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

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# FORM 10-Q

(Mark One)

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

For the quarterly period ended August 1, 2004.

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 |

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark (" ✓ ") whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ✓ No __

As of August 29, 2004, 116,562,517 shares of the registrant's Common Stock were outstanding.

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**WILLIAMS-SONOMA, INC.**
**REPORT ON FORM 10-Q**
**FOR THE QUARTER ENDED AUGUST 1, 2004**

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**PART I. FINANCIAL INFORMATION**

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**ITEM 1. FINANCIAL STATEMENTS**

**WILLIAMS-SONOMA, INC.**
**CONDENSED CONSOLIDATED BALANCE SHEETS**
(Unaudited)

| Dollars and shares in thousands, except per share amounts | August 1, 2004 | February 1, 2004 | August 3, 2003 |
|---|---|---|---|
| ASSETS | | | |
| Current assets | | | |
| Cash and cash equivalents | $ 119,218 | $ 163,910 | $ 81,779 |
| Accounts receivable – net | 47,700 | 31,573 | 38,522 |
| Merchandise inventories – net | 409,993 | 404,100 | 376,860 |
| Prepaid catalog expenses | 47,124 | 38,465 | 41,275 |
| Prepaid expenses | 28,395 | 24,780 | 25,218 |
| Deferred income taxes | 20,530 | 20,532 | 16,316 |
| Other assets | 13,880 | 4,529 | 8,549 |
| Total current assets | 686,840 | 687,889 | 588,519 |
| Property and equipment – net | 791,691 | 765,030 | 654,916 |
| Other assets – net | 21,962 | 17,816 | 19,526 |
| Total assets | $1,500,493 | $1,470,735 | $1,262,961 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | |
| Current liabilities | | | |
| Accounts payable | $ 157,621 | $ 155,888 | $ 145,074 |
| Accrued salaries, benefits, and other | 69,233 | 78,674 | 59,646 |
| Customer deposits | 136,684 | 116,173 | 109,573 |
| Income taxes payable | 1,067 | 64,525 | 19,786 |
| Current portion of long-term debt | 24,046 | 8,988 | 7,427 |
| Other liabilities | 18,078 | 18,636 | 17,919 |
| Total current liabilities | 406,729 | 442,884 | 359,425 |
| Deferred rent and lease incentives | 184,501 | 176,015 | 163,570 |
| Long-term debt | 27,046 | 28,389 | 17,206 |
| Deferred income tax liabilities | 8,891 | 8,887 | 11,350 |
| Other long-term obligations | 10,552 | 9,969 | 7,494 |
| Total liabilities | 637,719 | 666,144 | 559,045 |
| Commitments and contingencies | — | — | — |
| Shareholders' equity | | | |
| Preferred stock, $.01 par value, 7,500 shares authorized, none issued | — | — | — |
| Common stock, $.01 par value, 253,125 shares authorized, issued and outstanding: 116,517, 115,827 and 116,646 at August 1, 2004, February 1, 2004, and August 3, 2003, respectively | 1,165 | 1,158 | 1,166 |
| Additional paid-in capital | 275,035 | 252,325 | 222,588 |
| Retained earnings | 583,039 | 547,821 | 478,056 |
| Accumulated foreign currency translation adjustment | 3,535 | 3,287 | 2,106 |
| Total shareholders' equity | 862,774 | 804,591 | 703,916 |
| Total liabilities and shareholders' equity | $1,500,493 | $1,470,735 | $1,262,961 |

*See Notes to Condensed Consolidated Financial Statements.*

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**WILLIAMS-SONOMA, INC.**
**CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS**
(Unaudited)

| Dollars and shares in thousands, except per share amounts | Thirteen Weeks Ended August 1, 2004 | Thirteen Weeks Ended August 3, 2003 | Twenty-Six Weeks Ended August 1, 2004 | Twenty-Six Weeks Ended August 3, 2003 |
|---|---|---|---|---|
| Net revenues | $689,621 | $580,423 | $1,330,531 | $1,117,263 |
| Cost of goods sold | 430,093 | 365,345 | 825,627 | 697,877 |
| Gross margin | 259,528 | 215,078 | 504,904 | 419,386 |
| Selling, general and administrative expenses | 214,599 | 186,226 | 425,172 | 369,069 |
| Interest expense (income) – net | 150 | (130) | 285 | (446) |
| Earnings before income taxes | 44,779 | 28,982 | 79,447 | 50,763 |
| Income taxes | 17,150 | 11,158 | 30,428 | 19,544 |
| Net earnings | $ 27,629 | $ 17,824 | $ 49,019 | $ 31,219 |
| Basic earnings per share | $ 0.24 | $ 0.15 | $ 0.42 | $ 0.27 |
| Diluted earnings per share | $ 0.23 | $ 0.15 | $ 0.41 | $ 0.26 |
| Shares used in calculation of earnings per share: | | | | |
| Basic | 116,253 | 116,082 | 116,021 | 115,145 |
| Diluted | 119,229 | 119,770 | 119,228 | 118,453 |

*See Notes to Condensed Consolidated Financial Statements.*

**WILLIAMS-SONOMA, INC.**
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**
(Unaudited)

| | Twenty-Six Weeks Ended | |
|---|---|---|
| **Dollars in thousands** | **August 1, 2004** | **August 3, 2003** |
| Cash flows from operating activities: | | |
| Net earnings | $ 49,019 | $ 31,219 |
| Adjustments to reconcile net earnings to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 54,224 | 49,639 |
| Net loss on disposal of assets | 806 | 919 |
| Amortization of deferred lease incentives | (10,975) | (9,251) |
| Amortization of deferred stock-based compensation | — | 250 |
| Other | 335 | — |
| Changes in: | | |
| Accounts receivable | (16,130) | (4,192) |
| Merchandise inventories | (5,928) | (55,235) |
| Prepaid catalog expenses | (8,659) | (6,112) |
| Prepaid expenses and other assets | (17,413) | (21,235) |
| Accounts payable | 1,720 | (21,799) |
| Accrued salaries, benefits and other | (9,310) | (21,826) |
| Customer deposits | 20,514 | 16,356 |
| Deferred rent and lease incentives | 19,485 | 11,450 |
| Income taxes payable | (55,442) | (36,679) |
| Net cash provided by (used in) operating activities | 22,246 | (66,496) |
| Cash flows from investing activities: | | |
| Purchases of property and equipment | (81,731) | (71,831) |
| Net cash used in investing activities | (81,731) | (71,831) |
| Cash flows from financing activities: | | |
| Proceeds from bond issuance | 15,000 | — |
| Repayments of long-term obligations | (1,285) | (856) |
| Proceeds from exercise of stock options | 15,679 | 26,353 |
| Repurchase of common stock | (14,755) | — |
| Credit facility renewal costs | (208) | — |
| Net cash provided by financing activities | 14,431 | 25,497 |
| Effect of exchange rates on cash and cash equivalents | 362 | 1,114 |
| Net decrease in cash and cash equivalents | (44,692) | (111,716) |
| Cash and cash equivalents at beginning of period | 163,910 | 193,495 |
| Cash and cash equivalents at end of period | $119,218 | $ 81,779 |

*See Notes to Condensed Consolidated Financial Statements.*

**WILLIAMS-SONOMA, INC.**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
Thirteen and Twenty-Six Weeks Ended August 1, 2004 and August 3, 2003
(Unaudited)

**NOTE A. FINANCIAL STATEMENTS — BASIS OF PRESENTATION**

These financial statements include Williams-Sonoma, Inc. and its wholly owned subsidiaries (“we”, “us” or “our”). The condensed consolidated balance sheets as of August 1, 2004 and August 3, 2003, the condensed consolidated statements of earnings for the thirteen and twenty-six week periods ended August 1, 2004 and August 3, 2003, and the condensed consolidated statements of cash flows for the twenty-six week periods ended August 1, 2004 and August 3, 2003 have been prepared by us, without audit. In our opinion, the financial statements include all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position at the balance sheet dates and the results of operations for the thirteen and twenty-six week periods then ended. Significant intercompany transactions and accounts have been eliminated. The balance sheet at February 1, 2004, presented herein, has been derived from our audited balance sheet included in our Annual Report on Form 10-K for the fiscal year ended February 1, 2004.

The results of operations for the thirteen and twenty-six weeks ended August 1, 2004 are not necessarily indicative of the operating results of the full year.

Certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended February 1, 2004.

Certain reclassifications have been made to the prior period financial statements to conform to the presentation used in the current period.

**NOTE B. ACCOUNTING POLICIES**

*Stock-Based Compensation* We account for stock options 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 is recognized in the consolidated financial statements for stock options granted at fair value. Statement of Financial Accounting Standards (“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 using the Black-Scholes option-pricing model.

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.

