Sales Return Reserve
Our customers may return purchased items for an exchange or refund. We record a reserve for estimated product returns, net of cost of goods sold, based on historical return trends together with current product sales performance. If actual returns, net of cost of goods sold, are different than those projected by management, the estimated sales return reserve will be adjusted accordingly.

Income Taxes
Income taxes are accounted for using the asset and liability method. Under this method, deferred income taxes arise from temporary differences between the tax basis of assets and liabilities and their reported amounts in the consolidated financial statements. We record reserves for estimates of probable settlements of foreign and domestic tax audits. At any one time, many tax years are subject to audit by various taxing jurisdictions. The results of these audits and negotiations with taxing authorities may affect the ultimate settlement of these issues. Our effective tax rate in a given financial statement period may be materially impacted by changes in the mix and level of earnings.

Stock-Based Compensation
We account for stock options and awards granted to employees using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees." No

compensation expense has been recognized in the consolidated financial statements for stock options, as we grant all stock options with an exercise price equal to the market price of our common stock at the date of grant, however, stock compensation expense is recognized in the consolidated financial statements for restricted stock unit awards. SFAS No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure," however, requires the disclosure of pro forma net earnings and earnings per share as if we had adopted the fair value method. Under SFAS No. 123, the fair value of stock-based awards to employees is calculated through the use of option pricing models. These models require subjective assumptions, including future stock price volatility and expected time to exercise, which affect the calculated values. Our calculations are based on a single option valuation approach, and forfeitures are recognized as they occur.

NEW ACCOUNTING PRONOUNCEMENTS

In December 2004, the FASB issued SFAS No. 123R, "Share Based Payment." SFAS No. 123R will require us to measure and record compensation expense in our consolidated financial statements for all employee share-based compensation awards using a fair value method. In addition, the adoption of SFAS No. 123R requires additional accounting and disclosure related to the income tax and cash flow effects resulting from share-based payment arrangements. We expect to adopt this Statement using the modified prospective application transition method beginning in the first quarter of fiscal 2006. We anticipate the adoption of this Statement to result in a reduction to our diluted earnings per share of approximately $0.19 for fiscal 2006.

In March 2005, the FASB issued FIN No. 47, "Accounting for Conditional Asset Retirement Obligations – An Interpretation of FASB Statement No. 143," which requires an entity to recognize a liability for the fair value of a conditional asset retirement obligation when incurred if the liability's fair value can be reasonably estimated. We adopted the provisions of FIN 47 as of January 29, 2006. The adoption of this Interpretation did not have a material impact on our consolidated financial position, results of operations or cash flows.

In October 2005, the FASB issued FASB Staff Position ("FSP") No. FAS 13-1, "Accounting for Rental Costs Incurred during a Construction Period," which requires us, beginning on January 30, 2006, to expense all rental costs associated with our operating leases that are incurred during a construction period. Prior to this date, rental costs incurred during the construction period were capitalized until the store opening date. We anticipate the adoption of this Staff Position to result in a reduction to our diluted earnings per share of approximately $0.03 for fiscal 2006.

In September 2005, the Emerging Issues Task Force ("EITF") issued EITF No. 05-6, "Determining the Amortization Period for Leasehold Improvements Purchased after Lease Inception or Acquired in a Business Combination," which requires us to amortize leasehold improvements that are placed in service significantly after the beginning of a lease term over the shorter of the useful life of the assets, or a term that includes required lease periods and renewals that are deemed to be reasonably assumed at the date the leasehold improvement is purchased. This EITF did not have a material impact on our consolidated financial position, results of operations or cash flows.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risks, which include changes in U.S. interest rates and foreign exchange rates. We do not engage in financial transactions for trading or speculative purposes.

Interest Rate Risk

The interest payable on our credit facility, industrial development bond and the bond-related debt associated with our Memphis-based distribution facilities is based on variable interest rates and is therefore affected by changes in market interest rates. If interest rates on existing variable rate debt rose 44 basis points (an approximate 10% increase in the associated variable rates as of January 29, 2006), our results from operations and cash flows would not be materially affected.

In addition, we have fixed and variable income investments consisting of short-term investments classified as cash and cash equivalents, which are also affected by changes in market interest rates. An increase in interest rates of 10% would have an immaterial effect on the value of these investments. Declines in interest rates would, however, decrease the income derived from these investments.

Foreign Currency Risks

We purchase a significant amount of inventory from vendors outside of the U.S. in transactions that are denominated in U.S. dollars. Approximately 5% of our international purchase transactions are in currencies other than the U.S. dollar. As of January 29, 2006, any currency risks related to these transactions were not significant to us. A decline in the relative value of the U.S. dollar to other foreign currencies could, however, lead to increased purchasing costs.

As of January 29, 2006, we have 14 retail stores in Canada, which expose us to market risk associated with foreign currency exchange rate fluctuations. As necessary, we have utilized 30-day foreign currency contracts to minimize any currency remeasurement risk associated with intercompany assets and liabilities of our Canadian subsidiary. These contracts are accounted for by adjusting the carrying amount of the contract to market and recognizing any gain or loss in selling, general and administrative expenses in each reporting period. We did not enter into any new foreign currency contracts during fiscal 2005 or fiscal 2004. Any gain or loss associated with these types of contracts in prior years was not material to us.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Williams-Sonoma, Inc.
Consolidated Statements of Earnings

	Fiscal Year Ended		
Dollars and shares in thousands, except per share amounts	Jan. 29, 2006	Jan. 30, 2005	Feb. 1, 2004
Net revenues	$ 3,538,947	$ 3,136,931	$ 2,754,368
Cost of goods sold	2,103,465	1,865,786	1,643,791
Gross margin	1,435,482	1,271,145	1,110,577
Selling, general and administrative expenses	1,090,392	961,176	855,790
Interest income	(5,683)	(1,939)	(873)
Interest expense	1,975	1,703	22
Earnings before income taxes	348,798	310,205	255,638
Income taxes	133,932	118,971	98,427
Net earnings	$ 214,866	$ 191,234	$ 157,211
Basic earnings per share	$ 1.86	$ 1.65	$ 1.36
Diluted earnings per share	$ 1.81	$ 1.60	$ 1.32
Shares used in calculation of earnings per share:			
Basic	115,616	116,159	115,583
Diluted	118,427	119,347	119,016

See Notes to Consolidated Financial Statements.

Williams-Sonoma, Inc.
Consolidated Balance Sheets

Dollars and shares in thousands, except per share amounts	Jan. 29, 2006	Jan. 30, 2005
ASSETS		
Current assets		
Cash and cash equivalents	$ 360,982	$ 239,210
Accounts receivable (less allowance for doubtful accounts of $168 and $217)	51,020	42,520
Merchandise inventories – net	520,292	452,421
Prepaid catalog expenses	53,925	53,520
Prepaid expenses	31,847	38,018
Deferred income taxes	57,267	39,015
Other assets	7,831	9,061
Total current assets	1,083,164	873,765
Property and equipment – net	880,305	852,412
Other assets (less accumulated amortization of $679 and $2,066)	18,151	19,368
Total assets	$ 1,981,620	$ 1,745,545
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 196,074	$ 173,781
Accrued salaries, benefits and other	93,434	86,767
Customer deposits	172,775	148,535
Income taxes payable	83,589	72,052
Current portion of long-term debt	18,864	23,435
Other liabilities	25,656	17,587
Total current liabilities	590,392	522,[illegible]57
Deferred rent and lease incentives	218,254	212,193
Long-term debt	14,490	19,154
Deferred income tax liabilities	18,455	21,057
Other long-term obligations	14,711	13,322
Total liabilities	856,302	787,883
Commitments and contingencies – See Note L		
Shareholders' equity		
Preferred stock, $.01 par value, 7,500 shares authorized, none issued	—	—
Common stock, $.01 par value, 253,125 shares authorized, 114,779 shares issued and outstanding at January 29, 2006; 115,372 shares issued and outstanding at January 30, 2005	1,148	1,154
Additional paid-in capital	325,146	286,720
Retained earnings	791,329	664,619
Accumulated other comprehensive income	7,695	5,169
Total shareholders' equity	1,125,318	957,662
Total liabilities and shareholders' equity	$ 1,981,620	$ 1,745,545

See Notes to Consolidated Financial Statements.

Williams-Sonoma, Inc.
Consolidated Statements of Shareholders' Equity

Dollars and shares in thousands	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Deferred Stock-Based Compensation	Total Shareholders' Equity	Comprehensive Income
Balance at February 2, 2003	114,317	$ 1,143	$ 196,259	$446,837	$ (11)	$ (250)	$ 643,978	
Net earnings	—	—	—	157,211	—	—	157,211	$ 157,211
Foreign currency translation adjustment and related tax effect	—	—	—	—	3,298	—	3,298	3,298
Exercise of stock options and related tax effect	3,295	33	59,516	—	—	—	59,549	
Repurchase and retirement of common stock	(1,785)	(18)	(3,450)	(56,227)	—	—	(59,695)	
Amortization of deferred stock-based compensation	—	—	—	—	—	250	250	
Comprehensive income								$ 160,509
Balance at February 1, 2004	115,827	1,158	252,325	547,821	3,287	—	804,591	
Net earnings	—	—	—	191,234	—	—	191,234	$ 191,234
Foreign currency translation adjustment	—	—	—	—	1,882	—	1,882	1,882
Exercise of stock options and related tax effect	1,818	18	39,257	—	—	—	39,275	
Repurchase and retirement of common stock	(2,273)	(22)	(4,862)	(74,436)	—	—	(79,320)	
Comprehensive income								$ 193,116
Balance at January 30, 2005	115,372	1,154	286,720	664,619	5,169	—	957,662	
Net earnings	—	—	—	214,866	—	—	214,866	$ 214,866
Foreign currency translation adjustment	—	—	—	—	2,526	—	2,526	2,526
Exercise of stock options and related tax effect	1,829	18	43,727	—	—	—	43,745	
Repurchase and retirement of common stock	(2,422)	(24)	(5,741)	(88,156)	—	—	(93,921)	
Stock-based compensation expense	—	—	440	—	—	—	440	
Comprehensive income								$ 217,392
Balance at January 29, 2006	114,779	$ 1,148	$ 325,146	$791,329	$ 7,695	$ —	$ 1,125,318	

See Notes to Consolidated Financial Statements.

Williams-Sonoma, Inc.
Consolidated Statements of Cash Flows

Dollars in thousands	*Fiscal Year Ended* Jan. 29, 2006	Jan. 30, 2005	Feb. 1, 2004
Cash flows from operating activities:			
Net earnings	$ 214,866	$ 191,234	$ 157,211
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	123,199	111,624	99,534
Loss on disposal/impairment of assets	12,050	1,080	2,353
Amortization of deferred lease incentives	(24,909)	(22,530)	(19,513)
Deferred income taxes	(20,791)	(6,254)	(6,472)
Tax benefit from exercise of stock options	15,743	13,085	20,429
Stock-based compensation expense	440	—	250
Other	—	335	—
Changes in:			
Accounts receivable	(6,829)	(10,900)	2,796
Merchandise inventories	(67,474)	(48,017)	(82,196)
Prepaid catalog expenses	(405)	(15,056)	(3,302)
Prepaid expenses and other assets	9,032	(19,702)	(15,161)
Accounts payable	14,365	17,773	(11,358)
Accrued salaries, benefits and other	15,950	9,955	(1,020)
Customer deposits	24,066	32,273	23,014
Deferred rent and lease incentives	27,661	42,080	34,800
Income taxes payable	11,409	7,457	7,986
Net cash provided by operating activities	348,373	304,437	209,351
Cash flows from investing activities:			
Purchases of property and equipment	(151,788)	(181,453)	(211,979)
Net cash used in investing activities	(151,788)	(181,453)	(211,979)
Cash flows from financing activities:			
Proceeds from bond issuance	—	15,000	—
Repayments of long-term obligations	(9,235)	(9,789)	(7,610)
Proceeds from exercise of stock options	28,002	26,190	39,120
Repurchase of common stock	(93,921)	(79,320)	(59,695)
Credit facility costs	(654)	(288)	(41)
Net cash used in financing activities	(75,808)	(48,207)	(28,226)
Effect of exchange rates on cash and cash equivalents	995	523	1,269
Net increase (decrease) in cash and cash equivalents	121,772	75,300	(29,585)
Cash and cash equivalents at beginning of year	239,210	163,910	193,495
Cash and cash equivalents at end of year	$ 360,982	$ 239,210	$ 163,910
Supplemental disclosure of cash flow information:			
Cash paid during the year for:			
Interest[1]	$ 3,352	$ 3,585	$ 2,367
Income taxes	130,766	105,910	79,184
Non-cash investing and financing activities:			
Assets acquired under capital lease obligations	—	—	1,275
Consolidation of Memphis-based distribution facilities:			
Fixed assets assumed	—	—	19,512
Long-term debt assumed	—	—	18,223
Other long-term liabilities assumed	—	—	1,289

[1] *Interest paid, net of capitalized interest, was $2.2 million, $1.9 million and $0.2 million in fiscal 2005, 2004 and 2003, respectively.*

See Notes to Consolidated Financial Statements.

Note A: Summary of Significant Accounting Policies

We are a specialty retailer of products for the home. The retail segment of our business sells our products through our six retail store concepts (Williams-Sonoma, Pottery Barn, Pottery Barn Kids, Hold Everything, West Elm and Williams-Sonoma Home). The direct-to-customer segment of our business sells similar products through our eight direct-mail catalogs (Williams-Sonoma, Pottery Barn, Pottery Barn Kids, Pottery Barn Bed + Bath, PBteen, Hold Everything, West Elm and Williams-Sonoma Home) and six e-commerce websites (williams-sonoma.com, potterybarn.com, potterybarnkids.com, pbteen.com, westelm.com and holdeverything.com). The catalogs reach customers throughout the U.S., while the six retail concepts currently operate 570 stores in 43 states, Washington, D.C. and Canada.

In January 2006, we decided to transition the merchandising strategies of our Hold Everything brand into our other existing brands by the end of fiscal 2006. In connection with this transition, we incurred a pre-tax charge of approximately $13,500,000, or $0.07 per diluted share, in the fourth quarter of fiscal 2005. These costs primarily included the initial asset impairment and lease termination costs associated with the shutdown of the Hold Everything retail stores, the asset impairment of the e-commerce website, and the write-down of impaired merchandise inventories. Of this pre-tax charge, approximately $4,500,000 is included in cost of goods sold and approximately $9,000,000 is included in selling, general, and administrative expenses. We expect to incur an additional after-tax charge of $0.03 per diluted share in the first half of fiscal 2006.

Significant intercompany transactions and accounts have been eliminated.

Fiscal Year
Our fiscal year ends on the Sunday closest to January 31, based on a 52/53-week year. Fiscal years 2005, 2004 and 2003 ended on January 29, 2006 (52 weeks), January 30, 2005 (52 weeks) and February 1, 2004 (52 weeks), respectively. The Company's next 53-week fiscal year will be fiscal 2007, ending on February 3, 2008.

Use of Estimates
The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosures of contingent assets and liabilities. These estimates and assumptions are evaluated on an on-going basis and are based on historical experience and various other factors that we believe to be reasonable under the circumstances. Actual results could differ from these estimates.

Cash Equivalents
Cash equivalents include highly liquid investments with an original maturity of three months or less. Our policy is to invest in high-quality, short-term instruments to achieve maximum yield while maintaining a level of liquidity consistent with our needs. Book cash overdrafts issued but not yet presented to the bank for payment are reclassified to accounts payable.

Allowance for Doubtful Accounts
A summary of activity in the allowance for doubtful accounts is as follows:

Dollars in thousands	Fiscal 2005	Fiscal 2004	Fiscal 2003
Balance at beginning of year	$ 217	$ 207	$ 64
Provision for loss on accounts receivable	(49)	10	143
Accounts written off	—	—	—
Balance at end of year	$ 168	$ 217	$ 207

Merchandise Inventories
Merchandise inventories, net of an allowance for excess quantities and obsolescence, are stated at the lower of cost (weighted average method) or market. We estimate a provision for damaged, obsolete, excess and slow- moving inventory based on inventory aging reports and specific identification. We generally reserve, based on inventory aging reports, for 50% of the cost of all inventory between one and two years old and 100% of the cost of all inventory over two years old. If actual obsolescence is different from our estimate, we will adjust our provision accordingly. Specific reserves are also recorded in the event the cost of the inventory exceeds the fair market value. In addition, on a monthly basis, we estimate a reserve for expected shrinkage at the concept and channel level based on historical shrinkage factors and our current inventory levels. Actual shrinkage is recorded at year-end based on the results of our physical inventory count and can vary from our estimates due to such factors as changes in operations within our distribution centers, the mix of our inventory (which ranges from large furniture to small tabletop items) and execution against loss prevention initiatives in our stores, off-site storage locations, and our third party transportation providers.

Approximately 63%, 62% and 61% of our merchandise purchases in fiscal 2005, fiscal 2004 and fiscal 2003, respectively, were foreign-sourced, primarily from Asia and Europe.

Prepaid Catalog Expenses
Prepaid catalog expenses consist of third party incremental direct costs, including creative design, paper, printing, postage and mailing costs for all of our direct response catalogs. Such costs are capitalized as prepaid catalog expenses and are amortized over their expected period of future benefit. Such amortization is based upon the ratio of actual revenues to the total of actual and estimated future revenues on an individual catalog basis. Estimated future revenues are based upon various factors such as the total number of catalogs and pages circulated, the probability and magnitude of consumer response and the assortment of merchandise offered. Each catalog is generally fully amortized over a six to nine month period, with the majority of the amortization occurring within the first four to five months. Prepaid catalog expenses are evaluated for realizability on a monthly basis by comparing the carrying amount associated with each catalog to the estimated probable remaining future profitability (remaining net revenues less merchandise cost of goods sold, selling expenses and catalog related-costs) associated with that catalog. If the catalog is not expected to be profitable, the carrying amount of the catalog is impaired accordingly. Catalog advertising expenses were $321,610,000, $278,169,000 and $250,337,000 in fiscal 2005, fiscal 2004 and fiscal 2003, respectively.

Property and Equipment
Property and equipment is stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets below. Any reduction in the estimated lives would result in higher depreciation expense in a given period for the related assets.

Leasehold improvements	Shorter of estimated useful life or lease term (generally 3 – 22 years)
Fixtures and equipment	2 – 20 years
Buildings and building improvements	12 – 40 years
Capitalized software	2 – 10 years
Corporate aircraft	20 years (20% salvage value)
Capital leases	Shorter of estimated useful life or lease term (generally 4 – 5 years)

Internally developed software costs are capitalized in accordance with the American Institute of Certified Public Accountants Statement of Position 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use."

Interest costs related to assets under construction, including software projects, are capitalized during the construction or development period. We capitalized interest costs of $1,200,000, $1,689,000 and $2,142,000 in fiscal 2005, fiscal 2004 and fiscal 2003, respectively.

For any store closures where a lease obligation still exists, we record the estimated future liability associated with the rental obligation on the date the store is closed in accordance with Statement of Financial Accounting Standards ("SFAS") No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." However, most store closures occur upon the lease expiration.

We review the carrying value of all long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," we review for impairment all stores for which current cash flows from operations are negative, or the construction costs are significantly in excess of the amount originally expected. Impairment results when the carrying value of the assets exceeds the undiscounted future cash flows over the life of the lease. Our estimate of undiscounted future cash flows over the lease term (typically 5 to 22 years) is based upon our experience, historical operations of the stores and estimates of future store profitability and economic conditions. The future estimates of store profitability and economic conditions require estimating such factors as sales growth, employment rates, lease escalations, inflation on operating expenses and the overall economics of the retail industry for up to 20 years in the future, and are therefore subject to variability and difficult to predict. If a long-lived asset is found to be impaired, the amount recognized for impairment is equal to the difference between the carrying value and the asset's fair value. The fair value is estimated based upon future cash flows (discounted at a rate that approximates our weighted average cost of capital) or other reasonable estimates of fair market value.

Lease Rights and Other Intangible Assets
Lease rights, representing costs incurred to acquire the lease of a specific commercial property, are recorded at cost in other assets and are amortized over the lives of the respective leases. Other intangible assets include fees associated with the acquisition of our credit facility and are recorded at cost in other assets and amortized over the life of the facility.

Self-Insured Liabilities
We are primarily self-insured for workers' compensation, employee health benefits and product and general liability claims. We record self-insurance liabilities based on claims filed, including the development of those claims, and an estimate of claims incurred but not yet reported. Factors affecting this estimate include future inflation rates, changes in severity, benefit level changes, medical costs and claim settlement patterns. Should a different amount of claims occur compared to what was estimated, or costs of the claims increase or decrease beyond what was anticipated, reserves may need to be adjusted accordingly. We determine our workers' compensation liability and general liability claims reserves based on an actuarial analysis. Reserves for self-insurance liabilities are recorded within accrued salaries, benefits and other on our consolidated balance sheet.

Customer Deposits
Customer deposits are primarily comprised of unredeemed gift certificates and merchandise credits and deferred revenue related to undelivered merchandise. We maintain a liability for unredeemed gift certificates and merchandise credits until the earlier of redemption, escheatment or seven years. After seven years, the remaining unredeemed gift certificate or merchandise credit liability is relieved and recorded within selling, general and administrative expenses.

Deferred Rent and Lease Incentives
For leases that contain fixed escalations of the minimum annual lease payment during the original term of the lease, we recognize rental expense on a straight-line basis over the lease term, including the construction period, and record the difference between rent expense and the amount currently payable as deferred rent. Any rental expense incurred during the construction period is capitalized as a leasehold improvement within property and equipment and depreciated over the lease term. Deferred lease incentives include construction allowances received from landlords, which are amortized on a straight-line basis over the lease term, including the construction period. Beginning in fiscal 2006, in accordance with Financial Accounting Standards Board

("FASB") Staff Position ("FSP") FAS 13-1, "Accounting for Rental Costs Incurred During a Construction Period," we will expense any rental costs incurred during the construction period.

Contingent Liabilities
Contingent liabilities are recorded when it is determined that the outcome of an event is expected to result in a loss that is considered probable and reasonably estimable.

Fair Value of Financial Instruments
The carrying values of cash and cash equivalents, accounts receivable, investments, accounts payable and debt approximate their estimated fair values.

Revenue Recognition
We recognize revenues and the related cost of goods sold (including shipping costs) at the time the products are received by customers in accordance with the provisions of Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition in Financial Statements" as amended by SAB No. 104, "Revenue Recognition." Revenue is recognized for retail sales (excluding home-delivered merchandise) at the point of sale in the store and for home-delivered merchandise and direct-to-customer sales when the merchandise is delivered to the customer. Discounts provided to customers are accounted for as a reduction of sales. We record a reserve for estimated product returns in each reporting period. Shipping and handling fees charged to the customer are recognized as revenue at the time the products are delivered to the customer.

Sales Returns Reserve
Our customers may return purchased items for an exchange or refund. We record a reserve for estimated product returns, net of cost of goods sold, based on historical return trends together with current product sales performance. If actual returns, net of cost of goods sold, are different than those projected by management, the estimated sales returns reserve will be adjusted accordingly. A summary of activity in the sales returns reserve is as follows:

Dollars in thousands	Fiscal 2005[1]	Fiscal 2004[1]	Fiscal 2003[1]
Balance at beginning of year	$ 13,506	$ 12,281	$ 10,292
Provision for sales returns	243,807	215,715	182,829
Actual sales returns	(243,631)	(214,490)	(180,840)
Balance at end of year	$ 13,682	$ 13,506	$ 12,281

[1] *Amounts are shown net of cost of goods sold.*

Vendor Allowances
We may receive allowances or credits from vendors for volume rebates. In accordance with Emerging Issues Task Force ("EITF") 02-16, "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor," our accounting policy is to treat such volume rebates as an offset to the cost of the product or services provided at the time the expense is recorded. These allowances and credits received are primarily recorded in cost of goods sold or in selling, general and administrative expenses.

Foreign Currency Translation
The functional currency of our Canadian subsidiary is the Canadian dollar. Assets and liabilities are translated into U.S. dollars using the current exchange rates in effect at the balance sheet date, while revenues and expenses are translated at the average exchange rates during the period. The resulting translation adjustments are recorded as other comprehensive income within shareholders' equity. Gains and losses resulting from foreign currency transactions have not been significant and are included in selling, general and administrative expenses.

Financial Instruments
As of January 29, 2006, we have 14 retail stores in Canada, which expose us to market risk associated with foreign currency exchange rate fluctuations. As necessary, we have utilized 30-day foreign currency contracts to minimize any currency remeasurement risk associated with intercompany assets and liabilities of our Canadian subsidiary. These contracts are accounted for by adjusting the carrying amount of the contract to market and recognizing any gain or loss in selling, general and administrative expenses in each reporting period. We did not enter into any new foreign currency contracts during fiscal 2005 or fiscal 2004. Any gain or loss associated with these types of contracts in prior years was not material to us.

Income Taxes
Income taxes are accounted for using the asset and liability method. Under this method, deferred income taxes arise from temporary differences between the tax basis of assets and liabilities and their reported amounts in the consolidated financial statements. We record reserves for estimates of probable settlements of foreign and domestic tax audits. At any one time, many tax years are subject to audit by various taxing jurisdictions. The results of these audits and negotiations with taxing authorities may affect the ultimate settlement of these issues. Our effective tax rate in a given financial statement period may be materially impacted by changes in the mix and level of earnings.

Earnings Per Share
Basic earnings per share is computed as net earnings divided by the weighted average number of common shares outstanding for the period. Diluted earnings per share is computed as net earnings divided by the weighted average number of common shares outstanding for the period plus common stock equivalents, consisting of shares subject to stock options and other stock compensation awards.

