

AUTOZONE INC
Form 10-Q
December 14, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

**Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended November 19, 2016, 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 1-10714

AUTOZONE, INC.

(Exact name of registrant as specified in its charter)

Nevada
(State or other jurisdiction of
incorporation or organization)

62-1482048
(I.R.S. Employer
Identification No.)

123 South Front Street,

Memphis, Tennessee
(Address of principal executive offices)
(901) 495-6500

38103
(Zip Code)

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, \$.01 Par Value 28,620,620 shares outstanding as of December 9, 2016.

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements.****AUTOZONE, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

(Unaudited)

<i>(in thousands)</i>	November 19, 2016	August 27, 2016
Assets		
Current assets:		
Cash and cash equivalents	\$ 195,538	\$ 189,734
Accounts receivable	270,768	287,680
Merchandise inventories	3,773,242	3,631,916
Other current assets	129,138	130,243
Total current assets	4,368,686	4,239,573
Property and equipment:		
Property and equipment	6,397,584	6,330,115
Less: Accumulated depreciation and amortization	(2,647,073)	(2,596,861)
	3,750,511	3,733,254
Goodwill	391,887	391,887
Deferred income taxes	35,581	36,855
Other long-term assets	195,879	198,218
	623,347	626,960
	\$ 8,742,544	\$ 8,599,787
Liabilities and Stockholders Deficit		
Current liabilities:		
Accounts payable	\$ 4,162,316	\$ 4,095,854
Accrued expenses and other	550,940	551,625
Income taxes payable	136,963	42,841
Total current liabilities	4,850,219	4,690,320
Long-term debt	4,997,446	4,924,119
Deferred income taxes	293,241	284,500
Other long-term liabilities	496,863	488,386

Commitments and contingencies

Stockholders' deficit:

Preferred stock, authorized 1,000 shares; no shares issued

Common stock, par value \$.01 per share, authorized 200,000 shares; 30,350 shares issued and 28,662 shares outstanding as of November 19, 2016; 30,329 shares issued and 29,118 shares outstanding as of August 27, 2016

	304	303
Additional paid-in capital	1,070,143	1,054,647
Retained deficit	(1,324,062)	(1,602,186)
Accumulated other comprehensive loss	(346,203)	(307,529)
Treasury stock, at cost	(1,295,407)	(932,773)

Total stockholders' deficit	(1,895,225)	(1,787,538)
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	\$ 8,742,544	\$ 8,599,787
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See Notes to Condensed Consolidated Financial Statements.

Table of Contents**AUTOZONE, INC.****CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

(Unaudited)

<i>(in thousands, except per share data)</i>	Twelve Weeks Ended	
	November 19, 2016	November 21, 2015
Net sales	\$ 2,467,845	\$ 2,386,043
Cost of sales, including warehouse and delivery expenses	1,166,303	1,133,109
Gross profit	1,301,542	1,252,934
Operating, selling, general and administrative expenses	842,640	814,939
Operating profit	458,902	437,995
Interest expense, net	33,306	35,010
Income before income taxes	425,596	402,985
Income taxes	147,471	144,873
Net income	\$ 278,125	\$ 258,112
Weighted average shares for basic earnings per share	28,951	30,498
Effect of dilutive stock equivalents	752	640
Weighted average shares for diluted earnings per share	29,703	31,138
Basic earnings per share	\$ 9.61	\$ 8.46
Diluted earnings per share	\$ 9.36	\$ 8.29

See Notes to Condensed Consolidated Financial Statements.**AUTOZONE, INC.****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(Unaudited)

<i>(in thousands)</i>	Twelve Weeks Ended	
	November 19, 2016	November 21, 2015

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Net income	\$ 278,125	\$ 258,112
Other comprehensive (loss) income:		
Pension liability adjustments, net of taxes ⁽¹⁾	1,816	1,234
Foreign currency translation adjustments	(40,591)	7,787
Unrealized losses on marketable securities, net of taxes ⁽²⁾	(229)	(62)
Net derivative activities, net of taxes ⁽³⁾	330	164
Total other comprehensive (loss) income	(38,674)	9,123
Comprehensive income	\$ 239,451	\$ 267,235

(1) Pension liability adjustments are presented net of taxes of \$1,385 in fiscal 2017 and \$1,190 in fiscal 2016.