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| Dollars in thousands, except per share amounts | Thirteen Weeks Ended | | Twenty-Six Weeks Ended | |
|---|---|---|---|---|
| | August 1, 2004 | August 3, 2003 | August 1, 2004 | August 3, 2003 |
| Net earnings, as reported | $27,629 | $17,824 | $49,019 | $31,219 |
| Add: Stock-based employee compensation expense included in reported net earnings, net of related tax effect | — | — | — | 154 |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effect | (4,277) | (4,337) | (8,364) | (8,701) |
| Pro forma net earnings | $23,352 | $13,487 | $40,655 | $22,672 |
| Basic earnings per share | | | | |
| As reported | $ 0.24 | $ 0.15 | $ 0.42 | $ 0.27 |
| Pro forma | 0.20 | 0.12 | 0.35 | 0.20 |
| Diluted earnings per share | | | | |
| As reported | $ 0.23 | $ 0.15 | $ 0.41 | $ 0.26 |
| Pro forma | 0.19 | 0.11 | 0.33 | 0.19 |

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:

| | Thirteen Weeks Ended | | Twenty-Six Weeks Ended | |
|---|---|---|---|---|
| | August 1, 2004 | August 3, 2003 | August 1, 2004 | August 3, 2003 |
| Dividend yield | — | — | — | — |
| Volatility | 61.6% | 64.4% | 61.8% | 64.8% |
| Risk-free interest | 4.2% | 3.4% | 4.2% | 3.4% |
| Expected term (years) | 6.9 | 6.6 | 6.9 | 6.6 |

During fiscal 2001, we entered into employment agreements with certain executive officers. All stock-based compensation expense related to these agreements was fully amortized as of our first quarter ended May 4, 2003. We recognized zero and $250,000 of stock-based compensation expense related to these employment agreements in the twenty-six weeks ended August 1, 2004 and August 3, 2003, respectively.

**NOTE C. BORROWING ARRANGEMENTS**

We have a line of credit facility that provides for $200,000,000 of unsecured revolving credit and contains certain restrictive loan covenants, including minimum tangible net worth, maximum leverage ratio (funded debt adjusted for lease and rent expense to EBITDAR), minimum fixed charge coverage ratio and maximum annual capital expenditures. The agreement expires on October 22, 2005. Through April 22, 2005, we may, upon notice to the lenders, request an increase in the facility up to $250,000,000. We may elect interest rates calculated by reference to the agent’s internal reference rate or LIBOR plus a margin based on our leverage ratio. During the twenty-six weeks ended August 1, 2004 and August 3, 2003, we had no borrowings under the line of credit facility and were in compliance with all of our loan covenants.

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 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 $200,000,000 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 August 1, 2004 was 1.47%.

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

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draw upon the letter of credit to fund the purchase of the bonds. As of August 1, 2004, these bonds are 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 August 1, 2004, we had acquired and installed leasehold improvements and equipment associated with the facility in the amount of $9,546,000 and are in the process of submitting the documentation required to receive reimbursement of the bond proceeds. As a result, these funds are recorded as restricted cash within current other assets. The balance of the proceeds have been recorded on the balance sheet as non-current restricted cash within long-term other assets.

We have three unsecured commercial letter of credit reimbursement agreements for an aggregate of $125,000,000, each of which expires on July 2, 2005. As of August 1, 2004, $90,134,000 was outstanding under the letter of credit agreements. Such letters of credit represent only a future commitment to fund inventory purchases to which we had not taken legal title as of August 1, 2004. The latest expiration for the letters of credit issued under the agreements is November 29, 2005.

As of August 1, 2004, we had issued and outstanding standby letters of credit under the line of credit facility in an aggregate amount of $29,127,000. The standby letters of credit were issued to secure the liabilities associated with workers' compensation, other insurance programs and the Mississippi Debt Transaction.

## NOTE D. COMPREHENSIVE INCOME

Comprehensive income for the thirteen and twenty-six weeks ended August 1, 2004 and August 3, 2003 was as follows:

| | Thirteen Weeks Ended | | Twenty-Six Weeks Ended | |
|---|---|---|---|---|
| **Dollars in thousands** | **August 1, 2004** | **August 3, 2003** | **August 1, 2004** | **August 3, 2003** |
| Net earnings | $27,629 | $17,824 | $49,019 | $31,219 |
| Other comprehensive income - | | | | |
| Foreign currency translation adjustment | 715 | 322 | 248 | 2,117 |
| Comprehensive income | $28,344 | $18,146 | $49,267 | $33,336 |

## NOTE E. 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 reflects the potential dilution that could occur from common shares issuable through stock options.

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

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| Dollars and amounts in thousands, except per share amounts | Net Earnings | Weighted Average Shares | Per-Share Amount |
|---|---|---|---|
| Thirteen weeks ended August 1, 2004 | | | |
| Basic | $27,629 | 116,253 | $0.24 |
| Effect of dilutive stock options | — | 2,976 | |
| Diluted | $27,629 | 119,229 | $0.23 |
| Thirteen weeks ended August 3, 2003 | | | |
| Basic | $17,824 | 116,082 | $0.15 |
| Effect of dilutive stock options | — | 3,688 | |
| Diluted | $17,824 | 119,770 | $0.15 |
| Twenty-Six weeks ended August 1, 2004 | | | |
| Basic | $49,019 | 116,021 | $0.42 |
| Effect of dilutive stock options | — | 3,207 | |
| Diluted | $49,019 | 119,228 | $0.41 |
| Twenty-Six weeks ended August 3, 2003 | | | |
| Basic | $31,219 | 115,145 | $0.27 |
| Effect of dilutive stock options | — | 3,308 | |
| Diluted | $31,219 | 118,453 | $0.26 |

Options with an exercise price greater than the average market price of common shares were 1,515,000 and 237,000 for the thirteen weeks and 1,440,000 and 1,548,000 for the twenty-six weeks ended August 1, 2004 and August 3, 2003, respectively, and were not included in the computation of diluted earnings per share.

**NOTE F. 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.

**NOTE G. SEGMENT REPORTING**

We have two reportable segments, retail and direct-to-customer. The retail segment sells products for the home through our five retail concepts (Williams-Sonoma, Pottery Barn, Pottery Barn Kids, Hold Everything and West Elm). The five retail concepts are operating segments, which have been aggregated into one reportable segment, retail. The direct-to-customer segment 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 Chambers) and five e-commerce websites (williams-sonoma.com, potterybarn.com, potterybarnkids.com. pbteen.com and westelm.com).

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. Management’s expectation is that the overall economics of each of our major concepts within each reportable segment will be similar over time.

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 | Direct-to-Customer | Unallocated | Total |
|---|---|---|---|---|
| Thirteen weeks ended August 1, 2004 | | | | |
| Net revenues | $382,848 | $306,773 | — | $ 689,621 |
| Depreciation and amortization expense | 18,889 | 3,886 | $ 4,508 | 27,283 |
| Earnings before income taxes | 34,642 | 46,653 | (36,516) | 44,779 |
| Capital expenditures | 25,615 | 15,823 | 2,751 | 44,189 |
| Thirteen weeks ended August 3, 2003 | | | | |
| Net revenues | $337,232 | $243,191 | — | $ 580,423 |
| Depreciation and amortization expense | 17,667 | 4,096 | $ 3,603 | 25,366 |
| Earnings before income taxes | 27,320 | 37,410 | (35,748) | 28,982 |
| Capital expenditures | 34,557 | 5,426 | 7,468 | 47,451 |
| Twenty-Six weeks ended August 1, 2004 | | | | |
| Net revenues | $733,952 | $596,579 | — | $1,330,531 |
| Depreciation and amortization expense | 37,694 | 7,601 | $ 8,929 | 54,224 |
| Earnings before income taxes | 64,889 | 91,068 | (76,510) | 79,447 |
| Assets | 844,021 | 254,026 | 402,446 | 1,500,493 |
| Capital expenditures | 50,099 | 26,922 | 4,710 | 81,731 |
| Twenty-Six weeks ended August 3, 2003 | | | | |
| Net revenues | $641,771 | $475,492 | — | $1,117,263 |
| Depreciation and amortization expense | 33,773 | 8,627 | $ 7,239 | 49,639 |
| Earnings before income taxes | 53,051 | 67,760 | (70,048) | 50,763 |
| Assets | 774,531 | 186,164 | 302,266 | 1,262,961 |
| Capital expenditures | 52,896 | 9,555 | 9,380 | 71,831 |

## ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### BUSINESS

We are a specialty retailer of products for the home. The retail segment of our business sells our products through our five retail store concepts (Williams-Sonoma, Pottery Barn, Pottery Barn Kids, Hold Everything and West Elm). 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 Chambers) and five e-commerce websites (williams-sonoma.com, potterybarn.com, potterybarnkids.com, pbteen.com and westelm.com). Based on net revenues in fiscal 2003, retail net revenues accounted for 58.9% of our business and direct-to-customer net revenues accounted for 41.1% of our business. Based on their contribution to our net revenues in fiscal 2003, the core brands in both retail and direct-to-customer are: Pottery Barn, which sells contemporary tableware and home furnishings; Williams-Sonoma, which sells cookware essentials; and Pottery Barn Kids, which sells stylish children’s furnishings. The following discussion and analysis of financial condition, results of operations, liquidity and capital resources should be read in conjunction with our condensed consolidated financial statements and the notes thereto.

### FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements 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, projections of earnings, revenues or financial items, statements of the plans, strategies and objectives of management for future operations, statements concerning proposed new products, retail concepts or brands, statements regarding future economic conditions or performance, statements relating to the use of our available cash, statements relating to our plans to increase retail leased square footage, statements relating to the future performance of our brands, statements relating to our plans to open new retail stores or close existing stores, statements relating to launching new websites, statements relating to our projected capital expenditures, statements relating to increased catalog circulation and launching new catalogs, statements relating to the stock repurchase program, 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 “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 this document 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.

### OVERVIEW

In the second quarter of 2004 versus the second quarter of 2003, on revenue growth of 18.8%, we increased our diluted earnings per share by 53.3%, to $0.23 per share, and our pre-tax operating margin rate as a percentage of revenues by 150 basis points. A strong consumer response to our merchandising initiatives, especially in the Pottery Barn brands, a higher in-stock position in both our retail and direct-to-customer businesses, and continuing benefits from successful supply chain and overhead cost containment initiatives drove these results.

During the second quarter of 2004, in our retail channel, net revenues increased 13.5% from the second quarter of 2003, primarily driven by increases in the Pottery Barn and Pottery Barn Kids brands. A positive consumer response to both our core and seasonal product offerings and a higher in-stock position on core merchandise inventories drove these better-than-expected results.

In our direct-to-customer channel, net revenues increased 26.1% in the second quarter of 2004 versus the second quarter of 2003. This increase was primarily driven by incremental sales generated in the Pottery Barn, PBteen and Pottery Barn Kids brands resulting from increased catalog circulation, the continued success of our e-commerce initiatives and a higher order fulfillment rate on core merchandise inventories, primarily in the Pottery Barn brands.

Operationally, in the second quarter, we began our first phase of operations in approximately one-third of our new 781,000 square foot East Coast furniture distribution center in Cranbury, New Jersey. Upon the completion of this facility in the third quarter of 2004, we believe this center will enable us to improve service levels to our East Coast customers and, over time, reduce furniture delivery costs as we fine-tune inventory balancing between the coastal distribution centers.

As we look ahead to the third and fourth quarters, we are encouraged by the overall sales trends we have seen in our retail and direct-to-customer businesses, especially in our Pottery Barn brands, and by the opportunities that exist in our emerging brands. During the third and fourth quarters of 2004, we plan to open 29 and remodel 8 additional stores and to increase catalog prospecting in all of our brands with 26% of our planned catalog circulation mailed in the emerging brands. We will also continue to focus on the strategic initiatives that are fueling our success: driving top-line sales growth, increasing pretax operating margin, and enhancing shareholder value.

Consistent with our strategic effort to drive top-line sales growth, we are continuing to invest in new growth opportunities in both our core and emerging brands. In our core brands (Williams-Sonoma, Pottery Barn and Pottery Barn Kids), we are increasing retail leased square footage and catalog circulation, introducing new core and seasonal merchandise assortments, enhancing product quality with a particular focus on furniture, closely monitoring our in-stock positions on retail and direct-to-customer inventories, and implementing new marketing initiatives that will continue to expand the reach of our brands.

We are also making investments in our emerging brands (PBteen, Hold Everything, West Elm and Williams-Sonoma Home). In PBteen, we intend to continue to increase catalog circulation and expand our on-line marketing initiatives. We will also focus on increasing interactions with teens through a variety of contests and campaigns that we expect will build brand affinity and drive customer acquisitions. In Hold Everything, we plan to continue to increase catalog circulation, launch our e-commerce website in the fourth quarter of 2004, and open three new prototype stores during the remainder of fiscal 2004. In West Elm, we intend to expand our on-line marketing initiatives and launch a new version of the e-commerce website, as the Internet continues to be a strong revenue driver in the West Elm brand. We are also committed to opening three new West Elm prototype stores during the remainder of 2004.

In the third quarter of 2004, we will be launching Williams-Sonoma Home, our newest brand. This new premium brand, offering classic home furnishings and decorative accessories of enduring quality and casual elegance, will extend the Williams-Sonoma lifestyle beyond the kitchen into every room of the home. With an initial circulation of over three million catalogs, this launch will be our largest mailing ever for a new brand.

In addition, for all of our emerging brands, we will incur costs to build infrastructure to support our emerging brands, including occupying additional distribution leased square footage.

**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 catalogs and the Internet, and shipping fees consist of revenue received from customers for delivery of merchandise.

The following table summarizes our net revenues for the thirteen weeks ended August 1, 2004 ("Second Quarter of 2004") and August 3, 2003 ("Second Quarter of 2003"), and the twenty-six weeks ended August 1, 2004 ("Year-to-Date 2004") and August 3, 2003 ("Year-to-Date 2003").

| | Thirteen Weeks Ended | | | | Twenty-Six Weeks Ended | | | |
|---|---|---|---|---|---|---|---|---|
| Dollars in thousands | August 1, 2004 | % Total | August 3, 2003 | % Total | August 1, 2004 | % Total | August 3, 2003 | % Total |
| Retail sales | $380,659 | 55.2% | $335,272 | 57.8% | $ 730,088 | 54.9% | $ 638,356 | 57.1% |
| Direct-to-customer sales | 262,022 | 38.0% | 206,327 | 35.5% | 508,622 | 38.2% | 404,947 | 36.2% |
| Shipping fees | 46,940 | 6.8% | 38,824 | 6.7% | 91,821 | 6.9% | 73,960 | 6.7% |
| Net revenues | $689,621 | 100.0% | $580,423 | 100.0% | $1,330,531 | 100.0% | $1,117,263 | 100.0% |

Net revenues for the Second Quarter of 2004 increased by $109,198,000, or 18.8%, over net revenues for the Second Quarter of 2003. This was primarily due to a year-over-year increase in store leased square footage of 12.0%, driven by 45 new store openings and the remodeling and expansion of an additional 23 stores, a comparable store sales increase of 5.0%, increased catalog circulation of 23.3%, and the strong momentum from our Internet growth initiatives. This increase was partially offset by the temporary closure of 23 stores and the permanent closure of 12 stores.

Net revenues for Year-to-Date 2004 increased by $213,268,000, or 19.1%, over net revenues for Year-to-Date 2003. This was primarily due to a year-over-year increase in store leased square footage of 12.0%, driven by 45 new store openings and the remodeling and expansion of an additional 23 stores, a comparable store sales increase of 5.8%, increased catalog circulation of 24.6%, and the strong momentum from our Internet growth initiatives. This increase was partially offset by the temporary closure of 23 stores and the permanent closure of 12 stores.

## RETAIL REVENUES AND OTHER DATA

| | Thirteen Weeks Ended | | Twenty-Six Weeks Ended | |
|---|---|---|---|---|
| Dollars in thousands | August 1, 2004 | August 3, 2003 | August 1, 2004 | August 3, 2003 |
| Retail sales | $ 380,659 | $ 335,272 | $ 730,088 | $ 638,356 |
| Shipping fees | 2,189 | 1,960 | 3,864 | 3,415 |
| Total retail revenues | $ 382,848 | $ 337,232 | $ 733,952 | $ 641,771 |
| Percent growth in retail sales | 13.5% | 17.3% | 14.4% | 15.4% |
| Percent increase in comparable store sales | 5.0% | 6.5% | 5.8% | 2.9% |
| Number of stores — beginning of period | 520 | 487 | 512 | 478 |
| Number of new stores | 4 | 4 | 12 | 13 |
| Number of new stores due to remodeling[1] | 7 | 2 | 9 | 5 |
| Number of closed stores due to remodeling[1] | (7) | (4) | (9) | (7) |
| Number of permanently closed stores | (2) | — | (2) | — |
| Number of stores — end of period | 522 | 489 | 522 | 489 |
| Store selling square footage at quarter-end | 2,705,000 | 2,411,000 | 2,705,000 | 2,411,000 |
| Store leased square footage ("LSF") at quarter-end | 4,292,000 | 3,833,000 | 4,292,000 | 3,833,000 |

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.*

| | Store Count | | | | | Avg. LSF per Store | |
|---|---|---|---|---|---|---|---|
| | May 2, 2004 | Openings | Closings | August 1, 2004 | August 3, 2003 | August 1, 2004 | August 3, 2003 |
| Williams-Sonoma | 241 | 7 | (6) | 242 | 236 | 5,600 | 5,300 |
| Pottery Barn | 175 | 3 | (2) | 176 | 160 | 11,800 | 11,500 |
| Pottery Barn Kids | 81 | 1 | — | 82 | 66 | 7,700 | 7,700 |
| Hold Everything | 8 | — | (1) | 7 | 13 | 4,400 | 3,800 |
| West Elm | 1 | — | — | 1 | — | 9,500 | — |
| Outlets | 14 | — | — | 14 | 14 | 14,400 | 13,100 |
| Total | 520 | 11 | (9) | 522 | 489 | 8,200 | 7,800 |

Retail revenues for the Second Quarter of 2004 increased by $45,616,000, or 13.5%, over the Second Quarter of 2003 primarily driven by a year-over-year increase in retail leased square footage of 12.0%, including 45 new store openings and the remodeling and expansion of an additional 23 stores, and a comparable store sales increase of 5.0%. This increase was partially offset by the temporary closure of 23 stores and the permanent closure of 12 stores. Net sales generated in the Pottery Barn and Pottery Barn Kids brands were the primary contributors to the year-over-year sales increase, partially offset by lower sales in the Hold Everything brand due to a year-over-year reduction in Hold Everything retail stores from 13 stores to 7 stores.