Stock-Based Compensation
We account for stock options and awards granted to employees using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees." No compensation expense has been recognized in the consolidated financial statements for stock options, as we grant all stock options with an exercise price equal to the market price of our common stock at the date of grant, however, stock compensation expense is recognized in the consolidated financial statements for restricted stock unit awards. SFAS No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure," however, requires the disclosure of pro forma net earnings and earnings per share as if we had adopted the fair value method. Under SFAS No. 123, the fair value of stock-based awards to employees is calculated through the use of option pricing models. These models require subjective assumptions, including future stock price volatility and expected time to exercise, which affect the calculated values. Our calculations are based on a single option valuation approach, and forfeitures are recognized as they occur.

The following table illustrates the effect on net earnings and earnings per share as if we had applied the fair value recognition provisions of SFAS No. 123, as amended by SFAS No. 148, to all of our stock-based compensation arrangements.

	Fiscal Year Ended		
Dollars in thousands, except per share amounts	Jan. 29, 2006	Jan. 30, 2005	Feb. 1, 2004
Net earnings, as reported	$ 214,866	$ 191,234	$ 157,211
Add: Stock-based employee compensation expense included in reported net earnings, net of related tax effect	273	—	154
Deduct: Total stock-based employee compensation expense determined under fair value method for all awards, net of related tax effect	(16,788)	(17,059)	(16,780)
Pro forma net earnings	$ 198,351	$ 174,175	$ 140,585
Basic earnings per share			
As reported	$ 1.86	$ 1.65	$ 1.36
Pro forma	1.72	1.50	1.22
Diluted earnings per share			
As reported	$ 1.81	$ 1.60	$ 1.32
Pro forma	1.69	1.47	1.16

The fair value of each option grant was estimated on the date of the grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

	Fiscal Year Ended		
	Jan. 29, 2006	Jan. 30, 2005	Feb. 1, 2004
Dividend yield	—	—	—
Volatility	59.2%	60.1%	63.9%
Risk-free interest rate	4.3%	3.9%	3.4%
Expected term (years)	6.5	6.8	6.7

In January 2006, we issued 840,000 restricted stock units of our common stock to certain employees. Fifty percent of the restricted stock units will vest on January 31, 2010, and the remaining fifty percent will vest on January 31, 2011 based upon the employees' continued employment throughout the vesting period. Accordingly, total compensation expense (based upon the fair market value of $42.18 on the issue date) of $35,431,000 will be recognized on a straight-line basis over the vesting period. In fiscal 2005, we recognized approximately $440,000 of compensation expense related to these restricted stock units.

During fiscal 2001, we entered into employment agreements with certain executive officers. All stock-based compensation expense related to these agreements was fully recognized as of our first quarter ended May 4, 2003. We recognized approximately zero, zero and $250,000 of stock-based compensation expense related to these employment agreements in fiscal 2005, fiscal 2004 and fiscal 2003, respectively.

New Accounting Pronouncements
In December 2004, the FASB issued SFAS No. 123R, "Share Based Payment." SFAS No. 123R will require us to measure and record compensation expense in our consolidated financial statements for all employee share-based compensation awards using a fair value method. In addition, the adoption of SFAS No. 123R requires additional accounting and disclosure related to the income tax and cash flow effects resulting from share-based payment arrangements. We expect to adopt this Statement using the modified prospective application transition method beginning in the first quarter of fiscal 2006. We anticipate the adoption of this Statement to result in a reduction to our diluted earnings per share of approximately $0.19 for fiscal 2006.

In March 2005, the FASB issued FASB Interpretation No. ("FIN") No. 47, "Accounting for Conditional Asset Retirement Obligations – An Interpretation of FASB Statement No. 143," which requires an entity to recognize a liability for the fair value of a conditional asset retirement obligation when incurred if the liability's fair value can be reasonably estimated. We adopted the provisions of FIN 47 as of January 29, 2006. The adoption of this Interpretation did not have a material impact on our consolidated financial position, results of operations or cash flows.

In October 2005, the FASB issued FSP No. FAS 13-1, "Accounting for Rental Costs Incurred during a Construction Period," which requires us, beginning on January 30, 2006, to expense all rental costs associated with our operating leases that are incurred during a construction period. Prior to this date, rental costs incurred during the construction period were capitalized until the store opening date. We anticipate the adoption of this Staff Position to result in a reduction to our diluted earnings per share of approximately $0.03 for fiscal 2006.

In September 2005, the EITF issued EITF No. 05-6, "Determining the Amortization Period for Leasehold Improvements Purchased after Lease Inception or Acquired in a Business Combination," which requires us to amortize leasehold improvements that are placed in service significantly after the beginning of a lease term over the shorter of the useful life of the assets, or a term that includes required lease periods and renewals that are deemed to be reasonably assumed at the date the leasehold improvement is purchased. This EITF did not have a material impact on our consolidated financial position, results of operations or cash flows.

Reclassifications
Certain items in the fiscal 2004 and fiscal 2003 consolidated financial statements have been reclassified to conform to the fiscal 2005 presentation.

Note B: Property and Equipment

Property and equipment consists of the following:

Dollars in thousands	Jan. 29, 2006	Jan. 30, 2005
Leasehold improvements	$ 651,498	$ 600,249
Fixtures and equipment	437,243	398,826
Land and buildings	131,484	131,471
Capitalized software	145,407	132,614
Corporate systems projects in progress[1]	98,398	77,077
Corporate aircraft	48,677	48,618
Construction in progress[2]	31,501	8,063
Capital leases	11,920	11,920
Total	1,556,128	1,408,838
Accumulated depreciation and amortization	(675,823)	(556,426)
Property and equipment – net	$ 880,305	$ 852,412

[1]*Corporate systems projects in progress is primarily comprised of a new merchandising, inventory management and order management system currently under development.*

[2]*Construction in progress is primarily comprised of leasehold improvements and furniture and fixtures related to new, unopened retail stores.*

Note C: Borrowing Arrangements

Long-term debt consists of the following:

Dollars in thousands	Jan. 29, 2006	Jan. 30, 2005
Senior notes		$ 5,716
Obligations under capital leases	$ 3,458	5,673
Memphis-based distribution facilities obligation	15,696	17,000
Industrial development bonds	14,200	14,200
Total debt	33,354	42,589
Less current maturities	18,864	23,435
Total long-term debt	$ 14,490	$ 19,154

Senior Notes
In August, 2005, we repaid the remaining outstanding balance of $5,716,000 on our unsecured senior notes, with interest payable semi-annually at 7.2% per annum.

Capital Leases
Our $3,458,000 of capital lease obligations consist primarily of in-store computer equipment leases with a term of 60 months. The in-store computer equipment leases include an early purchase option at 54 months for $2,496,000, which is approximately 25% of the acquisition cost. We have an end of lease purchase option to acquire the equipment at the greater of fair market value or 15% of the acquisition cost.

Subsequent to year-end, we exercised the early purchase option on three of these leases and expect to exercise this option on the remaining computer equipment leases during fiscal 2006.

See Note F for a discussion on our bond-related debt pertaining to our Memphis-based distribution facilities.

Industrial Development Bonds
In June 2004, in an effort to utilize tax incentives offered to us by the state of Mississippi, we entered into an agreement whereby the Mississippi Business Finance Corporation issued $15,000,000 in long-term variable rate industrial development bonds, the proceeds, net of debt issuance costs, of which were loaned to us to finance the acquisition and installation of leasehold improvements and equipment located in our newly leased Olive Branch distribution center (the "Mississippi Debt Transaction"). The bonds are marketed through a remarketing agent and are secured by a letter of credit issued under our $300,000,000 line of credit facility. The bonds mature on June 1, 2024. The bond rate resets each week based upon current market rates. The rate in effect at January 29, 2006 was 4.5%.

The bond agreement allows for each bondholder to tender their bonds to the trustee for repurchase, on demand, with seven days advance notice. In the event the remarketing agent fails to remarket the bonds, the trustee will draw upon the letter of credit to fund the purchase of the bonds. As of January 29, 2006, $14,200,000 remained outstanding on these bonds and was classified as current debt. The bond proceeds are restricted for use in the acquisition and installation of leasehold improvements and equipment located in our Olive Branch, Mississippi facility. As of January 29, 2006, we had acquired and installed $14,700,000 of leasehold improvements and equipment associated with the facility.

The aggregate maturities of long-term debt at January 29, 2006 were as follows:

Dollars in thousands	
Fiscal 2006[1]	$18,864
Fiscal 2007	1,668
Fiscal 2008	1,584
Fiscal 2009	1,438
Fiscal 2010	1,462
Thereafter	8,338
Total	$33,354

[1] *Includes $14.2 million related to the Mississippi Debt Transaction classified as current debt.*

Credit Facility
As of January 29, 2006, we have a credit facility that provides for a $300,000,000 unsecured revolving line of credit that may be used for loans or letters of credit and contains certain financial covenants, including a maximum leverage ratio (funded debt adjusted for lease and rent expense to EBITDAR), and a minimum fixed charge coverage ratio. Prior to August 22, 2009, we may, upon notice to the lenders, request an increase in the credit facility of up to $100,000,000, to provide for a total of $400,000,000 of unsecured revolving credit. The credit facility contains events of default that include, among others, non-payment of principal, interest or fees, inaccuracy of representations and warranties, violation of covenants, bankruptcy and insolvency events, material judgments, cross defaults to certain other indebtedness and events constituting a change of control. The occurrence of an event of default will increase the applicable rate of interest by 2.0% and could result in the acceleration of our obligations under the credit facility, and an obligation of any or all of our U.S. subsidiaries to pay the full amount of our obligations under the credit facility. The credit facility matures on February 22, 2010, at which time all outstanding borrowings must be repaid and all outstanding letters of credit must be cash collateralized.

We may elect interest rates calculated at Bank of America's prime rate (or, if greater, the average rate on overnight federal funds plus one-half of one percent) or LIBOR plus a margin based on our leverage ratio. No amounts were borrowed under the credit facility during fiscal 2005 or fiscal 2004. However, as of January 29, 2006, $36,073,000 in issued but undrawn standby letters of credit were outstanding under the credit facility. The standby letters of credit were issued to secure the liabilities associated with workers' compensation, other insurance programs and certain debt transactions. As of January 29, 2006, we were in compliance with our financial covenants under the credit facility.

Letter of Credit Facilities
We have three unsecured commercial letter of credit reimbursement facilities for an aggregate of $145,000,000, each of which expires on September 9, 2006. As of January 29, 2006, an aggregate of $105,260,000 was outstanding under the letter of credit facilities. Such letters of credit represent only a future commitment to fund inventory purchases to which we had not taken legal title as of January 29, 2006. The latest expiration possible for any future letters of credit issued under the agreements is February 6, 2007.

Interest Expense
Interest expense was $1,975,000 (net of capitalized interest of $1,200,000), $1,703,000 (net of capitalized interest of $1,689,000), and $22,000 (net of capitalized interest of $2,142,000) for fiscal 2005, fiscal 2004 and fiscal 2003, respectively.

Note D: Income Taxes

The components of earnings before income taxes, by tax jurisdiction, are as follows:

	Fiscal Year Ended		
Dollars in thousands	Jan. 29, 2006	Jan. 30, 2005	Feb. 1, 2004
United States	$ 337,468	$ 303,986	$ 252,119
Foreign	11,330	6,219	3,519
Total earnings before income taxes	$ 348,798	$ 310,205	$ 255,638

The provision for income taxes consists of the following:

	Fiscal Year Ended		
Dollars in thousands	Jan. 29, 2006	Jan. 30, 2005	Feb. 1, 2004
Current payable			
Federal	$ 131,242	$ 105,096	$ 87,194
State	19,002	17,642	15,640
Foreign	4,479	2,487	2,065
Total current	154,723	125,225	104,899
Deferred			
Federal	(18,912)	(6,168)	(3,587)
State	(1,538)	(70)	(2,015)
Foreign	(341)	(16)	(870)
Total deferred	(20,791)	(6,254)	(6,472)
Total provision	$ 133,932	$ 118,971	$ 98,427

Except where required by U.S. tax law, no provision was made for U.S. income taxes on the cumulative undistributed earnings of our Canadian subsidiary, as we intend to utilize those earnings in the Canadian operations for an indefinite period of time and do not intend to repatriate such earnings.

Accumulated undistributed earnings of our Canadian subsidiary were approximately $13,440,000 as of January 29, 2006. It is currently not practical to estimate the tax liability that might be payable if these foreign earnings were repatriated.

A reconciliation of income taxes at the federal statutory corporate rate to the effective rate is as follows:

	Fiscal Year Ended		
	Jan. 29, 2006	Jan. 30, 2005	Feb. 1, 2004
Federal income taxes at the statutory rate	35.0%	35.0%	35.0%
State income tax rate, less federal benefit	3.4%	3.4%	3.5%
Total	38.4%	38.4%	38.5%

Significant components of our deferred tax accounts are as follows:

Dollars in thousands	Jan. 29, 2006	Jan. 30, 2005
Deferred tax asset (liability):		
Current:		
Compensation	$ 15,362	$ 14,667
Inventory	11,580	11,357
Accrued liabilities	14,186	13,725
Customer deposits	36,079	19,342
Deferred catalog costs	(20,696)	(20,540)
Other	756	464
Total current	57,267	39,015
Non-current:		
Depreciation	(11,559)	(18,634)
Deferred rent	8,683	8,275
Deferred lease incentives	(16,506)	(11,595)
Other	927	897
Total non-current	(18,455)	(21,057)
Total	$ 38,812	$ 17,958

Note E: Accounting for Leases

Operating Leases
We lease store locations, warehouses, corporate facilities, call centers and certain equipment under operating and capital leases for original terms ranging generally from 3 to 22 years. Certain leases contain renewal options for periods up to 20 years. The rental payment requirements in our store leases are typically structured as either minimum rent, minimum rent plus additional rent based on a percentage of store sales if a specified store sales threshold is exceeded, or rent based on a percentage of store sales if a specified store sales threshold or contractual obligations of the landlord have not been met.

We have an operating lease for a 1,002,000 square foot retail distribution facility located in Olive Branch, Mississippi. The lease has an initial term of 22.5 years, expiring January 2022, with two optional five-year renewals. The lessor, an unrelated party, is a limited liability company. The construction and expansion of the distribution facility was financed by the original lessor through the sale of $39,200,000 Taxable Industrial Development Revenue Bonds, Series 1998 and 1999, issued by the Mississippi Business Finance Corporation. The bonds are collateralized by the distribution facility. As of January 29, 2006, approximately $31,249,000 was outstanding on the bonds. During fiscal 2005, we made annual rental payments of approximately $3,753,000, plus applicable taxes, insurance and maintenance expenses.

We have an operating lease for an additional 1,103,000 square foot retail distribution facility located in Olive Branch, Mississippi. The lease has an initial term of 22.5 years, expiring January 2023, with two optional five-year renewals. The lessor, an unrelated party, is a limited liability company. The construction of the distribution facility was financed by the original lessor through the sale of $42,500,000 Taxable Industrial Development Revenue Bonds, Series 1999, issued by the Mississippi Business Finance Corporation. The bonds are collateralized by the distribution facility. As of January 29, 2006, approximately $34,396,000 was outstanding on the bonds. During fiscal 2005, we made annual rental payments of approximately $4,181,000, plus applicable taxes, insurance and maintenance expenses.

In December 2003, we entered into an agreement to lease 780,000 square feet of a distribution facility located in Olive Branch, Mississippi. The lease has an initial term of six years, with two optional two-year renewals. The agreement includes an option to lease an additional 390,000 square feet of the same distribution center. We exercised this option during fiscal 2005, however, as of January 29, 2006, we had not occupied this space. During fiscal 2005, we made annual rental payments of approximately $1,927,000, plus applicable taxes, insurance and maintenance expenses.

On February 2, 2004, we entered into an agreement to lease 781,000 square feet of a distribution center located in Cranbury, New Jersey. The lease has an initial term of seven years, with three optional five-year renewals. The agreement requires us to lease an additional 219,000 square feet of the facility in the event the current tenant vacates the premises. As of January 29, 2006, the current tenant had not yet vacated the premises. During fiscal 2005, we made annual rental payments of approximately $3,339,000, plus applicable taxes, insurance and maintenance expenses.

On August 18, 2004, we entered into an agreement to lease a 500,000 square foot distribution facility located in Memphis, Tennessee. The lease has an initial term of four years, with one optional three-year and nine-month renewal. During fiscal 2005, we made annual rental payments of approximately $913,000, plus applicable taxes, insurance and maintenance expenses.

Total rental expense for all operating leases was as follows:

	Fiscal Year Ended		
Dollars in thousands	Jan. 29, 2006	Jan. 30, 2005	Feb. 1, 2004[1]
Minimum rent expense	$ 119,440	$ 110,618	$ 101,377
Contingent rent expense	33,529	26,724	21,796
Less: Sublease rental income	(62)	(59)	(90)
Total rent expense	$ 152,907	$ 137,283	$ 123,083

[1] *Includes rent expense for our Memphis-based distribution facilities which were consolidated by us on February 1, 2004. See Note F.*

The aggregate minimum annual rental payments under noncancelable operating leases (excluding the Memphis-based distribution facilities) in effect at January 29, 2006 were as follows:

Dollars in thousands	Minimum Lease Commitments[1]
Fiscal 2006	$ 178,846
Fiscal 2007	176,891
Fiscal 2008	170,041
Fiscal 2009	160,569
Fiscal 2010	149,092
Thereafter	672,358
Total	$ 1,507,797

[1] *Projected payments include only those amounts that are fixed and determinable as of the reporting date.*

Note F: Consolidation of Memphis-Based Distribution Facilities

Our Memphis-based distribution facilities include an operating lease entered into in July 1983 for a distribution facility in Memphis, Tennessee. The lessor is a general partnership ("Partnership 1") comprised of W. Howard Lester, Chairman of the Board of Directors and a significant shareholder, and James A. McMahan, a Director Emeritus and a significant shareholder. Partnership 1 does not have operations separate from the leasing of this distribution facility and does not have lease agreements with any unrelated third parties.

Partnership 1 financed the construction of this distribution facility through the sale of a total of $9,200,000 of industrial development bonds in 1983 and 1985. Annual principal payments and monthly interest payments are required through maturity in December 2010. The Partnership 1 industrial development bonds are collateralized by the distribution facility and the individual partners guarantee the bond repayments. As of January 29, 2006, $1,887,000 was outstanding under the Partnership 1 industrial development bonds.

During fiscal 2005, we made annual rental payments of approximately $618,000 plus interest on the bonds calculated at a variable rate determined monthly (3.5% in January 2006), applicable taxes, insurance and

maintenance expenses. Although the current term of the lease expires in August 2006, we are obligated to renew the operating lease on an annual basis until these bonds are fully repaid.

Our other Memphis-based distribution facility includes an operating lease entered into in August 1990 for another distribution facility that is adjoined to the Partnership 1 facility in Memphis, Tennessee. The lessor is a general partnership ("Partnership 2") comprised of W. Howard Lester, James A. McMahan and two unrelated parties. Partnership 2 does not have operations separate from the leasing of this distribution facility and does not have lease agreements with any unrelated third parties.

Partnership 2 financed the construction of this distribution facility and related addition through the sale of a total of $24,000,000 of industrial development bonds in 1990 and 1994. Quarterly interest and annual principal payments are required through maturity in August 2015. The Partnership 2 industrial development bonds are collateralized by the distribution facility and require us to maintain certain financial covenants. As of January 29, 2006, $13,809,000 was outstanding under the Partnership 2 industrial development bonds.

During fiscal 2005, we made annual rental payments of approximately $2,600,000, plus applicable taxes, insurance and maintenance expenses. This operating lease has an original term of 15 years expiring in August 2006, with three optional five-year renewal periods. We are, however, obligated to renew the operating lease on an annual basis until these bonds are fully repaid.

As of February 1, 2004, the Company adopted FIN 46R, which requires existing unconsolidated variable interest entities to be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among parties involved. The two partnerships described above qualify as variable interest entities under FIN 46R due to their related party relationship and our obligation to renew the leases until the bonds are fully repaid. Accordingly, the two related party variable interest entity partnerships from which we lease our Memphis-based distribution facilities were consolidated by us as of February 1, 2004. As of January 29, 2006, the consolidation resulted in increases to our consolidated balance sheet of $18,250,000 in assets (primarily buildings), $15,696,000 in debt, and $2,554,000 in other long-term liabilities. Consolidation of these partnerships did not have an impact on our net income. However, the interest expense associated with the partnerships' debt, shown as occupancy expense in fiscal 2003, is now recorded as interest expense. In fiscal 2005 and fiscal 2004, this interest expense approximated $1,462,000 and $1,525,000, respectively.

Note G: Earnings Per Share

The following is a reconciliation of net earnings and the number of shares used in the basic and diluted earnings per share computations:

Dollars and amounts in thousands, except per share amounts	Net Earnings	Weighted Average Shares	Per-Share Amount
2005			
Basic	$214,866	115,616	$1.86
Effect of dilutive stock options	—	2,811	
Diluted	$214,866	118,427	$1.81
2004			
Basic	$191,234	116,159	$1.65
Effect of dilutive stock options	—	3,188	
Diluted	$191,234	119,347	$1.60
2003			
Basic	$157,211	115,583	$1.36
Effect of dilutive stock options	—	3,433	
Diluted	$157,211	119,016	$1.32

Options with an exercise price greater than the average market price of common shares for the period were 320,000 in fiscal 2005, 196,000 in fiscal 2004 and 436,000 in fiscal 2003 and were not included in the computation of diluted earnings per share, as their inclusion would be anti-dilutive.

Note H: Common Stock

Authorized preferred stock consists of 7,500,000 shares at $0.01 par value of which none was outstanding during fiscal 2005 or fiscal 2004. Authorized common stock consists of 253,125,000 shares at $0.01 par value. Common stock outstanding at the end of fiscal 2005 and fiscal 2004 was 114,779,000 and 115,372,000 shares, respectively. Our Board of Directors is authorized to issue stock options for up to the total number of shares authorized and remaining available for grant under each plan.

In May 2005, our Board of Directors authorized a stock repurchase program to acquire up to 2,000,000 additional shares of our outstanding common stock. During the fourth quarter of fiscal 2005, we repurchased and retired 780,800 shares at a weighted average cost of $41.70 per share and a total cost of approximately $32,556,000. During fiscal 2005, we repurchased and retired a total of 2,422,300 shares at a weighted average cost of $38.77 per share and a total cost of approximately $93,921,000. As of fiscal year-end, the remaining authorized number of shares eligible for repurchase was 20,000. During the first quarter of fiscal 2006, we repurchased and retired these shares at a weighted average cost of $38.84 per share and a total cost of approximately $777,000, which completed all stock repurchase programs previously authorized by our Board of Directors.

In March 2006, our Board of Directors authorized a stock repurchase program to acquire up to an additional 2,000,000 shares of our outstanding common stock. Stock repurchases under this program may be made through open market and privately negotiated transactions at times and in such amounts as management deems appropriate. The timing and actual number of shares repurchased will depend on a variety of factors, including price, corporate and regulatory requirements, capital availability, and other market conditions. The stock repurchase program does not have an expiration date and may be limited or terminated at any time without prior notice.

Prior to March 2006, we had never declared or paid a cash dividend on our common stock. In March 2006, our Board of Directors authorized the initiation of a quarterly cash dividend. The quarterly dividend will be initiated at $0.10 per common share, payable on May 24, 2006, to shareholders of record as of the close of business on April 26, 2006. The aggregate quarterly dividend is estimated at approximately $11,500,000 based on the current number of common shares outstanding. The indicated annual cash dividend, subject to capital availability, is $0.40 per common share, or approximately $46,000,000 in fiscal 2006 based on the current number of common shares outstanding.

Note I: Stock Compensation

Our 1993 Stock Option Plan, as amended (the "1993 Plan"), provides for grants of incentive and nonqualified stock options up to an aggregate of 17,000,000 shares. Stock options may be granted under the 1993 Plan to key employees and Board members of the company and any parent or subsidiary. Annual grants are limited to options to purchase 200,000 shares on a per person basis under this plan. All stock option grants made under the 1993 Plan have a maximum term of ten years, except incentive stock options issued to shareholders with greater than 10% of the voting power of all of our stock, which have a maximum term of five years. The exercise price of these options is not less than 100% of the fair market value of our stock on the date of the option grant or not less than 110% of such fair market value for an incentive stock option granted to a 10% shareholder. Options granted to employees generally vest over five years. Options granted to non-employee Board members generally vest in one year.

Our 2000 Nonqualified Stock Option Plan, as amended (the "2000 Plan"), provides for grants of nonqualified stock options up to an aggregate of 3,000,000 shares. Stock options may be granted under the 2000 Plan to employees who are not officers or Board members. Annual grants are not limited on a per person basis under this plan. All nonqualified stock option grants under the 2000 Plan have a maximum term of ten years with an exercise price of 100% of the fair value of the stock at the option grant date. Options granted to employees generally vest over five years.

Our Amended and Restated 2001 Long-Term Incentive Plan (the "2001 Plan") provides for grants of incentive stock options, nonqualified stock options, restricted stock awards and deferred stock awards up to an aggregate of 8,500,000 shares. Awards may be granted under the 2001 Plan to officers, employee and non-employee Board

members of the company and any parent or subsidiary. Annual grants are limited to options to purchase 1,000,000 shares, 200,000 shares of restricted stock, and deferred stock awards of up to 200,000 shares on a per person basis. All stock option grants made under the 2001 Plan have a maximum term of ten years, except incentive stock options issued to 10% shareholders, which have a maximum term of five years. The exercise price of these stock options is not less than 100% of the fair market value of our stock on the date of the option grant or not less than 110% of such fair market value for an incentive stock option granted to a 10% shareholder. Options granted to employees generally vest over five years. Options granted to non-employee Board members generally vest in one year. Non-employee Board members automatically receive stock options on the date of their initial election to the Board and annually thereafter on the date of the annual meeting of shareholders (so long as they continue to serve as a non-employee Board member).

