ADVANCE AUTO PARTS INC
Form 10-Q
November 17, 2015
Table of Contents

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 10, 2015
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 Registration 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

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 12, 2015, the registrant had outstanding 73,236,597 shares of Common Stock, par value $0.0001 per share (the only class of common stock of the registrant outstanding).

Table of Contents

			Page
PART I.	FINANCIAL INFORMATION		
	Item 1.	Condensed Consolidated Financial Statements of Advance Auto Parts, Inc. and Subsidiaries (unaudited):	
		Condensed Consolidated Balance Sheets as of October 10, 2015 and January 3, 2015	1
		Condensed Consolidated Statements of Operations for the Twelve and Forty Week Periods Ended October 10, 2015 and October 4, 2014	2
		Condensed Consolidated Statements of Comprehensive Income for the Twelve and Forty Week Periods Ended October 10, 2015 and October 4, 2014	2
		Condensed Consolidated Statement of Changes in Stockholders' Equity for the Forty Week Period Ended October 10, 2015	3
		Condensed Consolidated Statements of Cash Flows for the Forty Week Periods Ended October 10, 2015 and October 4, 2014	4
		Notes to the Condensed Consolidated Financial Statements	6
	Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	27
	Item 3.	Quantitative and Qualitative Disclosures About Market Risk	39
	Item 4.	Controls and Procedures	40
PART II.	OTHER INFORMATION		
	Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	41
	Item 6.	Exhibits	42
SIGNATURE			S-1

Table of Contents

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
October 10, 2015 and January 3, 2015
(in thousands, except per share data)
(unaudited)

Assets	October 10, 2015	January 3, 2015
Current assets:		
Cash and cash equivalents	$105,346	$104,671
Receivables, net	664,614	579,825
Inventories, net	4,141,562	3,936,955
Other current assets	96,863	119,589
Total current assets	5,008,385	4,741,040
Property and equipment, net of accumulated depreciation of $1,469,254 and $1,372,359	1,396,093	1,432,030
Goodwill	992,576	995,426
Intangible assets, net	702,719	748,125
Other assets, net	81,763	45,737
	$8,181,536	$7,962,358
Liabilities and Stockholders' Equity		
Current liabilities:		
Current portion of long-term debt	$595	$582
Accounts payable	3,180,175	3,095,365
Accrued expenses	582,661	520,673
Other current liabilities	187,483	126,446
Total current liabilities	3,950,914	3,743,066
Long-term debt	1,293,102	1,636,311
Other long-term liabilities	524,444	580,069
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, nonvoting, $0.0001 par value	—	—
Common stock, voting, $0.0001 par value	7	7
Additional paid-in capital	589,324	562,945
Treasury stock, at cost	(114,864)	(113,044)
Accumulated other comprehensive loss	(32,053)	(12,337)
Retained earnings	1,970,662	1,565,341
Total stockholders' equity	2,413,076	2,002,912
	$8,181,536	$7,962,358

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

1

Table of Contents

Advance Auto Parts, Inc. and Subsidiaries
Condensed Consolidated Statements of Operations
For the Twelve and Forty Week Periods Ended
October 10, 2015 and October 4, 2014
(in thousands, except per share data)
(unaudited)

	Twelve Week Periods Ended		Forty Week Periods Ended	
	October 10, 2015	October 4, 2014	October 10, 2015	October 4, 2014
Net sales	$2,295,203	$2,289,456	$7,703,473	$7,606,652
Cost of sales, including purchasing and warehousing costs	1,262,816	1,255,014	4,189,873	4,156,980
Gross profit	1,032,387	1,034,442	3,513,600	3,449,672
Selling, general and administrative expenses	826,862	825,284	2,788,498	2,744,039
Operating income	205,525	209,158	725,102	705,633
Other, net:				
Interest expense	(14,384)	(15,903)	(51,599)	(56,406)
Other income (expense), net	1,276	398	(4,440)	

2,194

*

—

Michael J. Schewel
6,189

230

l
6,419

*

—

Richard R. Whitt, III
6,070

—

6,070

*

6,575

Debora J. Wilson
2,725

926

m
3,651

*

—

Robert C. Cox
—

—

—

*

1,189

Bradley J. Kiscaden
4,920

—

4,920

*

2,338

Jeremy A. Noble
555

—

555

*

340

Linda V. Schreiner
449

—

449

*

916

Anne G. Waleski
3,669

—

3,669

*

956

All directors and executive officers as a group
243,956

80,594

324,550

2.34
%

30,994

The Vanguard Group (Pennsylvania corporation)
100 Vanguard Blvd., Malvern, PA 19355[n]
1,189,579

—

1,189,579

8.58
%

—

BlackRock, Inc.
55 East 52nd St., New York, NY 10055[o]
904,635

—

904,635

6.52
%

—

*Less than 1% of class.