Retail revenues for Year-to-Date 2004 grew $92,181,000, or 14.4%, over Year-to-Date 2003, primarily due to 45 new store openings and the remodeling and expansion of an additional 23 stores, and a comparable store sales increase of 5.8%. This increase was partially offset by the temporary closure of 23 stores and the permanent closure of 12 stores. Net sales generated in the Pottery Barn, Pottery Barn Kids, and Williams-Sonoma brands were the primary contributors to the year-over-year sales increase, partially offset by lower sales in the Hold Everything brand due to the year-over-year reduction in Hold Everything retail stores from 13 stores to 7 stores.

***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. 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 expansions and closings. Percentages represent changes in comparable store sales versus the same period in the prior year.

| | Thirteen Weeks Ended | | Twenty-Six Weeks Ended | |
|---|---|---|---|---|
| Percent increase (decrease) in comparable store sales | August 1, 2004 | August 3, 2003 | August 1, 2004 | August 3, 2003 |
| Williams-Sonoma | (1.6%) | 12.1% | 0.9% | 8.9% |
| Pottery Barn | 10.2% | 2.6% | 10.2% | (0.9%) |
| Pottery Barn Kids | (0.4%) | 5.7% | 0.2% | (1.6%) |
| Hold Everything | 7.1% | (2.5%) | 6.8% | (5.0%) |
| Outlets | 19.0% | 6.5% | 15.9% | 8.4% |
| Total | 5.0% | 6.5% | 5.8% | 2.9% |

The Second Quarter of 2004 comparable store decrease of 1.6% in the Williams-Sonoma brand was driven by the decision not to repeat two significant sales-generating events from last year. Our inventory reinstatement initiative and the additional traffic resulting from a deeply promotional tabletop transition generated a substantial portion of the brand's 12.1% comparable store sales increase in the Second Quarter of 2003. The absence of these two events in the Second Quarter of 2004 was almost fully offset by a strong consumer response to key

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merchandising categories including core and seasonal foods, high-end electrics, housewares, cook's tools and cutlery.

The Second Quarter of 2004 comparable store sales increase in Pottery Barn was primarily driven by a positive consumer response to overall merchandise assortments, including core and seasonal product offerings, and a higher in-stock position on retail inventories.

The Second Quarter of 2004 comparable store sales decrease in Pottery Barn Kids was primarily driven by the negative impact of new store openings in multi-store markets. Comparable store sales, however, were positive in both our single-store markets and those multi-store markets where there has not been an additional store opened in the last 12 months. We expect comparable store sales for Pottery Barn Kids stores in multi-store markets to remain volatile during the growth phase of the concept, consistent with our experience in the early years of the Pottery Barn store rollout.

**DIRECT-TO-CUSTOMER REVENUES**

| | Thirteen Weeks Ended | | Twenty-Six Weeks Ended | |
|---|---|---|---|---|
| **Dollars in thousands** | **August 1, 2004** | **August 3, 2003** | **August 1, 2004** | **August 3, 2003** |
| Catalog sales | $151,020 | $137,008 | $302,068 | $275,398 |
| Internet sales | 111,002 | 69,319 | 206,554 | 129,549 |
| Total direct-to-customer sales | 262,022 | 206,327 | 508,622 | 404,947 |
| Shipping fees | 44,751 | 36,864 | 87,957 | 70,545 |
| Total direct-to-customer revenues | $306,773 | $243,191 | $596,579 | $475,492 |
| Percent growth in direct-to-customer sales | 27.0% | 16.5% | 25.6% | 13.9% |
| Percent growth in number of catalogs circulated | 23.3% | 15.6% | 24.6% | 16.9% |

Direct-to-customer revenues (including catalog and Internet) in the Second Quarter of 2004 increased by $63,582,000, or 26.1%, over the Second Quarter of 2003. This increase was primarily driven by net sales generated in the Pottery Barn, PBteen and Pottery Barn Kids brands resulting from increased catalog circulation and the positive response to our on-line marketing initiatives. All of the brands in the direct-to-customer channel delivered positive growth during the quarter except Chambers, which mailed its final transition catalog during the quarter in preparation for the launch of Williams-Sonoma Home in the third quarter.

Direct-to-customer revenues for Year-to-Date 2004 increased $121,087,000, or 25.5%, over Year-to-Date 2003. This increase was primarily driven by net sales generated in the Pottery Barn, PBteen and Pottery Barn Kids brands, resulting from increased catalog circulation and the positive response to our on-line marketing initiatives. All of the brands in the direct-to-customer channel delivered positive growth year-to-date, except Chambers, which mailed its final transition catalog during the Second Quarter of 2004 in preparation for the launch of Williams-Sonoma Home in the third quarter of 2004.

Internet sales in the Second Quarter of 2004 increased by $41,683,000, or 60.1%, over the Second Quarter of 2003 and contributed 42.4% of total direct-to-customer sales in the Second Quarter of 2004 versus 33.6% in the Second Quarter of 2003. Internet sales for Year-to-Date 2004 increased by $77,005,000, or 59.4%, over Year-to-Date 2003 and contributed 40.6% of total direct-to-customer sales in Year-to-Date 2004 versus 32.0% in Year-to-Date 2003. Although the amount of Internet sales that are incremental to our direct-to-customer channel cannot be identified precisely, we estimate that approximately 35%-40% of company-wide non-gift registry Internet sales are incremental to the direct-to-customer channel and approximately 60%-65% are from customers who recently received a catalog.

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**COST OF GOODS SOLD**

| Dollars in thousands | Thirteen Weeks Ended August 1, 2004 | % Net Revenues | August 3, 2003 | % Net Revenues | Twenty-Six Weeks Ended August 1, 2004 | % Net Revenues | August 3, 2003 | % Net Revenues |
|---|---|---|---|---|---|---|---|---|
| Cost of goods and occupancy expenses | $391,689 | 56.8% | $335,213 | 57.8% | $749,570 | 56.3% | $637,510 | 57.1% |
| Shipping costs | 38,404 | 5.6% | 30,132 | 5.2% | 76,057 | 5.7% | 60,367 | 5.4% |
| Total cost of goods sold | $430,093 | 62.4% | $365,345 | 63.0% | $825,627 | 62.0% | $697,877 | 62.5% |

Cost of goods and occupancy expenses in the Second Quarter of 2004 increased by $56,476,000, or 16.9%, over the Second Quarter of 2003. As a percentage of net revenues, cost of goods and occupancy expenses decreased 100 basis points for the Second Quarter of 2004 from the Second Quarter of 2003. This percentage decrease was primarily driven by a rate reduction in occupancy expenses, partially offset by a higher percentage of furniture-driven merchandise cost of goods sold. The rate reduction in occupancy expenses resulted from a greater percentage of total Company net revenues being generated in the direct-to-customer channel, which does not incur store-related occupancy expenses, in addition to the overall leverage of fixed occupancy expenses that resulted from strong sales growth during the quarter.

Cost of goods and occupancy expenses for Year-to-Date 2004 increased by $112,060,000, or 17.6%, over Year-to-Date 2003. As a percentage of net revenues, cost of goods and occupancy expenses decreased 80 basis points for Year-to-Date 2004 from Year-to-Date 2003. This percentage decrease was primarily driven by a rate reduction in occupancy expenses, partially offset by the cost of replacing and liquidating damaged merchandise that was returned from customers. The rate reduction in occupancy expenses resulted from a greater percentage of total Company net revenues being generated in the direct-to-customer channel, which does not incur store-related occupancy expenses, in addition to the overall leverage of fixed occupancy expenses that resulted from strong sales growth during the year.

Shipping costs consist of third-party delivery services and shipping materials. Shipping costs in the Second Quarter of 2004 increased by $8,272,000, or 27.5%, versus the Second Quarter of 2003. This increase was directly related to a higher number of direct-to-customer shipments associated with the increase in direct-to-customer sales. Shipping costs, as a percentage of shipping fees, were 81.8% in the Second Quarter of 2004 versus 77.6% in the Second Quarter of 2003, primarily driven by an increase in furniture sales and a corresponding increase in furniture shipments, which generate lower shipping margins than the Company average.

Shipping costs for Year-to-Date 2004 increased by $15,690,000, or 26.0%, from Year-to-Date 2003 due to an increase in the number of customer shipments. This increase was directly related to a higher number of direct-to-customer shipments associated with the increase in direct-to-customer sales. Shipping costs, as a percentage of shipping fees, were 82.8% for Year-to-Date 2004 versus 81.6% for Year-To-Date 2003, primarily driven by an increase in furniture sales and a corresponding increase in furniture shipments, which generate lower shipping margins than the Company average.

