ADVANCE AUTO PARTS INC
Form 10-Q
November 14, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended October 7, 2017
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ________ to ________.

Commission file number 001-16797

ADVANCE AUTO PARTS, INC.
(Exact name of registrant as specified in its charter)

Delaware	54-2049910
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

5008 Airport Road, Roanoke, Virginia 24012
(Address of Principal Executive Offices)
(Zip Code)

(540) 362-4911
(Registrant’s telephone number, including area code)

Not Applicable
(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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o
	Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

As of November 10, 2017, the registrant had outstanding 73,898,043 shares of Common Stock, par value $0.0001 per share (the only class of common stock of the registrant outstanding).

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PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS OF ADVANCE AUTO PARTS, INC. AND SUBSIDIARIES

Advance Auto Parts, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets
(In thousands, except per share data) (Unaudited)

	October 7, 2017	December 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	$363,302	$135,178
Receivables, net	679,359	641,252
Inventories	4,219,321	4,325,868
Other current assets	105,970	70,466
Total current assets	5,367,952	5,172,764
Property and equipment, net of accumulated depreciation of $1,755,749 and $1,660,648	1,418,486	1,446,340
Goodwill	994,408	990,877
Intangible assets, net	608,520	640,903
Other assets, net	78,858	64,149
	$8,468,224	$8,315,033
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	2,921,653	3,086,177
Accrued expenses	572,360	554,397
Other current liabilities	43,396	35,472
Total current liabilities	3,537,409	3,676,046
Long-term debt	1,044,008	1,042,949
Deferred income taxes	429,194	454,282
Other long-term liabilities	226,826	225,564
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, nonvoting, $0.0001 par value	—	—
Common stock, voting, $0.0001 par value	8	8
Additional paid-in capital	656,718	631,052
Treasury stock, at cost	(141,482)	(138,102)
Accumulated other comprehensive loss	(24,503)	(39,701)
Retained earnings	2,740,046	2,462,935
Total stockholders' equity	3,230,787	2,916,192
	$8,468,224	$8,315,033

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

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Advance Auto Parts, Inc. and Subsidiaries
Condensed Consolidated Statements of Operations
(In thousands, except per share data) (Unaudited)

	Twelve Week Periods Ended		Forty Week Periods Ended	
	October 7, 2017	October 8, 2016	October 7, 2017	October 8, 2016
Net sales	$2,182,233	$2,248,855	$7,336,798	$7,484,788
Cost of sales, including purchasing and warehousing costs	1,234,525	1,260,650	4,125,318	4,136,437
Gross profit	947,708	988,205	3,211,480	3,348,351
Selling, general and administrative expenses	791,139	794,437	2,728,420	2,666,900
Operating income	156,569	193,768	483,060	681,451
Other, net:				
Interest expense	(13,314)	(13,581)	(45,665)	(46,545)
Other income (expense), net	745	(2,349)	8,727	7,018
Total other, net	(12,569)	(15,930)	(36,938)	(39,527)
Income before provision for income taxes	144,000	177,838	446,122	641,924
Provision for income taxes	48,004	63,994	155,117	244,667
Net income	$95,996	$113,844	$291,005	$397,257
Basic earnings per share	$1.30	$1.54	$3.94	$5.38
Weighted average shares outstanding	73,866	73,638	73,827	73,524
Diluted earnings per share	$1.30	$1.53	$3.93	$5.36
Weighted average shares outstanding - assuming dilution	74,106	73,860	74,097	73,847
Dividends declared per share	$0.06	$0.06	$0.18	$0.18

Condensed Consolidated Statements of Comprehensive Income
(In thousands) (Unaudited)

	Twelve Week Periods Ended		Forty Week Periods Ended	
	October 7, 2017	October 8, 2016	October 7, 2017	October 8, 2016
Net income	$95,996	$113,844	$291,005	$397,257
Other comprehensive income (loss):				
Changes in net unrecognized other postretirement benefit costs, net of tax of $41, $88, $137 and $295	(63)	(136)	(211)	(455)
Currency translation adjustments	2,225	(4,939)	15,409	7,018
Total other comprehensive income (loss)	2,162	(5,075)	15,198	6,563
Comprehensive income	$98,158	$108,769	$306,203	$403,820

