

AUTOZONE INC
Form 10-Q
March 16, 2018
Table of Contents

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 February 10, 2018, 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)

38103
(Zip Code)

(901) 495-6500

(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

Edgar Filing: AUTOZONE INC - Form 10-Q

(§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, smaller reporting company, or an emerging growth company. See the definitions of large accelerated filer, accelerated filer, smaller reporting company, and emerging growth company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Emerging growth company

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.

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 26,900,873 shares outstanding as of March 9, 2018.

Table of Contents

TABLE OF CONTENTS

PART I.	<u>FINANCIAL INFORMATION</u>	3
Item 1.	<u>Financial Statements</u>	3
	<u>CONDENSED CONSOLIDATED BALANCE SHEETS</u>	3
	<u>CONDENSED CONSOLIDATED STATEMENTS OF INCOME</u>	4
	<u>CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME</u>	4
	<u>CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS</u>	5
	<u>NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS</u>	6
	<u>REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM</u>	17
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	18
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	26
Item 4.	<u>Controls and Procedures</u>	26
PART II.	<u>OTHER INFORMATION</u>	27
Item 1.	<u>Legal Proceedings</u>	27
Item 1A.	<u>Risk Factors</u>	27
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	27
Item 3.	<u>Defaults Upon Senior Securities</u>	28
Item 4.	<u>Mine Safety Disclosures</u>	28
Item 5.	<u>Other Information</u>	28
Item 6.	<u>Exhibits</u>	29
	<u>SIGNATURES</u>	30
	<u>EXHIBIT INDEX</u>	

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

(Unaudited)

<i>(in thousands)</i>	February 10, 2018	August 26, 2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 288,522	\$ 293,270
Accounts receivable	282,532	280,733
Merchandise inventories	4,085,528	3,882,086
Other current assets	169,725	155,166
Total current assets	4,826,307	4,611,255
Property and equipment:		
Property and equipment	7,041,562	6,873,193
Less: Accumulated depreciation and amortization	(2,960,261)	(2,842,175)
	4,081,301	4,031,018
Goodwill	302,645	391,887
Deferred income taxes	34,251	35,308
Other long-term assets	159,215	190,313
	496,111	617,508
	\$ 9,403,719	\$ 9,259,781
Liabilities and Stockholders Deficit		
Current liabilities:		
Accounts payable	\$ 4,365,666	\$ 4,168,940
Accrued expenses and other	576,224	563,350
Income taxes payable	5,338	34,011
Total current liabilities	4,947,228	4,766,301
Long-term debt	5,043,541	5,081,238

Edgar Filing: AUTOZONE INC - Form 10-Q

Deferred income taxes	222,932	371,111
Other long-term liabilities	520,565	469,508
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; 27,465 shares issued and 27,251 shares outstanding as of February 10, 2018; 28,735 shares issued and 27,833 shares outstanding as of August 26, 2017	275	287
Additional paid-in capital	1,112,748	1,086,671
Retained deficit	(1,990,317)	(1,642,387)
Accumulated other comprehensive loss	(286,384)	(254,557)
Treasury stock, at cost	(166,869)	(618,391)
Total stockholders' deficit	(1,330,547)	(1,428,377)
	\$ 9,403,719	\$ 9,259,781

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		Twenty-Four Weeks Ended	
	February 10, 2018	February 11, 2017	February 10, 2018	February 11, 2017
Net sales	\$ 2,413,026	\$ 2,289,219	\$ 5,002,156	\$ 4,757,065
Cost of sales, including warehouse and delivery expenses	1,135,980	1,083,683	2,359,263	2,249,988
Gross profit	1,277,046	1,205,536	2,642,893	2,507,077
Operating, selling, general and administrative expenses	1,071,948	821,567	1,969,041	1,664,206
Operating profit	205,098	383,969	673,852	842,871
Interest expense, net	39,340	34,198	78,229	67,504
Income before income taxes	165,758	349,771	595,623	775,367
Income taxes	(123,772)	112,626	25,090	260,097
Net income	\$ 289,530	\$ 237,145	\$ 570,533	\$ 515,270
Weighted average shares for basic earnings per share	27,355	28,606	27,496	28,779
Effect of dilutive stock equivalents	527	734	493	743
Weighted average shares for diluted earnings per share	27,882	29,340	27,989	29,522
Basic earnings per share	\$ 10.58	\$ 8.29	\$ 20.75	\$ 17.90
Diluted earnings per share	\$ 10.38	\$ 8.08	\$ 20.38	\$ 17.45