The following table reflects the aggregate activity under our stock option plans:

	Shares	Weighted Average Exercise Price
Balance at February 2, 2003	14,567,106	$14.77
Granted (weighted average fair value of $15.56)	1,596,075	24.37
Exercised	(3,294,478)	11.87
Canceled	(1,089,045)	18.07
Balance at February 1, 2004	11,779,658	16.58
Granted (weighted average fair value of $20.58)	1,626,811	32.57
Exercised	(1,817,308)	14.41
Canceled	(488,734)	20.81
Balance at January 30, 2005	11,100,427	19.08
Granted (weighted average fair value of $23.77)	1,754,990	39.07
Exercised	(1,829,082)	15.30
Canceled	(716,426)	26.81
Balance at January 29, 2006	10,309,909	22.63
Exercisable, February 1, 2004	5,077,371	$12.83
Exercisable, January 30, 2005	5,461,541	14.26
Exercisable, January 29, 2006	5,704,164	16.00

Options to purchase 2,424,858 shares were available for grant at January 29, 2006.

The following table summarizes information about stock options outstanding at January 29, 2006:

	Options Outstanding			*Options Exercisable*	
Range of exercise prices	Number Outstanding	Weighted Average Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$ 4.50 – $ 9.50	1,651,008	2.71	$ 8.17	1,651,008	$ 8.17
$ 9.66 – $14.50	1,880,843	4.07	12.80	1,529,680	12.61
$15.00 – $22.47	2,006,335	5.68	19.56	1,282,100	18.26
$22.48 – $31.58	1,786,723	7.14	26.80	922,126	26.66
$32.01 – $43.85	2,985,000	8.82	36.39	319,250	32.92
$ 4.50 – $43.85	10,309,909	6.07	$22.63	5,704,164	$16.00

In January 2006, we issued 840,000 restricted stock units of our common stock to certain employees. Fifty percent of the restricted stock units will vest on January 31, 2010, and the remaining fifty percent will vest on January 31, 2011 based upon the employees' continued employment throughout the vesting period. As of January 29, 2006, 840,000 restricted stock units were outstanding.

Note J: Associate Stock Incentive Plan and Other Employee Benefits

We have a defined contribution retirement plan, the "Williams-Sonoma, Inc. Associate Stock Incentive Plan" (the "Plan"), for eligible employees, which is intended to be qualified under Internal Revenue Code Sections 401(a), 401(k) and 401(m). The Plan permits eligible employees to make salary deferral contributions in accordance with Internal Revenue Code Section 401(k) up to 15% of eligible compensation each pay period (4% for certain higher paid individuals). Employees designate the funds in which their contributions are invested. Each participant may choose to have his or her salary deferral contributions and earnings thereon invested in one or more investment funds, including investing in our company stock fund. Prior to November 1, 2005, all matching contributions were invested in our company stock fund. Effective November 1, 2005, participants were allowed to reallocate past matching contributions to one or more investment funds. Effective December 1, 2005, company contributions are invested in a similar manner as the participant's salary deferral contributions. Effective August 1, 2003, our matching contribution is equal to 50% of the participant's salary deferral contribution each pay period, taking into account only those contributions that do not exceed 6% of the participant's eligible pay for the pay period (4% for certain higher paid individuals). For the first five years of the participant's employment, all matching contributions generally vest at the rate of 20% per year of service, measuring service from the participant's hire date. Thereafter, all matching contributions vest immediately. Our contributions to the plan were $3,322,000 in fiscal 2005, $2,850,000 in fiscal 2004 and $3,540,000 in fiscal 2003.

We have a nonqualified executive deferred compensation plan that provides supplemental retirement income benefits for a select group of management and other certain highly compensated employees. This plan permits eligible employees to make salary and bonus deferrals that are 100% vested. We have an unsecured obligation to pay in the future the value of the deferred compensation adjusted to reflect the performance, whether positive or negative, of selected investment measurement options, chosen by each participant, during the deferral period. At January 29, 2006, $11,176,000 was included in other long-term obligations. Additionally, we have purchased life insurance policies on certain participants to potentially offset these unsecured obligations. The cash surrender value of these policies was $9,661,000 at January 29, 2006 and was included in other assets.

Note K: Financial Guarantees

We are party to a variety of contractual agreements under which we may be obligated to indemnify the other party for certain matters. These contracts primarily relate to our commercial contracts, operating leases, trademarks, intellectual property, financial agreements and various other agreements. Under these contracts, we may provide certain routine indemnifications relating to representations and warranties or personal injury matters. The terms of these indemnifications range in duration and may not be explicitly defined. Historically, we have not made significant payments for these indemnifications. We believe that if we were to incur a loss in any of these matters, the loss would not have a material effect on our financial condition or results of operations.

Note L: Commitments and Contingencies

On September 30, 2004, we entered into a five-year service agreement with IBM to host and manage certain aspects of our data center information technology infrastructure. The terms of the agreement require the payment of both fixed and variable charges over the life of the agreement. The variable charges are primarily based on CPU hours, storage capacity and support services that are expected to fluctuate throughout the term of the agreement.

Under the terms of the agreement, we are subject to a minimum charge over the five-year term of the agreement. This minimum charge is based on both a fixed and variable component calculated as a percentage of the total estimated service charges over the five-year term of the agreement. As of January 29, 2006, we estimate the remaining minimum charge to be approximately $21,000,000. The fixed component of this minimum charge will be paid annually not to exceed approximately $5,000,000, while the variable component will be based on usage. The agreement can be terminated at any time for cause and after 24 months for convenience. In the event the agreement is terminated for convenience, a graduated termination fee will be assessed based on the time period remaining in the contract term, not to exceed $9,000,000. During fiscal 2005, we recognized expense of approximately $12,000,000 relating to this agreement.

In addition, we are involved in lawsuits, claims and proceedings incident to the ordinary course of our business. These disputes, which are not currently material, are increasing in number as our business expands and our company grows larger. Litigation is inherently unpredictable. Any claims against us, whether meritorious or not, could be time consuming, result in costly litigation, require significant amounts of management time and result in the diversion of significant operational resources. The results of these lawsuits, claims and proceedings cannot be predicted with certainty. However, we believe that the ultimate resolution of these current matters will not have a material adverse effect on our consolidated financial statements taken as a whole.

Note M: Segment Reporting

We have two reportable segments, retail and direct-to-customer. The retail segment has six merchandising concepts which sell products for the home (Williams-Sonoma, Pottery Barn, Pottery Barn Kids, Hold Everything, West Elm and Williams-Sonoma Home). The six retail merchandising concepts are operating segments, which have been aggregated into one reportable segment, retail. The direct-to-customer segment has seven merchandising concepts (Williams-Sonoma, Pottery Barn, Pottery Barn Kids, PBteen, Hold Everything, West Elm and Williams-Sonoma Home) and sells similar products through our eight direct-mail catalogs (Williams-Sonoma, Pottery Barn, Pottery Barn Kids, Pottery Barn Bed + Bath, PBteen, Hold Everything, West Elm and Williams-Sonoma Home) and six e-commerce websites (williams-sonoma.com, potterybarn.com, potterybarnkids.com, pbteen.com, westelm.com and holdeverything.com). Management's expectation is that the overall economics of each of our major concepts within each reportable segment will be similar over time.

These reportable segments are strategic business units that offer similar home-centered products. They are managed separately because the business units utilize two distinct distribution and marketing strategies. It is not practicable for us to report revenue by product group.

We use earnings before unallocated corporate overhead, interest and taxes to evaluate segment profitability. Unallocated costs before income taxes include corporate employee-related costs, depreciation expense, other occupancy expense and administrative costs, primarily in our corporate systems, corporate facilities and other administrative departments. Unallocated assets include corporate cash and cash equivalents, the net book value of corporate facilities and related information systems, deferred income taxes and other corporate long-lived assets.

Income tax information by segment has not been included as taxes are calculated at a company-wide level and are not allocated to each segment.

Segment Information

Dollars in thousands	Retail[1]	Direct-to-Customer	Unallocated	Total
2005				
Net revenues	$2,032,907	$1,506,040	—	$3,538,947
Depreciation and amortization expense	84,045	17,566	$ 21,588	123,199
Earnings (loss) before income taxes[2]	278,057	232,023	(161,282)	348,798
Assets[3]	986,222	295,200	700,198	1,981,620
Capital expenditures	96,918	20,984	33,886	151,788
2004				
Net revenues	$1,810,979	$1,325,952	—	$3,136,931
Depreciation and amortization expense	76,667	16,174	$ 18,783	111,624
Earnings (loss) before income taxes	253,038	210,809	(153,642)	310,205
Assets[3]	910,924	279,579	555,042	1,745,545
Capital expenditures	90,027	40,894	50,532	181,453
2003				
Net revenues	$1,622,383	$1,131,985	—	$2,754,368
Depreciation and amortization expense	68,800	15,472	$ 15,262	99,534
Earnings (loss) before income taxes	231,512	172,266	(148,140)	255,638
Assets[3]	822,340	218,603	429,792	1,470,735
Capital expenditures	121,759	11,845	78,375	211,979

[1] Net revenues include $64.6 million, $50.1 million and $42.7 million in fiscal 2005, 2004 and 2003, respectively, related to our foreign operations.

[2] Includes $11.4 million, $2.0 million, and $0.1 million in the retail, direct-to-customer, and corporate unallocated segments, respectively, related to the transitioning of the merchandising strategies of our Hold Everything brand into our other existing brands.

[3] Includes $26.5 million, $23.1 million and $22.5 million of long-term assets in fiscal 2005, 2004 and 2003, respectively, related to our foreign operations.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of
Williams-Sonoma, Inc.:

We have audited the accompanying consolidated balance sheets of Williams-Sonoma, Inc. and subsidiaries (the "Company") as of January 29, 2006 and January 30, 2005, and the related consolidated statements of earnings, shareholders' equity, and cash flows for each of the three years in the period ended January 29, 2006. We also have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting (under Part II, Item 9a, Controls and Procedures), that the Company maintained effective internal control over financial reporting as of January 29, 2006, based on criteria established in Internal Control–Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on these financial statements, an opinion on management's assessment, and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audit of financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A Company's internal control over financial reporting is a process designed by, or under the supervision of, the Company's principal executive and principal financial officers, or persons performing similar functions, and effected by the Company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A Company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Williams-Sonoma, Inc. and subsidiaries as of January 29, 2006 and January 30, 2005, and the results of their operations and their cash flows for each of the three years in the period ended January 29, 2006, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, management's assessment that the Company maintained effective internal control over financial

reporting as of January 29, 2006, is fairly stated, in all material respects, based on the criteria established in Internal Control–Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of January 29, 2006, based on the criteria established in Internal Control–Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

/s/ DELOITTE & TOUCHE LLP

San Francisco, California
April 6, 2006.

Quarterly Financial Information
(Unaudited)

Dollars in thousands, except per share amounts

Fiscal 2005	First Quarter	Second Quarter	Third Quarter	Fourth Quarter[3]	Full Year
Net revenues	$720,688	$776,239	$827,623	$1,214,397	$3,538,947
Gross margin	284,922	294,835	326,077	529,648	1,435,482
Earnings before income taxes	44,324	49,601	59,958	194,915	348,798
Net earnings	26,173	30,823	37,087	120,783	214,866
Basic earnings per share[1]	$ 0.23	$ 0.27	$ 0.32	$ 1.05	$ 1.86
Diluted earnings per share[1]	$ 0.22	$ 0.26	$ 0.31	$ 1.02	$ 1.81
Stock price (as of quarter-end)[2]	$ 33.49	$ 44.16	$ 37.34	$ 40.62	$ 40.62

Fiscal 2004	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Full Year
Net revenues	$640,910	$689,621	$722,761	$1,083,639	$3,136,931
Gross margin	245,376	259,528	281,214	485,027	1,271,145
Earnings before income taxes	34,668	44,779	46,143	184,615	310,205
Net earnings	21,390	27,629	28,467	113,748	191,234
Basic earnings per share[1]	$ 0.18	$ 0.24	$ 0.24	$ 0.98	$ 1.65
Diluted earnings per share[1]	$ 0.18	$ 0.23	$ 0.24	$ 0.95	$ 1.60
Stock price (as of quarter-end)[2]	$ 32.48	$ 32.49	$ 38.17	$ 34.53	$ 34.53

[1] *The sum of the quarterly net earnings per share amounts will not necessarily equal the annual net earnings per share as each quarter is calculated independently.*

[2] *Stock price represents our common stock price at the close of business on the Friday before our fiscal quarter-end.*

[3] *Includes a pre-tax charge of $4,500,000 in cost of goods sold and $9,000,000 in selling, general and administrative expenses related to the transitioning of the merchandising strategies of our Hold Everything brand into our other existing brands. See Note A to our Consolidated Financial Statements.*

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As of January 29, 2006, an evaluation was performed by management, with the participation of our Chief Executive Officer ("CEO") and our Executive Vice President, Chief Financial Officer ("CFO"), of the effectiveness of our disclosure controls and procedures. Based on that evaluation, our management, including our CEO and CFO, concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 is accumulated and communicated to our management, including our CEO and CFO, as appropriate, to allow timely discussions regarding required disclosures, and that such information is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC.

Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting that occurred during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over the company's financial reporting. There are inherent limitations in the effectiveness of any internal control, including the possibility of human error and the circumvention or overriding of controls. Accordingly, even any effective internal control can provide only reasonable assurance with respect to financial statement preparation. Further, because of changes in conditions, the effectiveness of any internal control may vary over time.

Our management assessed the effectiveness of the company's internal control over financial reporting as of January 29, 2006. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework.* Based on our assessment using those criteria, our management concluded that, as of January 29, 2006, our internal control over financial reporting is effective.

Our independent registered public accounting firm audited the financial statements included in this Annual Report on Form 10-K and has issued an attestation report on management's assessment of the company's internal control over financial reporting. This report appears on pages 60 through 61 of this annual report on Form 10-K.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Information required by this Item is incorporated by reference herein to the information under the headings "Election of Directors," "Information Concerning Executive Officers," "Committee Reports–Nominations and Corporate Governance Committee Report," "Committee Reports–Audit and Finance Committee Report," "Corporate Governance Guidelines and Corporate Code of Conduct" and "Section 16(a) Beneficial Ownership Reporting Compliance" in our Proxy Statement.

ITEM 11. EXECUTIVE COMPENSATION

Information required by this Item is incorporated by reference herein to information under the headings "Election of Directors," "Information Concerning Executive Officers," "Committee Reports–Compensation Committee Report" and "Performance Graph" in our Proxy Statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Information required by this Item is incorporated by reference herein to information under the headings "Security Ownership of Principal Shareholders and Management" and "Equity Compensation Plan Information" in our Proxy Statement.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Information required by this Item is incorporated by reference herein to information under the heading "Certain Relationships and Related Transactions" in our Proxy Statement.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Information required by this Item is incorporated by reference herein to information under the headings "Committee Reports–Audit and Finance Committee Report" and "Audit and Related Fees" in our Proxy Statement.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a)(1) Financial Statements:

The following consolidated financial statements of Williams-Sonoma, Inc. and subsidiaries and the related notes are filed as part of this report pursuant to Item 8:

Consolidated Statements of Earnings for the fiscal years ended January 29, 2006, January 30, 2005 and February 1, 2004

Consolidated Balance Sheets as of January 29, 2006 and January 30, 2005

Consolidated Statements of Shareholders' Equity for the fiscal years ended January 29, 2006, January 30, 2005 and February 1, 2004

Consolidated Statements of Cash Flows for the fiscal years ended January 29, 2006, January 30, 2005 and February 1, 2004

Notes to Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm

Quarterly Financial Information

(a)(2) Financial Statement Schedules: Schedules have been omitted because they are not required or because the required information, where material, is included in the financial statements, notes, or supplementary financial information.

(a)(3) Exhibits: See Exhibit Index on pages 67 through 71.

(b) Exhibits: See Exhibit Index on pages 67 through 71.

(c) Financial Statement Schedules: Schedules have been omitted because they are not required or are not applicable.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

WILLIAMS-SONOMA, INC.

Date: April 7, 2006

By /s/ EDWARD A. MUELLER
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Date: April 7, 2006
/s/ W. HOWARD LESTER
W. Howard Lester
Chairman of the Board

Date: April 7, 2006
/s/ EDWARD A. MUELLER
Edward A. Mueller
Director and Chief Executive Officer
(principal executive officer)

Date: April 7, 2006
/s/ SHARON L. MCCOLLAM
Sharon L. McCollam
Executive Vice President, Chief Financial Officer
(principal financial officer and principal accounting officer)

Date: April 7, 2006
/s/ SANJIV AHUJA
Sanjiv Ahuja
Director

Date: April 7, 2006
/s/ ADRIAN D.P. BELLAMY
Adrian D.P. Bellamy
Director

Date: April 7, 2006
/s/ PATRICK J. CONNOLLY
Patrick J. Connolly
Director and Executive Vice President, Chief Marketing Officer

Date: April 7, 2006
/s/ ADRIAN T. DILLON
Adrian T. Dillon
Director

Date: April 7, 2006
/s/ JEANNE P. JACKSON
Jeanne P. Jackson
Director

Date: April 7, 2006
/s/ MICHAEL R. LYNCH
Michael R. Lynch
Director

Date: April 7, 2006
/s/ RICHARD T. ROBERTSON
Richard T. Robertson
Director

Date: April 7, 2006
/s/ DAVID B. ZENOFF
David B. Zenoff
Director

EXHIBIT INDEX TO ANNUAL REPORT ON FORM 10-K
FOR THE
FISCAL YEAR ENDED JANUARY 29, 2006

EXHIBIT NUMBER	EXHIBIT DESCRIPTION
ARTICLES OF INCORPORATION AND BYLAWS	
3.1	Restated Articles of Incorporation (incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the period ended October 29, 1995 as filed with the Commission on December 13, 1995, File No. 000-12704)
3.2	Certificate of Amendment of Restated Articles of Incorporation (incorporated by reference to Exhibit 3.1A to the Company's Annual Report on Form 10-K for the fiscal year ended January 30, 2000 as filed with the Commission on May 1, 2000, File No. 001-14077)
3.3	Certificate of Amendment of Restated Articles of Incorporation, as Amended, of the Company, dated April 29, 2002 (incorporated by reference to Exhibit 3.3 to the Company's Quarterly Report on Form 10-Q for the period ended August 1, 2004 as filed with the Commission on September 10, 2004, File No. 001-14077)
3.4	Certificate of Amendment of Restated Articles of Incorporation, as Amended, of the Company, dated as of July 22, 2003 (incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the period ended August 3, 2003 as filed with the Commission on September 11, 2003, File No. 001-14077)
3.5	Restated Bylaws and Amendment Number One to the Restated Bylaws of Registrant (incorporated by reference to Exhibit 3.3 to the Company's Annual Report on Form 10-K for the fiscal year ended January 28, 2001 as filed with the Commission on April 26, 2001, File No. 001-14077)
FINANCING AGREEMENTS	
10.1	Third Amended and Restated Credit Agreement, dated February 22, 2005, between the Company and Bank of America, N.A., as administrative agent and L/C Issuer, Banc of America Securities LLC, as sole lead arranger and sole book manager, The Bank of New York and Wells Fargo Bank N.A., as co-syndication agents, JPMorgan Chase Bank, N.A. and Union Bank of California, N.A. as co-documentation agents and the lenders party hereto (incorporated by reference to Exhibit 10.2 to the Company's Annual Report on Form 10-K for the fiscal year ended January 30, 2005 as filed with the Commission on April 15, 2005, File No. 001-14077)
10.2	Reimbursement Agreement between the Company and Bank of America, N.A. dated as of July 1, 2005 (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the period ended July 31, 2005 as filed with the Commission on September 9, 2005, File No. 001-14077)
10.3	Reimbursement Agreement between the Company and The Bank of New York dated as of July 1, 2005 (incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the period ended July 31, 2005 as filed with the Commission on September 9, 2005, File No. 001-14077)
10.4	Reimbursement Agreement between the Company and Wells Fargo Bank, N.A. dated as of July 1, 2005 (incorporated by reference to Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q for the period ended July 31, 2005 as filed with the Commission on September 9, 2005, File No. 001-14077)

EXHIBIT NUMBER	EXHIBIT DESCRIPTION
10.5	Amendment No 1. dated September 9, 2005, to the Reimbursement Agreement between the Company and Bank of America, N.A. dated as of July 1, 2005 (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the period ended October 30, 2005 as filed with the Commission on December 6, 2005, File No. 001-14077)
10.6	Amendment No 1. dated September 9, 2005, to the Reimbursement Agreement between the Company and The Bank of New York dated as of July 1, 2005 (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the period ended October 30, 2005 as filed with the Commission on December 6, 2005, File No. 001-14077)
10.7	Amendment No 1. dated September 9, 2005, to the Reimbursement Agreement between the Company and Wells Fargo Bank, N.A. dated as of July 1, 2005 (incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the period ended October 30, 2005 as filed with the Commission on December 6, 2005, File No. 001-14077)
STOCK PLANS	
10.8+	Williams-Sonoma, Inc. Amended and Restated 1993 Stock Option Plan (incorporated by reference to Exhibit 10.12 to the Company's Annual Report on Form 10-K for the fiscal year ended January 30, 2005 as filed with the Commission on April 15, 2005, File No. 001-14077)
10.9+	Williams-Sonoma, Inc. 2000 Nonqualified Stock Option Plan (incorporated by reference to Exhibit 4 to the Company's Registration Statement on Form S-8 as filed with the Commission on October 27, 2000, File No. 333-48750)
10.10+	Williams-Sonoma, Inc. 2001 Long-Term Incentive Plan (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-8 as filed with the Commission on August 18, 2004, File No. 333-118351)
10.11+	Forms of Notice of Grant and Stock Option Agreement under the Company's 1993 Stock Option Plan, 2000 Nonqualified Stock Option Plan and 2001 Long-Term Incentive Plan (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the period ended October 31, 2004 as filed with the Commission on December 10, 2004, File No. 001-14077)
10.12+	Form of Williams-Sonoma, Inc. 2001 Long-Term Incentive Plan Restricted Stock Unit Award Agreement (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on January 12, 2006, File No. 001-14077)
OTHER INCENTIVE PLANS	
10.13+	2001 Incentive Bonus Plan, as amended and restated (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on May 24, 2005, File No. 001-14077)
10.14+	Second Amendment and Restatement of the Williams-Sonoma, Inc. Executive Deferral Plan, dated November 23, 1998 (incorporated by reference to Exhibit 10.11 to the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 1999 as filed with the Commission on April 30, 1999, File No. 001-14077)
10.15*+	Williams-Sonoma, Inc. Associate Stock Incentive Plan, as amended and restated effective January 1, 1997, and including amendments effective through December 21, 2005

EXHIBIT NUMBER	EXHIBIT DESCRIPTION
PROPERTIES	
10.16	Warehouse – Distribution Facility lease dated July 1, 1983, between the Company as lessee and the Lester-McMahan Partnership as lessor (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the period ended September 30, 1983 as filed with the Commission on October 14, 1983, File No. 000-12704)
10.17	First Amendment, dated December 1, 1985, to the Warehouse – Distribution Facility lease dated July 1, 1983, between the Company as lessee and the Lester-McMahan Partnership as lessor (incorporated by reference to Exhibit 10.48 to the Company's Annual Report on Form 10-K for the fiscal year ended February 2, 1986 as filed with the Commission on May 2, 1986, File No. 000-12704)
10.18	Second Amendment, dated December 1, 1993, to the Warehouse – Distribution Facility lease dated July 1, 1983 between the Company as lessee and the Lester-McMahan Partnership as lessor (incorporated by reference to Exhibit 10.27 to the Company's Annual Report on Form 10-K for the fiscal year ended January 30, 1994 as filed with the Commission on April 29, 1994, File No. 000-12704)
10.19	Sublease for the Distribution Facility at 4600 and 4650 Sonoma Cove, Memphis, Tennessee, dated as of August 1, 1990, by and between Hewson-Memphis Partners and the Company (incorporated by reference to Exhibit 10 to the Company's Quarterly Report on Form 10-Q for the period ended October 28, 1990 as filed with the Commission on December 12, 1990, File No. 000-12704)
10.20	First Amendment, dated December 22, 1993, to Sublease for the Distribution Facility at 4600 and 4650 Sonoma Cove, Memphis, Tennessee between the Company and Hewson-Memphis Partners, dated as of August 1, 1990 (incorporated by reference to Exhibit 10.7 to the Company's Annual Report on Form 10-K for the fiscal year ended January 28, 2001 as filed with the Commission on April 26, 2001, File No. 001-14077)
10.21	Second Amendment, dated September 1, 1994, to Sublease for the Distribution Facility at 4600 and 4650 Sonoma Cove, Memphis, Tennessee, dated as of August 1, 1990 between the Company and Hewson-Memphis Partners (incorporated by reference to Exhibit 10.38 to the Company's Quarterly Report on Form 10-Q for the period ended October 30, 1994 as filed with the Commission on December 13, 1994, File No. 000-12704)
10.22	Third Amendment, dated October 24, 1995, to Sublease for the Distribution Facility at 4600 and 4650 Sonoma Cove, Memphis, Tennessee, dated as of August 1, 1990 between the Company and Hewson-Memphis Partners (incorporated by reference to Exhibit 10.2E to the Company's Quarterly Report on Form 10-Q for the period ended October 29, 1995 as filed with the Commission on December 13, 1995, File No. 000-12704)
10.23	Fourth Amendment, dated February 1, 1996, to Sublease for the Distribution Facility at 4600 and 4650 Sonoma Cove, Memphis, Tennessee, dated as of August 1, 1990 between the Company and Hewson-Memphis Partners (incorporated by reference to Exhibit 10.16 to the Company's Annual Report on Form 10-K for the fiscal year ended January 28, 2001 as filed with the Commission on April 26, 2001, File No. 001-14077)