6

[a] Includes the following shares subject to pledges: (i) 9,000 shares pledged by Mr. Kirshner as collateral for loans; (ii) 30,000 shares pledged by Anthony F. Markel as collateral for loans; (iii) 40,000 shares pledged by Steven A. Markel as collateral for loans; and (iv) 533 shares held by Mr. Whitt in a brokerage margin account with respect to which there are currently no outstanding loans, and 1,630 shares pledged by Mr. Whitt as collateral for a line of credit for which there is an outstanding balance of $50,000.

[b] Restricted Stock Units ("RSUs") represent the right to receive unrestricted shares of Common Stock upon the lapse of restrictions, at which point the holders will have sole investment and voting power. RSUs that will not vest within 60 days of the date of the table are not considered beneficially owned for purposes of the table and are therefore not included in the Total Beneficial Ownership column because the holders are not entitled to voting rights or investment control until the restrictions lapse.

[c] Includes 172 shares held by Mr. Connell's wife, as to which beneficial ownership is disclaimed.

[d] Includes 447 shares held as trustee for the benefit of Mr. Gayner's wife and 2,000 shares held by Mr. Gayner's wife, in each case, as to which beneficial ownership is disclaimed.

[e] Of the number shown, 13,241 RSUs have vested, but receipt of the shares has been deferred.

[f] Includes 3,028 shares held by Mr. Kasen's wife, as to which beneficial ownership is disclaimed.

[g] Includes 15 shares held by Mr. Kirshner's wife and 273 shares held indirectly by Mr. Kirshner's wife under the Company's 401(K) Plan, in each case, as to which beneficial ownership is disclaimed.

[h] Includes 500 shares held by Ms. Leopold's husband, as to which beneficial ownership is disclaimed.

[i] Includes 30,524 shares held in Grantor Retained Annuity Trusts for which Anthony F. Markel is trustee and partial beneficiary; 6,220 shares held as trustee for the benefit of Mr. Markel and his children; and 2,443 shares held in trusts for his children for which Mr. Markel is trustee and partial beneficiary. Mr. Markel disclaims beneficial ownership of these shares except with respect to his interests in the trusts. Includes 8,177 shares held as trustee for the benefit of Mr. Markel's children as to which beneficial ownership is disclaimed, 2,520 shares held as trustee in a charitable lead unitrust for the partial benefit of Mr. Markel's children and 1,220 shares held by Mr. Markel's wife, in each case, as to which beneficial ownership is also disclaimed.

[j] Includes 15,000 shares held by Mr. Markel's wife, as to which beneficial ownership is disclaimed.

[k] Includes 6,900 shares held by Mr. Martin's wife, as to which beneficial ownership is disclaimed.

[l] Includes 230 shares held by Mr. Schewel's wife, as to which beneficial ownership is disclaimed.

[m] Includes 926 shares held by an irrevocable trust for the benefit of Ms. Wilson's spouse and children. Ms. Wilson's spouse and daughter are the trustees of the trust. Beneficial ownership of these shares is disclaimed.

[n] Based on a Schedule 13G/A dated February 11, 2019. Of the total shares, The Vanguard Group (a Pennsylvania corporation) has sole voting power of 9,606 shares, shared voting power of 5,187 shares, sole dispositive power with respect to 1,175,158 shares and shared dispositive power with respect to 14,421 shares.

[o] Based on a Schedule 13G/A dated February 6, 2019. Of the total shares, BlackRock, Inc. has sole voting power of 804,862 shares and sole dispositive power with respect to 904,635 shares.

Policy on Hedging and Pledging of Company Stock

In February 2013, the Board adopted a policy applicable to the Company's executive officers and directors prohibiting any future hedging of Company Common Stock through covered call, collar or other derivative transactions.