See Notes to Condensed Consolidated Financial Statements.**AUTOZONE, INC.**

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

<i>(in thousands)</i>	Twelve Weeks Ended		Twenty-Four Weeks Ended	
	February 10, 2018	February 11, 2017	February 10, 2018	February 11, 2017
Net income	\$ 289,530	\$ 237,145	\$ 570,533	\$ 515,270
Other comprehensive income (loss):				
Pension liability adjustments, net of taxes ⁽¹⁾	2,361	1,953	3,677	3,769
Foreign currency translation adjustments	7,507	(2,342)	(35,710)	(42,933)
Unrealized losses on marketable securities, net of taxes ⁽²⁾	(258)	(46)	(574)	(275)
Net derivative activities, net of taxes ⁽³⁾	457	321	780	651
Total other comprehensive income (loss)	10,067	(114)	(31,827)	(38,788)
Comprehensive income	\$ 299,597	\$ 237,031	\$ 538,706	\$ 476,482

- (1) Pension liability adjustments are presented net of taxes of \$117 in fiscal 2018 and \$1,248 in fiscal 2017 for the twelve weeks ended and \$1,278 in fiscal 2018 and \$2,634 in fiscal 2017 for the twenty-four weeks ended.
- (2) Unrealized gains on marketable securities are presented net of taxes of \$139 in fiscal 2018 and \$2 in fiscal 2017 for the twelve weeks ended and \$309 in fiscal 2018 and \$146 in fiscal 2017 for the twenty-four weeks ended.
- (3) Net derivative activities are presented net of taxes of \$52 in fiscal 2018 and \$188 in fiscal 2017 for the twelve weeks ended and \$237 in fiscal 2018 and \$367 in fiscal 2017 for the twenty-four weeks ended.

See Notes to Condensed Consolidated Financial Statements.

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

(Unaudited)

<i>(in thousands)</i>	Twenty-Four Weeks Ended	
	February 10, 2018	February 11, 2017
Cash flows from operating activities:		
Net income	\$ 570,533	\$ 515,270
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of property and equipment and intangibles	157,337	144,645
Amortization of debt origination fees	3,927	3,948
Deferred income taxes	(150,613)	2,777
Share-based compensation expense	23,764	20,711
Asset impairments	193,162	
Changes in operating assets and liabilities:		
Accounts receivable	(3,139)	38,697
Merchandise inventories	(269,210)	(290,921)
Accounts payable and accrued expenses	211,902	24,882
Income taxes payable	(6,967)	82,620
Other, net	21,647	21,269
Net cash provided by operating activities	752,343	563,898
Cash flows from investing activities:		
Capital expenditures	(214,747)	(216,103)
Purchase of marketable securities	(80,828)	(27,798)
Proceeds from sale of marketable securities	63,102	40,473
Disposal of capital assets and other, net	1,866	714
Net cash used in investing activities	(230,607)	(202,714)
Cash flows from financing activities:		
Net (payments) proceeds of commercial paper	(39,600)	625,600
Repayment of debt		(400,000)
Net proceeds from sale of common stock	65,244	23,302
Purchase of treasury stock	(527,454)	(560,619)
Payments of capital lease obligations	(21,247)	(22,627)
Other, net	(1,250)	(2,224)
Net cash used in financing activities	(524,307)	(336,568)

Effect of exchange rate changes on cash	(2,177)	(3,701)
Net (decrease) increase in cash and cash equivalents	(4,748)	20,915
Cash and cash equivalents at beginning of period	293,270	189,734
Cash and cash equivalents at end of period	\$ 288,522	\$ 210,649

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

AUTOZONE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note A General

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and are presented in accordance with the requirements of 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 GAAP 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 26, 2017.