**SELLING, GENERAL AND ADMINISTRATIVE EXPENSES**

Selling, general and administrative expenses increased $28,373,000, or 15.2%, to $214,599,000 in the Second Quarter of 2004 from $186,226,000 in the Second Quarter of 2003. Selling, general and administrative expenses expressed as a percentage of net revenues decreased to 31.1% in the Second Quarter of 2004 from 32.1% in the Second Quarter of 2003. This 100 basis point decrease as a percentage of net revenues was primarily driven by a rate reduction in employment expenses, partially offset by a rate increase in catalog advertising expenses. The employment rate decrease was primarily driven by year-over-year sales leverage in corporate employment, store labor, and employee benefit expenses. The advertising rate increase was primarily driven by a greater percentage of total Company net revenues in the Second Quarter of 2004 being generated in the direct-to-customer channel, which incurs advertising expense at a higher rate than the retail channel.

For Year-to-Date 2004, selling, general and administrative expenses increased $56,103,000, or 15.2%, to $425,172,000 from $369,069,000 for Year-to-Date 2003. Selling, general and administrative expenses expressed as a percentage of net revenues decreased by 100 basis points to 32.0% for Year-to-Date 2004 from 33.0% for Year-to-Date 2003. This percentage decrease was primarily driven by a rate reduction in employment expenses, resulting from year-over-year sales leverage in corporate employment and store labor, as well as an overall reduction in employee benefit costs.

**INTEREST EXPENSE (INCOME) – NET**

Interest expense, net of capitalized interest, was $150,000 in the Second Quarter of 2004 compared to interest income of $130,000 in the Second Quarter of 2003. For Year-to-Date 2004, net interest expense was $285,000 compared to net interest income of $446,000 for Year-to-Date 2003. The increase in interest expense in the Second Quarter of 2004 and for Year-to-Date 2004 was primarily due to additional interest expense of $389,000 and $779,000, respectively, associated with the consolidation of our Memphis-based distribution facilities. Prior to the adoption of FIN 46R, this expense would have been classified as occupancy expense.

**INCOME TAXES**

Our effective tax rate was 38.3% for Year-to-Date 2004 and 38.5% for Year-to-Date 2003. We expect our effective tax rate to remain at 38.3% for fiscal 2004.

**LIQUIDITY AND CAPITAL RESOURCES**

As of August 1, 2004, we held $119,218,000 in cash and cash equivalents. As is consistent with our industry, 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 significantly lower during the period from January through September. As a result, we utilize our cash throughout the year to fund the on-going operations of the business and we utilize the additional cash during the third quarter to build our inventory levels in preparation for our fourth quarter holiday sales. In fiscal 2004, we plan to utilize our cash resources to fund our inventory and inventory-related purchases, catalog advertising and marketing initiatives, and to support current store development and infrastructure strategies. In addition to the current cash balances on-hand, we have a $200,000,000 credit facility available as of August 1, 2004. We have not borrowed against this facility in Year-to-Date 2004. We believe our cash on-hand, in addition to our available credit facilities, will provide adequate liquidity and capital for our business operations and growth opportunities during the next twelve months.

For Year-to-Date 2004, net cash provided by operating activities was $22,246,000 as compared to net cash used in operating activities of $66,496,000 in Year-to-Date 2003. Net cash provided by operating activities for Year-to-Date 2004 was primarily attributable to net earnings, depreciation expense, an increase in customer deposits due to the continued growth in our unredeemed gift certificates and gift card liabilities and an increase in deferred rent and lease incentives due to an increase in retail store openings. This cash increase was partially offset by the payment of income taxes, an increase in accounts receivable due to the timing of credit card receipts, an increase in landlord receivables relating to the cost of store construction and the timing of new store openings in 2004 as well as an increase in prepaid expenses and other assets primarily related to the Mississippi Debt Transaction. (See Note C to our “Notes to Condensed Consolidated Financial Statements”).

For Year-to-Date 2004, net cash used in investing activities was $81,731,000 as compared to $71,831,000 for Year-to-Date 2003. Year-to-Date 2004 purchases of property and equipment included approximately $38,425,000 for stores, $26,543,000 for systems development projects (including e-commerce websites) and $16,763,000 for distribution and facility infrastructure projects.

Year-to-Date 2003 purchases of property and equipment of $71,831,000 included approximately $41,976,000 for stores, $27,559,000 for systems development projects (including e-commerce websites) and $2,296,000 for distribution and facility infrastructure projects.

In fiscal 2004, we anticipate investing $180,000,000 to $190,000,000 in the purchase of property and equipment, primarily for the construction of 41 new stores and the remodeling of 17 stores, systems development projects (including e-commerce websites), and distribution and facility infrastructure projects.

For Year-to-Date 2004, net cash provided by financing activities was $14,431,000 comprised primarily of proceeds from the issuance of bonds associated with the Mississippi Debt Transaction and the exercise of stock options, partially offset by cash used to repurchase common stock and the repayment of capital lease obligations. For Year-to-Date 2003, cash provided by financing activities was $25,497,000, comprised primarily of proceeds from the exercise of stock options, partially offset by the repayment of capital lease obligations.

***Stock Repurchase Program***

In May 2004, the Board of Directors authorized a stock repurchase program to acquire up to 2,500,000 shares of our outstanding common stock in the open market. During the Second Quarter of 2004, we repurchased and retired 255,500 shares of our common stock under the program at a total cost of approximately $7,915,000, a weighted average cost of $30.98 per share. At August 1, 2004, the remaining authorized amount of stock eligible for repurchase was 2,244,500 shares. 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 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.

| Period | Total Number of Shares Purchased | Average Price Paid Per Share | Number of Shares Purchased as Part of a Publicly Announced Plan or Program | Maximum Number of Shares That May Yet Be Purchased Under the Plan |
|---|---|---|---|---|
| May 3, 2004 - May 30, 2004 | — | — | — | 2,500,000 |
| May 31, 2004 - June 27, 2004 | — | — | — | 2,500,000 |
| June 28, 2004 - August 1, 2004 | 255,500 | $30.98 | 255,500 | 2,244,500 |
| Total | 255,500 | — | 255,500 | 2,244,500 |

***Impact of Inflation***

The impact of inflation on results of operations was not significant for Year-to-Date 2004 or Year-to-Date 2003.

***Seasonality***

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 significantly lower during the period from January through September. We believe this is the general pattern associated with the retail and direct-to-customer industries, and we expect this to continue going forward. 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.

***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 judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosures of contingent assets and liabilities. The 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 may differ significantly from these estimates. As of August 1, 2004, there have been no significant changes to our critical accounting policies as disclosed in our Annual Report on Form 10-K for the year ended February 1, 2004.

## 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 report, our Annual Report on Form 10-K for the fiscal year ended February 1, 2004 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 disclosed 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 upon our ability to anticipate and respond to changing merchandise trends and customer demands in a timely manner. Consumer preferences cannot be predicted with certainty and may change between sales 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 sell such inventory through our outlet stores, or other liquidation channels, at prices which are significantly lower than our retail prices, each of which would harm 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, well 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. 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, recession and fears of recession, war and fears of war, inclement weather, consumer debt, interest rates, sales tax rates and rate increases, consumer confidence in future economic conditions and political conditions, and consumer perceptions of personal well-being and security generally. 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.

*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; and
- 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.

In light of the many competitive challenges facing us, we may not be able to compete successfully. Increased competition could adversely affect 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 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.

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 might 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.

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

In fiscal 2003, we sourced our products from manufacturers in 41 countries outside of the United States. Approximately 61% of our merchandise purchases were foreign-sourced, primarily from Asia and Europe. Our dependence on foreign vendors means, in part, that we may be affected by declines in the relative value of the U.S. dollar to other foreign currencies. Although substantially all 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 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, against home-centered items 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 are in the process of implementing an enhanced 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, our retail stores have generated approximately 59% of our net revenues. We currently expect an increase of approximately 41 new and 17 remodeled retail stores in fiscal 2004 as part of our growth strategy. There is no assurance that we will be able to open the number of stores that we predict for 2004 or for future periods, or that the stores we open will be successful.

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 demographics 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 the reliable data regarding the timing of those shipments, including shipments to our customers and to and from all of our stores. Accordingly, we are subject to the risks, including labor disputes such as the west coast port strike of 2002, 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, we are seeing fuel costs increase 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 might 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, security breaches, human error, union organizing activity, 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, especially during our peak season, to support our direct-to-customer operations, due to war or other 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 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, fire, floods, power loss, telecommunications failures, and similar events. If any of these events results 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 of stores we open, close and expand in any period, the general retail sales environment, changes in sales mix between distribution channels, our ability to efficiently source and distribute products, changes in our merchandise mix, competition, current economic conditions, the timing of our releases of new merchandise and promotional events, the success of marketing programs, and the cannibalization of existing store sales by new stores. Among other things, weather conditions can affect comparable store sales, because inclement weather can 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 may cause our comparable store sales results to differ materially from prior periods and from earnings guidance we have provided.