On the same date, the Board adopted a policy applicable to its executive officers and directors regarding the pledging of Company Common Stock. The policy initially prohibited the pledging by any one individual of shares of Company Common Stock in excess of one percent of the Company's outstanding common shares. In February 2015, the Board amended the policy to reduce the percentage to 0.75%. In addition to this prohibition, the policy stipulates that shares of Company Common Stock received as compensation by executive officers and directors may not be pledged. Compliance with these policies will be reviewed by the Nominating/Corporate Governance Committee on an annual basis. Any shares pledged in violation of this policy will not be considered as "owned" for purposes of the Company's stock ownership guidelines.

On February 19, 2019, the Nominating/Corporate Governance Committee conducted a review of the policy and of the number of shares pledged by the Company's executive officers and directors, the number of the Company's outstanding shares and average trading volume. The Committee acknowledged that over the last several years the number of shares pledged by executive officers and directors has been substantially reduced. The Committee also acknowledged that, as descendants of Sam Markel, who in the 1930s formed the company that Anthony F. Markel and Steven A. Markel would later take public in 1986, it is not surprising that a significant portion of their net worth is held in the form of Markel stock. As proud and committed long-term stockholders, it has been their preference to hold onto their Markel stock rather than sell it. Pledging has enabled them to unlock a portion of the value of their stock without having to sell it. Within the constraints set forth in the policy, the Committee affirmed its support of this approach. The Committee reviewed the outstanding pledge balances of each of the Company's executive officers and directors and confirmed the adequacy of and compliance with the policy.

CORPORATE GOVERNANCE

Committees of the Board of Directors; Director Independence

The Board of Directors has adopted Corporate Governance Guidelines and written charters for the Audit Committee, Compensation Committee and Nominating/Corporate Governance Committee. Current copies of the Guidelines and the written charters for each of these committees are available to security holders on the Company's website, www.markelcorp.com.

The Board of Directors held nine meetings in 2018. Each director attended at least 75% of the meetings of the Board and all committees on which he or she served during 2018.

The following table reflects the current membership and the chair of the Audit, Compensation and Nominating/Corporate Governance Committees.

	Audit	Compensation	Nominating/Corporate Governance
J. Alfred Broaddus, Jr.	Member		Chair
K. Bruce Connell	Member	Member	
Stewart M. Kasen	Member	Member	
Diane Leopold		Member	Member
Lemuel E. Lewis	Chair		Member
Michael O'Reilly	Member	Member	Member
Michael J. Schewel	Member		Member
Debora J. Wilson	Member	Chair	

The Board has determined that, of the current directors, Messrs. Broaddus, Connell, Kasen, Lewis, Martin, O'Reilly and Schewel and Mses. Leopold and Wilson are each "independent" of management under applicable New York Stock Exchange ("NYSE") rules. Other than Mr. Martin, each of these directors is "independent" under categorical standards for determining independence adopted by the Nominating/Corporate Governance Committee. The Board has also determined that each member of the Audit, Compensation and Nominating/Corporate Governance Committees meets applicable NYSE independence standards for service on those committees. No additional factors were identified that would impair any Compensation Committee member's ability to make independent judgments about the compensation of the Company's executive officers.

Under the categorical standards adopted by the Nominating/Corporate Governance Committee, a director is considered independent without further Board determination if the director meets NYSE standards, unless:

- The director is, or has been within the last three years, an employee of the Company, or an immediate family member is, or has been within the last three years, an executive officer, of the Company. Employment as an interim Chairman or Chief Executive Officer or other executive officer shall not disqualify a director from being considered independent following that employment.
- The director has received, or has an immediate family member who has received, during any 12 month period within the past three years, more than $120,000 in direct compensation from the company other than director and committee fees and pension or other forms of deferred compensation for prior service (provided such compensation is not contingent in any way on continued service).
- The director is a current partner or employee of a firm that is the Company's internal or external auditor; the director has an immediate family member who is a current partner of such a firm; the director has an immediate family member who is a current employee of such a firm and personally works on the Company's audit; or the director or an immediate family member was within the last three years a partner or employee of such a firm and personally worked on the Company's audit within that time.
- The director or an immediate family member is, or has been within the last three years, employed as an executive officer of another company where any of the Company's present executive officers at the same time serves or served on that company's compensation committee.

- The director is a current employee, or an immediate family member is a current executive officer, of a company that has made payments to, or received payments from, the Company for property or services in an amount which, in any of the last three fiscal years, exceeds the greater of $1,000,000, or 2% of such other company's consolidated gross revenues.
- The director or an immediate family member is a current executive officer of a tax exempt organization that has received contributions from the Company in an amount which, in any of the last three fiscal years, exceeds the greater of $1,000,000, or 2% of such tax exempt organization's consolidated gross revenues.