Operating results for the twelve and twenty-four weeks ended February 10, 2018 are not necessarily indicative of the results that may be expected for the full fiscal year ending August 25, 2018. 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 2018 and 2017 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 Issued Accounting Pronouncements:

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update (ASU) 2014-09, *Revenue from Contracts with Customers*. 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. It also requires more detailed disclosures to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. This update will be effective for the Company at the beginning of its fiscal 2019 year. The Company established a cross-functional implementation team to evaluate and identify the impact of the new standard on the Company s financial position, results of operations and cash flows. Based on the preliminary work completed, the Company is considering the potential implications of the new standard on the Company s recognition of customer related accounts receivable, warranty costs, the Company s loyalty program, gift cards, subscriptions and other related topics in addition to all applicable financial statement disclosures required by the new guidance. The Company is currently in the process of identifying changes to its business processes, systems and controls to support adoption of the new standard. At this time, the team has not completed its full analysis on impact or means of adoption.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. ASU 2016-02 requires an entity to recognize a right-of-use asset and lease liability for all leases with terms of more than 12 months. Recognition, measurement and presentation of expenses will depend on classification as a finance or operating lease. The amendments also require certain quantitative and qualitative disclosures about leasing arrangements. Early adoption is permitted. The updated guidance requires a modified retrospective adoption. This update will be effective for the Company at the beginning of its fiscal 2020 year. The Company established a cross-functional implementation team to evaluate and identify the

impact of ASU 2016-02 on the Company's financial position, results of operations and cash flows. Based on the preliminary work completed, the Company is considering the possible implications of the new standard, including the discount rate to be used in valuing new and existing leases, the treatment of existing favorable and unfavorable lease agreements acquired in connection with previous acquisitions, procedural and operational changes that may be necessary to comply with the provisions of the guidance and all applicable financial statement disclosures required by the new guidance. The Company is also in the process of identifying changes to its business processes, systems and controls to support adoption of the new standard. At this time, the team has not completed its full analysis and is unable to quantify the impact; however, the Company believes the adoption of the new guidance will have a material impact on the total assets and total liabilities reported on the Company's consolidated balance sheets.

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 its fiscal 2019 year.

In January 2017, the FASB issued ASU 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business*. ASU 2017-01 provides guidance to assist entities in evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The updated guidance requires a prospective adoption. Early adoption is permitted. The Company does not expect the provisions of ASU 2017-01 to have a material impact on its consolidated financial statements. This update will be effective for the Company at the beginning of its fiscal 2019 year.

Table of Contents

In February 2018, the FASB issued ASU 2018-02, *Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. ASU 2018-02 allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act (Tax Reform). The guidance states that because the adjustment of deferred taxes due to the reduction of the historical corporate income tax rate to the newly enacted corporate income tax rate is required to be included in income from continuing operations, the tax effects of items within accumulated other comprehensive income (stranded tax effects) do not reflect the appropriate tax rate. As stated within the guidance, the amendments in this update should be applied retrospectively to each period in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Reform is recognized. At this time, the Company is in the process of evaluating the impact of the provisions of ASU 2018-02 on its consolidated financial statements.

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 \$12.7 million for the twelve week period ended February 10, 2018, and \$10.9 million for the comparable prior year period. Share-based compensation expense was \$23.8 million for the twenty-four week period ended February 10, 2018, and \$20.7 million for the comparable prior year period.

During the twenty-four week period ended February 10, 2018, 234,114 stock options were exercised at a weighted average exercise price of \$278.69. In the comparable prior year period, 91,136 stock options were exercised at a weighted average exercise price of \$265.16.

The Company made stock option grants of 283,290 shares during the twenty-four week period ended February 10, 2018, and granted options to purchase 290,805 shares during the comparable prior year period. The weighted average fair value of the stock option awards granted during the twenty-four week period ended February 10, 2018, and February 11, 2017, using the Black-Scholes-Merton multiple-option pricing valuation model, was \$128.99 and \$139.80 per share, respectively, using the following weighted average key assumptions:

	Twenty-Four Weeks Ended	
	February 10, 2018	February 11, 2017
Expected price volatility	20%	18%
Risk-free interest rate	1.9%	1.2%
Weighted average expected lives (in years)	5.1	5.1
Forfeiture rate	10%	10%
Dividend yield	0%	0%

See AutoZone s Annual Report on Form 10-K for the year ended August 26, 2017, 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 February 10, 2018, 609,435 stock options were excluded from the diluted earnings per share computation because they would have been anti-dilutive. For the comparable prior year period, 645,561 anti-dilutive shares were excluded from the dilutive earnings per share computation. There were 844,912 anti-dilutive shares excluded from the diluted earnings per share computation for the twenty-four week period ended February 10, 2018, and 605,065 anti-dilutive shares excluded for the comparable prior year period.