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

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Advance Auto Parts, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(In thousands) (Unaudited)

	Forty Week Periods Ended October 7, 2017	October 8, 2016
Cash flows from operating activities:		
Net income	$ 291,005	$ 397,257
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	192,753	199,262
Share-based compensation	28,156	11,664
Loss on property and equipment, net	4,692	4,602
(Benefit) provision for deferred income taxes	(25,712)	21,130
Other, net	2,262	(2,657)
Net change in:		
Receivables, net	(35,760)	(87,488)
Inventories	116,957	(175,678)
Accounts payable	(170,227)	(9,222)
Accrued expenses	36,564	84,897
Other assets and liabilities	(39,685)	(16,735)
Net cash provided by operating activities	401,005	427,032
Cash flows from investing activities:		
Purchases of property and equipment	(160,960)	(204,213)
Proceeds from sales of property and equipment	6,120	1,483
Other, net	20	(2,672)
Net cash used in investing activities	(154,820)	(205,402)
Cash flows from financing activities:		
Increase in bank overdrafts	4,676	8,765
Borrowings under credit facilities	534,400	686,100
Payments on credit facilities	(534,400)	(846,100)
Dividends paid	(17,828)	(17,734)

Proceeds from the issuance of common stock	3,142			3,438		
Tax withholdings related to the exercise of stock appreciation rights	(6,414		)	(15,764		)
Repurchase of common stock	(3,380		)	(12,300		)
Other, net	(2,095		)	(323		)
Net cash used in financing activities	(21,899		)	(193,918		)
Effect of exchange rate changes on cash	3,838			1,000		
Net increase in cash and cash equivalents	228,124			28,712		
Cash and cash equivalents, beginning of period	135,178			90,782		
Cash and cash equivalents, end of period	$	363,302		$	119,494	
Non-cash transactions:						
Accrued purchases of property and equipment	$	7,860		$	20,300	

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

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Advance Auto Parts, Inc. and Subsidiaries
Notes to the Condensed Consolidated Financial Statements
(Unaudited)

1. Description of Business and Basis of Presentation

Advance Auto Parts, Inc. and subsidiaries is a leading automotive aftermarket parts provider in North America, serving both “do-it-for-me”, or Professional, and “do-it-yourself”, or DIY customers. The accompanying interim unaudited condensed consolidated financial statements have been prepared by the Company and include the accounts of Advance Auto Parts, Inc. (“Advance”), its wholly owned subsidiary, Advance Stores Company, Incorporated (“Advance Stores”), and its subsidiaries (collectively referred to as “Advance”, “we”, “us”, “our” or “the Company”).

As of October 7, 2017, the Company operated a total of 5,074 stores and 129 distribution branches primarily within the United States, with additional locations in Canada, Puerto Rico and the U.S. Virgin Islands. The Company’s stores operate primarily under the trade names “Advance Auto Parts,” “Carquest” and “Autopart International,” and our distribution branches operate under the “Worldpac” trade name. In addition, as of October 7, 2017, the Company served approximately 1,250 independently-owned Carquest branded stores (“independent stores”) across the same geographic locations served by the Company’s stores in addition to Mexico, the Bahamas, Turks and Caicos, the British Virgin Islands and the Pacific Islands.

The accounting policies followed in the presentation of interim financial results are consistent with those followed on an annual basis. All intercompany balances and transactions have been eliminated in consolidation. In the opinion of management, all adjustments consisting of normal recurring adjustments necessary for a fair presentation of the financial position of the Company, the results of its operations and cash flows have been made.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America, or GAAP, have been condensed or omitted based upon the Securities and Exchange Commission (“SEC”) interim reporting guidance. These financial statements should be read in conjunction with the financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for 2016 as filed with the SEC on February 28, 2017.

The results of operations for the interim periods are not necessarily indicative of the operating results to be expected for the full fiscal year. The first quarter of each of the Company’s fiscal years contains sixteen weeks. The Company’s remaining three quarters consist of twelve weeks.