(2) Unrealized losses on marketable securities are presented net of taxes of \$144 in fiscal 2017 and \$33 in fiscal 2016.

(3) Net derivative activities are presented net of taxes of \$179 in fiscal 2017 and \$85 in fiscal 2016.

See Notes to Condensed Consolidated Financial Statements.

Table of Contents**AUTOZONE, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited)

<i>(in thousands)</i>	Twelve Weeks Ended	
	November 19, 2016	November 21, 2015
Cash flows from operating activities:		
Net income	\$ 278,125	\$ 258,112
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of property and equipment and intangibles	71,812	66,283
Amortization of debt origination fees	1,950	1,726
Deferred income taxes	6,881	1,464
Share-based compensation expense	9,787	8,656
Changes in operating assets and liabilities:		
Accounts receivable	14,935	88
Merchandise inventories	(160,918)	(90,420)
Accounts payable and accrued expenses	77,360	20,339
Income taxes payable	95,523	73,957
Other, net	11,045	6,798
Net cash provided by operating activities	406,500	347,003
Cash flows from investing activities:		
Capital expenditures	(97,917)	(86,658)
Purchase of intangibles		(10,000)
Purchase of marketable securities	(10,843)	(29,303)
Proceeds from sale of marketable securities	8,752	24,640
Disposal of capital assets and other, net	357	228
Net cash used in investing activities	(99,651)	(101,093)
Cash flows from financing activities:		
Net proceeds from commercial paper	72,200	428,300
Repayment of debt		(300,000)
Net proceeds from sale of common stock	5,742	25,040
Purchase of treasury stock	(362,634)	(400,100)
Payments of capital lease obligations	(11,012)	(10,096)
Other, net	(2,222)	
Net cash used in financing activities	(297,926)	(256,856)

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Effect of exchange rate changes on cash	(3,119)	1,123
Net increase (decrease) in cash and cash equivalents	5,804	(9,823)
Cash and cash equivalents at beginning of period	189,734	175,309
Cash and cash equivalents at end of period	\$ 195,538	\$ 165,486

See Notes to Condensed Consolidated Financial Statements.

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(Unaudited)

Note A General

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission's (the SEC) rules and regulations. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments, including normal recurring accruals, considered necessary for a fair presentation have been included. For further information, refer to the consolidated financial statements and related notes included in the AutoZone, Inc. (AutoZone or the Company) Annual Report on Form 10-K for the year ended August 27, 2016.

Operating results for the twelve weeks ended November 19, 2016, are not necessarily indicative of the results that may be expected for the fiscal year ending August 26, 2017. Each of the first three quarters of AutoZone's fiscal year consists of 12 weeks, and the fourth quarter consists of 16 or 17 weeks. The fourth quarters for fiscal 2017 and 2016 each have 16 weeks. Additionally, the Company's business is somewhat seasonal in nature, with the highest sales generally occurring during the months of February through September and the lowest sales generally occurring in the months of December and January.

Recently Adopted Accounting Pronouncements: In March 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update (ASU) 2016-09, *Compensation - Stock Compensation (Topic 718): Improvement to Employee Share-based Payment Accounting*. ASU 2016-09 simplifies several aspects of accounting for share-based payments transactions, including income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. The Company adopted this standard on August 28, 2016. The Company has applied the amendment requiring recognition of excess tax deficiencies and tax benefits in the income statement prospectively. The adoption of the new standard increased earnings per share for the twelve week period ended November 19, 2016 by \$0.03, driven by a lower effective tax rate of 74 basis points (an \$0.11 benefit to earnings per share), partially offset by a change to the dilutive outstanding shares calculation (an \$0.08 reduction to earnings per share). The Company has applied the amendment relating to the presentation of the excess tax benefits on the Consolidated Statements of Cash Flows retrospectively, resulting in the reclassification of \$23.5 million of excess tax benefits from cash flows from financing activities to cash flows from operating activities for the twelve weeks ended November 21, 2015. The Company will continue to estimate forfeitures of share-based awards.