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 the fair value hierarchy, which prioritizes the inputs used to measure fair value. The hierarchy, as defined below, gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The three levels of the fair value hierarchy are set forth below:

Level 1 inputs unadjusted quoted prices in active markets for identical assets or liabilities that the Company can access at the measurement date.

Level 2 inputs inputs other than quoted market prices included within Level 1 that are observable, either directly or indirectly, for the asset or liability.

Level 3 inputs unobservable inputs for the asset or liability, which are based on the Company's own assumptions as there is little, if any, observable activity in identical assets or liabilities.

Table of Contents*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:

<i>(in thousands)</i>	February 10, 2018			Fair Value
	Level 1	Level 2	Level 3	
Other current assets	\$ 30,007	\$ 1,928	\$	\$ 31,935
Other long-term assets	61,534	24,248		85,782
	\$ 91,541	\$ 26,176	\$	\$ 117,717

<i>(in thousands)</i>	August 26, 2017			Fair Value
	Level 1	Level 2	Level 3	
Other current assets	\$ 18,453	\$ 120	\$	\$ 18,573
Other long-term assets	53,319	28,981		82,300
	\$ 71,772	\$ 29,101	\$	\$ 100,873

At February 10, 2018, the fair value measurement amounts for assets and liabilities recorded in the accompanying Condensed Consolidated Balance Sheet consisted of short-term marketable securities of \$31.9 million, which are included within Other current assets, and long-term marketable securities of \$85.8 million, which are included in Other long-term assets. The Company's marketable securities are typically valued at the closing price in the principal active market as of the last business day of the quarter or through the use of other market inputs relating to the securities, including benchmark yields and reported trades. The fair values of the marketable securities, by asset class, are described in Note D Marketable Securities.

Non-Financial Assets and Liabilities Measured at Fair Value on a Non-Recurring Basis

Certain non-financial assets and liabilities are required to be measured at fair value on a non-recurring basis in certain circumstances, including the event of impairment. These non-financial assets and liabilities could include assets and liabilities acquired in an acquisition as well as goodwill, intangible assets and property, plant and equipment that are determined to be impaired. During the second quarter, the Company recorded impairment charges related to its Interamerican Motor Corporation (IMC) and AutoAnything businesses as the Company determined that the approximate fair value less costs to sell the businesses was significantly lower than the carrying value of the net assets. Based on the latest offers received as of the end of the second quarter from potential acquirers of these business operations, the Company recorded impairment charges related to goodwill, intangible assets and property, plant and equipment in order to record these assets at fair value. See Note L Assets Impairments for further discussion. The fair value remeasurements are based on Level 2 inputs as defined in the fair value hierarchy. As of February 10, 2018 and August 26, 2017, the Company did not have any other significant non-financial assets or liabilities that had been measured at fair value on a non-recurring basis subsequent to initial recognition.

Financial Instruments not Recognized at Fair Value

The Company has financial instruments, including cash and cash equivalents, accounts receivable, other current assets and accounts payable. The carrying amounts of these financial instruments approximate fair value because of their short maturities. A discussion of the carrying values and fair values of the Company's debt is included in Note H Financing.

Table of Contents**Note D Marketable Securities**

The Company's basis for determining the cost of a security sold is the Specific Identification Model. Unrealized gains (losses) on marketable securities are recorded in Accumulated other comprehensive loss. The Company's available-for-sale marketable securities consisted of the following:

<i>(in thousands)</i>	February 10, 2018			Fair Value
	Amortized Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	
Corporate securities	\$ 65,261	\$	\$ (533)	\$ 64,728
Government bonds	22,996		(129)	22,867
Mortgage-backed securities	4,005		(79)	3,926
Asset-backed securities and other	26,348		(152)	26,196
	\$ 118,610	\$	\$ (893)	\$ 117,717

<i>(in thousands)</i>	August 26, 2017			Fair Value
	Amortized Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	
Corporate securities	\$ 39,917	\$ 73	\$ (13)	\$ 39,977
Government bonds	31,076	49	(74)	31,051
Mortgage-backed securities	4,850	2	(42)	4,810
Asset-backed securities and other	25,042	28	(35)	25,035
	\$ 100,885	\$ 152	\$ (164)	\$ 100,873

The debt securities held at February 10, 2018, had effective maturities ranging from less than one year to approximately three years. The Company did not realize any material gains or losses on its marketable securities during the twenty-four week period ended February 10, 2018.