EXHIBIT NUMBER	EXHIBIT DESCRIPTION
10.24	Fifth Amendment to Sublease, dated March 1, 1999, incorrectly titled Fourth Amendment to Sublease for the Distribution Facility at 4600 and 4650 Sonoma Cove, Memphis, Tennessee, dated as of August 1, 1990 between the Company and Hewson-Memphis Partners (incorporated by reference to Exhibit 10.43 to the Company's Annual Report on Form 10-K for the fiscal year ended February 3, 2002 as filed with the Commission on April 29, 2002, File No. 001-14077)
10.25	Memorandum of Understanding between the Company and the State of Mississippi, Mississippi Business Finance Corporation, Desoto County, Mississippi, the City of Olive Branch, Mississippi and Hewson Properties, Inc., dated August 24, 1998 (incorporated by reference to Exhibit 10.6 to the Company's Quarterly Report on Form 10-Q for the period ended August 2, 1998 as filed with the Commission on September 14, 1998, File No. 001-14077)
10.26	Olive Branch Distribution Facility Lease, dated December 1, 1998, between the Company as lessee and WSDC, LLC (the successor-in-interest to Hewson/Desoto Phase I, L.L.C.) as lessor (incorporated by reference to Exhibit 10.3D to the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 1999 as filed with the Commission on April 30, 1999, File No. 001-14077)
10.27	First Amendment, dated September 1, 1999, to the Olive Branch Distribution Facility Lease between the Company as lessee and WSDC, LLC (the successor-in-interest to Hewson/Desoto Phase I, L.L.C.) as lessor, dated December 1, 1998 (incorporated by reference to Exhibit 10.3B to the Company's Annual Report on Form 10-K for the fiscal year ended January 30, 2000 as filed with the Commission on May 1, 2000, File No. 001-14077)
10.28	Lease for an additional Company distribution facility located in Olive Branch, Mississippi between Williams-Sonoma Retail Services, Inc. as lessee and SPI WS II, LLC (the successor-in-interest to Hewson/Desoto Partners, L.L.C.) as lessor, dated November 15, 1999 (incorporated by reference to Exhibit 10.14 to the Company's Annual Report on Form 10-K for the fiscal year ended January 30, 2000 as filed with the Commission on May 1, 2000, File No. 001-14077)
10.29	Lease for an additional Company distribution facility located in Olive Branch, Mississippi, between Pottery Barn, Inc. as lessee and ProLogis-Macquarie MS Investment Trust (the successor-in-interest to Robert Pattillo Properties, Inc.) as lessor, dated December 1, 2003 (incorporated by reference to Exhibit 10.46 to the Company's Annual Report on Form 10-K for the fiscal year ended February 1, 2004 as filed with the Commission on April 15, 2004, File No. 001-14077)
10.30	First Addendum, dated February 27, 2004, to Lease for an additional Company distribution facility located in Olive Branch, Mississippi, between Pottery Barn, Inc. as lessee, ProLogis-Macquarie MS Investment Trust (the successor-in-interest to Robert Pattillo Properties, Inc.) as lessor, and the Company as guarantor dated December 1, 2003 (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the period ended May 2, 2004 as filed with the Commission on June 9, 2004, File No. 001-14077)
10.31	Second Addendum, dated June 1, 2004, to Lease for an additional Company distribution facility located in Olive Branch, Mississippi, between Pottery Barn, Inc. as lessee, ProLogis-Macquarie MS Investment Trust (the successor-in-interest to Robert Pattillo Properties, Inc.) as lessor, and the Company as guarantor dated December 1, 2003 (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the period ended August 1, 2004 as filed with the Commission on September 10, 2004, File No. 001-14077)

EXHIBIT NUMBER	EXHIBIT DESCRIPTION
10.32	Lease for Company distribution facility on the East Coast located in Cranbury, New Jersey between Williams-Sonoma Direct, Inc. and Keystone Cranbury East, LLC, effective as of February 2, 2004 (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the period ended May 2, 2004 as filed with the Commission on June 9, 2004, File No. 001-14077)
EMPLOYMENT AGREEMENTS	
10.33+	Employment Agreement between the Company and Laura Alber, dated March 19, 2001 (incorporated by reference to Exhibit 10.77 to the Company's Annual Report on Form 10-K for the fiscal year ended February 3, 2002 as filed with the Commission on April 29, 2002, File No. 001-14077)
10.34+	Employment Agreement between the Company and Sharon McCollam, dated December 28, 2002 (incorporated by reference to Exhibit 10.42 to the Company's Annual Report on Form 10-K for the fiscal year ended January 30, 2005 as filed with the Commission on April 15, 2005, File No. 001-14077)
OTHER AGREEMENTS	
10.35#	Aircraft Purchase Agreement, dated April 30, 2003, between the Company as buyer and Bombardier Inc. as seller (incorporated by reference to Exhibit 10.40 to the Company's Annual Report on Form 10-K for the fiscal year ended February 1, 2004 as filed with the Commission on April 15, 2004, File No. 001-14077)
10.36#	Services Agreement, dated September 30, 2004, by and between the Company and International Business Machines Corporation (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the period ended October 31, 2004 as filed with the Commission on December 10, 2004, File No. 001-14077)
OTHER EXHIBITS	
21.1*	Subsidiaries
23.1*	Consent of Independent Registered Public Accounting Firm
CERTIFICATIONS	
31.1*	Certification of Chief Executive Officer, pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended
31.2*	Certification of Chief Financial Officer, pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended
32.1*	Certification of Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2*	Certification of Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

** Filed herewith.*

+ Indicates a management contract or compensatory plan or arrangement.

 # We have requested confidential treatment on certain portions of this exhibit from the SEC. The omitted portions have been filed separately with the SEC.

EXHIBIT 10.15

WILLIAMS-SONOMA, INC.
ASSOCIATE STOCK INCENTIVE PLAN
(ASIP)

As Amended and Restated Effective January 1, 1997, Except as Otherwise Noted

And Including Amendments Effective Through December 21, 2005

TABLE OF CONTENTS

Page

PREAMBLE 1

ARTICLE I – DEFINITIONS 2

1.1 ACCOUNT 2
1.2 AGE 50 CATCH-UP CONTRIBUTIONS 2
1.3 AGE 50 CATCH-UP CONTRIBUTIONS ACCOUNT 2
1.4 ASSOCIATE 2
1.5 BENEFICIARY 2
1.6 BENEFICIARY DESIGNATION FORM 2
1.7 BOARD OF DIRECTORS OR BOARD 3
1.8 BORROWER 3
1.9 CASUAL ASSOCIATE 3
1.10 CODE 3
1.11 COMPANY 3
1.12 COMPANY STOCK 3
1.13 COMPANY'S CONTROLLED GROUP 3
1.14 COMPENSATION 3
1.15 CONTRIBUTION ELECTION 4
1.16 DISABILITY 4
1.17 EFFECTIVE DATE 4
1.18 ELIGIBLE ASSOCIATE 4
1.19 ELIGIBILITY COMPUTATION PERIODS 4
1.20 ELIGIBLE PAY 4
1.21 ELIGIBLE RETIREMENT PLAN 5
1.22 ELIGIBLE ROLLOVER DISTRIBUTION 5
1.23 EMPLOYER 5
1.24 EMPLOYMENT COMMENCEMENT DATE 5
1.25 ERISA 6
1.26 EXCESS CONTRIBUTIONS 6
1.27 EXCESS DEFERRALS 6
1.28 FIDUCIARIES 6
1.29 FULL-TIME REGULAR ASSOCIATE 6
1.30 IRS HIGHLY COMPENSATED EMPLOYEE 6
1.31 HOUR OF SERVICE 7
1.32 INVESTMENT ELECTION 8
1.33 INVESTMENT FUND 8
1.34 LEAVE OF ABSENCE 8
1.35 MATCHING CONTRIBUTIONS 8
1.36 MATCHING CONTRIBUTIONS ACCOUNT 8
1.37 NON-HIGHLY COMPENSATED EMPLOYEE 8
1.38 NORMAL RETIREMENT AGE 8
1.39 PART-TIME ASSOCIATE 8
1.40 PARTICIPANT 9
1.41 PARTICIPANT RESPONSE SYSTEM 9
1.42 PERIOD OF SEVERANCE 9

1.43	PLAN	9
1.44	PLAN ADMINISTRATOR	9
1.45	PLAN YEAR	10
1.46	PRE-TAX CONTRIBUTIONS	10
1.47	PRE-TAX CONTRIBUTIONS ACCOUNT	10
1.48	PRIOR 2005 EMPLOYEE QNEC ACCOUNT	10
1.49	PRIOR 2005 COMPANY SPECIAL MATCHING CONTRIBUTION ACCOUNT	10
1.50	PROFIT SHARING CONTRIBUTIONS	10
1.51	PROFIT SHARING CONTRIBUTION ACCOUNT	10
1.52	REEMPLOYMENT COMMENCEMENT DATE	10
1.53	ROLLOVER CONTRIBUTION	10
1.54	ROLLOVER CONTRIBUTIONS ACCOUNT	11
1.55	SEPARATION FROM SERVICE OR SEPARATES FROM SERVICE	11
1.56	SERVICE CUTOFF DATE	11
1.57	SPOUSE	12
1.58	START DATE	12
1.59	SURVIVING SPOUSE	12
1.60	TEMPORARY ASSOCIATE	12
1.61	TRUST	12
1.62	TRUST AGREEMENT	12
1.63	TRUSTEE	12
1.64	U.S. OR UNITED STATES	12
1.65	WILLIAMS-SONOMA, INC. STOCK FUND	12
1.66	YEAR OF VESTING SERVICE	12
ARTICLE II – PARTICIPATION		**13**
2.1	ELIGIBILITY	13
2.2	RESUMPTION AFTER A PERIOD OF SEVERANCE, BREAK IN SERVICE OR REDUCTION IN HOURS	15
2.3	TERMINATION OF PARTICIPATION	16
2.4	ACQUISITIONS AND DIVESTITURES	17
ARTICLE III - CONTRIBUTIONS		**18**
3.1	CONTRIBUTION ELECTIONS	18
3.2	PRE-TAX CONTRIBUTIONS	19
3.3	MATCHING CONTRIBUTIONS	21
3.4	NO CURRENT AFTER-TAX CONTRIBUTIONS OR PROFIT SHARING CONTRIBUTIONS	22
3.5	ROLLOVER CONTRIBUTIONS	23
3.6	MILITARY LEAVE	23
3.7	CONTRIBUTIONS SUBJECT TO DEDUCTIBILITY	23
3.8	ALLOCATION OF CONTRIBUTIONS	23
3.9	VALUATION, EARNINGS, LOSSES AND INVESTMENT EXPENSES	23
3.10	RETURN OF CONTRIBUTIONS	24
ARTICLE IV – INVESTMENTS		**25**
4.1	PARTICIPANT INVESTMENT PROVISIONS	25
4.2	INVESTMENT ELECTIONS	26
4.3	INVESTMENT FUNDS OTHER THAN THE WILLIAMS-SONOMA, INC. STOCK FUND	28
4.4	WILLIAMS-SONOMA, INC. STOCK FUND	28
4.5	INVESTMENT OF LOAN REPAYMENTS AND RESTORATION OF FORFEITURES	31
ARTICLE V – VESTING		**32**

5.1	Pre-tax Contributions, Rollover Contributions	32
5.2	Matching Contributions and Profit Sharing Contributions	32
5.3	Forfeitures	33
5.4	Allocation of Forfeitures	33
5.5	Restoration of Forfeited Account	33
5.6	Vesting After a Break in Service	34
5.7	Retention of Pre-Break Service	34
ARTICLE VI - IN-SERVICE WITHDRAWALS		**35**
6.1	Withdrawals After Attaining Age 59 1/2	35
6.2	Hardship Withdrawals	35
6.3	In-Service Withdrawal Procedures and Restrictions	37
ARTICLE VII – LOANS		**38**
7.1	General Rule	38
7.2	Amount of Loan	38
7.3	Interest Rate, Security and Fees	39
7.4	Source of Loans	40
7.5	Repayment and Term	40
7.6	Deemed Distributions	43
7.7	Additional Rules	44
ARTICLE VIII – DISTRIBUTIONS		**45**
8.1	Eligibility for Distribution Upon Separation From Service or Disability	45
8.2	Form of Payment	45
8.3	Amount of Distribution	45
8.4	Cashout Distributions and Automatic Rollovers	45
8.5	Distribution Upon Death	46
8.6	Commencement of Payments	47
8.7	Direct Rollovers	51
8.8	Qualified Domestic Relations Orders	51
8.9	Beneficiary Designation	52
8.10	Incompetent or Lost Distributee	54
ARTICLE IX - INVESTMENT OF THE TRUST		**56**
9.1	Trust Agreement	56
9.2	Appointment of Investment Managers	56
9.3	Investment Manager Powers	56
9.4	Power to Direct Investments	56
9.5	Exclusive Benefit Rule	56
ARTICLE X - PLAN ADMINISTRATION		**58**
10.1	Allocation of Responsibility Among Fiduciaries for Plan and Trust Administration	58
10.2	Administration	58
10.3	Claims Procedure	59
10.4	Records and Reports	63
10.5	Administrative Powers and Duties	63
10.6	Rules and Decisions	64
10.7	Procedures	64
10.8	Authorization of Benefit Distributions	64
10.9	Application and Forms for Distributions	64

10.10 Certain Operational Mistakes 64

ARTICLE XI - AMENDMENT AND TERMINATION **65**

11.1 Amendment of the Plan 65
11.2 Right to Terminate the Plan or Discontinue Contributions 65
11.3 Effect of Termination or Discontinuance of Contributions 65
11.4 Effect of a Partial Termination 66
11.5 Plan Merger 66
11.6 Additional Participating Employers 66
11.7 Withdrawal of a Participating Employer 66

ARTICLE XII - MISCELLANEOUS PROVISIONS **67**

12.1 Action by the Company 67
12.2 No Right to Be Retained in Employment 67
12.3 Rights to Trust Assets 67
12.4 Non-Alienation of Benefits 67
12.5 Requirement to Provide Information to Plan Administrator 68
12.6 Source of Benefit Payments 68
12.7 Indemnification 68
12.8 Construction 68
12.9 Governing Law 69

ARTICLE XIII - LIMITATION ON PRE-TAX CONTRIBUTIONS **70**

13.1 Treatment of Excess Deferrals 70
13.2 Coordination With Other Arrangements In Which Earnings are Deferred 70

ARTICLE XIV - NONDISCRIMINATION RULES: ADP and ACP TESTS **71**

14.1 Definitions Applicable to the Nondiscrimination Rules 71
14.2 Actual Deferral Percentage Test 72
14.3 More Than One Employer-Sponsored Plan Subject to the ADP Test 73
14.4 Recharacterization of Pre-tax Contributions 73
14.5 Treatment of Excess Contributions 73
14.6 QNECs 74
14.7 Actual Contribution Percentage Test 75
14.8 More Than One Plan Subject to the Actual Contribution Test 76
14.9 Required Plan Aggregation for Purposes of the ADP and ACP Test 76
14.10 Required Plan Disaggregation for Purposes of the ADP and ACP Test 76
14.11 Treatment of Excess Aggregate Contributions 77
14.12 Pre-2002 Multiple Use Limitation 78

ARTICLE XV - CODE § 415 LIMITATION **79**

15.1 Definitions Applicable to the Code § 415 Limitation 79
15.2 Limitation on Annual Additions 80
15.3 Pre-2000 Combined Plan Code §415 Limitation 82
15.4 Applicable Regulations 82

ARTICLE XVI - TOP HEAVY PROVISIONS **83**

16.1 Definitions Applicable to the Top Heavy Provisions 83
16.2 Application of Article XVI 86
16.3 Minimum Contributions 87

APPENDIX A - 2003 ADDITIONAL MATCHING CONTRIBUTION **88**

WILLIAMS-SONOMA, INC. ASSOCIATE STOCK INCENTIVE PLAN

PREAMBLE

The Williams-Sonoma, Inc. Associate Stock Incentive Plan ("Plan") permits eligible associates to defer receipt of their compensation on a pre-tax basis in order to promote retirement savings. The Plan also provides for matching contributions to be made on the basis of the pre-tax contributions. The Plan provides for distributions in the event of termination of employment. In addition, in-service withdrawals are permitted at age 59 1/2 or on account of hardship, and loans are available to eligible associates who are not on leaves of absence.

The Plan is a profit-sharing plan consisting of a cash or deferred arrangement and a matching contribution arrangement. The Plan is intended to meet the requirements for qualification under Code §§ 401(a), 401(k) and 401(m).

The Plan was originally established February 1, 1989 as the Williams-Sonoma, Inc. Employee Profit Sharing and Stock Incentive Plan, and was later renamed the Williams-Sonoma, Inc. Associate Stock Incentive Plan.

The Plan was amended and restated effective January 1, 1997 to incorporate the provisions of the federal tax legislation known as "EGTRRA" (the Economic Growth and Tax Relief Reconciliation Act of 2001, PL 107-16, enacted June 7, 2001), as well as the federal tax legislation commonly referred to as "GUST" (the Uruguay Round Agreements Act, Pub. L. 103-465 (GATT); the Small Business Job Protection Act of 1996, Pub. L. 104-188 (SBJPA) (including § 414(u) of the Internal Revenue Code (Code) and the Uniformed Services Employment and Reemployment Rights Act of 1994, Pub. L. 103-353 (USERRA)); the Taxpayer Relief Act of 1997, Pub. L. 105-34 (TRA '97); the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105-206 (RRA); and the Community Renewal Tax Relief Act of 2000 (CRA), P.L. 106-554)).

The Plan has been amended from time to time since its initial January 1, 1997 restatement. The present amendment and restatement retains the general January 1, 1997 Effective Date, but incorporates amendments to the Plan with specific effective dates through November 1, 2005, as indicated in the text.

ARTICLE I – DEFINITIONS

Where the following, boldfaced words and phrases appear in this Plan with initial capitals, they shall have the meaning set forth below.

1.1 **"Account"** means the sum of a Participant's Matching Contributions Account, Pre-tax Contributions Account, Rollover Contributions Account and Profit Sharing Contributions Account, which sum constitutes the Participant's total interest in the Trust.

1.2 **"Age 50 Catch-up Contributions"** means Pre-tax Contributions made pursuant to Section 3.2(d).

1.3 **"Age 50 Catch-up Contributions Account"** means the separate subaccount of a Participant's Account to which Age 50 Catch-up Contributions and any income or loss thereon are credited.

1.4 **"Associate"** means any person who is receiving compensation as a common law employee for personal services rendered in the employment of the Employer.

(a) No self-employed individual shall be an Associate under this Plan by virtue of his or her self-employment (except as provided in (c) below). An individual shall not be considered to be in "employment" unless the individual is classified by the Employer as being in employment.

(b) If a former Associate's termination of employment did not constitute a Separation from Service, such individual shall be treated as a current Associate for purposes of the withdrawal provisions of Article VI and the loan provisions of Article VII.

(c) The term "Associate" shall also include an individual who performs services for the Employer (other than an associate of the Employer), who pursuant to an agreement between the Employer and any other person ("leasing organization") has performed services for the Employer (and related persons determined in accordance with Code § 414(n)(6)) determined on a substantially full-time basis for a period of at least one year, and such services are performed under the primary direction or control by the Employer. Notwithstanding the foregoing, if such leased employees constitute less than 20% of the Employer's Non-highly Compensated Employees within the meaning of Code § 414(n)(1)(C)(ii), the term "Associate" shall not include those leased employees covered by a plan described in Code § Section 414(n)(5).

1.5 **"Beneficiary"** means the person designated by a Participant on the Beneficiary Designation Form or such other person who becomes entitled to a benefit under the Plan in accordance with Section 8.9.

1.6 **"Beneficiary Designation Form"** means a form prescribed by the Plan Administrator for designating Beneficiaries.

1.7 **"Board of Directors or Board"** means the Board of Directors of the Company.

1.8 **"Borrower"** means a Participant who has made an application for or who has received a loan from the Plan in accordance with Section 7.1.

1.9 **"Casual Associate"** means an Associate who is classified as a casual associate by the Associate's Employer and who is not in an ineligible classification under Section 2.1(e).

1.10 **"Code"** means the Internal Revenue Code of 1986, as amended.

1.11 **"Company"** means Williams-Sonoma, Inc., a corporation organized and existing under the laws of the State of California, or its successor or successors.

1.12 **"Company Stock"** means shares of common stock of Williams-Sonoma, Inc.

1.13 **"Company's Controlled Group"** means the controlled group of organizations of which the Company is a part, as defined by Code § 414 and regulations issued thereunder. An entity shall be considered a member of the Company's Controlled Group only during the period it is one of the group of organizations described in the preceding sentence.

1.14 **"Compensation"** means:

(a) Either of the following, depending on the context:

(i) For purposes of the Actual Deferral Percentage test and the Actual Contribution Percentage test in Article XIV, any definition of compensation permissible under Code § 414(s), as chosen by the Plan Administrator for each Plan Year.

(ii) For all other purposes, an Associate's W-2 wages as reported or reportable (determined without regard to any rules that limit the remuneration included in wages based on the nature or location of the employment or the services performed such as the exception for agricultural labor in Code § 3401(a)(2)). Such compensation shall also include contributions that are made by an Employer that are not includible in gross income under Code §§ 125 (cafeteria plan salary reduction amounts), 402(g)(3) (pre-tax deferrals) and effective January 1, 2001, 132(f)(4) (qualified transportation benefits). The preceding sentence shall not be effective until January 1, 1998 in the case of Article XV (Code § 415 limitation).

(b) Notwithstanding the above, a Participant's Compensation for a Plan Year shall not exceed:

(i) For the 2002 and later Plan Years, $200,000 (or such higher dollar amount as may permissibly apply for the Plan Year pursuant to adjustments in the dollar limitation under Code § 401(a)(17) announced by the Secretary of the Treasury);

(ii) For the 2000 and 2001 Plan Years, $170,000; or

(iii) For the 1997, 1998 and 1999 Plan Years, $160,000.

In the case of a Plan Year of less than 12 months, the limitation specified in the previous sentence shall be adjusted by first dividing the limit by 12 and then multiplying the resulting quotient by the number of months in the Plan Year.

1.15 **"Contribution Election"** means the election made by an Eligible Associate or Participant selecting the percentage of Eligible Pay to be deferred and contributed to the Plan by the Employer as a Pre-tax Contribution.

1.16 **"Disability"** means the total and permanent incapacity of a Participant to perform the usual duties of employment for an Employer due to physical impairment or legally established mental incompetence. "Disability" shall be determined on evidence that the Participant has become entitled to receive primary benefits as a disabled employee under the Social Security Act in effect on the date of disability. If Participant's incapacity is due to alcohol, drugs, or other substance abuse, the Participant must be enrolled or have completed a rehabilitation program approved by the Company for such disability to constitute a "Disability."

1.17 **"Effective Date"** means January 1, 1997, the date that this restatement of the Plan is first effective. Certain identified provisions are effective on different dates, as noted herein. The Plan itself was first effective February 1, 1989.

1.18 **"Eligible Associate"** means an Associate who has met the eligibility and entry date requirements to be a Participant under Article II, without regard to whether the Associate has elected to make Pre-tax Contributions. For purposes of the nondiscrimination tests in Article XIV, an Associate with no Compensation for a Plan Year shall not be treated as an Eligible Associate for that Plan Year.

1.19 **"Eligibility Computation Periods"** mean: (i) the twelve-consecutive-month period that begins on the Associate's Start Date, (ii) the first Plan Year that begins on or after such Associate's Start Date, and (iii) each succeeding Plan Year.

1.20 **"Eligible Pay"** means the amount of regular, recurring compensation of an Associate, including base salary and hourly wages plus overtime pay. "Eligible Pay" is determined prior to reduction for any Pre-tax Contributions made on behalf of the Participant and for any amount allocated to a cafeteria plan maintained pursuant to Code § 125. "Eligible Pay" does not include any other items of compensation, such as: (a) commissions, (b) bonuses paid at the discretion of the Company, (c) the value of stock options granted to or exercised by an Associate or former Associate during the Plan Year, (d) car allowances, (e) expense reimbursements, or (f) nonqualified deferred compensation deferred by or paid to an Associate or former Associate. Eligible pay is further limited by the same dollar limitations that are set forth in subsection (b) of the definition of "Compensation" in this Article I.

1.21 **"Eligible Retirement Plan"** means:

(a) For Plan Years beginning on or after January 1, 2002, an individual retirement account described in Code § 408(a), an individual retirement annuity described in Code § 408(b), an annuity plan described in Code § 403(a), a qualified trust described in Code § 401(a), an annuity contract described in Code § 403(b) and an eligible plan under Code § 457(b) which is maintained by a state, political subdivision of a state, or any agency or instrumentality of a state or political subdivision of a state and which agrees to separately account for amounts transferred into such 457(b) plan from this Plan; and

(b) For Plan Years beginning before January 1, 2002, an individual retirement account described in Code § 408(a), an individual retirement annuity described in Code § 408(b), an annuity plan described in Code § 403(a) or a qualified trust described in Code § 401(a); provided, however, with respect to a Participant's Surviving Spouse, an Eligible Retirement Plan shall be only an individual retirement account or individual retirement annuity.