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 2003, 2002 and 2001 were 4.0%, 2.7% and 1.7%, 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 more 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, such as discounts for bulk mailings and sorting by zip code and carrier routes. Our cost of paper has fluctuated significantly during the past three fiscal years, and our paper costs may increase in the future. Although we have entered into long-term contracts for catalog paper and catalog printing, these contracts offer no assurance that our catalog production costs will not substantially increase following expiration of the contracts. Future increases in postal rates or 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 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 the catalogs could affect the timing of catalog delivery, which 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, 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 may not receive full retail value from the resale or liquidation of the merchandise. In addition, 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 materially affect 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 expansions, 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. 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, we cannot ensure that, as our Internet business grows and as we add e-commerce websites for more of our concepts, it will not cannibalize a portion of our retail and catalog businesses.

*We may not be able to introduce new brands and brand extensions that improve our business.*

We have recently introduced two new brands, PBteen and West Elm, and expect to introduce additional new brands such as Williams-Sonoma Home and brand extensions in the future. If we devote time and resources to new brands and brand extensions, and those businesses are not as successful as we planned, then we risk damaging our overall business results. Alternatively, if our new brands and brand extensions prove to be very successful, we risk hurting our existing brands through the potential migration of existing brand customers to the new businesses. We may not be able to introduce new brands and brand extensions that improve our overall business and operating results.

*Our inability to obtain commercial insurance at acceptable prices 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 or terrorist attacks, we might determine that we cannot obtain commercial insurance at acceptable prices. Therefore, we might choose to forego or limit our purchase of relevant commercial insurance, choosing instead to self-insure one or more types or levels of risks. If we suffer a substantial loss that is not covered by commercial insurance, the loss and attendant expenses could have a material adverse effect on our business and operating results.

*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 patent litigation cases relating to the Internet.*

There appears to be a growing number of patent infringement lawsuits instituted against companies such as ours that have an Internet business. The plaintiff in each case claims to hold a patent that covers certain website technology, which is allegedly infringed by the operation of the defendants' e-commerce websites. We are currently a defendant in one such patent infringement case and anticipate being 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 are very 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 manage our employment, occupancy and other operating costs.*

To be successful, we need to manage our operating costs while we 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. Although we strive to secure long-term contracts with our service providers and other vendors and otherwise limit our financial commitment to them, we may not be able to avoid unexpected operating cost increases in the future. In addition, there appears to be a growing number of wage and hour lawsuits against retail companies, especially in California. 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, which would harm our business and operating results. 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 planning 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 have a material adverse effect on our business and operating results.

*We are considering changes to our information technology infrastructure that might disrupt our business.*

We are considering engaging a third party to host and manage some portions of our information technology infrastructure. If this occurs, we would rely on the third party to host our servers, software applications and websites. Accordingly, we would be subject to the risks associated with such third party's ability to provide information technology services to meet our needs. Our operations would depend significantly on this party's 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 this party is unable to adequately protect our data and information is lost or our ability to deliver our services is interrupted, then our business may be harmed.

*While we believe that we currently have adequate internal control procedures in place, we are still exposed to potential risks from recent legislation requiring companies to evaluate controls under Section 404 of the Sarbanes-Oxley Act of 2002.*

We are evaluating our internal controls systems 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. We are performing the system and process evaluation and testing required in an effort to comply with the management certification and auditor attestation requirements of Section 404. As a result, we are incurring additional expenses and a diversion of management's time. While we anticipate being able to fully implement the requirements relating to internal controls and all other aspects of Section 404 in a timely fashion, we cannot be certain as to the timing of completion of our evaluation, testing and remediation actions or the impact of the same on our operations since there is no precedent available by which to measure compliance adequacy. If we are not able to implement the requirements of Section 404 in a timely manner or with adequate compliance, we might 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 adversely affect our financial results and the market price of our common stock.

*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 fosters confidence among investors and analysts, 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. We cannot ensure that our guidance will 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, the market price of our common stock could 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.

## ITEM 3. 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 bank line of credit, the Mississippi Debt Transaction and on two of our operating leases is based on variable interest rates and is therefore affected by changes in market interest rates. If interest rates on existing variable rate debt and operating leases rose 24 basis points (an approximate 10% increase in the associated variable rates as of August 1, 2004), our results from operations and cash flows would not be significantly affected.

For one of the operating leases with a variable interest rate (2.8% at August 1, 2004), we have an interest rate cap contract at 5.88% with a notional amount as of August 1, 2004 of $11,833,000 which extends through February 2005. The contract has not been designated as a hedge and is accounted for by adjusting the carrying amount of the contract to market. Any gain or loss associated with this contract was recorded in selling, general and administrative expenses and was not material to us for Year-to-Date 2004 and Year-to-Date 2003.

In addition, we have fixed and variable income investments which are also affected by changes in market interest rates. An increase in interest rates of 10% would have an insignificant 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. During fiscal 2003, approximately 7% of our international purchase transactions were in currencies other than the U.S. dollar. As of August 1, 2004, 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 August 1, 2004, we have 11 retail stores in Canada, which expose us to market risk associated with foreign currency exchange rate fluctuations. As necessary, we utilize 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 contracts during the Second Quarter of 2004. Any gain or loss associated with foreign currency exchange rate fluctuations were not material to us.

## ITEM 4. CONTROLS AND PROCEDURES

As of August 1, 2004, an evaluation was performed under the supervision and with the participation of our management, including our Chief Executive Officer and our Executive Vice President, Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation as of August 1, 2004, our management, including our Chief Executive Officer and Executive Vice President, Chief Financial Officer, concluded that our disclosure controls and procedures were effective such that material information required to be included in our SEC reports is recorded, processed, summarized and reported within the periods specified in the SEC rules and forms. There have been no significant changes in our internal controls over financial reporting, or in other factors subsequent to August 1, 2004, that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

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## PART II — OTHER INFORMATION

### ITEM 1. 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 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Information required by this Item is contained in the section titled "Management's Discussion and Analysis of Financial Condition and Results of Operations" under the heading "Stock Repurchase Program" within Part I of this Form 10-Q.

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

The Company's Annual Meeting of Shareholders was held on May 19, 2004.

At the Company's 2004 Annual Meeting of Shareholders, the shareholders took the following actions:

(I) The shareholders elected each of the following persons by the vote indicated to serve as a Director of the Company until the next Annual Meeting of Shareholders or until his or her successor is elected and qualified:

| Name | For | Withheld |
|---|---|---|
| Sanjiv Ahuja | 105,524,847 | 898,708 |
| Adrian D.P. Bellamy | 104,144,663 | 2,278,892 |
| Patrick J. Connolly | 101,383,413 | 5,040,142 |
| Jeanne P. Jackson | 104,119,427 | 2,304,128 |
| W. Howard Lester | 103,891,038 | 2,532,517 |
| Michael R. Lynch | 102,460,867 | 3,962,688 |
| Edward A. Mueller | 103,879,314 | 2,544,241 |
| Richard T. Robertson | 105,552,852 | 870,703 |

(II) The shareholders approved, by the vote indicated, an amendment and restatement of the Williams-Sonoma, Inc. 2001 Stock Option Plan to (i) increase the shares issuable under the plan by 3,500,000 shares, and (ii) provide for the issuance of stock options, restricted stock and deferred stock awards:

| For | Against | Abstain | Broker Non-vote |
|---|---|---|---|
| 87,205,436 | 7,991,436 | 61,061 | 11,165,622 |

(III) The shareholders ratified, by the vote indicated, the selection of Deloitte & Touche LLP as the independent registered public accounting firm for the Company's fiscal year ending January 30, 2005:

| For | Against | Abstain | Broker Non-vote |
|---|---|---|---|
| 104,301,393 | 2,064,770 | 57,392 | 0 |

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## ITEM 6. EXHIBITS

| Exhibit Number | Exhibit Description |
|---|---|
| 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 |
| 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) |
| 10.1 | 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, Robert Pattillo Properties, Inc. as lessor, and the Company as guarantor dated December 1, 2003 |
| 10.2 | Second Amendment, dated as of July 2, 2004, to the Reimbursement Agreement between the Company and Bank of America, National Association, dated July 2, 2002 |
| 10.3 | Second Amendment, dated as of July 2, 2004, to the Reimbursement Agreement between the Company and The Bank of New York, dated July 2, 2002 |
| 10.4 | Second Amendment, dated as of July 2, 2004, to the Reimbursement Agreement between the Company and Fleet National Bank, dated July 2, 2002 |
| 10.5 | 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) |
| 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 |

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## SIGNATURE

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

WILLIAMS-SONOMA, INC.

By: /s/ SHARON L. MCCOLLAM

Sharon L. McCollam
Executive Vice President,
Chief Financial Officer

Dated: September 10, 2004

EXHIBIT 3.3

CERTIFICATE OF AMENDMENT OF
RESTATED ARTICLES OF INCORPORATION OF
WILLIAMS-SONOMA, INC.

Sharon L. McCollam and Charles K. Birkett certify that:

1. They are the Senior Vice President and Chief Financial Officer and the Assistant Secretary, respectively, of Williams-Sonoma, Inc., a California corporation.