The Company holds 112 securities that are in an unrealized loss position of approximately \$893 thousand at February 10, 2018. The Company has the intent and ability to hold these investments until recovery of fair value or maturity, and does not deem the investments to be impaired on an other than temporary basis. In evaluating whether the securities are deemed to be impaired on an other than temporary basis, the Company considers factors such as the duration and severity of the loss position, the credit worthiness of the investee, the term to maturity and the intent and ability to hold the investments until maturity or until recovery of fair value.

Included above in total marketable securities are \$85.0 million of marketable securities transferred by the Company's insurance captive to a trust account to secure its obligations to an insurance company related to future workers compensation and casualty losses.

Note E Derivative Financial Instruments

At February 10, 2018, the Company had \$9.0 million recorded in Accumulated other comprehensive loss related to realized losses associated with terminated interest rate swap and treasury rate lock derivatives which were designated as hedging instruments. Net losses are amortized into Interest expense over the remaining life of the associated debt. The Company reclassified \$509 thousand of net losses from Accumulated other comprehensive loss to interest expense for the twelve weeks ended February 10, 2018 and the comparable prior year period. During the twenty-four week period ended February 10, 2018 and the comparable prior year period, the Company reclassified \$1.0 million of net losses from Accumulated other comprehensive loss to Interest expense. The Company expects to reclassify \$2.2 million of net losses from Accumulated other comprehensive loss to Interest expense over the next 12 months.

Note F Merchandise Inventories

Merchandise inventories are stated at the lower of cost or market. Merchandise inventories include related purchasing, storage and handling costs. Inventory cost has been determined using the last-in, first-out (LIFO) method for domestic inventories and the weighted average cost method for Mexico and Brazil inventories. Due to price deflation on the Company s merchandise purchases, the Company has exhausted its LIFO reserve balance. The Company s policy is not to write up inventory in excess of replacement cost, which is based on average cost. The difference between LIFO cost and replacement cost, which will be reduced upon experiencing price inflation on the Company s merchandise purchases, was \$433.5 million at February 10, 2018 and \$414.9 million at August 26, 2017.

Table of Contents**Note G Pension and Savings Plans**

The components of net periodic pension expense related to the Company's pension plans consisted of the following:

<i>(in thousands)</i>	Twelve Weeks Ended		Twenty-Four Weeks Ended	
	February 10, 2018	February 11, 2017	February 10, 2018	February 11, 2017
Interest cost	\$ 2,390	\$ 2,385	\$ 4,780	\$ 4,770
Expected return on plan assets	(4,384)	(4,628)	(8,768)	(9,257)
Amortization of net loss	2,478	3,201	4,955	6,403
Net periodic pension expense	\$ 484	\$ 958	\$ 967	\$ 1,916

The Company makes contributions in amounts at least equal to the minimum funding requirements of the Employee Retirement Income Security Act of 1974, as amended by the Pension Protection Act of 2006. During the twenty-four weeks period ended February 10, 2018, the Company did not make contributions to its funded plan.

On December 19, 2017, the Board of Directors approved a resolution to terminate the Company's pension plans, effective March 15, 2018. Benefit accruals have been frozen, and the plan closed to new participants on January 1, 2003. The Company has commenced the plan termination process and expects to distribute a portion of the pension plan assets as lump sum payments with the remaining balance transferred to an insurance company in the form of an annuity. The total payments distributed will depend on the participation rate of eligible participants. Based on the estimated value of assets held in the plan, the Company currently estimates that a cash contribution of approximately \$20-\$30 million will be required to fully fund the plan's liabilities at termination. The pension plan termination is expected to be completed by the end of fiscal 2018, and the Company is in the process of evaluating the impact of the termination and future settlement accounting on its consolidated financial statements and related disclosures.