For these purposes, "immediate family" means a person's spouse, parents, children, siblings, mothers and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law, and anyone (other than domestic employees) who shares the person's home.

Mr. Martin was Chief Financial Officer of the Company from 1988 to 2005 and continued in a part-time advisory and consulting role from 2005 until he was elected to the Board effective October 1, 2009. Mr. Martin has not been employed by the Company for over nine years. He has not been a Section 16 officer of the Company since 2005. He has a son employed by a subsidiary of the Company as a Managing Executive. He is not an "executive officer" as defined in Rule 16a-1(f) under the Securities Exchange Act of 1934. After consideration of all the relevant factors, including the length of time since Mr. Martin has been employed on a full-time basis and his son's position, the Board, on recommendation of the Nominating/Corporate Governance Committee, has determined that Mr. Martin is "independent" for purposes of Board membership.

In 2018, Jay M. Weinberg served as a director of the Company and a member of the Compensation and Nominating/Corporate Governance Committees until his retirement as a director, which became effective upon the election of Ms. Leopold as his successor at the 2018 Annual Meeting. The Board had determined that, during this period of service, Mr. Weinberg was "independent" of management under applicable NYSE rules and had also met applicable NYSE independence standards for service on those committees.

Board Leadership Structure and Risk Oversight

Mr. Kirshner has served as Chairman of the Board since the Company became a public company in 1986. He also served as our Chief Executive Officer from 1986 through 2015. On January 1, 2016, Mr. Gayner and Mr. Whitt were appointed by the Board as Co-Chief Executive Officers of the Company ("Co-CEOs") reporting to Mr. Kirshner, the Company's Executive Chairman. On August 30, 2016, Mr. Gayner and Mr. Whitt became members of the Board. On April 24, 2018, with approval from the Board, the functions, duties and responsibilities of the Company's principal executive officer were transitioned from Mr. Kirshner collectively to Mr. Gayner and Mr. Whitt. As Co-CEOs and Board members, Mr. Gayner and Mr. Whitt manage the day-to-day operations of the Company and formulate and implement the long-term strategic direction and initiatives of the Company (including the allocation of capital) in consultation with the other members of the Board.

The Company's Corporate Governance Guidelines provide for the designation of a Lead Director by the non-employee directors, and Mr. Kasen has been appointed as the Lead Director. The Lead Director presides at meetings of the non-employee directors and is responsible for communicating to the Chairman of the Board regarding the meetings.

In August 2016, the Board adopted changes to the Company's Corporate Governance Guidelines to address director qualifications. The changes state that continued Board membership of a former Chief Executive Officer of the Company is a matter to be decided in each individual instance, and that when a Chief Executive Officer resigns from that position, he or she should offer to resign from the Board at the same time.

The Audit Committee and the Board are principally responsible for monitoring risk management by the Company. Management regularly reports to the Audit Committee and the Board on litigation risks, underwriting risks, operating risks, reserving issues, investment risks, reinsurance and catastrophe risk management. Management also has established an enterprise risk management committee which periodically reports on its activities to the Audit Committee or the Board. In addition, management reviews with the Compensation Committee the design of the Company's incentive compensation programs to assist in evaluating whether the programs might encourage the taking of excessive or unnecessary risks in order to earn incentive compensation.

Executive Sessions

The non-employee directors (all of whom are independent) meet in executive session without management at each regularly scheduled Board meeting and at such other times as the non-employee directors deem appropriate.

Communications with Directors

Any security holder or other interested party wishing to communicate with the Board of Directors as a whole, the non-employee directors or an individual director should write to “Board of Directors,” “Non-Employee Directors” or the individual director in care of the Company Secretary at 4521 Highwoods Parkway, Glen Allen, Virginia, 23060. Communications from security holders or other interested parties addressed in this fashion will be sent directly to the Board of Directors, the non-employee directors or the individual director, as applicable.