The definition of an "Eligible Retirement Plan" in this subsection shall also apply in the case of a distribution to a spouse or former spouse who is the alternate payee under a qualified domestic relations order, as defined in Code § 414(p).

1.22 **"Eligible Rollover Distribution"** means any distribution under the Plan of all or any portion of a Participant's Account, other than:

(a) A distribution that is one of a series of substantially equal periodic payments (made not less frequently than annually) made for the life (or life expectancy) of the Participant (or the Participant's Surviving Spouse) or the joint lives (or joint life expectancies) of the Participant (or the Participant's Surviving Spouse) and the Participant's (or the Participant's Surviving Spouse's) designated beneficiary;

(b) A distribution for a specified period of ten years or more;

(c) A distribution required under Code § 401(a)(9) (*see* Section 8.6(d));

(d) Effective January 1, 1999, a hardship distribution described in Code § 401(k)(2)(B)(i)(IV) (*see* Section 6.2); or

(e) The portion of any distribution in excess of the amount that would be includible in gross income were it not rolled over to an Eligible Retirement Plan (disregarding for this purpose, the exclusion from income applicable to net unrealized appreciation when employer securities are distributed).

1.23 **"Employer"** means the Company and any subsidiary which is authorized by the Company to participate herein.

1.24 **"Employment Commencement Date"** means the date on which the Associate first performs an Hour of Service for which the Associate is paid or entitled to payment for the performance of duties for the Employer or any other employer within the Company's Controlled Group.

1.25 **"ERISA"** means the Employee Retirement Income Security Act of 1974, as amended.

1.26 **"Excess Contributions"** means, with respect to any Plan Year, the aggregate amount of Pre-tax Contributions paid to the Trustee for a Plan Year on behalf of IRS Highly Compensated Employees in excess of the Actual Deferral Percentage test limits set forth in Section 14.2.

1.27 **"Excess Deferrals"** means, with respect to any Plan Year, the aggregate amount of Pre-tax Contributions contributed on behalf of Participants in excess of the annual limitation on Pre-tax Contributions set forth in Section 3.2(b).

1.28 **"Fiduciaries"** means:

(a) The named fiduciaries as defined in § 402 of ERISA who shall be the Company (but solely with respect to its power to designate successor Trustees), the Plan Administrator and the Trustee; and

(b) Other parties designated as fiduciaries, as defined in § 3(21) of ERISA, by such named fiduciaries in accordance with the terms of the Plan and the Trust Agreement;

provided that a party shall be a Fiduciary only with respect to its specific responsibilities in connection with the Plan and Trust.

1.29 **"Full-Time Regular Associate"** means an Associate who is classified as a full-time regular associate by the Associate's Employer and who is not in an ineligible classification under Section 2.1(e).

1.30 **"IRS Highly Compensated Employee"** means any Associate of the Company's Controlled Group (whether or not eligible for participation in the Plan) who, for the applicable Plan Year:

(a) Was a five-percent owner (as defined in Code § 416(i)) for the applicable Plan Year or the immediately preceding Plan Year, or

(b) Received Compensation in excess of:

(i) For the Plan Year 2003 or later, $90,000 during the preceding Plan Year or such other amount as may apply for the preceding Plan Year pursuant to adjustments in the compensation amount under Code § 414(q)(1)(B) announced by the Secretary of Treasury;

(ii) For the 2001 and 2002 Plan Years, $85,000 during the preceding Plan Year; and

(iii) For the 1997, 1998, 1999 and 2000 Plan Years, $80,000 during the preceding Plan Year.

Associates who are nonresident aliens and who receive no earned income from any employer within the Company's Controlled Group which constitutes income from sources within the United States shall be disregarded for all purposes of this Section.

1.31 **"Hour of Service"** means, with respect to any applicable computation period,

(a) Performance of Duties. Each hour for which the Associate is paid or entitled to payment for the performance of duties for the Employer or any other employer within the Company's Controlled Group;

(b) Paid Leave. Each hour for which the Associate is paid or entitled to payment by the Employer or any other employer within the Company's Controlled Group on account of a period during which no duties are performed, whether or not the employment relationship has terminated, due to vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty or leave of absence, but not more than 501 hours for any single continuous period, provided that no hours shall be credited on account of any period during which the Associate performs no duties and receives payment solely for the purpose of complying with unemployment compensation, workers' compensation or disability insurance laws;

(c) Back Pay. Each hour for which back pay, irrespective of mitigation of damages, is either awarded or agreed to by the Employer or any other employer within the Company's Controlled Group, excluding any hours credited under subsection (a) or (b), which shall be credited to the computation period or periods to which the award, agreement or payment pertains rather than to the computation period in which the award, agreement or payment is made;

(d) Parental Leave. Solely for purposes of determining whether an Associate has incurred a break in service, each hour for which an Associate would normally be credited under subsection (a) or (b) above during a period of parental leave but not more than 501 hours for any single continuous period. However, the number of hours credited to an Associate under this subsection (d) during the computation period in which the parental leave began, when added to the hours credited to an Associate under subsections (a) through (c) above during that computation period, shall not exceed 501. If the number of hours credited under this subsection (d) for the computation period in which the parental leave began is zero, the provisions of this subsection (d) shall apply as though the parental leave began in the immediately following computation period. For this purpose, a parental leave means a period in which the Associate is absent from work immediately following his or her active employment because of the Associate's pregnancy, the birth of the Associate's child or the placement of a child with the Associate in connection with the adoption of that child by the Associate, or for purposes of caring for that child for a period beginning immediately following such birth or placement; and

(e) Family and Medical Leave Act. Solely for purposes of determining whether an Associate has incurred a break in service, each hour for which an Associate would normally be credited under subsection (a) or (b) above, and not otherwise credited under subsection (d) above, during a period of unpaid leave for the birth, adoption or placement of a child, to care for a spouse or an immediate family member with a serious illness or for the Associate's own illness pursuant to the Family and Medical Leave Act of 1993 and the regulations thereunder.

Hours of Service to be credited to an individual under subsections (b), (c), (d) and (e) above will be calculated by the Plan Administrator by reference to the individual's most recent work schedule. The Hours of Service credited shall be determined as required by Department of Labor regulations §§ 2530.200b-2(b) and (c), and the rules set forth in such Sections are hereby incorporated by reference. For periods before May 1, 1997, a salaried Associate shall be credited with 45 Hours of Service for each calendar week during which he or she performs at least 1 Hour of Service (*i.e.*, before May 1, 1997, the Plan used an optional equivalency under Department of Labor regulation § 2530.200b-3(e)(ii) in which a salaried Associate was credited with 45 Hours of Service for each week for which the Associate was credited with at least one Hour of Service).

1.32 **"Investment Election"** means the election by which a Participant directs the investment of his or her Account in accordance with Section 4.2.

1.33 **"Investment Fund"** means any of the funds described in Article IV into which a Participant's Account may be invested.

1.34 **"Leave of Absence"** shall mean any absence authorized by an Employer under the Employer's standard personnel practices, whether paid or unpaid, to the extent the leave does not exceed one year (unless otherwise required by applicable law). A Leave of Absence shall include an absence from work because of reasons covered by, and only while the absence is protected by, the Family and Medical Leave Act of 1993 and its regulations.

1.35 **"Matching Contributions"** means the contributions made by the Employer to a Participant's Matching Contributions Account pursuant to Section 3.3.

1.36 **"Matching Contributions Account"** means the separate subaccount of a Participant's Account which reflects the amount attributable to a Participant's Matching Contributions and earnings and losses thereon.

1.37 **"Non-highly Compensated Employee"** means an Associate who is not a IRS Highly Compensated Employee.

1.38 **"Normal Retirement Age"** means age 65.

1.39 **"Part-Time Associate"** means an Associate who is classified as a part-time associate by the Associate's Employer and who is not in an ineligible classification under Section 2.1(e).

1.40 **"Participant"** means an individual who has commenced participation in the Plan by electing to make Pre-tax Contributions and has not terminated participation, as determined under Section 2.1.

1.41 **"Participant Response System"** means the Participant Response System established by the Company to permit Participants to manage their Account and communicate with the Plan Administrator, Trustee, recordkeeper and/or delegate thereof. As determined by the Plan Administrator, this system may take any form (*e.g.*, it may include an interactive telephone participant response system, either menu-driven or with a live attendant, a paper document system, an internet site, an intranet site, or an e-mail protocol). The system may allow Participants to commence participation in the Plan (in accordance with Section 2.1), to make and change their Contribution Elections (in accordance with Section 3.1(c)), to make and change their Investment Elections (in accordance with Section 4.2), to apply for an in-service withdrawal (in accordance with Article VI), to apply for a plan loan (in accordance with Article VII), and to request a distribution (in accordance with Article VIII). Different features of the Participant Response System may be used for different purposes (*e.g.*, Participants may be allowed to use the internet for some purposes but may be required to contact a live telephone attendant to initiate a loan), may be offered to different groups of Participants, and may be made available only in limited circumstances (*e.g.*, a live telephone attendant may only be available during limited hours). The Participant Response System may require Participants to use security protocols, including a "personal identification number" ("PIN"). Unless the Participant uses the form or protocol that is specifically permitted by the Plan Administrator for the purpose in question, the Participant's communication shall not be deemed to be made through the Participant Response System.

1.42 **"Period of Severance"** means the period of time commencing on an Associate's Service Cutoff Date and ending on the Associate's next Reemployment Commencement Date during which the Associate is not employed by the Company's Controlled Group.

1.43 **"Plan"** means this Plan, the Williams-Sonoma, Inc. Associate Stock Incentive Plan, as it may be amended and restated from time to time. This Plan may also be referred to as the "ASIP" or "ASIP 401(k) Plan."

1.44 **"Plan Administrator"** means the Administrative Committee. Effective December 21, 2005, the Administrative Committee shall consist of the following: (i) Manager, Accounting, (ii) Senior Vice President, CCC and Training, and (iii) Vice President, Compensation and Benefits. Prior to that date, the Administrative Committee was appointed by the Compensation Committee of the Board of Directors. As Plan Administrator, the Administrative Committee shall have authority to administer the Plan as provided in Article X. The Plan Administrator may interact with Participants and Beneficiaries through the party currently designated as recordkeeper for the Plan. Therefore, to the extent authorized by the Plan Administrator, any communication by a Participant or Beneficiary with such recordkeeper shall be deemed to be a communication with the Plan Administrator, and any communication by the recordkeeper with a Participant and Beneficiary shall be deemed to be a communication by the Plan Administrator.

1.45 **"Plan Year"** means the calendar year. The first Plan Year shall commence on February 1, 1989 (the date the Plan was first effective) and shall end on December 31, 1989.

1.46 **"Pre-tax Contributions"** means contributions made by an Employer on behalf of a Participant in accordance with his or her Contribution Election pursuant to Article III.

1.47 **"Pre-tax Contributions Account"** means the separate subaccount of a Participant's Account to which Pre-tax Contributions and any income or loss thereon are credited.

1.48 **"Prior 2005 Employee QNEC Account"** means the separate subaccount of a Participant's Account to which pre-2005 qualified nonelective contributions, and any income or loss thereon, were credited.

1.49 **"Prior 2005 Company Special Matching Contribution Account"** means the separate subaccount of a Participant's Account to which certain pre-2005 corrective matching contributions, and any income or loss thereon, are credited.

1.50 **"Profit Sharing Contributions"** means profit sharing contributions made to the Plan by an Employer on behalf of a Participant before January 1, 1997. Effective January 1, 1997, the Company will not make any further Profit Sharing Contributions.

1.51 **"Profit Sharing Contribution Account"** means the separate subaccount of a Participant's Account to which any Profit Sharing Contributions and any income or loss thereon are credited.

1.52 **"Reemployment Commencement Date"** means the date on which an Associate first performs an Hour of Service for the Employer or any other employer within the Company's Controlled Group following a Period of Severance.

1.53 **"Rollover Contribution"** means a contribution made in accordance with Section 3.5, by an Eligible Associate to the Plan:

(a) Which consists only of the taxable portion of a cash distribution from –

(i) A qualified plan under Code § 401(a),

(ii) A qualified annuity under Code § 403(a),

(iii) An individual retirement account or an individual retirement annuity (collectively, an "IRA") described in Code § 408(a) or 408(b), except that for Plan Years beginning before January 1, 2002, the IRA must originate from a tax-free rollover from a qualified plan under Code § 401(a) and the IRA must contain only such funds and earnings thereon; or

(iv) For Plan Years beginning on or after January 1, 2002, an annuity contract under Code § 403(b) and an eligible plan under Code § 457(b), which is maintained by a state, political subdivision of a state, or any agency or instrumentality of a state or political subdivision of a state.

(b) Which is an "eligible rollover distribution" as defined in Code § 402(c)(4); and

(c) Which is contributed to the Plan not later than 60 days after the Eligible Associate receives it (or such later date as is permitted by the Secretary of the Treasury on account of the recipient's hardship pursuant to Code § 402(c)(3)(B)), in the event the Eligible Associate receives the distribution from the other plan, annuity, account or contract instead of electing its direct rollover to this Plan.

Accordingly, an Eligible Associate's after-tax contributions to, and hardship distributions from, another plan or arrangement are not eligible for rollover into this Plan. The Plan Administrator shall determine whether a requested contribution constitutes a Rollover Contribution.

1.54 **"Rollover Contributions Account"** means the separate subaccount of a Participant's Account or an Account established on behalf of an Eligible Associate to which Rollover Contributions and any income or loss thereon are credited.

1.55 **"Separation from Service"** or **"Separates from Service"** means the termination of the Associate's employment relationship with the Company's Controlled Group, including by quit, resignation, discharge, retirement, disability, or layoff. For purposes of the Plan's limitations on the right of a Participant to take an in-service distribution from the Plan pursuant to Code § 401(k)(2)(B) (*e.g.*, as the term is used in Section 8.1 (eligibility for distribution upon separation from service)), the following rules shall apply. "Separation from Service" means separation from service as that phrase is defined for purposes of Code § 401(k)(2)(B), and a Participant shall also be treated as having a Separation from Service upon the disposition by the Employer of substantially all of the assets used by the Employer in a trade or business within the meaning of Code § 401(k)(10)(A)(ii), if such Participant continues employment with the corporation acquiring such assets, or upon the disposition by the Employer of the Employer's interest in a subsidiary within the meaning of Code § 401(k)(10)(A)(iii), if the Participant continues employment with such subsidiary, but only if such Participant satisfies the requirements for receiving a distribution under Code § 401(k)(10) or other applicable ruling or regulation under such provision, except that for purposes of this sentence "Code" refers to the Code as in effect immediately before enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001, PL 107-16 (EGTRRA).

1.56 **"Service Cutoff Date"** means the earliest of:

(a) The Associate's Separation from Service date,

(b) The 12-month anniversary of the date the Associate was otherwise first absent from employment,

(c) The last day of the 24-month period following the date the Associate is first absent from employment on account of parental leave (as defined in the definition of Hour of Service in this Article I), and

(d) The date that an Associate fails to return from a family or medical leave under the Family and Medical Leave Act of 1993.

1.57 **"Spouse"** means the person to whom an Associate is lawfully married.

1.58 **"Start Date"** means

(a) In connection with an Associate's initial hire, his or her Employment Commencement Date; and

(b) In connection with determining an Associate's Plan eligibility after his or her rehire, the date the Associate is credited, following rehire, with an Hour of Service for the performance of duties for the Employer or any other employer within the Company's Controlled Group.

1.59 **"Surviving Spouse"** means the Spouse of a Participant as of the date of the Participant's death.

1.60 **"Temporary Associate"** means an Associate who is classified as a temporary associate by the Associate's Employer and who is not in an ineligible classification under Section 2.1(e).

1.61 **"Trust"** means the trust fund or funds which hold the assets of the Plan and are established by the Trust Agreement.

1.62 **"Trust Agreement"** means the trust agreement or agreements entered into between the Company and the Trustee to provide for holding the Plan assets.

1.63 **"Trustee"** means the individual(s) or corporation(s) appointed pursuant to the Trust Agreement. The Trustee may be changed from time to time, including by adoption of a new or amended Trust Agreement. The Trustee may interact with Participants and Beneficiaries through the party currently designated as recordkeeper for the Plan. Therefore, to the extent authorized by the Trustee, any communication by a Participant or Beneficiary with such recordkeeper shall be deemed to be a communication with the Trustee, and any communication by the recordkeeper with a Participant and Beneficiary shall be deemed to be a communication by the Trustee.

1.64 **"U.S."** or **"United States"** means the 50 states and the District of Columbia.

1.65 **"Williams-Sonoma, Inc. Stock Fund"** means a stock fund that invests primarily in Company Stock and that is required to be available as an Investment Fund under this Plan, as described in Article IV.

1.66 **"Year of Vesting Service"** means a 365 day "period of service" (as defined below), but excluding service before February 1, 1988. Separate periods of service shall be aggregated in calculating Years of Vesting Service. A period of service means the period commencing on the Associate's Employment Commencement Date or Reemployment Commencement Date and ending on the next Service Cutoff Date, and shall include a Period of Severance (post-February 1, 1988) that lasts no more than 12 consecutive months.

ARTICLE II – PARTICIPATION

2.1 Eligibility.

An Associate who meets the eligibility requirements in this Article II is an Eligible Associate. If the Eligible Associate elects to make Pre-tax Contributions pursuant to Section 3.1, the Eligible Associate will become a Participant.

(a) Full-Time Regular Associates. Each Full-Time Regular Associate shall be eligible to participate in the Plan as soon as administratively practicable (*e.g.*, 30 days) after the later of:

(i) Such Associate's Start Date, and

(ii) Such Associate's 21st birthday.

(b) Part-Time Associates and Casual Associates. Effective as of May 1, 1997, each Part-Time Associate and Casual Associate shall be eligible to participate in the Plan as soon as administratively practicable (*e.g.*, 30 days) after the later of:

(i) The first date on which the Associate completes 1,000 Hours of Service within one Eligibility Computation Period, without regard to whether the applicable Eligibility Computation Period has ended and without regard to the Associate's age at the time, and

(ii) Such Associate's 21st birthday.

For purposes of the 1,000 Hours of Service requirement, all Hours of Service completed as an Associate with the Company's Controlled Group are counted, including Hours of Service earned as a Temporary Associate and Hours of Service for which the Associate is paid but does not actually perform services such as vacation time or paid Leaves of Absence.

(c) Temporary Associates. A Temporary Associate is not eligible to become an Eligible Associate, except as provided in the next sentence. An Eligible Associate (*e.g.*, a Full-Time Regular Associate, Part-Time Associate or Casual Associate who meets the requirements of this Section 2.1) who is reclassified or rehired as a Temporary Associate shall continue to be treated as an Eligible Associate while so classified.

(d) Pre-May 1, 1997 Rule. This subsection (b) governs eligibility in the Plan before May 1, 1997. Notwithstanding the preceding provisions of this Section 3.1, before May 1, 1997, each Full-Time Regular Associate, Part-Time Associate and Casual Associate shall be eligible to participate in the Plan on the January 1 or July 1 next following the later of:

(i) The date on which such Associate completes 1,000 Hours of Service, provided that he or she completes the 1,000 Hours of Service within one Eligibility Computation Period, and

(ii) Such Associate's 21st birthday,

even if such date occurs before the end of the applicable Eligibility Computation Period.

(e) Excluded Classifications. Notwithstanding the preceding provisions of this Section 2.1, no Associate shall be an Eligible Associate or Participant hereunder while such Associate is:

(i) Neither a citizen nor a resident of the United States, and derives no earned income from the Employer that would constitute income from sources within the United States,

(ii) A member of a collective bargaining unit covered by a collective bargaining agreement with respect to which retirement benefits were the subject of good-faith bargaining between the employee representatives and the Employer and that does not specifically provide for coverage of such Associate under this Plan,

(iii) Not a common law employee of an Employer,

(iv) Any individual classified by an Employer as an independent contractor,

(v) Any individual classified by an Employer as a leased employee within the meaning of Code § 414(n) unless: (A) the leasing organization is an Employer, (B) the recipient organization is a member of the Company's Controlled Group, and (C) the individual is otherwise eligible, or

(vi) An Associate who is eligible to participate in one or more employee benefit plans of a third party with whom an Employer has contracted for the provision of the Associates' services.

For purposes of this Section, it is expressly intended that individuals whom an Employer classifies as independent contractors (under subsection (f)(iv)) and any other individuals classified as excluded associates under this Section can not be Eligible Associates until the Plan Administrator affirmatively changes their classification. Therefore, an independent contractor or any other individual who is reclassified by a court, administrative agency, governmental unit, tribunal or other party as an Eligible Associate will nevertheless not be considered an Eligible Associate hereunder for periods before the Plan Administrator implements the reclassification decision, even if the decision applies retroactively.

2.2 Resumption after a Period of Severance, Break in Service or Reduction in Hours.

If an Associate has a Break in Service or Period of Severance, the following rules apply, and the Associate must notify the Company of his or her pre-break Service so that the Associate can be properly credited with all Service to which he or she is entitled.

(a) Full-Time Associate Who Has a Period of Severance. If a Full-Time Associate has a Period of Severance of at least 12 consecutive months and later resumes employment, the rules in this subsection (a) apply.

(i) Full-Time Associate After the Period of Severance. If the individual is re-employed as a Full-Time Associate after the Period of Severance, the individual will become an Eligible Associate upon meeting the requirements of Section 2.1(a).

(ii) Part-Time Associate or Casual Associate After the Period of Severance. If the individual is re-employed as a Part-Time Associate or Casual Associate after the Period of Severance, the following rules apply.

(A) If the individual was an Eligible Associate before the Period of Severance, the individual will resume Eligible Associate status immediately and will be eligible to resume making Pre-Tax Contributions as soon as administratively practicable (*e.g.*, within 30 days), even if the individual has not satisfied the 1,000 hour requirement of Section 2.1(b).

(B) If the individual was not an Eligible Associate before the Period of Severance, the individual will become an Eligible Associate upon meeting the requirements of Section 2.1(b), including the 1,000 Hours of Service requirement therein.

(iii) Temporary Associate After the Period of Severance. If the individual is re-employed as a Temporary Associate after the Period of Severance, the following rules apply.

(A) If the individual was an Eligible Associate before the Period of Severance, the individual will resume Eligible Associate status immediately and will be eligible to resume making Pre-Tax Contributions as soon as administratively practicable (*e.g.*, within 30 days).

(B) If the individual was not an Eligible Associate before the Period of Severance, the individual will not be eligible to become an Eligible Associate while a Temporary Employee.

(b) Part-Time Associate or Casual Associate Who Has a Break. If a Part-Time Associate or Casual Associate has a break in service and later resumes

employment, the rules in this subsection (b) apply. For this purpose, a "break in service" means a Plan Year during which the Associate is credited with not more than 500 Hours of Service (*i.e.*, a reduction in Hours of Service can trigger a break in service even if the Associate has not terminated employment). If the Part-Time Associate or Casual Associate has an interruption in service that is less than a break in service (*e.g.*, a Plan Year in which the Associate completes only 501 Hours of Service), the interruption is ignored.

(i) Full-Time Associate After the Break. If the individual is re-employed as a Full-Time Associate after the break in service, the individual will become an Eligible Associate upon meeting the requirements of Section 2.1(a).

(ii) Part-Time, Casual or Temporary Associate After the Break. If the individual is re-employed as a Part-Time Associate, Casual Associate or Temporary Associate after the break in service, the following rules apply.

(A) If the individual was an Eligible Associate before the break in service, the individual will resume Eligible Associate status immediately and will be eligible to resume making Pre-Tax Contributions as soon as administratively practicable (*e.g.*, within 30 days).

(B) If the individual was not an Eligible Associate before the break in service, the individual will become an Eligible Associate upon meeting the requirements of Section 2.1(b), including the 1,000 Hours of Service requirement therein.

(iii) Temporary Associate After the Break. If the individual is re-employed as a Temporary Associate after the break in service, the following rules apply.

(A) If the individual was an Eligible Associate before the break in service, the individual will resume Eligible Associate status immediately and will be eligible to resume making Pre-Tax Contributions as soon as administratively practicable (*e.g.*, within 30 days).

(B) If the individual was not an Eligible Associate before the break in service, the individual will not be eligible to become an Eligible Associate while a Temporary Employee.

2.3 Termination of Participation.

(a) A Participant shall cease to be a participant in the Plan upon the earliest of:

(i) The payment to him or her of all vested benefits due to him or her under the Plan;

(ii) His or her Separation from Service with no vested benefits under the Plan; or

(iii) His or her death.

A Participant shall cease to be eligible to make Pre-tax Contributions upon ceasing to be an Eligible Associate.

(b) An Associate's Service shall not be considered terminated for purposes of this Plan if the Associate has been on a Leave of Absence, provided that the Associate returns to the employ of the Employer at the expiration of the Leave of Absence. An Associate's employment shall likewise not be deemed to have been terminated while the Associate is a member of the Armed Forces of the United States, as provided in Code § 414(u), if he or she returns to the service of the Employer within ninety (90) days (or such longer period as may be prescribed by law) from the date he or she first became entitled to discharge.