Note H Financing

The Company's long-term debt consisted of the following:

<i>(in thousands)</i>	February 10, 2018	August 26, 2017
7.125% Senior Notes due August 2018, effective interest rate of 7.28%	\$ 250,000	\$ 250,000
1.625% Senior Notes due April 2019, effective interest rate of 1.77%	250,000	250,000
4.000% Senior Notes due November 2020, effective interest rate of 4.43%	500,000	500,000
2.500% Senior Notes due April 2021, effective interest rate of 2.62%	250,000	250,000
3.700% Senior Notes due April 2022, effective interest rate of 3.85%	500,000	500,000
2.875% Senior Notes due January 2023, effective interest rate of 3.21%	300,000	300,000
3.125% Senior Notes due July 2023, effective interest rate of 3.26%	500,000	500,000

Edgar Filing: AUTOZONE INC - Form 10-Q

3.250% Senior Notes due April 2025, effective interest rate 3.36%	400,000	400,000
3.125% Senior Notes due April 2026, effective interest rate of 3.28%	400,000	400,000
3.750% Senior Notes due June 2027, effective interest rate of 3.83%	600,000	600,000
Commercial paper, weighted average interest rate of 1.80% and 1.44% at February 10, 2018 and August 26, 2017, respectively	1,115,500	1,155,100
Total debt before discounts and debt issuance costs	5,065,500	5,105,100
Less: Discounts and debt issuance costs	21,959	23,862
Long-term debt	\$ 5,043,541	\$ 5,081,238

As of February 10, 2018, the commercial paper borrowings and the \$250 million 7.125% Senior Notes due August 2018 were classified as long-term in the accompanying Consolidated Balance Sheets as the Company had the ability and intent to refinance on a long-term basis through available capacity in its revolving credit facility. As of February 10, 2018, the Company had \$1.997 billion of availability under its \$2.0 billion revolving credit facility, which would allow it to replace these short-term obligations with long-term financing facilities.

The Company entered into a Master Extension, New Commitment and Amendment Agreement dated as of November 18, 2017 (the "Extension Amendment") to the Third Amended and Restated Credit Agreement dated as of November 18, 2016, as amended, modified, extended or restated from time to time. Under the Extension Amendment: (i) the Company's borrowing capacity under the Revolving Credit Agreement was increased from \$1.6 billion to \$2.0 billion; (ii) the Company's option to increase its borrowing capacity under the Revolving Credit Agreement was refreshed and the amount of such option remained at \$400 million; the maximum borrowing under the Revolving Credit Agreement may, at the Company's option, subject to lenders approval, be increased from \$2.0 billion to \$2.4 billion; (iii) the termination date of the Revolving Credit Agreement was extended from November 18, 2021 until November 18, 2022; and (iv) the Company has the option to make one additional written request of the lenders to extend the termination date then in effect for an additional one year. Under the revolving credit facility, the Company may borrow funds consisting of Eurodollar loans, base rate loans or a combination of both. Interest accrues on Eurodollar loans at a defined Eurodollar rate, defined as LIBOR plus the applicable percentage, as defined in the revolving

Table of Contents

credit facility, depending upon the Company's senior, unsecured, (non-credit enhanced) long-term debt rating. Interest accrues on base rate loans as defined in the credit facility. As of February 10, 2018, the Company had \$3.3 million of outstanding letters of credit under the Revolving Credit Agreement.

On November 18, 2016, the Company amended and restated its existing 364-Day revolving credit facility (the "New 364-Day Credit Agreement") by decreasing the committed credit amount from \$500 million to \$400 million, extending the expiration date by one year and renegotiating other terms and conditions. The credit facility was available to primarily support commercial paper borrowings and other short-term unsecured bank loans. Under the credit facility, the Company could borrow funds consisting of Eurodollar loans, base rate loans or a combination of both. Interest accrued on Eurodollar loans at a defined Eurodollar rate, defined as LIBOR plus the applicable margin, as defined in the revolving credit facility, depending upon the Company's senior, unsecured, (non-credit enhanced) long-term debt rating. Interest accrued on base rate loans as defined in the credit facility. The New 364-Day Credit Agreement expired on November 17, 2017, and the Company did not renew this revolving credit facility.

The fair value of the Company's debt was estimated at \$5.049 billion as of February 10, 2018, and \$5.171 billion as of August 26, 2017, based on the quoted market prices for the same or similar issues or on the current rates available to the Company for debt of the same terms (Level 2). Such fair value is greater than the carrying value of debt by \$5.4 million at February 10, 2018, and \$90.3 million at August 26, 2017, which reflects their face amount, adjusted for any unamortized debt issuance costs and discounts.