2. Article III of the Restated Articles of Incorporation of this corporation is amended to read in its entirety as follows:

"ARTICLE III

(a) This corporation is authorized to issue two classes of shares: Common and Preferred. The number of Preferred shares authorized to be issued is 7,500,000, with a par value of one cent ($.01) per share, and the number of Common shares authorized to be issued is 253,125,000, with a par value of one cent ($.01) per share.

Upon the filing and effectiveness of this Certificate of Amendment of Articles of Incorporation, each outstanding Common share of the corporation shall be split and converted into two Common shares of the corporation.

(b) The Preferred shares may be divided into such number or series as the board of directors may determine. The board of directors is authorized to determine and alter the rights, preferences, privileges and restrictions granted to and imposed upon the Preferred shares or any series thereof with respect to any wholly unissued class or series of Preferred shares, and to fix the number of shares of any series of Preferred shares and the designation of any such series of Preferred shares. The board of directors, within the limits and restrictions stated in any resolution or resolutions of the board of directors originally fixing the number of shares constituting any series, may increase or decrease (but not below the number of shares of such series then outstanding) the number of shares of any series subsequent to the issue of shares of that series."

3. The foregoing amendment of the Restated Articles of Incorporation shall be effective as of the close of business on the date of filing with the Secretary of State.

4. The foregoing amendment of the Restated Articles of Incorporation has been duly approved by the Board of Directors of this corporation in accordance with the provisions of Sections 902(c) of the California General Corporation Law. The board alone is entitled to approve this amendment without shareholder approval because the amendment provides for only a stock split of the Common shares and a proportional increase in the authorized number of Common shares. This corporation has only Common shares outstanding.

We further declare under penalty of perjury under the laws of the State of California that the matters set forth in this certificate are true and correct of our own knowledge.

Executed at San Francisco, California, this 25th day of April, 2004.

/s/ Sharon L. McCollam

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Sharon L. McCollam

Senior Vice President and Chief Financial Officer

/s/ Charles K. Birkett

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Charles K. Birkett
Assistant Secretary



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EXHIBIT 10.1

SECOND ADDENDUM TO LEASE

This Second Addendum to Lease ("Addendum") is made effective as of the 1st day of June 2004, by and between ROBERT PATTILLO PROPERTIES, INC., a Georgia Corporation ("Landlord"), POTTERY BARN, INC., a California Corporation ("Tenant") and WILLIAMS-SONOMA, INC., a California Corporation ("Guarantor").

WITNESSETH:

WHEREAS, Landlord and Tenant entered into that certain Standard Industrial Lease Agreement dated December 1, 2003, for lease of property located at 11624 South Distribution Cove Olive Branch, MS ("Premises") as more particularly described in the Lease, and that certain First Amendment to Lease dated as of February 27, 2004, (said lease, as amended, is referred to herein as the "Lease"); and

WHEREAS, in conjunction with the execution and as part of the consideration for Landlord entering into the Lease, Guarantor executed a Guaranty dated as of December 1, 2003 ("Guaranty"); and

WHEREAS, the parties desire to modify certain terms of the Lease.

NOW, THEREFORE, for and in consideration of the mutual covenants and conditions contained herein and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

1. In accordance with the terms of Paragraph 6 of the Lease, Landlord has caused a registered surveyor to measure the actual square footage of the building on the Premises. The measurement reflects a total square footage in the Cell One Premises and the Cell Two Premises of 780,218 square feet. The parties agree that the portion of the building on the Cell One Premises contains 416,000 square feet and that the portion of the building on the Cell Two Premises contains 364,218 square feet. Accordingly, the Cell Two Rent shall be adjusted to reflect the actual square footage.

2. Time is of the essence as to all obligations of Landlord, Tenant and Guarantor hereunder. Landlord, Tenant and Guarantor hereby ratify and confirm the Lease, as amended hereby. All terms not otherwise defined herein shall have the meanings ascribed thereto in the Lease. This Addendum may be executed in two (2) or more counterparts, each of which shall be one and the same instrument and a duplicate original. Return of an executed copy of this Addendum by facsimile transmission shall bind the party so executing and returning such counterpart. Each party represents to the other that the person executing this Addendum on its behalf is authorized to do so by all required corporate, partnership or limited liability company action, as appropriate.

SIGNATURE CONTAINED ON FOLLOWING PAGES

IN WITNESS WHEREOF, the parties have hereunto set their hands and seals, effective the day and year first above written.

ROBERT PATTILLO PROPERTIES, INC.,
a Georgia Corporation

By: /s/ Clay W. Reese

---------------------------------- Witness

Its: Vice President

(CORP. SEAL)

POTTERY BARN, INC.,
a Delaware Corporation

By: /s/ Pat Connolly

---------------------------------- Witness

Its: Executive Vice President

(CORP. SEAL)

The undersigned executes this Second Addendum to Lease for the purpose of consenting to its terms and agreeing that its obligations under that certain Guaranty dated December 1, 2003, shall continue to apply to the Lease, as previously modified and as amended by this Second Addendum.

Guarantor:

WILLIAMS-SONOMA, INC.

By: /s/ Edward A. Mueller

Printed Name: Edward A. Mueller

Its: Chief Executive Officer



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Exhibit 10.2

SECOND AMENDMENT

THIS SECOND AMENDMENT dated as of July 2, 2004 (this "Amendment") amends the Reimbursement Agreement dated as of July 2, 2002 (as previously amended, the "Reimbursement Agreement") between Williams-Sonoma, Inc. (the "Parent") and Bank of America, N.A. (the "Bank"). Capitalized terms used but not otherwise defined herein have the respective meanings given to them in the Reimbursement Agreement.

WHEREAS, the Parent and the Bank have entered into the Reimbursement Agreement; and

WHEREAS, the Parent and the Bank desire to amend the Reimbursement Agreement as more fully set forth herein;

NOW, THEREFORE, the parties hereto agree as follows:

SECTION 1 Amendments. Subject to the satisfaction of the conditions precedent set forth in Section 3, the Reimbursement Agreement is amended as follows:

1.1 Amendment to Facility Size. Recital A is amended by replacing the reference to "$40,000,000"with "$45,000,000".

1.2 Amendment to Definition of Maturity Date. The definition of "Maturity Date" is amended by replacing the reference to "second anniversary" with "third anniversary".

1.3 Amendment to Section 2.1. Section 2.1 is amended by restating the first proviso therein to read as follows: "provided, however, that the Letter of Credit Usage shall not exceed $45,000,000 at any time".

1.4 Deletion of Sections 6.23 and 7.4. The text of each of Sections 6.23 and 7.4 is deleted and replaced with "[RESERVED]"

1.5 Amendment to Section 9.21. Section 9.21 is amended by deleting the last sentence thereof.

SECTION 2 Representations and Warranties. The Parent represents and warrants to the Bank that, after giving effect to the effectiveness hereof:

(a) each warranty set forth in Article 6 of the Reimbursement Agreement, as amended hereby, is true and correct in all material respects as of the date of the execution and delivery of this Amendment by the Parent, with the same effect as if made on such date, except to the extent any such warranty relates specifically to another date (in which case it was true and correct in all material respects as of such other date);

(b) no Default exists; and

(c) there has not occurred a material adverse change since February 2, 2004 in the business or financial condition, prospects, performance or operations of the Parent and its

Subsidiaries taken as a whole or in the facts and information regarding such Persons as represented to date.

SECTION 3 Effectiveness. The amendments set forth herein shall become effective as of July 2, 2004 when the Bank has received the following:

(a) a counterpart of this Amendment executed by the Parent;

(b) a Confirmation, substantially in the form of Exhibit A, executed by each Subsidiary Guarantor;

(c) an opinion of counsel to the Parent in form and substance reasonably acceptable to the Bank;

(d) evidence that the Parent has paid all accrued and invoiced Attorney Costs of the Bank; and

(e) such other documents as the Bank may reasonably request.

SECTION 4 Miscellaneous.

4.1 Continuing Effectiveness, etc. As amended hereby, the Reimbursement Agreement shall remain in full force and effect and is hereby ratified and confirmed in all respects. After the effectiveness of this Amendment, all references in the Reimbursement Agreement and the other Transaction Documents to "Reimbursement Agreement" or similar terms shall refer to the Reimbursement Agreement as amended hereby.

4.2 Counterparts. This Amendment may be executed in any number of counterparts and by the different parties on separate counterparts, and each such counterpart shall be deemed to be an original but all such counterparts shall together constitute one and the same Amendment.

4.3 Governing Law. This Amendment shall be a contract made under and governed by the laws of the State of New York applicable to contracts made and to be performed entirely within such state.

4.4 Successors and Assigns. This Amendment shall be binding upon the Parent and the Bank and their respective successors and assigns, and shall inure to the benefit of the Parent and the Bank and the successors and assigns of the Bank.

Delivered as of the day and year first above written.

WILLIAMS-SONOMA, INC.

By: /s/ Sharon L. McCollam
Name: Sharon L. McCollam
Title: Chief Financial Officer

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BANK OF AMERICA, N.A.