2.4 Acquisitions and Divestitures.

A written agreement between an Employer and a party that is not part of the Company's Controlled Group regarding the purchase or sale of a "business" (as defined below) may provide for the termination or commencement of the participation of Associates in this Plan. Absent specific provision in such agreement to the contrary:

(a) Each Associate of a business that is sold will cease being eligible for this Plan upon such sale; and

(b) No Associate of a business that is acquired is eligible for this Plan except as the Plan Administrator may specify.

Unless otherwise specifically provided therein, for purposes of Article XI (amendment and termination of the Plan), approval and execution of a written agreement of acquisition or divesture by one or more Employers is approval by the Company of the designation of Plan eligibility under such agreement and authorization from the Company to the Plan Administrator to carry out the provisions and intent of such agreement. For purposes of this Section 2.4, "business" means a business unit, division or subsidiary.

ARTICLE III - CONTRIBUTIONS

3.1 Contribution Elections.

An Eligible Associate who wishes to make a Contribution Election shall contact the Participant Response System and specify the percentage of Eligible Pay to be reduced and contributed to the Plan as Pre-tax Contributions each pay period. The amount of such election shall be governed by Section 3.2. In the event an Eligible Associate makes a Contribution Election, it will be designated for contribution by the Employer to the Trust on behalf of the Participant, and for deposit in his or her Pre-tax Contributions Account (or Catch-up Contributions Account in the case of contributions made pursuant to Section 3.2(d) below). All amounts deposited to a Participant's Pre-tax Contributions Account and Catch-up Contributions Account shall at all times be fully vested.

(a) Timing. A Pre-tax Contribution Election shall be effective as soon as administratively practicable following the date the Plan receives the Pre-tax Contribution Election (*e.g.*, usually by the third paycheck thereafter); provided, however, that no election shall be effective prior to the date the Associate is an Eligible Associate, or in the case of a Participant who ceases to be an Eligible Associate, the first date such Associate again is an Eligible Associate.

(b) Valid Investment Election. While the Plan contemplates that each Eligible Associate who makes a Pre-tax Contribution Election ordinarily will have a valid Investment Election in effect, the Plan generally will accept Pre-tax Contribution Elections before a valid Investment Election has been submitted unless otherwise prohibited by rules adopted by the Plan Administrator. *See* Section 4.1(b) (default investment elections).

(c) Election Applies to Future Eligible Pay. An Eligible Associate's Pre-tax Contribution Election shall only apply to Eligible Pay that becomes currently available after the date of the Pre-tax Contribution Election, and before the date the Participant's Pre-tax Contribution Election is considered revoked.

(d) Automatic Application to Changes in Eligible Pay. A Participant's Pre-tax Contribution Election shall apply automatically to any increases or decreases in the Participant's Eligible Pay.

(e) Changes to Elections. A Participant may increase, decrease or revoke his or her Pre-tax Contribution Election on a prospective basis by contacting the Participant Response System. Changes in a Participant's Pre-tax Contribution Election shall be effective as soon as administratively practicable following the date the Participant's revised Pre-tax Contribution Election is received. If a Participant's Pre-tax Contributions terminate because an annual limit is reached (*e.g.*, if the Participant reaches one of the dollar limits in Section 3.2(b)), the Pre-tax Contributions will restart the following January 1 unless the Participant affirmatively revokes or changes his or her Pre-tax Contribution Election.

(f) Changes in Eligible Associate Status. If a Participant with a Pre-tax Contribution Election in effect:

(i) Ceases to be an Eligible Associate, and then again becomes an Eligible Associate, a new Pre-tax Contribution Election shall be required; or

(ii) Goes on unpaid leave and then again returns as an Eligible Associate, the Participant's Pre-tax Contribution Election shall be given effect following the return to pay status.

(g) Negative Elections. The Plan Administrator has the authority to provide for automatic elections (*see* Internal Revenue Service Rulings 2000-8 and 98-30).

3.2 Pre-tax Contributions.

The amount of Pre-tax Contributions a Participant may defer is subject to the remainder of this Section, as well as the limitations in Articles XIV (ADP/ACP nondiscrimination tests) and XV (Code § 415 maximum contribution limitations).

(a) Plan's Percentage Limit for Regular Pre-Tax Contributions. Each Participant who is an Eligible Associate may elect to reduce his or her Eligible Pay for a pay period by at least 1% and not more than 15% (10% for periods before January 1, 1999) in whole percentages, and have that amount contributed to the Trust by the Employer as a Pre-tax Contribution. A separate rule applies to Age 50 Catch-up Contributions, which are addressed in subsection (d) below.

(b) Annual Dollar Limit for Regular Pre-Tax Contributions. An Associate's Pre-tax Contributions plus any elective deferrals made under any other Employer-sponsored cash or deferred arrangement for a calendar year shall not exceed:

(i) For calendar years 2006 and later, $15,000 (or such higher amount as is permitted under the cost-of-living provisions of Code § 402(g)(4));

(ii) For calendar year 2005, $14,000;

(iii) For calendar year 2004, $13,000;

(iv) For calendar year 2003, $12,000;

(v) For calendar year 2002, $11,000;

(vi) For calendar years 2000 and 2001, $10,500;

(vii) For calendar years 1998 and 1999, $10,000; and

(viii) For calendar year 1997, $9,500.

These limits do not apply to Age 50 Catch-up Contributions, which are addressed in subsection (d) below.

(c) Highly Paid Associate Limits for Regular Pre-Tax Contributions.

(i) 4% Limit for Certain Williams-Sonoma, Inc. Highly Paid Employees. The following Participants shall not be eligible to make Pre-tax Contributions that exceed 4% of such Participants' total Eligible Pay for a pay period: Participants whose annualized base pay rate for the pay period: (A) effective beginning during March 2003, equals or exceeds the dollar limit in Code § 414(q)(1)(B)(i) (*i.e.*, the dollar limit used to identify IRS Highly Compensated Employees) in effect for the year of the pay period, and (B) effective previously and beginning during 1998, exceeds such dollar limit. For this purpose, Part-Time, Casual and Temporary Employees will be treated as if they are employed on a full-time basis at their current rate of pay, and their pay annualized accordingly.

(ii) Limitation on IRS Highly Compensated Employees. The Plan Administrator has the authority to limit the Pre-tax Contributions of IRS Highly Compensated Employees who are eligible to make Pre-tax Contributions under subsection (a) above and to change that limit at any time as it deems appropriate to assist the Plan in passing any applicable qualification standards the Plan is required to meet, provided that IRS Highly Compensated Employees are never permitted to make Pre-tax Contributions in excess of the limitation in (a) above. The Plan Administrator may impose the same limitation on all IRS Highly Compensated Employees, or may impose different limitations on different classifications of IRS Highly Compensated Employees.

(d) Age 50 Catch-up Contributions. Notwithstanding subsections (a), (b) and (c) above, as soon as administratively practicable on or after May 1, 2003, each Participant who is an Eligible Associate and who attains age 50 before the close of a Plan Year may elect to reduce his or her Eligible Pay for a pay period by at least 1% and not more than 60% and have that amount contributed to the Plan by the Employer as an Age 50 Catch-up Contribution in accordance with and subject to the limitations of Code § 414(v).

(i) The amount of the Age 50 Catch-up Contribution for a calendar year may not exceed:

(A) For calendar years 2006 and later, $5,000 (or such higher amount as is permitted under the cost-of-living provisions of Code § 414(v)(2)(C));

(B) For calendar year 2005, $4,000;

(C) For calendar year 2004, $3,000; or

(D) For calendar year 2003, $2,000,

when combined with any catch-up contributions made under Code § 414(v) to any other plan or arrangement of the Employer.

(ii) Age 50 Catch-up Contributions made pursuant to this subsection shall be treated as Pre-tax Contributions under the Plan, except as otherwise provided below.

(A) Age 50 Catch-up Contributions shall not be taken into account for purposes of the dollar limitations in Section 3.2(b), the limitations on certain highly paid associates in Section 3.2(c), or for determining Matching Contributions under Section 3.3.

(B) The Plan shall not be treated as failing to satisfy the provisions of Article XIV (ADP/ACP nondiscrimination tests), Article XVI (top heavy), Code § 401(a)(4) (nondiscrimination in contributions), Code § 401(a)(17) (limit on compensation taken into account) or Code § 410(b) (nondiscrimination in coverage) by reason of such Age 50 Catch-up Contributions.

(C) Age 50 Catch-up Contributions may be made in the same pay periods as regular Pre-tax Contributions under Section 3.1(a). At the end of the Plan Year the Plan Administrator will determine if any Age 50 Catch-up Contributions will need to be recharacterized as regular Pre-tax Contributions under Section 3.1(a) or vice versa, pursuant to the requirements of Code section 414(v) and the regulations thereunder.

3.3 Matching Contributions.

The Employer shall make discretionary Matching Contributions to the Matching Contributions Accounts of each Participant in the Plan who makes Pre-tax Contributions, subject to the following rules, subject to Articles XIII (Code § 415) and XIV (nondiscrimination).

(a) Matching Contribution Formula. Matching Contributions on behalf of each Participant shall equal 50% of the Participant's Pre-tax Contributions each pay period (excluding Age 50 Catch-up Contributions) that do not exceed 6% of the Participant's Eligible Pay for the pay period (*i.e.*, the maximum Pre-tax Contribution is 3% of Eligible Pay each pay period).

(i) Applicable Percentage for 1997 to 2003. "100%" shall replace "50%" in the preceding sentence, effective only for Pre-tax Contributions beginning May 1, 1997 and ending with the last pay period beginning on or before August 1, 2003.

(ii) Pre-August 2, 2003 Requirement for Williams-Sonoma Inc. Stock Fund. A Participant's Pre-tax Contributions are eligible for Matching Contributions regardless of how such Participant's Pre-tax Contributions

are invested. Notwithstanding the foregoing, effective for pay periods that began on or before August 1, 2003, a Participant's Pre-tax Contributions were eligible for Matching Contributions only to the extent they were invested in the Williams-Sonoma Inc. Stock Fund.

(iii) Timing of Matching Contributions.

(A) The Company shall make such Matching Contributions at such times as may be determined by the Plan Administrator in its discretion (provided that such times shall be substantially uniform among all Participants).

(B) The Matching Contribution is made solely on the basis of the measuring periods determined by the Company, and is not made with reference to full Plan Year Pre-tax Contributions.

(C) Notwithstanding references to "pay period" in Section 3.3(a) above, the Company has the authority to change the measuring period on the basis of which Matching Contributions are determined. In particular, before the Effective Date, the Company could use a quarterly or other measuring period instead of the pay period.

(b) Excess Deferrals and Excess Contributions. Notwithstanding anything in this Section to the contrary, Matching Contributions will be forfeited to the extent they are made with respect to Pre-tax Contributions which are Excess Deferrals or Excess Contributions. For this purpose, any Excess Deferrals and Excess Contributions are deemed to have been made with respect to Pre-tax Contributions that are not otherwise eligible for Matching Contributions to the maximum extent possible, pursuant to rules determined by the Plan Administrator.

(c) Changes in Matching Contributions Formula. The Company shall have the authority to change the Matching Contributions formula at any time.

3.4 No Current After-tax Contributions or Profit Sharing Contributions.

(a) After-Tax Contributions. Participants shall not be permitted to make after-tax contributions to the Plan.

(b) Profit Sharing Contributions. The Employer does not currently make Profit Sharing Contributions to the Plan and does not anticipate making Profit Sharing Contributions in the future. The Employer made Profit Sharing Contributions to the Plan prior to 1997, and these Profit Sharing Contributions were allocated to the Profit Sharing Contributions Accounts of those Participants who received them.

3.5 Rollover Contributions.

(a) An Eligible Associate may contribute eligible Rollover Contributions to the Plan, effective November 1, 2002. Only Eligible Associates are permitted to make Rollover Contributions. Before November 1, 2002, the Plan did not accept Rollover Contributions.

(b) The Plan Administrator may accept a Rollover Contribution provided the Plan Administrator determines, in its discretion, that the contribution meets all of the requirements to qualify as an eligible Rollover Contribution, and provided that the Plan Administrator receives any information it requires regarding the Rollover Contribution.

3.6 Military Leave.

Notwithstanding any provision of this Plan to the contrary, contributions, benefits and service credit with respect to qualified military service will be provided in accordance with Code § 414(u).

3.7 Contributions Subject to Deductibility.

The Employer's obligation to make any contributions under this Plan is expressly conditioned on its ability to deduct such contributions under Code § 404.

3.8 Allocation of Contributions.

(a) Pre-tax Contributions and Matching Contributions. A Participant's Pre-tax Contributions and any Matching Contributions shall be allocated to a Participant's Pre-tax Contributions Account, Age 50 Catch-up Contributions Account and Matching Contributions Account, as applicable, as soon as practicable after each pay period.

(b) Rollover Contribution. A Participant's Rollover Contribution shall be allocated to the Participant's Rollover Contributions Account as soon as practicable after the date such Rollover Contribution is made.

3.9 Valuation, Earnings, Losses and Investment Expenses.

(a) Valuation. Participants' Accounts shall be valued, and earnings and losses allocated, as of the end of each normal business day. A normal business day shall not include any business day when business is not conducted (or is otherwise restricted) as determined by the Plan Administrator due to abnormal conditions (*e.g.*, an emergency or disruption affecting the Company, the Employer, the recordkeeper, the Trustee, a geographical region, the U.S. or the financial markets), and in such case transfers, transactions, loans, withdrawals and distributions otherwise allowed under this Plan will not be allowed but shall be pended.

(b) Expenses.

(i) "Investment expenses" (as defined below) shall be allocated on the same date as earnings and losses are allocated as provided in subsection (a), and shall be allocated in proportion to the final account balances in the Investment Fund as of the preceding valuation date. "Investment expenses" means all expenses related to the management and maintained, on a separate basis, of the individual Investment Funds, but shall not include general fees for management and maintenance of the Trust as a whole.

(ii) The Plan Administrator may specify the rules for charging non-investment expenses to the Plan.

3.10 Return of Contributions.

Upon written demand by the Employer, the Trustee shall return any Pre-tax Contributions, Matching Contributions and QNECs (to the extent provided for in Section 14.6) contributed by the Employer to this Plan under any one of the circumstances described in (a), (b) or (c), subject to the special rules of (d):

(a) If a contribution is determined to:

(i) Be made due to a mistake of fact, the contribution may be returned, adjusted for losses but not earnings, within one year after it is contributed.

(ii) Not be deductible under Code § 404, the portion of the contribution that is disallowed may be returned to the Employer, adjusted for losses but not earnings, within one year after the disallowance.

(iii) Violate Code § 415, such contribution (or portion thereof) may be returned to the Employer to the extent necessary to satisfy the rules of Code § 415 and the applicable Treasury Regulations thereunder as provided in Article XV, and

(iv) Violate Code §§ 401(k)(3) or 402(g)(1), such contribution (or portion thereof) may be returned to the Employer to the extent necessary to satisfy the rules in such Code sections as provided in Article XIV, subject to the rules of Code §§ 401(k)(8) and 402(g)(2).

(b) If Pre-tax Contributions are returned to the Employer in accordance with subsections (a)(i), (ii) or (iii) above, Participants' Pre-tax Contribution Elections with respect to such returned contributions shall be adjusted retroactively to the beginning of the period for which such contributions were made. As a result, amounts returned in accordance with these subsections shall not be counted in determining a Participant's Actual Deferral Percentage for purposes of the limitations in Article XIV. The Pre-tax Contributions so returned shall be distributed in cash to those Participants for whom such contributions were made.

ARTICLE IV – INVESTMENTS

4.1 Participant Investment Provisions.

(a) Participation Investment Direction. Each Participant shall, in accordance with the procedures set forth in Section 4.2, have the right to direct the Trustee with respect to the investment or reinvestment of the assets comprising the Participant's Account among the Investment Funds, except as limited by the following historical and transitional provisions:

(i) Matching Contribution Pre-November 1, 2005 and Transitional Rule: All amounts allocated to a Participant's Matching Contributions Account and Profit Sharing Contributions Account before November 1, 2005 were required to be invested in the Williams-Sonoma, Inc. Stock Fund in the case of allocations to Participant Accounts.

(A) Transitional Rule for Existing Account Balance. A Participant's existing balance in his or her Matching Contribution Account as of November 1, 2005 shall remain invested in the Williams-Sonoma, Inc. Stock Fund until the time of the Participant's (or Beneficiary's or alternate payee's, if applicable) first investment direction covering the Participant's existing Account balance that is made after October 31, 2005; from that time forward, a single investment election will govern the Participant's entire existing Account balance as of the time of the election.

(B) Transitional Rule for Future Allocations. The Participant's investment direction for future Pre-Tax Contributions that is in effect on December 1, 2005 shall also govern the Participant's allocations of Matching Contributions made thereafter, until such time as the Participant makes a new investment election with respect to any future allocations; from that time forward a single investment election will govern both the Participant's future Matching Contributions and Pre-Tax contributions.

(ii) Pre-August 1, 2003 Rule: Effective for pay periods that began on or before August 1, 2003, Pre-tax Contributions invested in the Williams-Sonoma, Inc. Stock Fund were subject to the limitations set forth in subsection (c) below.

After a Participant's death, the Participant's Beneficiary shall have the right to direct the Trustee with respect to the investment or reinvestment of the assets comprising the Participant's Account to the same extent that the Participant had during his or her life. As necessary to accomplish this result, a reference in this Article to a Participant shall also be deemed to be a reference to the Participant's Beneficiary.

(b) Most Recent Direction Controls. In the event the Participant does not give the Trustee timely direction regarding the investment or reinvestment of the Participant's Account, the Trustee shall invest any new contributions made to the Participant's Account in accordance with the Participant's most recently submitted Investment Election; provided, however, to the extent it is not possible to continue to invest in accordance with the Participant's Investment Election (for example, because the Plan has ceased to offer the investment), the affected portion of the Participant's Account shall be invested in accordance with Section 4.2(d) (Default Investment Fund).

(c) Pre August 2, 2003 Rules for Changing the Investment of Pre-tax Contributions. For pay periods that began on or before August 1, 2003, the following restrictions governed transfers of Pre-tax Contributions from the Williams-Sonoma, Inc. Stock Fund to the Plan's other Investment Funds. Anytime on or after November 1, 2002, Participants could transfer to another Investment Fund the portion of their Pre-tax Contributions invested in the Williams-Sonoma, Inc. Stock Fund as of October 31, 2002. Anytime on or after January 4, 2003, Participants could transfer to another Investment Fund the portion of their Pre-tax Contributions invested in the Williams-Sonoma, Inc. Stock Fund as of December 31, 2002. Anytime on or after April 3, 2003, Participants could transfer to another Investment Fund the portion of their Pre-tax Contributions invested in the Williams-Sonoma, Inc. Stock Fund as of March 31, 2003. Anytime on or after July 3, 2003, Participants could transfer to another Investment Fund the portion of their Pre-tax Contributions invested in the Williams-Sonoma, Inc. Stock Fund as of June 30, 2003. Except as otherwise provided in this paragraph, for pay periods that began on or before August 1, 2003 Participants could not transfer any amounts from the Williams-Sonoma, Inc. Stock Fund to the Plan's other Investment Funds.

4.2 Investment Elections.

Investment Elections shall specify separately how (i) the Participant's existing Account, and (ii) the Participant's new contributions shall be invested in the available Investment Funds. The investment of a Participant's existing account is also referred to in the Plan as a "reinvestment election" or "reallocation election." Separate Investment Elections also are permitted for Rollover Contributions.

(a) 1% Increments. An Investment Election with respect to new contributions to the Plan shall be made in increments of 1% (or such other percentage as the Plan Administrator shall determine from time to time). An Investment Election to reallocate amounts already in a Participant's Account shall also be made in increments of 1% (or such other percentage that the Plan Administrator shall determine from time to time).

(b) Procedural Requirements. Participants may make or change their Investment Elections by contacting the Participant Response System and following the requirements of the Participant Response System for making or changing Investment Elections. A Participant's change in Investment Election shall be effective with respect to new contributions only, unless the Participant also makes a new Investment Election with respect to amounts already in his or her Account.

(c) Timing. A Participant's initial or changed Investment Election shall be effective as soon as administratively practicable on or following the date the Plan receives the Participant's Investment Election.

(d) Default Investment Fund. Subject to Section 4.1(a)(i) (regarding investment of matching contributions prior to November 1, 2005), any amounts credited to an Account for which no Investment Election has been received may either be invested in a default Investment Fund chosen by the Plan Administrator for such purpose, or returned to the Participant, pursuant to rules adopted by the Plan Administrator from time to time. In its discretion, the Plan Administrator may adopt rules from time to time intended to avoid amounts becoming subject to default investment in accordance with this subsection.

(e) Participant Responsible for Selection of Investment Funds. Each Participant is solely responsible for his or her selection of Investment Funds and transfers among the available Investment Funds. Neither the Trustee, the Plan Administrator, the Company, the Employer, any of the officers or supervisors of the Employer or the Company, nor any Fiduciary is empowered or authorized to advise a Participant regarding the Participant's Investment Election, and such individuals and entities shall have no liability for any loss or diminution in value resulting from the Participant's exercise of such investment responsibility. The fact that an Investment Fund is offered under the Plan shall not be construed as a recommendation that Participants invest in such Investment Fund.

(f) Rule 16b-3(f) Compliance. To the extent necessary to ensure compliance with Rule 16b-3(f) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), the Company may arrange for tracking of any transaction defined in Rule 16b-3(b)(1) of the Exchange Act involving the Williams-Sonoma, Inc. Stock Fund, and the Company may bar any such transaction to the extent it would not be exempt under Rule 16b-3(f) of the Exchange Act. To the extent the Company exercises its authority to bar a transaction under this subsection, the provisions of this subsection shall apply notwithstanding the provisions of subsection (e).

(g) Blackout Periods. Effective January 26, 2003, the Plan will comply with § 306 of the Sarbanes-Oxley Act of 2002 which in part requires the Plan to give advance notice of "blackout periods" (as defined in Department of Labor regulation § 2520.101-3(d)(1)) to affected Participants and Beneficiaries (*i.e.*, to Participants and Beneficiaries whose rights under the Plan to direct or diversify assets credited to their Accounts, to obtain loans from the Plan, or to obtain distributions from the Plan are suspended, limited or restricted by the blackout period).

   (i) The Company (with the consent of the Trustee) is authorized to impose blackout periods pursuant to this subsection (g) whenever the Company determines that circumstances warrant.

(ii) In addition, the Company imposes quarterly blackout periods on insider trading in the Williams-Sonoma, Inc. Stock Fund as needed (as determined by the Company), timed to coincide with the release of the Company's quarterly earnings reports. The commencement and termination of these blackout periods in each quarter, the parties to which they apply and the activities they restrict shall be as set forth in the official insider trading policy promulgated by the Company from time to time. These quarterly blackouts are "regularly scheduled" within the meaning of Department of Labor regulation § 2520.101-3(d)(1)(ii)(B).

4.3 Investment Funds Other Than the Williams-Sonoma, Inc. Stock Fund.

This Section 4.3 applies to Plan Investment Funds other than the Williams-Sonoma, Inc. Stock Fund. The rules governing the Williams-Sonoma, Inc. Stock Fund are set forth in Section 4.4.

(a) In General. As of the Effective Date, the Plan Administrator selected specific Investment Funds that were made available to Participants. From time to time after the Effective Date, in accordance with the investment policies and objectives established by the Plan Administrator, the Plan Administrator may add, cease offering or make changes in the operation and management of any of these Investment Funds at any time, and the Plan Administrator shall have the authority to specify rules and procedures as to how Investment Elections shall be adjusted to reflect the addition, deletion or change in the Investment Funds offered under the Plan. Pending allocation to the Investment Funds, contributions to the Plan may be held uninvested or may, on an interim basis, be invested, in whole or in part, in cash or cash equivalents. Except as otherwise provided herein (or in rules adopted by the Plan Administrator from time to time), dividends, interest, and other distributions received on the assets held by the Trustee in respect of any Investment Fund shall be reinvested in the respective Investment Fund.

(b) Maintaining Liquidity. For the purpose of providing liquidity in certain Investment Funds, the Trustee may invest a portion of each such Investment Fund in cash or short-term securities. If the liquid assets held by these Investment Funds are insufficient to satisfy the immediate demand for liquidity under the Plan, the Trustee, in consultation with the Plan Administrator, may temporarily limit or suspend transfers of any type (including withdrawals and distributions) to or from any affected Investment Fund. In any such case, the Plan Administrator shall temporarily change the Plan's valuation cycle (pursuant to Section 3.10) or, in its discretion, the valuation cycle for a specific Investment Fund. During this period, contributions to any affected Investment Fund may be redirected to any default Investment Fund chosen by the Trustee for such purpose and instructions and transfers may be pended.

4.4 Williams-Sonoma, Inc. Stock Fund.

This Section 4.4 governs the Williams-Sonoma, Inc. Stock Fund.

(a) Required Investment Option. The Williams-Sonoma, Inc. Stock Fund is required to be available to Participants as an Investment Fund pursuant to the terms of the Plan. No provision of the Plan is to be construed to confer discretion or authority in the Trustee or any Fiduciary to remove the Williams-Sonoma, Inc. Stock Fund as an Investment Fund or to limit Participants' access to invest therein.

(b) Investment in Company Stock. The Williams-Sonoma, Inc. Stock Fund shall be invested primarily in Company Stock. The Trustee shall direct the investment of a portion of the Williams-Sonoma, Inc. Stock Fund into cash or short-term securities to the extent necessary to maintain a level of liquidity that is reasonably expected to permit trades into and out of the fund.