All senior notes are subject to an interest rate adjustment if the debt ratings assigned to the senior notes are downgraded (as defined in the agreements). Further, the senior notes contain a provision that repayment of the senior notes may be accelerated if we experience a change in control (as defined in the agreements). Our borrowings under our senior notes contain minimal covenants, primarily restrictions on liens. Under our revolving credit facilities, covenants include restrictions on liens, a maximum debt to earnings ratio, a minimum fixed charge coverage ratio and a change of control provision that may require acceleration of the repayment obligations under certain circumstances. All of the repayment obligations under our borrowing arrangements may be accelerated and come due prior to the scheduled payment date if covenants are breached or an event of default occurs. As of February 10, 2018, we were in compliance with all covenants and expect to remain in compliance with all covenants under our borrowing arrangements.

Note I Stock Repurchase Program

From January 1, 1998 to February 10, 2018, the Company has repurchased a total of 143.1 million shares of its common stock at an aggregate cost of \$18.354 billion, including 824,733 shares of its common stock at an aggregate cost of \$527.5 million during the twenty-four week period ended February 10, 2018. On March 21, 2017, the Board voted to increase the authorization by \$750 million. This raised the total value of shares authorized to be repurchased to \$18.65 billion. Considering the cumulative repurchases as of February 10, 2018, the Company had \$296.2 million remaining under the Board's authorization to repurchase its common stock.

During the twenty-four week period ended February 10, 2018, the Company retired 1.5 million shares of treasury stock which had previously been repurchased under the Company's share repurchase program. The retirement increased Retained deficit by \$918.5 million and decreased Additional paid-in capital by \$60.5 million. During the comparable prior year period, the Company retired 1.8 million shares of treasury stock, which increased Retained deficit by \$1.321 billion and decreased Additional paid-in capital by \$64.9 million.

Subsequent to February 10, 2018, the Company has repurchased 382,928 shares of its common stock at an aggregate cost of \$264.9 million.

Table of Contents**Note J Accumulated Other Comprehensive Loss**

Accumulated other comprehensive loss includes certain adjustments to pension liabilities, foreign currency translation adjustments, certain activity for interest rate swaps and treasury rate locks that qualify as cash flow hedges and unrealized gains (losses) on available-for-sale securities. Changes in Accumulated other comprehensive loss for the twelve week periods ended February 10, 2018 and February 11, 2017 consisted of the following:

<i>(in thousands)</i>	Pension Liability	Foreign Currency⁽³⁾	Net Unrealized Gain on Securities	Derivatives	Total
Balance at November 18, 2017	\$ (71,060)	\$ (219,031)	\$ (327)	\$ (6,033)	\$ (296,451)
Other comprehensive income (loss) before reclassifications ⁽¹⁾		7,507	(224)		7,283
Amounts reclassified from Accumulated other comprehensive loss ⁽¹⁾	2,361 ⁽²⁾		(34) ⁽⁴⁾	457 ⁽⁵⁾	2,784
Balance at February 10, 2018	\$ (68,699)	\$ (211,524)	\$ (585)	\$ (5,576)	\$ (286,384)

<i>(in thousands)</i>	Pension Liability	Foreign Currency⁽³⁾	Net Unrealized Gain on Securities	Derivatives	Total
Balance at November 19, 2016	\$ (87,074)	\$ (251,603)	\$ (109)	\$ (7,417)	\$ (346,203)
Other comprehensive loss before reclassifications ⁽¹⁾		(2,342)	(13)		(2,355)
Amounts reclassified from Accumulated other comprehensive loss ⁽¹⁾	1,953 ⁽²⁾		(33) ⁽⁴⁾	321 ⁽⁵⁾	2,241
Balance at February 11, 2017	\$ (85,121)	\$ (253,945)	\$ (155)	\$ (7,096)	\$ (346,317)

(1) Amounts in parentheses indicate debits to Accumulated other comprehensive loss.

(2) Represents amortization of pension liability adjustments, net of taxes of \$117 for the twelve weeks ended February 10, 2018 and \$1,248 for the twelve weeks ended February 11, 2017, which is recorded in Operating, selling, general and administrative expenses on the Condensed Consolidated Statements of Income. See Note G Pension and Savings Plans for further discussion.