Recently Issued Accounting Pronouncements: In October 2016, the FASB issued ASU 2016-16, *Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other than Inventory*. ASU 2016-16 requires that an entity recognize the income tax consequences of an intra-entity transfer of assets other than inventory when the transfer occurs. The guidance must be applied using the modified retrospective basis. The Company does not expect the provisions of ASU 2016-16 to have a material impact on its financial statements. This update will be effective for the Company at the beginning of fiscal 2019.

Note B Share-Based Payments

AutoZone recognizes compensation expense for share-based payments based on the fair value of the awards at the grant date. Share-based payments include stock option grants, restricted stock grants, restricted stock unit grants and the discount on shares sold to employees under share purchase plans. Additionally, directors' fees are paid in restricted stock units with value equivalent to the value of shares of common stock as of the grant date. The change in fair value of liability-based stock awards is also recognized in share-based compensation expense.

Total share-based compensation expense (a component of Operating, selling, general and administrative expenses) was \$9.8 million for the twelve week period ended November 19, 2016, and was \$8.7 million for the comparable prior year period.

During the twelve week period ended November 19, 2016, 22,612 stock options were exercised at a weighted average exercise price of \$301.09. In the comparable prior year period, 124,199 stock options were exercised at a weighted average exercise price of \$209.78.

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The Company made stock option grants of 288,305 shares during the twelve week period ended November 19, 2016, and granted options to purchase 367,445 shares during the comparable prior year period. The weighted average fair value of the stock option awards granted during the twelve week periods ended November 19, 2016, and November 21, 2015, using the Black-Scholes-Merton multiple-option pricing valuation model, was \$139.66 and \$155.88 per share, respectively, using the following weighted average key assumptions:

	Twelve Weeks Ended	
	November 19, 2016	November 21, 2015
Expected price volatility	18%	18%
Risk-free interest rate	1.2%	1.5%
Weighted average expected lives (in years)	5.1	5.7
Forfeiture rate	10%	10%
Dividend yield	0%	0%

See AutoZone's Annual Report on Form 10-K for the year ended August 27, 2016, for a discussion regarding the methodology used in developing AutoZone's assumptions to determine the fair value of the option awards and a description of AutoZone's Amended and Restated 2011 Equity Incentive Award Plan, the 2011 Director Compensation Program and the 2014 Director Compensation Plan.

For the twelve week period ended November 19, 2016, 27,170 stock options were excluded from the diluted earnings per share computation because they would have been anti-dilutive. For the comparable prior year period, 17,280 anti-dilutive shares were excluded from the dilutive earnings per share computation.

Note C Fair Value Measurements

The Company defines fair value as the price received to transfer an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company uses a hierarchy of valuation inputs to measure fair value.

The hierarchy prioritizes the inputs into three broad levels:

Level 1 inputs unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. An active market for the asset or liability is one in which transactions for the asset or liability occur with sufficient frequency and volume to provide ongoing pricing information.

Level 2 inputs inputs other than quoted market prices included in Level 1 that are observable, either directly or indirectly, for the asset or liability. Level 2 inputs include, but are not limited to, quoted prices for similar assets or liabilities in an active market, quoted prices for identical or similar assets or liabilities in markets that are not active and inputs other than quoted market prices that are observable for the asset or liability, such as interest rate curves and yield curves observable at commonly quoted intervals, volatilities, credit risk and default rates.

Level 3 inputs unobservable inputs for the asset or liability.

Financial Assets & Liabilities Measured at Fair Value on a Recurring Basis

The Company's assets and liabilities measured at fair value on a recurring basis were as follows:

	November 19, 2016			Fair
<i>(in thousands)</i>	Level 1	Level 2	Level 3	Value
Other current assets	\$ 10,009	\$ 515	\$	\$ 10,524
Other long-term assets	64,735	24,771		89,506
	\$ 74,744	\$ 25,286	\$	\$ 100,030

	August 27, 2016			Fair
<i>(in thousands)</i>	Level 1	Level 2	Level 3	Value
Other current assets	\$ 7,326	\$	\$	\$ 7,326
Other long-term assets	65,350	25,675		91,025
	\$ 72,676	\$ 25,675	\$	\$ 98,351