(c) Unit Accounting. A Participant's interest in the Williams-Sonoma, Inc. Stock Fund shall be based on the ratio of his or her own investment in the Williams-Sonoma, Inc. Stock Fund to the aggregate investment of all Participants in the Williams-Sonoma, Inc. Stock Fund, and shall be denominated in whole and fractional "units." The value of a unit will fluctuate in response to various factors, including Williams-Sonoma, Inc. Stock Fund earnings, losses and expenses. Shares of Company Stock held in the Williams-Sonoma, Inc. Stock Fund and dividends and other distributions on Company Stock are not specifically allocated to Participant Accounts.

(d) Voting and Tender Rights. Shares of Company Stock held by the Williams-Sonoma, Inc. Stock Fund will be voted (or tendered, in the event a tender or exchange offer is made with respect to Company Stock) as follows:

(i) Effective for votes (or tenders) on or after November 1, 2005, the Trustee shall determine the number of units of the Williams-Sonoma, Inc. Stock Fund allocated to each Participant's Account and, in turn, determine the number of Fund shares of Company Stock that pertain to these units. The Trustee shall then solicit Participants' instructions as to how such Company Stock shall be voted (or tendered) and shall vote such Company Stock in accordance with each such instruction (or tender to the extent instructed to do so). The Trustee shall not vote (or tender) any Company Stock for which it does not receive such voting (or affirmative tender) instructions. The Trustee shall maintain the confidentiality of instructions received from Participants related to the vote (or tender) of Company Stock.

(ii) Prior to November 1, 2005, the Committee instructed the Trustee how to vote (or tender) shares of Company Stock represented by units of the Williams-Sonoma, Inc. Stock Fund.

(e) Dividends and Other Adjustments to the Williams-Sonoma, Inc. Stock Fund. The receipt of dividends or other distributions on Company Stock by the Williams-Sonoma, Inc. Stock Fund shall have no effect on the number of units in the Williams-Sonoma, Inc. Stock Fund, and shall be subject to the following provisions.

(i) All cash dividends on shares of Company Stock in the Williams-Sonoma, Inc. Stock Fund shall be credited to the Williams-Sonoma, Inc. Stock Fund and shall be used to purchase additional shares of Company Stock or to meet reasonable liquidity demands.

(ii) Any Company Stock received by the Trustee as a stock dividend or stock split, or as the result of a reorganization or other recapitalization, shall be credited to the Williams-Sonoma, Inc. Stock Fund.

(iii) Any other property (other than cash or shares of Company Stock) received by the Trustee (e.g., shares of stock in another company) shall be credited to the Williams-Sonoma, Inc. Stock Fund. Such other property shall be sold by the Trustee and the proceeds used to purchase additional shares of Company Stock or to meet reasonable liquidity demands. In the event of a significant distribution of such other property, the Plan Administrator may implement special arrangements for the holding or disposition of such other property by the Plan. Any rights to subscribe to additional shares of Company Stock shall be sold by the Trustee and the proceeds credited to the Williams-Sonoma, Inc. Stock Fund.

(f) Purchase and Sale of Company Stock. Shares of Company Stock shall be purchased or sold for the Williams-Sonoma, Inc. Stock Fund in the open market or in privately negotiated transactions. In the unusual event that the Williams-Sonoma, Inc. Stock Fund is acquiring or liquidating a block of stock that is so large that its purchase or sale, in the ordinary course, is expected to disrupt an orderly market in Company Stock, the Trustee (or its designated agent) may limit the daily volume of purchases and sales of Company Stock by the Williams-Sonoma, Inc. Stock Fund to the extent necessary to preserve an orderly market.

(g) Eligible Individual Account Plan. The Trustee is authorized to invest and hold up to 100% of the assets of the Trust in the Williams-Sonoma, Inc. Stock Fund. Shares of Company Stock in the Williams-Sonoma, Inc. Stock Fund are "qualifying securities" as that term is defined in ERISA. Accordingly, this Plan is an "eligible individual account plan" as defined in ERISA § 407(d)(3). The Trustee may purchase Company Stock from the Employer or any other source, and such Company Stock purchased by the Trustee may be outstanding, newly issued, or treasury shares. Notwithstanding the foregoing, any purchase by the Trustee of any shares of Company Stock from any "party in interest" as defined in ERISA § 3(14), or from any "disqualified person" as defined in Code § 4975(e)(2), shall not be made at a price that exceeds "adequate consideration" as defined in ERISA § 3(18) and no commissions shall be paid with Plan assets on such purchase. The Trustee and all Plan fiduciaries are expressly excused from the requirements of diversification as to the investment of the Trust in the Williams-Sonoma, Inc. Stock Fund.

4.5 Investment of Loan Repayments and Restoration of Forfeitures.

Any loan repayments shall be invested in the Investment Funds that have been selected by the Participant for new contributions as in effect on the date such repayments are received. Any repayments in connection with forfeiture restorations under Section 5.5 shall be invested as specified in the Participant's Investment Election described in such Section. If because of special circumstances a Participant's investment cannot be carried out in accordance with the two preceding sentences, Section 4.2(d) (default Investment Fund) shall govern.

ARTICLE V – VESTING

5.1 Pre-tax Contributions, Rollover Contributions.

A Participant shall be at all times 100% vested in amounts credited to his or her Pre-tax Contributions Account, Age 50 Catch-up Contributions Account and Rollover Contributions Account.

5.2 Matching Contributions and Profit Sharing Contributions.

(a) Vesting Schedule. Subject to subsection (b) below, Matching Contributions and Profit Sharing Contributions shall become vested in accordance with the following schedule:

Years of Vesting Service	Vested Percentage
Less than 1	0%
At least 1 but less than 2	20%
At least 2 but less than 3	40%
At least 3 but less than 4	60%
At least 4 but less than 5	80%
5 or more	100%

(b) Vesting Schedule For Participants who Terminate Before August 18, 1997. Subject to subsection (c) below, in the case of Matching Contributions and Profit Sharing Contributions earned by Participants whose employment with an Employer terminated before August 18, 1997, such amounts shall become vested in accordance with the following schedule:

Years of Vesting Service	Vested Percentage
Less than 2	0%
At least 2 but less than 3	20%
At least 3 but less than 4	60%
At least 4 but less than 5	80%
At least 5 but less than 6	80%
6 or more	100%

(c) 100% Vesting Provisions. Notwithstanding anything in this Section 5.2 to the contrary, a Participant shall become 100% vested in his or her Matching Contributions Account and Profit Sharing Account upon the Participant's death, Disability, or attainment of Normal Retirement Age while the Participant is an Associate.

5.3 Forfeitures.

(a) If a Participant Separates from Service prior to the time he or she is 100% vested in his or her Account, the non-vested portion of the Participant's Account shall be forfeited upon the earlier of:

(i) The Participant's incurring a Period of Severance that lasts at least 60 consecutive months, or

(ii) The distribution from the Plan of the vested portion of the Participant's Account on Separation from Service.

For purposes of this Section, a Participant who Separates from Service at a time when he or she has no vested portion shall be deemed to receive a distribution of his or her vested portion on Separation from Service.

5.4 Allocation of Forfeitures.

Any amounts forfeited under Section 5.3 shall be used to pay any administrative expenses of the Plan, restore any forfeitures required pursuant to Section 5.5, and offset future Employer contributions to the Plan.

5.5 Restoration of Forfeited Account.

(a) In the case of a Participant or former Participant who receives (or is deemed to receive) a distribution of the vested portion of his or her Account and who again becomes an Eligible Associate before incurring a Period of Severance that lasts at least 60 consecutive months, the forfeited amount shall be restored to such Participant's Account (without regard to any gains and losses).

(b) The Plan Administrator shall restore the forfeited portion of a Participant's Account from the amount of forfeitures available under the Plan. To the extent the amount of available forfeitures is insufficient to enable the Plan Administrator to make the required restoration, the Employer must contribute, without regard to any requirement or condition of Articles XIII through XVI, the additional amount necessary to enable the Plan Administrator to make the required restoration.

(c) If a Participant does not make an Investment Election and does not have an Investment Election in effect, then Section 4.2 (e) (default Investment Fund) shall govern.

(d) The Participant is responsible for notifying the Plan Administrator of his or her forfeited Account balance and his or her pre-break Years of Vesting Service.

(e) If the Participant's Period of Severance lasts at least 60 consecutive months, the forfeited amount shall not be restored.

5.6 Vesting After a Break in Service.

If a Participant has a Separation from Service prior to the time he or she is 100% vested in his or her Account and again becomes an Eligible Associate without incurring a Period of Severance that lasts at least 60 continuous months, such Associate's post-break Years of Vesting Service shall be taken into account for purposes of determining his or her vested percentage in his or her: (i) restored Account balance, if such Associate's Account is restored in accordance with Section 5.5, or (ii) existing Account balance, if no distributions have been made.

5.7 Retention of Pre-Break Service.

All Years of Vesting Service before a Period of Severance shall be taken into account for purposes of vesting in post-break Employer contributions except as provided in the next sentence. Effective in the case of Participants who are nonvested at the time a Period of Severance begins and who terminate before August 1, 2003 following the Period of Severance, Years of Vesting Service before the Period of Severance shall not be taken into account if the Period of Severance lasts 60 consecutive months or longer and if it equals or exceeds the aggregate number of Years of Vesting Service before the Period of Severance. For this purpose, a nonvested Participant is a Participant who does not have any nonforfeitable right under the Plan to an Account. In all cases, the Associate must notify the Company of his or her pre-break Service to make sure the Associate is properly credited with all Service to which he or she is entitled.

ARTICLE VI - IN-SERVICE WITHDRAWALS

Except as otherwise provided in this Article VI, a Participant may not take a withdrawal while an Associate of the Company's Controlled Group.

6.1 Withdrawals After Attaining Age 59 1/2.

A Participant may take a withdrawal from his or her vested interest in his or her Account at any time and for any reason after reaching age 59 1/2.

6.2 Hardship Withdrawals.

A Participant who is an Associate of the Company's Controlled Group may receive a hardship withdrawal of all or a portion of his or her Pre-tax Contributions Account (but not the earnings thereon), Age-50 Catch-up Contributions Account (but not the earnings thereon) and Rollover Contributions Account (including the earnings thereon); provided such Participant furnishes proof, satisfactory to the Plan Administrator, that the withdrawal is necessary to alleviate an immediate and heavy financial need (as determined in accordance with subsection (b) below) and that the amount of the withdrawal does not exceed the amount necessary to satisfy such financial need (as determined in accordance with subsection (c) below).

(a) Administrative Rules. The determination by the Plan Administrator of the existence of an immediate and heavy financial need and of the amount necessary to meet such need shall be made in a nondiscriminatory and uniform manner. The Plan Administrator shall not allow a hardship withdrawal to be made to a Participant unless the requirements of this Section are satisfied. No Participant may take more than one hardship withdrawal in any Plan Year, or any hardship withdrawal in an amount less than $500. Hardship withdrawals are made only in the form of a single lump sum cash distribution.

(b) Immediate and Heavy Financial Need. Subject to subsection (c), a Participant shall be deemed to have an immediate and heavy financial need if the Participant needs the hardship withdrawal for one of the following reasons:

(i) Medical expenses described in Code § 213(d) which are incurred by the Participant, the Participant's Spouse or dependents (as defined in Code § 152), or necessary for such persons to obtain medical care described in Code § 213 (d);

(ii) Effective September 16, 1997, costs directly related to the purchase of a principal residence for the Participant (excluding mortgage payments);

(iii) Effective September 16, 1997, payment of tuition and related educational fees for the next 12 months of post-secondary education for the Participant or for the Participant's Spouse or dependents (as defined in Code § 152);

(iv) Payments necessary to prevent the eviction of the Participant from his or her principal residence or to prevent foreclosure on the mortgage of the Participant's principal residence; or

(v) Effective September 16, 1997, any need prescribed by the Internal Revenue Service in a revenue ruling, notice or other document of general applicability which satisfies the Internal Revenue Service's safe harbor definition of hardship.

Notwithstanding the foregoing, a financial need shall not fail to qualify as immediate and heavy merely because such need was reasonably foreseeable or voluntarily incurred by the Participant.

(c) Distribution Necessary to Satisfy the Need. A distribution will be considered as necessary to satisfy an immediate and heavy financial need of the Participant only if all of the following are true:

(i) The Participant has: (A) obtained all distributions (other than hardship distributions), including the total amount available for withdrawal under Section 6.1 (withdrawals after age 59 1/2), and (B) has also taken all nontaxable loans, under all plans maintained by the Employer.

(ii) The Participant must certify in writing to the Plan Administrator that the immediate and heavy financial need (including amounts necessary to pay any federal, state or local income taxes or penalties reasonably anticipated to result from the distribution) cannot reasonably be relieved: (A) through reimbursement or compensation by insurance or otherwise, (B) by liquidation of the Participant's assets, (C) by cessation of Pre-tax Contributions, (D) by other distributions or nontaxable (at the time of the loan) plan loans from this Plan or other plans maintained by the Employer, or (E) by borrowing from commercial sources on reasonable commercial terms in an amount sufficient to satisfy the need. A need cannot reasonably be relieved if the effect of the action would be to increase the amount of the need.

(iii) A Participant who receives a hardship withdrawal under this Section shall not be permitted to have Pre-tax Contributions made on his or her behalf until 6 months after the hardship distribution is made. Effective for Pre-tax deferrals made in pay periods that began on or before August 1, 2003, "one year" shall replace "6 months"). To resume Pre-Tax Contributions, the Participant must contact the Participant Response System and make a new Contribution Election. This ban on Pre-tax Contributions shall also apply to elective deferrals under any other Employer-sponsored plan.

6.3 In-Service Withdrawal Procedures and Restrictions.

(a) Participants shall request an in-service withdrawal from the Plan by contacting the Participant Response System and submitting a request that complies with guidelines established by the Plan Administrator.

(b) In-service withdrawals shall be distributed as soon as administratively practicable following the date the Plan Administrator: (i) receives a request for an in-service withdrawal referred to in subsection (a) above which meets the Plan Administrator's guidelines regarding form and content, and (ii) determines that the applicable requirements for the withdrawal are met.

(c) All withdrawals shall be paid in a lump sum payment in cash or cash equivalent, except that a Participant who qualifies for an age 59 1/2 distribution under Section 6.1 may elect to take his entire distribution from the Williams-Sonoma, Inc. Stock Fund in whole shares of Company Stock as provided in Section 8.2(c).

(d) In-service withdrawals shall be taken from the Participant's subaccounts in the following order of priority:

(i) Pre-tax Contributions Account;

(ii) Rollover Contributions Account;

(iii) Vested amounts in the Matching Contributions Account,

(iv) Profit Sharing Contribution Account,

(v) Catch-Up Contribution Account,

(vi) Prior 2005 Employee QNEC Account, and

(vii) Prior 2005 Company Special Matching Contribution Account,

(to the extent each such Accounts are available for in-service withdrawal), and shall be taken from the Investment Funds in which such amounts are invested on a pro rata basis.

ARTICLE VII – LOANS

7.1 General Rule

Effective June 1, 2005, an Eligible Associate who is a Full-Time Regular Associate or Part-Time Associate and who is not on a Leave of Absence, may borrow a portion of his or her vested Account, subject to the remainder of this Article VII.

(a) Limited to One Loan. A Participant is not permitted to have more than one loan from the Plan outstanding at any time.

(b) Limitation in the Case of a Prior Defaulted Loan. A Participant who has had a deemed distribution (as would result from a prior defaulted loan) is subject to the restrictions in Section 7.3(c) on taking a new loan from the Plan.

(c) Reasonably Equivalent Basis. Loans shall be made available to all eligible Participants on a reasonably equivalent basis and shall not be made available to IRS Highly Compensated Employees or to shareholders in an amount greater than is made available to other Participants.

(d) Loan Initiation and Promissory Note. To initiate a loan, the Participant must contact the Participant Response System. Each loan shall be evidenced by a written promissory note signed by the Borrower. The promissory note shall be deemed to incorporate the provisions of this Article VII and any administrative rules established by the Plan Administrator.

(e) Historic Provisions. Effective from November 1, 2002 until May 30, 2005, any Eligible Associate who was not on a Leave of Absence was eligible to borrow a portion of his or her vested Account (subject to the other applicable restrictions in this Article). Loans were not available under the Plan before November 1, 2002.

7.2 Amount of Loan.

A loan may be made in an amount (not less than $1,000) which, when added to the outstanding balance of all prior loans (including outstanding interest) to the Borrower under the Plan, does not exceed the lesser of:

(a) $50,000, reduced by the excess, if any, of:

(i) The highest outstanding balance of the Borrower's loans from the Plan during the one-year period ending on the day before the date such loan was made, minus

(ii) The outstanding balance of the Borrower's loans from the Plan on the date on which such loan was made; or

(b) One-half of the present value of the Borrower's non-forfeitable accrued benefit under the Plan.

For purposes of applying the limitation in (a) above, the Plan and all other "qualified employer plans" (as defined in Code § 72 (p)(4)) maintained by an employer within the Company's Controlled Group shall be treated as a single plan, and any loan that has been deemed distributed pursuant to Section 7.6 shall be considered outstanding until it has been repaid (whether by plan loan offset or otherwise). Loans must be taken in an amount that is in an increment of $1 ($100, for loans taken before April 2004), or such other amount as is established by the Plan Administrator for this purpose.

7.3 Interest Rate, Security and Fees.

(a) Interest Rate. Loans shall be made at the "prime rate" plus one percentage point, or such other interest rate as may be designated by the Plan Administrator for this purpose. The prime rate shall be determined as of the date the loan is made (or the first normal business day of the calendar month before such loan is made, for loans taken before April 1, 2004) or such other date as is established by the Plan Administrator for this purpose. The applicable prime rate shall be the rate as announced in the Wall Street Journal (or to the extent the Wall Street Journal ceases to be published, such other newspaper as is selected by the Plan Administrator), or such other rate as is selected by the Plan Administrator for this purpose.

(b) Security. Loans shall be secured by the vested portion of the Borrower's Account. As of immediately after the origination of a loan, no more than 50% of the Participant's vested Account may be used as security for the loan.

(c) Consequences of Deemed Distribution. If a Participant has a loan that is deemed distributed pursuant to Section 7.6 as a result of the failure to make timely payments, then:

(i) Until the Participant has repaid the loan that was deemed distributed (whether by plan loan offset or otherwise):

(A) Effective June 1, 2005, the Participant shall not be eligible to take future loans from this Plan, and

(B) Effective before June 1, 2005, the Plan Administrator shall require any new loan issued to such Participant to include such enhanced security for the Plan as it deems appropriate, determined in light of the prior default (*e.g.*, the Plan Administrator may require payroll deductions for the life of the loan).

(ii) The Plan Administrator shall have the authority to suspend Participants from taking new loans for a period of time after a Participant has had a deemed distribution. The suspension period shall be determined from time to time by the Plan Administrator and shall be uniform and consistent for all Participants.

(d) Loan Fees. The Plan Administrator may charge a loan initiation fee and an ongoing loan maintenance fee that shall be assessed against the Participant's Account, the amount of which shall be subject to change.

(e) Reamortization. A Participant is not permitted to initiate a loan reamortization. The Plan Administrator may authorize a loan reamortization under circumstances to be determined from time to time by the Plan Administrator (*e.g.*, when loan repayments are not started promptly because of administrative error) under rules that shall be uniform and consistent for all Participants.

7.4 Source of Loans.

Amounts borrowed shall be taken from vested amounts in the Borrower's subaccounts in the following order of priority:

(a) Pre-tax Contributions Account;

(b) Rollover Contributions Account;

(c) Matching Contributions Account,

(d) Profit Sharing Contribution Account,

(e) Catch-up Contribution Account,

(f) Prior 2005 Employee QNEC Account, and

(g) Prior 2005 Company Special Matching Contribution Account,

and shall be taken from the Investment Funds in which such amounts are invested on a pro rata basis (except that effective February 20, 2004, to the extent the Participant's right to take a loan from an Investment Fund is suspended, limited or restricted by a blackout period described in Section 4.2(g), amounts in such Investment Fund shall be disregarded for purposes of this pro rata basis rule and shall not be available for borrowing).

7.5 Repayment and Term.

(a) Loan Repayment. Loans shall be amortized in substantially level payments, made not less frequently than quarterly, for a period of not less than 12 months and not more than 5 years; provided, however, that a "principal residence loan" (as defined below) may be amortized over a period not to exceed 15 years, and subject to the special rule for military leave (*see* clause (iii) below).

(i) Principal Residence Loan. A "principal residence loan" means a loan made in accordance with this Section 7.5 to acquire or construct any dwelling unit which, within a reasonable time, will be used as the principal

residence of the Participant (such use to be determined at the time the loan is made). A Participant requesting a principal residence loan shall provide copies of any documents relating to the purchase of such principal residence which the Plan Administrator may deem necessary to verify that the proceeds of such loan will be used to acquire or construct a principal residence.

(ii) Suspension During Leave of Absence. Loan repayments shall be suspended for up to one year for a Participant on a Leave of Absence lasting at least one month (or such other minimum period as shall be established by the Plan Administrator for this purpose) either without pay from the Employer or at a rate of pay (after applicable employment tax withholdings) that is less that the amount of the installment payments required under the terms of the loan, to the extent permitted by applicable Treasury Regulations. In no event shall the suspension period cause the loan to exceed the maximum 5 or 15 year term set forth in subsection (a) above. In the event loan repayments are suspended during a Leave of Absence:

(A) Effective June 1, 2005, when the suspension of loan repayments ends, the Participant's remaining loan payments shall be recalculated in substantially level payments automatically by the Plan Administrator or recordkeeper as follows: Any unpaid interest that accrued during the Leave of Absence shall be incorporated into the principal balance that is owed, the original term of the loan shall be extended by the length of the Leave of Absence (but in no event shall the total term, including the extension, exceed the maximum 5 or 15 year term set forth in subsection (a) above), and the original interest rate shall be retained. In the case of loans issued before June 1, 2005, Participants shall have the option of making payments at the original dollar payment level and then making a balloon payment to repay any remaining balance due at the end of the loan's term, instead of having the automatic loan recalculation described above.

(B) Effective for periods before June 1, 2005, the loan, including interest that accrues during such Leave of Absence, must be repaid by the latest permissible term of the loan and the amount of the installments due after the Leave of Absence ends must not be less than the amount required under the terms of the original loan.

(C) Effective April 1, 2004, during the period of the Leave of Absence, interest shall accrue during the Leave of Absence at the rate determined by the Plan Administrator for this purpose, applying reasonable commercial principles and with the object of providing adequate protection for the Plan's interest based on all the facts and circumstances.

See clause (iii) below for special rules governing military leave.

(iii) Suspension During Military Leave. Loan repayments shall be suspended for a Participant on military leave as permitted under Code § 414(u)(4), even if such suspension exceeds the maximum 5 or 15 year term provided for in Section 7.5(a). Such suspended loan repayments shall, upon the Participant's completion of the military leave, resume under the following rules:

(A) Effective June 1, 2005, the rules that apply to repayment of loans following a Leave of Absence shall apply to a suspension during military leave (including the automatic recalculation of loan repayments), except as otherwise provided in this Article. The suspension period can cause the loan to exceed the maximum 5 or 15 year term set forth in subsection (a) above. The total loan term shall be extended on rehire up to a period that is equal to (I) the original term of the loan, *plus* (II) the period of military leave (even if such term exceeds the maximum 5 or 15 year term provided for in Section 7.5(a)).

(B) The interest rate shall be capped at 6% during the period in which a Participant is on military leave to the extent required under Section 207 of the Servicemembers Civil Relief Act of 2003 (taking into account any fees referred to in (d) below).

(C) Effective for periods before June 1, 2005, the frequency of the installment payments and the amount of each installment payment shall not be less than the frequency and amount of the installments required under the terms of the original loan before entering military service. The loan must be repaid in full, including interest that accrues during the period of military service, not later than the end of the period that is equal to the greater of the maximum 5 or 15 year period, or: (A) the original term of the loan, *plus* (B) the period of military service.

(b) Payroll Deduction and Direct Payment. Loans shall be repaid by means of payroll deduction from the Borrower's earnings, starting promptly following the processing of the loan, subject to paragraph (ii) below. If payroll deductions for the loan payments do not start promptly following the processing of the loan, the Participant is responsible to notify the Plan Administrator.

(i) Loan repayment shall be made in accordance with the terms and procedures established by the Plan Administrator from time to time and applied on a uniform, nondiscriminatory basis.

(ii) Effective June 1, 2005, a Participant shall make loan repayments by direct payment (rather than payroll withholding) if the Participant:

(A) Is a Temporary Associate,

(B) Is a Casual Associate, or

(C) Falls more than one month behind in payments (or such other minimum period as shall be established by the Plan Administrator for this purpose) for any reason (including not receiving sufficient earnings to cover the loan payment by payroll withholding, *e.g.*, as might happen if the Participant shifts to a reduced-hours schedule so that the Participant's earnings are insufficient to cover the loan payment). This does not apply to a suspension during a Leave of Absence provided for in (a)(ii) above or during military leave provided for in (a)(iii) above.

If loan repayments are made by direct repayment, they shall be made pursuant to the terms and procedures established by the Plan Administrator and applied on a uniform, nondiscriminatory basis. Once a Participant begins making loan repayments by direct payment under this Section, the Participant will not be eligible to resume repayment by payroll deduction. (Participants returning from a Leave of Absence or military leave shall be eligible to resume payroll withholding unless they are otherwise described in this subsection (b)(ii).) Effective for periods before June 1, 2005, a Participant shall make loan repayments by direct payment (rather than payroll withholding) if the Participant is not receiving sufficient earnings to cover the loan payment and does not correct the missed payment by the end of the calendar quarter in which the missed payment occurs.