Segment and Related Information

Effective in the third quarter of 2017, the Company realigned its three geographic divisions, which included the operations of the stores operating under the Advance Auto Parts, Carquest and Autopart International trade names, into two US geographic divisions. As a result of this realignment and change in the operating structure of its Carquest Independent and Carquest Canada businesses, the Company has increased its number of operating segments from four to five. As a result, goodwill was reassigned to the affected reporting units using a relative fair value approach. The Company continues to aggregate its operating segments into one reportable segment.

Recently Adopted Accounting Pronouncements

In March 2016, the FASB issued ASU 2016-09, “Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting” aimed at simplifying certain aspects of accounting for share-based payment transactions. The areas for simplification include the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The Company adopted ASU 2016-09 in the first quarter of 2017 and recorded a cumulative effect reduction to beginning retained earnings of $490 thousand related to the Company’s election to record forfeitures as they occur. In addition, the Company elected to retrospectively adopt the provision regarding the presentation of excess tax benefits in the statement of cash flows, which resulted in an increase in our net cash provided by operating activities and a decrease in our net cash provided by financing activities of $17.6 million for the forty weeks ended October 8, 2016. The provision requiring the inclusion of excess tax benefits (deficits) as a component of the provision for income taxes in the consolidated results of operations is being applied prospectively. The Company recorded excess tax benefits of $4.5 million as a reduction in Provision for income taxes during the forty weeks ended October 7, 2017. The impact of excess tax benefits was immaterial during the twelve weeks ended October 7, 2017.

Recently Issued Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842).” This ASU is a comprehensive new leases standard that amends various aspects of existing guidance for leases and requires additional disclosures about leasing arrangements. It will require lessees to recognize lease assets and lease liabilities for all leases, including those leases previously classified as operating leases under current GAAP. The ASU is effective for annual periods beginning after December 15, 2018 with early adoption permitted. From a balance sheet perspective, the Company expects adoption of the new standard to have a material effect on its Total assets and Total liabilities as a result of recording the required right of use asset and associated lease liability. However, the Company has not completed its analysis and is unable to quantify the impact at this time. Currently, the Company does not expect adoption of ASU 2016-02 to have a material impact on its consolidated statements of operations as the majority of its leases will remain operating in nature. As such, the expense recognition will be similar to previously required straight-line expense treatment. The Company is also in the process of identifying changes to its business processes, systems and controls to support adoption of the new standard in 2019.

In May 2014, the FASB issued ASU 2014-09 “Revenue from Contracts with Customers (Topic 606).” This ASU, along with subsequent ASU’s issued to clarify certain provisions of ASU 2014-09, is a comprehensive new revenue recognition model that expands disclosure requirements and requires a company to recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2017 with early adoption permitted. The Company plans to adopt the new standard effective December 31, 2017 and will apply the modified retrospective method. The Company has analyzed the impact of ASU 2014-09, as amended, on its revenue contracts, comparing the Company’s current accounting policies and practices to the requirements of the new standard and identified differences that would result from applying the new standard to its contracts. The Company has determined the adoption of the new standard will not have a material impact on its consolidated financial condition, results of operations or cash flows. Additionally, the Company does not anticipate any significant changes to business processes, controls or systems as a result of adopting the new standard.

2. Inventories

Inventories are stated at the lower of cost or market. The Company used the LIFO method of accounting for approximately 88% and 89% of inventories at October 7, 2017 and December 31, 2016. Under the LIFO method, the Company’s cost of sales reflects the costs of the most recently purchased inventories, while the inventory carrying balance represents the costs for inventories purchased in 2017 and prior years. As a result of changes in the LIFO reserve, the Company recorded a reduction to cost of sales of $6.5 million and $48.7 million for the forty weeks ended October 7, 2017 and October 8, 2016.

An actual valuation of inventory under the LIFO method is performed by the Company at the end of each fiscal year based on the inventory levels and costs at that time. Accordingly, interim LIFO calculations are based on management’s estimates of expected year-end inventory levels and costs.