Compensation of Non-employee Directors

The following table sets forth compensation for the Company’s non-employee directors for 2018:

Name	Fees Earned or Paid in Cash ($)	Stock Awards ($)	All Other Compensation ($)	Total ($)
J. Alfred Broaddus, Jr.	$95,000	$124,486	$10,000	$229,486
K. Bruce Connell	$95,000	$124,486	$5,000	$224,486
Stewart M. Kasen	$120,000	$124,486	$11,000	$255,486
Diane Leopold	$95,000	$124,486	$3,000	$222,486
Lemuel E. Lewis	$95,000	$124,486	$24,135	$243,621
Darrell D. Martin	$95,000	$124,486	$15,000	$234,486
Michael O. Reilly	$95,000	$124,486	$24,135	$243,621
Michael J. Schewel	$95,000	$124,486	$6,090	$225,576
Debora J. Wilson	$95,000	$124,486	$14,000	$233,486

Each non-employee director is paid an annual fee of $95,000, unless the director chooses to receive his or her fee in the form of shares of the Company’s Common Stock, and reimbursement of expenses incurred in connection with attending meetings. The Lead Director, Mr. Kasen, receives an additional annual retainer of $25,000. In 2018, Mr. Lewis, Mr. O’Reilly, Mr. Schewel, Ms. Leopold and Ms. Wilson elected to receive their entire fee in the form of shares of the Company’s Common Stock.

Non-employee directors also receive a grant of approximately $125,000 in restricted stock annually, calculated based on the fair market value of the Company’s Common Stock on the grant date. In 2018, the Company matched up to $15,000 in charitable contributions made by each non-employee director. All Other Compensation includes the following amounts representing matching gifts: Mr. Broaddus ($10,000); Mr. Connell ($5,000); Mr. Kasen ($11,000);

Ms. Leopold ($3,000); Mr. Lewis ($15,000); Mr. Martin ($15,000); Mr. O'Reilly ($15,000); and Ms. Wilson ($14,000).

Non-employee directors are also eligible to participate, up to the total amount of fees received by the director, in the Stock Purchase Plan. Participating directors receive Stock Bonus Awards in accordance with the terms of that plan equal to 10% of the net increase in shares purchased under the plan in a calendar year. Each of the following directors received bonus shares under the Stock Purchase Plan during 2018 for fees that were elected to be received in the form of shares of the Company's Common Stock in 2017 with the grant-date fair value for the bonus shares as indicated: Mr. Lewis ($9,135); Mr. O'Reilly ($9,135); and Mr. Schewel ($6,090).

The Company places a strong emphasis on equity ownership by executive officers and other members of senior management, and in 2012, it extended that philosophy to its Board of Directors by adopting stock ownership guidelines for non-employee directors. The guidelines require non-employee directors to acquire and maintain ownership of Common Stock with a value at least equal to five times the annual cash retainer paid. Following an increase in the ownership requirement due to an increase in the annual cash retainer paid, the non-employee directors have five years to comply with the additional ownership expected to be held due to the annual cash retainer increasing. All shares acquired under the Stock Purchase Plan count toward ownership requirements along with any restricted stock granted but not vested. Purchased shares are valued at the higher of cost to the director or market. All current non-employee directors meet the guideline requirements. Newly-elected non-employee directors, if any, are expected to reach the required minimum levels of ownership within five years of their initial election to the Board.

Audit Committee

The purpose of the Audit Committee is to assist the Board in fulfilling its oversight responsibilities with respect to: (i) the integrity of the Company's financial statements; (ii) the Company's compliance with legal and regulatory requirements; (iii) the independent auditors' qualifications and independence; and (iv) the performance of the independent auditors and the performance of the Company's internal audit function. In addition, the Committee provides an avenue for communication between the internal auditors, the independent auditors, financial management and the Board. The Committee meets in executive session at each of its regularly scheduled meetings with key members of management privately as well as with the Managing Director of Internal Audit.

The Board of Directors has determined that the following members of the Audit Committee are "audit committee financial experts" as defined by Item 407(d) of Regulation S-K under the Exchange Act: Messrs. Broaddus, Kasen, Lewis and O'Reilly and Ms. Wilson and that Mr. Connell and Mr. Schewel are financially literate. In making this determination, the Board considered, among other things, the experience described under "Election of Directors" above and other relevant experience as summarized below:

Mr. Broaddus - As President of the Federal Reserve Bank of Richmond for eleven years, he had ultimate oversight responsibility for financial and accounting officers preparing financial reports for the bank. A Ph.D. in economics, he spent over 34 years working for the Federal Reserve Bank. He served on the audit committees of two other publicly traded companies and has supplemented his experience with formal training in accounting issues for corporate directors.

Mr. Connell - As Executive Vice President and Group Underwriting Officer of XL Capital Ltd. as well as chief executive and underwriter at various subsidiaries and predecessors to XL Capital Ltd., Mr. Connell has thirty years experience of combined insurance and financial expertise.