(c) Prepayment. A Participant may repay an outstanding loan in full at any time without penalty.

(d) Loan Due on Termination of Employment. In the event a Participant terminates employment with the Company, the entire loan (both outstanding principal and interest) is due and payable immediately (subject to the cure period in Section 7.6(c)).

7.6 Deemed Distributions.

(a) General Rule. Effective June 1, 2005, if the Plan Administrator determines that a Borrower's loan repayments are in arrears, then the amount of such loan (plus any accrued interest) shall be deemed distributed as of the end of the cure period described in subsection (c) below, if the arrearage has not been corrected by that time. The value of the Borrower's Account shall be offset and reduced to reflect the deemed distribution as of the later of date of the deemed distribution, or the date the Participant Separates from Service, Retires, dies or becomes disabled. If a loan is deemed to be distributed, additional interest shall continue to accrue following the deemed distribution date on the portion of the loan that is not repaid as of that date. This additional interest shall not be considered an additional deemed distribution, but it shall be taken into account in determining the amount of the Participant's outstanding indebtedness to the Plan.

(b) Cure Period. The failure to make any loan payment when otherwise due in accordance with the terms of the loan shall not result in a deemed distribution under subsection (a) if such loan payment is otherwise made by the last day of the calendar quarter following the calendar quarter in which the loan payment was due (the "cure period"). The determination of when a deemed distribution occurs under subsection (a) shall be made by the Plan Administrator applying reasonable commercial principles and with the object of providing adequate protection for the Plan's interest based on all the facts and circumstances.

(c) Administrative Provisions. The provisions of this Section and Section 7.1(b) reflect how Plan loans are intended to be administered for purposes of determining their taxability under the Code. These provisions are not requirements for purposes of the prohibited transaction rules of the Code and ERISA or for purposes of the qualification rules of the Code.

7.7 Additional Rules.

The Plan Administrator may establish rules and procedures regarding loans to Participants which may be more restrictive than the rules and procedures set forth in this Article VII. Any such rules and procedures must be in writing and be applied on a uniform, nondiscriminatory basis. In addition, they shall be deemed to be a part of the Plan for purposes of the loan regulations issued by the Department of Labor.

ARTICLE VIII – DISTRIBUTIONS

8.1 Eligibility for Distribution Upon Separation From Service or Disability.

A Participant who Separates from Service or suffers a Disability shall be entitled to receive a distribution of the vested portion of his or her Account.

8.2 Form of Payment.

Distributions shall be in one lump sum payment, except that a Participant who is required to commence distributions under Section 8.6(d) (distributions at age 70 1/2) may instead elect to receive installment payments in the amount of the minimum required distributions provided for therein.

(a) The Participant may elect to defer receipt of the distribution until the April 1st following the calendar year he or she attains age 70 1/2, subject to the cashout rules in Section 8.4.

(b) All distributions shall be in cash or cash equivalent, except as provided in subsection (b).

(c) A Participant receiving a lump sum distribution under this Article VIII (other than a distribution subject to the cashout rules of Section 8.4) or a withdrawal under Section 6.1 (withdrawals after attaining age 59 1/2), may elect to receive his or her entire interest in the Williams-Sonoma, Inc. Stock Fund in whole shares of Company Stock (but with cash or cash equivalent paid for any fractional shares, uninvested cash or amounts invested for liquidity purposes). For such an election to be effective, the Participant must make this election in the manner and form specified by the Plan Administrator from time to time.

8.3 Amount of Distribution.

The amount of any distribution that is based on the value of a Participant's Account, or a portion thereof, shall be determined with reference to the value of such Account (or portion thereof) as of the time the payment of the distribution is processed.

8.4 Cashout Distributions and Automatic Rollovers.

If the vested portion of the Account of a Participant who has a Separation from Service does not exceed $5,000 ($3,500 for periods before January 1, 2003), excluding Rollover Contributions, ("small dollar cashout") on the date payment of the distribution is processed, or on a determination date established by the Plan Administrator in each calendar quarter thereafter, the Participant's Account shall be distributed in a lump sum "cashout distribution" to the Participant as soon as administratively practical thereafter. Effective March 28, 2005, in the event of a mandatory distribution greater than $1,000 in accordance with the provisions of this Section 8.4, if the Participant or Beneficiary does not elect to have such distribution paid directly to an Eligible Retirement Plan specified

by the Participant in a direct rollover or to receive the distribution directly in accordance with this Section 8.4 and Section 8.7, then the Plan Administrator will pay the distribution in a direct rollover to an individual retirement plan designated by the Plan Administrator. Pursuant to Q&A 9 of IRS Notice 2005-5, the Plan may delay processing such mandatory distributions due to a lack of sufficient administrative procedures for automatic rollovers, provided the mandatory distributions are made on or before December 31, 2005.

8.5 Distribution Upon Death.

(a) Death Before Distributions Commence. Except as otherwise provided in paragraph (i) (optional deferral of distribution commencement), if a Participant dies before distributions begin from his or her Account, 100% of the Participant's Account shall be paid to his or her Beneficiary in one lump sum following notice to the Plan Administrator of the Participant's death. For this purpose, distributions are considered to begin no later than the Participant's Required Beginning Date.

(i) Optional Deferral of Distribution Commencement. The Participant's Beneficiary may elect to defer receipt of the lump sum distribution until the fifth-anniversary of the Participant's death (subject to subparagraph (A) (applicable rules), subparagraph (B) (surviving spouse rules), Section 8.4 (cashout rules) and the rules in Code § 401(a)(9).

(A) Applicable Rules. Such deferral election must be made within 30 days of when the Plan notifies the Beneficiary that he or she is recognized as a Beneficiary (or such later time as the Plan Administrator shall prescribe). The Beneficiary may revoke the deferral election at any time and elect in lieu thereof to receive an immediate lump sum distribution of the balance in the Participant's Account.

(B) Additional Deferral Option for Surviving Spouse. If the Surviving Spouse is the sole Beneficiary, the Surviving Spouse may elect to defer distribution of the lump sum distribution until the April 1st following the date the Participant would have attained age 70 1/2. A Surviving Spouse who makes such a deferral election shall be eligible to revoke such election at any time and in lieu thereof receive a lump sum distribution of the balance of the Participant's Account.

(C) Death of Surviving Spouse Before Distributions Begin. If the Participant's Surviving Spouse is the Participant's sole Beneficiary and the Surviving Spouse dies after the Participant but before distributions begin to either the Participant or the Surviving Spouse, the fifth-anniversary election will apply as if the Surviving Spouse were the Participant. For this purpose, distributions are considered to begin on the date distributions are required to begin

to the Surviving Spouse under paragraph (B) (which allows the Surviving Spouse to defer until the Participant would have attained age 70 1/2).

(b) Death After Distributions Commence. If a Participant dies after distribution of his or her Account has commenced in the form of installment payments (*i.e.*, pursuant to Section 8.6(d), Code section 401(a)(9) distributions), the remaining portion of such Participant's Account shall be distributed to the Participant's Beneficiary in a lump sum. Payment of this lump sum cannot be deferred.

(c) Proof of Death. The Plan Administrator may require and rely upon such proof of death and such evidence of the right of any Beneficiary or other person to receive the value of a deceased Participant's Account as the Plan Administrator may deem proper and its determination of death and of the right of that Beneficiary or other person to receive payment shall be conclusive.

(d) Cashout Distributions and Automatic Rollovers. Rules similar to the rules in Section 8.4 (Cashout Distributions and Automatic Rollovers) shall apply in the case of any Beneficiary of a deceased Participant for whom the vested portion of the Participant's Account does not exceed the small dollar cashout amount described in such Section, pursuant to rules established by the Plan Administrator for this purpose.

(e) Definitions. For purposes of this Section 8.5, the definitions of Distribution Calendar Year, Life Expectancy, Participant's Account Balance, and Required Beginning Date in Section 8.6(d) apply.

8.6 Commencement of Payments.

(a) General Time of Commencement. Subject to the remaining provisions of this Section, following a Participant's Separation from Service, the distribution of the Participant's Account shall commence as soon as practicable after the earlier of:

(i) The receipt of a distribution request from the Participant (or his or her Beneficiary, in the case of a distribution at death) that meets all the requirements applied by the Plan Administrator (including any requirement for Participant consent applicable under subsection (b)); or

(ii) In the case of a distribution that is made pursuant to the cashout rules of Section 8.4, as soon as practicable following the Participant's Separation from Service or the applicable quarterly review date applicable thereunder.

Participants may request a distribution by contacting the Participant Response System and submitting a request that complies with guidelines established by the Plan Administrator. If a Participant has a Separation from Service and again becomes an Associate prior to the date the distribution is deemed to be processed by the Plan's current recordkeeper, the Participant shall not receive a distribution.

(b) Participant Consent.

(i) Participant consent is a pre-condition for commencing distributions unless the distribution is made: (A) pursuant to the cashout rules of Section 8.4, (B) in connection with a Participant's death, or (C) pursuant to the Code § 401(a)(9) requirements of subsection (d) below

(ii) Except as provided in paragraph (iii) below, a Participant's consent to receive a distribution shall not be valid unless the Participant gives consent: (A) after the Participant has received the notice required under Treas. Reg. § 1.411(a)-11(c), and (B) within a reasonable time before the effective date of the commencement of the distribution as prescribed by such regulations. A Participant's consent shall be in writing or, if authorized by the Plan Administrator, provided through an electronic medium that meets the requirements of Treas. Reg. § 1.411(a)-11(f).

(iii) Once a Participant or Beneficiary has made an appropriate distribution request through the Participant Response System and the Plan Administrator has received notice of the Participant's death (if applicable), such distribution may commence less than 30 days after the notice required under Treas. Reg. § 1.411(a)-11(c) is given, provided that: (A) the Plan Administrator clearly informs the Participant that he or she has a right to a period of at least 30 days after receiving the notice to consider the decision of whether or not to elect a distribution (and, if applicable, a particular distribution option), and (B) the Participant, after receiving the notice, affirmatively elects a distribution.

(c) Code § 401(a)(14) Provisions: In the case of a Participant who has filed a claim to commence benefits in accordance with applicable regulations under Code § 401(a)(14), including Treas. Reg. § 1.401(a)-14(a) thereof, distribution of the Participant's interest in the Plan shall commence no later than the 60th day after the close of the latest of the following:

(i) The Plan Year in which the Participant attains age 65,

(ii) The Plan Year in which occurs the tenth anniversary of the date his participation commenced, or

(iii) The Plan Year in which occurs the Participant's Separation from Service.

(d) Code § 401(a)(9) Provisions.

(i) General Rule. A Participant must begin receiving distributions from his or her Account no later than the April 1st following the later of the calendar year in which the Participant attains age 70 1/2 or has a Separation from Service. Minimum required distributions will be determined under this subsection (d) beginning with the first Distribution Calendar Year and up to and including the Distribution Calendar Year that includes the Participant's date of death.

(ii) Exception for 5-Percent Owners. Notwithstanding paragraph (i) above, in the case of a Participant who is a "5-percent owner" within the meaning of Code § 401(a)(9(C)(ii)(I), the Required Beginning Date is the April 1 following the calendar year in which the Participant attains age 70 1/2.

(iii) Suspension of In-Service Distributions That Commenced Pre-1997. In the event a Participant is receiving payments while in service with the Company's Controlled Group because distributions commenced in accordance with the pre-1997 provisions of Code § 401(a)(9), other than a 5-Percent Owner described in paragraph (ii) above, the Participant may elect to suspend payments while he or she remains in service in accordance with such uniform rules as the Plan Administrator shall adopt.

(iv) Minimum Required Distributions. Effective January 1, 2003, if a Participant who has attained age 70 1/2 elects to commence receipt of his or her Account in periodic installments, the Plan Administrator shall direct the Trustee to distribute to the Participant the lesser of:

(A) The quotient obtained by dividing the Participant's Account Balance by the distribution period in the Uniform Lifetime Table set forth in Treasury Regulation § 1.401(a)(9)-9, using the Participant's age as of the Participant's birthday in the Distribution Calendar Year; or

(B) If the Participant's sole designated Beneficiary for the Distribution Calendar Year is the Participant's Spouse, the quotient obtained by dividing the Participant's Account Balance by the number in the Joint and Last Survivor Table set forth in Treasury Regulation § 1.401(a)(9)-9, using the Participant's and Spouse's attained ages as of the Participant's and Spouse's birthdays in the Distribution Calendar Year.

Effective before January 1, 2003, the calculation of the minimum required distributions shall be determined pursuant to applicable Internal Revenue Service proposed regulations.

(v) Applicable IRS Regulations.

(A) Post-2002 Calculations. With respect to Participant distributions under the Plan calculated after December 31, 2002 (regardless of the calendar year to which the distribution applies), the Plan will apply the minimum distribution requirements of Code § 401(a)(9) in accordance with the final regulations under Code § 401(a)(9) issued in 2002, notwithstanding any provision of the Plan to the contrary.

(B) 2002 Calculations. With respect to Participant distributions under the Plan calculated in the 2002 Plan Year (regardless of the calendar year to which the distribution applies), the Plan will apply the minimum distribution requirements of Code § 401(a)(9) in accordance with the regulations under Code § 401(a)(9) that were proposed on January 17, 2001, notwithstanding any provision of the Plan to the contrary.

(C) Pre-2002 Calculations. With respect to Participant distributions under the Plan calculated before January 1, 2002, (regardless of the calendar year to which the distribution applies), the Plan will apply the minimum distribution requirements of Code § 401(a)(9) in accordance with the proposed regulations under Code § 401 (a)(9) as indicated in Section 8.6(d)(iv) (applicable IRS regulations), notwithstanding any provision of the Plan to the contrary.

(vi) Definitions. The following definitions apply for purposes of this Section 8.6.

(A) Distribution Calendar Year. A calendar year for which a minimum distribution is required. For distributions beginning before the Participant's death, the first Distribution Calendar Year is the calendar year immediately preceding the calendar year which contains the Participant's Required Beginning Date. For distributions beginning after the Participant's death, the first Distribution Calendar Year is the calendar year in which distributions are required to begin under Section 8.5(a) (death before distributions commence) above. The required minimum distribution for the participant's first Distribution Calendar Year will be made on or before the Participant's Required Beginning Date. The required minimum distribution for other Distribution Calendar Years, including the required minimum distribution for the Distribution Calendar Year in which the Participant's Required Beginning Date occurs, will be made on or before December 31 of that Distribution Calendar Year.

(B) Life Expectancy. Life expectancy as computed by use of the Single Life Table in Treasury regulation § 1.401 (a)(9)-9, or for periods before January 1, 2003, in accordance with the applicable guidance under Code § 401 (a)(9) as indicated in Section 8.6(d)(iv) (applicable IRS regulations), notwithstanding any provision of the Plan to the contrary.

(C) Participant's Account Balance. The Account balance as of the last valuation date in the calendar year immediately preceding the Distribution Calendar Year (valuation calendar year) increased by the amount of any contributions made and allocated or forfeitures allocated to the Account balance as of dates in the valuation

calendar year after the valuation date and decreased by distributions made in the valuation calendar year after the valuation date. The Participant's Account Balance for the valuation calendar year includes any amounts rolled over or transferred to the Plan either in the valuation calendar year or in the Distribution Calendar Year if distributed or transferred in the valuation calendar year.

(D) Required Beginning Date. The date specified in Section 8.6(d)(i) and (ii) of the Plan.

8.7 Direct Rollovers.

A Participant (or an alternate payee or a Beneficiary who is the Participant's Surviving Spouse) may elect to have any portion of a distribution from this Plan that is an Eligible Rollover Distribution paid directly to an Eligible Retirement Plan by submitting a request through the Participant Response System.

8.8 Qualified Domestic Relations Orders.

The Plan Administrator shall establish reasonable procedures to determine the qualified status of a domestic relations order in accordance with the requirements of Code § 414(p) and ERISA § 206(d) ("qualified domestic relations order").

(a) Distributions.

(i) An alternate payee under a qualified domestic relations order may receive a distribution from this Plan prior to the date the Participant to whom the order relates attains the earliest retirement age under the Plan, even if this precedes the Participant's Separation from Service.

(ii) An alternate payee will be eligible for periodic installments under Section 8.2 only to the extent the Participant would be eligible for such installment payments by separating from service and receiving a payout on the proposed distribution date selected by the alternate payee.

(iii) For purposes of Section 8.6(d) (Code § 401(a)(9) provisions), an alternate payee's separate interest in the Plan shall be distributed beginning not later than the Participant's required beginning date and shall be paid out based on the life expectancy of the alternate payee.

(b) Investment Elections. Under rules to be adopted by the Plan Administrator from time to time, amounts credited to an Account maintained on behalf of an alternate payee under a qualified domestic relations order shall be initially invested pursuant to the Participant's Investment Election. Thereafter, the alternate payee may change such Investment Election by contacting the Participant Response System.

(c) Cashout Distributions and Automatic Rollovers. Rules similar to the rules in Section 8.4 (Cashout Distributions and Automatic Rollovers) shall apply in the case of any alternate payee for whom the vested portion of the Participant's Account does not exceed the small dollar cashout amount described in such Section, pursuant to rules established by the Plan Administrator for this purpose.

8.9 Beneficiary Designation.

(a) A Participant may from time to time designate a Beneficiary to receive the value of his or her Account following the Participant's death by properly completing a Beneficiary Designation Form and filing it with the Plan Administrator pursuant to any applicable rules of the Plan Administrator. When a Participant (or Beneficiary, if applicable) properly completes and files a Beneficiary Designation Form, such Beneficiary Designation Form shall supersede any previously-filed Beneficiary Designation Forms of the Participant (or Beneficiary, if applicable).

(b) Notwithstanding subsection (a) above, if a Participant dies leaving a Surviving Spouse before the complete distribution of his or her Account, the Participant's Beneficiary shall be the Participant's Surviving Spouse, unless such Surviving Spouse has consented to the designation of another Beneficiary in a writing that acknowledges the effect of such consent and that is witnessed by a notary public or Plan representative, or as otherwise provided by applicable law and permitted by the Plan Administrator. The Surviving Spouse's consent shall not be required if:

(i) The Plan Administrator is unable to locate the Participant's Spouse;

(ii) The Participant is legally separated or the spouse has abandoned the Participant and the Participant has a court order to that effect; or

(iii) Other circumstances exist under which the Secretary of the Treasury will excuse the consent requirement.

If the Participant's Spouse is legally incompetent to give consent, the Spouse's legal guardian may give consent (even if the Participant is the legal guardian). Consent by a Spouse, or establishment that a Spouse's consent cannot be obtained, shall only be effective with respect to such individual Spouse.

(c) Effective January 1, 1997, if a Participant does not have a Beneficiary or if the Beneficiary predeceases the Participant, then the Participant shall be deemed to have designated a Beneficiary or Beneficiaries in the following order of priority, and the Plan Administrator shall direct the Trustee to pay benefits under this Plan to such Beneficiary or Beneficiaries:

(i) To the Participant's surviving spouse;

(ii) To the Participant's surviving children in equal shares;

(iii) To the Participant's surviving parents in equal shares;

(iv) To the Participant's surviving siblings in equal shares;

(v) To the Participant's surviving nieces and nephews in equal shares; or

(vi) To the Participant's estate.

(d) If the Beneficiary survives the Participant, but dies prior to the complete distribution of the Participant's Account, the Plan Administrator shall direct the Trustee to pay the amounts remaining in the Participant's Account to the Beneficiary's estate (unless the Plan Administrator establishes written rules that allow a Beneficiary to name another Beneficiary, in which case amounts remaining in the Participant's Account shall be paid to such Beneficiary if so designated through a Beneficiary Designation Form).

(e) If the Plan Administrator, after reasonable inquiry, is unable within one year to determine whether or not any designated Beneficiary survived the event that entitled him or her to receive a distribution of any benefit under the Plan, the Plan Administrator shall conclusively presume that such Beneficiary died prior to the date he or she was entitled to a distribution.

(f) If the Participant designates more than one Beneficiary (whether such individuals are primary Beneficiaries or contingent Beneficiaries), the following rules shall apply regarding distributions:

(i) If the Participant has designated one or more primary Beneficiaries and one or more contingent Beneficiaries, no contingent Beneficiary shall be entitled to any portion of a distribution if the Participant is survived by any person designated as a primary Beneficiary.

(ii) If the Participant has designated two primary Beneficiaries and only one of the primary Beneficiaries survives the Participant, the surviving primary Beneficiary shall be entitled to 100% of the Participant's Account upon the death of the Participant, regardless of whether any contingent Beneficiaries have been designated.

(iii) If the Participant designates three or more primary Beneficiaries, and any of the primary Beneficiaries predecease the Participant, then upon the death of the Participant:

(A) In the case where the Beneficiary Designation Form used to designate the Beneficiaries states that the surviving primary Beneficiaries shall share equally in the portion of the Account that would have been allocated to the deceased primary Beneficiary, then the Beneficiary Designation Form shall govern, and

(B) In all other cases, the deceased primary Beneficiary's share of the Participant's Account shall be allocated to the surviving primary Beneficiaries in a pro rata fashion based upon the allocations made

to the surviving primary Beneficiaries. For example, if primary Beneficiaries A, B, and C have been allocated 60%, 20%, and 20% of the Participant's Account, respectively, and C predeceases the Participant, then A and B shall be entitled to 75% and 25% of the Account, respectively.

If all primary Beneficiaries predecease the Participant and contingent Beneficiaries have been designated, then the rules in paragraphs (ii) and (iii) above shall apply with respect to allocating the Participant's Account among the contingent Beneficiaries.

8.10 Incompetent or Lost Distributee.

(a) If the Plan Administrator determines that a Participant or Beneficiary entitled to a distribution hereunder is unable to care for his or her affairs because of illness or accident or because he or she is a minor, then, unless a claim is made for the benefit by a duly appointed legal representative, the Plan Administrator may direct that such distribution be paid to such distributee's spouse, child, parent or other blood relative, or to a person with whom such distributee resides. Any such payment, when made, shall be a complete discharge of the liabilities of the Plan therefore.

(b) In the event that the Plan Administrator, after reasonable and diligent effort, cannot locate any person to whom a payment or distribution is due under the Plan, and no other distributee has become entitled to such distribution pursuant to any provision of the Plan, the Participant's Account in respect of which such payment or distribution is to be made shall be forfeited six months after the date in which such payment or distribution first becomes due or such later date as the Plan Administrator prescribes (but in all events prior to the time such Account would otherwise escheat under any applicable State law); provided, however, that any Account so forfeited shall be reinstated, in accordance with subsection (e) of this Section, if such person subsequently makes a valid claim for such benefit.

(c) The Plan Administrator shall be deemed to have made a reasonable and diligent effort to locate a person if it has sent notification describing the relative values of the optional forms of benefit available under the Plan (including any right to defer such distribution) and the risk of forfeiture of such benefit, or a small dollar cashout distribution under Section 8.4, by certified or registered mail to the last known address of such person.

(d) If a Participant or Beneficiary whose Account is forfeited pursuant to subsection (b) of this Section makes a valid claim for benefits, the Plan Administrator shall restore the Participant's Account to the same dollar amount as the dollar amount forfeited, unadjusted for any gains or losses occurring subsequent to the date of the forfeiture. Such amounts shall be restored from the amount of forfeitures that the Employer would have otherwise allocated to Participants. To the extent the amount of available forfeitures is insufficient to enable the Plan Administrator to make the required restoration, the Employer must contribute, without regard to any requirement or condition of Articles XIII through XVI, the additional amount necessary to enable the Plan Administrator to make the required restoration.

(e) Accounts restored under this Section 8.10 shall be distributed no later than 60 days after the close of the Plan Year in which the Account is restored (provided the Participant is not employed by the Company's Controlled Group at such time).

ARTICLE IX - INVESTMENT OF THE TRUST

9.1 Trust Agreement.

The assets of the Plan shall be held in the Trust by one or more Trustees selected by the Company and pursuant to the terms of a Trust Agreement. The Trust Agreement shall provide that:

(a) Subject to Participants' Investment Elections and the terms of the Plan, the assets of the Trust shall be invested and reinvested in such investments as either the Trustee or investment managers appointed by the Plan Administrator deem advisable from time to time; and

(b) The Plan Administrator has concurrent authority, exercisable at its sole discretion, to direct the Trustee as to the sale or purchase of particular assets.

9.2 Appointment of Investment Managers.

The Plan Administrator shall have authority to appoint investment managers to manage all or a portion of the Trust. Any investment manager appointed by the Plan Administrator shall be:

(a) An investment adviser under the Investment Advisers Act of 1940;

(b) A bank as defined in the Investment Advisors Act of 1940; or

(c) An insurance company qualified to perform investment management services under the laws of more than one State, and must acknowledge in writing that it is a fiduciary with respect to the Plan.

9.3 Investment Manager Powers.

Subject to the Investment Elections made by Participants and to the terms of the Plan and the investment management agreement, an investment manager shall have the power to invest and reinvest the Trust assets (including the authority to acquire and dispose of Plan assets) for which it has been given discretionary authority, as it deems advisable.

9.4 Power to Direct Investments.

The Company retains no authority or responsibility over the management, acquisition or disposition of Plan assets except with respect to the Company's power to select, retain and replace Trustees.

9.5 Exclusive Benefit Rule.

Except as otherwise provided in the Plan, no part of the corpus or income of the funds of the Plan shall be used for, or diverted to, purposes other than for the exclusive benefit of

Participants and other persons entitled to benefits under the Plan. No person shall have any interest in or right to any part of the assets held under the Plan, or any right in, or to, any part of the assets held under the Plan, except to the extent expressly provided by the Plan.