/s/ Lisa M. Thomas
By: Lisa M. Thomas
Title: Senior Vice President



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Exhibit 10.3

# SECOND AMENDMENT

THIS SECOND AMENDMENT dated as of July 2, 2004 (this "Amendment") amends the Reimbursement Agreement dated as of July 2, 2002 (as previously amended, the "Reimbursement Agreement") between Williams-Sonoma, Inc. (the "Parent") and The Bank of New York (the "Bank"). Capitalized terms used but not otherwise defined herein have the respective meanings given to them in the Reimbursement Agreement.

WHEREAS, the Parent and the Bank have entered into the Reimbursement Agreement; and

WHEREAS, the Parent and the Bank desire to amend the Reimbursement Agreement as more fully set forth herein;

NOW, THEREFORE, the parties hereto agree as follows:

SECTION 1 Amendments. Subject to the satisfaction of the conditions precedent set forth in Section 3, the Reimbursement Agreement is amended as follows:

1.1 Amendment to Definition of Maturity Date. The definition of "Maturity Date" is amended by replacing the reference to "second anniversary" with "third anniversary".

1.2 Deletion of Sections 6.23 and 7.4. The text of each of Sections 6.23 and 7.4 is deleted and replaced with "[RESERVED]"

1.3 Amendment to Section 9.21. Section 9.21 is amended by deleting the last sentence thereof.

SECTION 2 Representations and Warranties. The Parent represents and warrants to the Bank that, after giving effect to the effectiveness hereof:

(a) each warranty set forth in Article 6 of the Reimbursement Agreement, as amended hereby, is true and correct in all material respects as of the date of the execution and delivery of this Amendment by the Parent, with the same effect as if made on such date, except to the extent any such warranty relates specifically to another date (in which case it was true and correct in all material respects as of such other date);

(b) no Default exists; and

(c) there has not occurred a material adverse change since February 2, 2004 in the business or financial condition, prospects, performance or operations of the Parent and its Subsidiaries taken as a whole or in the facts and information regarding such Persons as represented to date.

SECTION 3 Effectiveness. The amendments set forth herein shall become effective as of July 2, 2004 when the Bank has received the following:

(a) a counterpart of this Amendment executed by the Parent;

(b) a Confirmation, substantially in the form of Exhibit A, executed by each Subsidiary Guarantor;

(c) an opinion of counsel to the Parent in form and substance reasonably acceptable to the Bank;

(d) evidence that the Parent has paid all accrued and invoiced Attorney Costs of the Bank; and

(e) such other documents as the Bank may reasonably request.

SECTION 4 Miscellaneous.

4.1 Continuing Effectiveness, etc. As amended hereby, the Reimbursement Agreement shall remain in full force and effect and is hereby ratified and confirmed in all respects. After the effectiveness of this Amendment, all references in the Reimbursement Agreement and the other Transaction Documents to "Reimbursement Agreement" or similar terms shall refer to the Reimbursement Agreement as amended hereby.

4.2 Counterparts. This Amendment may be executed in any number of counterparts and by the different parties on separate counterparts, and each such counterpart shall be deemed to be an original but all such counterparts shall together constitute one and the same Amendment.

4.3 Governing Law. This Amendment shall be a contract made under and governed by the laws of the State of New York applicable to contracts made and to be performed entirely within such state.

4.4 Successors and Assigns. This Amendment shall be binding upon the Parent and the Bank and their respective successors and assigns, and shall inure to the benefit of the Parent and the Bank and the successors and assigns of the Bank.

Delivered as of the day and year first above written.

WILLIAMS-SONOMA, INC.

By: /s/ Sharon L. McCollam
Name: Sharon L. McCollam
Title: Chief Financial Officer

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THE BANK OF NEW YORK

By: /s/ Randolph Medrano
Title: Vice President



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Exhibit 10.4

SECOND AMENDMENT

THIS SECOND AMENDMENT dated as of July 2, 2004 (this "Amendment") amends the Reimbursement Agreement dated as of July 2, 2002 (as previously amended, the "Reimbursement Agreement") between Williams-Sonoma, Inc. (the "Parent") and Fleet National Bank (the "Bank"). Capitalized terms used but not otherwise defined herein have the respective meanings given to them in the Reimbursement Agreement.

WHEREAS, the Parent and the Bank have entered into the Reimbursement Agreement; and

WHEREAS, the Parent and the Bank desire to amend the Reimbursement Agreement as more fully set forth herein;

NOW, THEREFORE, the parties hereto agree as follows:

SECTION 1 Amendments. Subject to the satisfaction of the conditions precedent set forth in Section 3, the Reimbursement Agreement is amended as follows:

1.1 Amendment to Facility Size. Recital A is amended by replacing the reference to "$40,000,000"with "$45,000,000".

1.2 Amendment to Definition of Maturity Date. The definition of "Maturity Date" is amended by replacing the reference to "second anniversary" with "third anniversary".

1.3 Amendment to Section 2.1. Section 2.1 is amended by restating the first proviso therein to read as follows: "provided, however, that the Letter of Credit Usage shall not exceed $45,000,000 at any time".

1.4 Deletion of Sections 6.23 and 7.4. The text of each of Sections 6.23 and 7.4 is deleted and replaced with "[RESERVED]"

1.5 Amendment to Section 9.21. Section 9.21 is amended by deleting the last sentence thereof.

SECTION 2 Representations and Warranties. The Parent represents and warrants to the Bank that, after giving effect to the effectiveness hereof:

(a) each warranty set forth in Article 6 of the Reimbursement Agreement, as amended hereby, is true and correct in all material respects as of the date of the execution and delivery of this Amendment by the Parent, with the same effect as if made on such date, except to the extent any such warranty relates specifically to another date (in which case it was true and correct in all material respects as of such other date);

(b) no Default exists; and

(c) there has not occurred a material adverse change since February 2, 2004 in the business or financial condition, prospects, performance or operations of the Parent and its

Subsidiaries taken as a whole or in the facts and information regarding such Persons as represented to date.

SECTION 3 Effectiveness. The amendments set forth herein shall become effective as of July 2, 2004 when the Bank has received the following:

(a) a counterpart of this Amendment executed by the Parent;

(b) a Confirmation, substantially in the form of Exhibit A, executed by each Subsidiary Guarantor;

(c) an opinion of counsel to the Parent in form and substance reasonably acceptable to the Bank;

(d) evidence that the Parent has paid all accrued and invoiced Attorney Costs of the Bank; and

(e) such other documents as the Bank may reasonably request.

SECTION 4 Miscellaneous.

4.1 Continuing Effectiveness, etc. As amended hereby, the Reimbursement Agreement shall remain in full force and effect and is hereby ratified and confirmed in all respects. After the effectiveness of this Amendment, all references in the Reimbursement Agreement and the other Transaction Documents to "Reimbursement Agreement" or similar terms shall refer to the Reimbursement Agreement as amended hereby.

4.2 Counterparts. This Amendment may be executed in any number of counterparts and by the different parties on separate counterparts, and each such counterpart shall be deemed to be an original but all such counterparts shall together constitute one and the same Amendment.

4.3 Governing Law. This Amendment shall be a contract made under and governed by the laws of the State of New York applicable to contracts made and to be performed entirely within such state.

4.4 Successors and Assigns. This Amendment shall be binding upon the Parent and the Bank and their respective successors and assigns, and shall inure to the benefit of the Parent and the Bank and the successors and assigns of the Bank.

Delivered as of the day and year first above written.

WILLIAMS-SONOMA, INC.

By: /s/ Sharon L. McCollam
Name: Sharon L. McCollam
Title: Chief Financial Officer

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FLEET NATIONAL BANK

/s/ Lisa M. Thomas
By: Lisa M. Thomas
Title: Senior Vice President



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**Exhibit 31.1**

## CERTIFICATION

I, Edward A. Mueller, Chief Executive Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Williams-Sonoma, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: September 10, 2004

By: /s/ Edward A. Mueller

Edward A. Mueller
Chief Executive Officer

**Exhibit 31.2**

**CERTIFICATION**

I, Sharon L. McCollam, Executive Vice President, Chief Financial Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Williams-Sonoma, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

    a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

    a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

    b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: September 10, 2004

By: /s/ Sharon L. McCollam

Sharon L. McCollam
Executive Vice President,
Chief Financial Officer

**Exhibit 32.1**

**CERTIFICATION BY CHIEF EXECUTIVE OFFICER**
**PURSUANT TO 18 U.S.C. SECTION 1350,**
**AS ADOPTED PURSUANT TO**
**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q for the period ended August 1, 2004 of Williams-Sonoma, Inc. (the "Company") as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Edward A. Mueller, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of and for the periods presented in the Report.

By: /s/ Edward A. Mueller

Edward A. Mueller
Chief Executive Officer

Dated: September 10, 2004

**Exhibit 32.2**

**CERTIFICATION BY CHIEF FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q for the period ended August 1, 2004 of Williams-Sonoma, Inc. (the "Company") as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Sharon L. McCollam, Executive Vice President, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of and for the periods presented in the Report.

By: /s/ Sharon L. McCollam

Sharon L. McCollam
Executive Vice President,
Chief Financial Officer

Dated: September 10, 2004