(3)

Foreign currency is not shown net of additional U.S. tax as earnings of non-U.S. subsidiaries are intended to be permanently reinvested.

- (4) Represents realized losses on marketable securities, net of taxes of \$16 for the twelve weeks ended February 10, 2018 and \$18 for the twelve weeks ended February 11, 2017, which is recorded in Operating, selling, general and administrative expenses on the Condensed Consolidated Statements of Income. See Note D Marketable Securities for further discussion.*
- (5) Represents gains and losses on derivatives, net of taxes of \$52 for the twelve weeks ended February 10, 2018 and \$188 for the twelve weeks ended February 11, 2017, which is recorded in Interest expense, net, on the Condensed Consolidated Statements of Income. See Note E Derivative Financial Instruments for further discussion.*

Table of Contents

Changes in Accumulated other comprehensive loss for the twenty-four week periods ended February 10, 2018 and February 11, 2017, consisted of the following:

<i>(in thousands)</i>	Pension Liability	Foreign Currency⁽³⁾	Net Unrealized Gain on Securities	Derivatives	Total
Balance at August 26, 2017	\$ (72,376)	\$ (175,814)	\$ (11)	\$ (6,356)	\$ (254,557)
Other comprehensive income (loss) before reclassifications ⁽¹⁾		(35,710)	(538)		(36,248)
Amounts reclassified from Accumulated other comprehensive loss ⁽¹⁾	3,677 ⁽²⁾		(36) ⁽⁴⁾	780 ⁽⁵⁾	4,421
Balance at February 10, 2018	\$ (68,699)	\$ (211,524)	\$ (585)	\$ (5,576)	\$ (286,384)

<i>(in thousands)</i>	Pension Liability	Foreign Currency⁽³⁾	Net Unrealized Gain on Securities	Derivatives	Total
Balance at August 27, 2016	\$ (88,890)	\$ (211,012)	\$ 120	\$ (7,747)	\$ (307,529)
Other comprehensive (loss) before reclassifications ⁽¹⁾		(42,933)	(248)		(43,181)
Amounts reclassified from Accumulated other comprehensive loss ⁽¹⁾	3,769 ⁽²⁾		(27) ⁽⁴⁾	651 ⁽⁵⁾	4,393
Balance at February 11, 2017	\$ (85,121)	\$ (253,945)	\$ (155)	\$ (7,096)	\$ (346,317)

(1) Amounts in parentheses indicate debits to Accumulated other comprehensive loss.

(2) Represents amortization of pension liability adjustments, net of taxes of \$1,278 in fiscal 2018 and \$2,634 in fiscal 2017, which is recorded in Operating, selling, general and administrative expenses on the Condensed Consolidated Statements of Income. See Note G Pension and Savings Plans for further discussion.

(3) Foreign currency is not shown net of additional U.S. tax as earnings of non-U.S. subsidiaries are intended to be permanently reinvested.

(4) Represents realized losses on marketable securities, net of taxes of \$18 in fiscal 2018 and \$15 in fiscal 2017, which is recorded in Operating, selling, general and administrative expenses on the Condensed Consolidated Statements of Income. See Note D Marketable Securities for further discussion.

(5) Represents gains and losses on derivatives, net of taxes of \$237 in fiscal 2018 and \$367 in fiscal 2017, which is recorded in Interest expense, net, on the Condensed Consolidated Statements of Income. See Note E Derivative Financial Instruments for further discussion.

Note K Goodwill and Intangibles

The changes in the carrying amount of goodwill are as follows:

<i>(in thousands)</i>	Auto Parts Stores	Other	Total
Net balance as of August 26, 2017	\$ 326,703	\$ 65,184	\$ 391,887
Goodwill adjustments ⁽¹⁾	(24,058)	(65,184)	(89,242)
Net balance as of February 10, 2018	\$ 302,645	\$	\$ 302,645

(1) See Note L Asset Impairments for further discussion.

Table of Contents

The carrying amounts of intangible assets, other than goodwill, are included in Other long-term assets as follows:

<i>(in thousands)</i>	Estimated Useful Life	Gross Carrying Amount	Accumulated Amortization	Impairment⁽¹⁾	Net Carrying Amount
Amortizing intangible assets:					
Technology	3-5 years	\$ 10,570	\$ (9,994)	\$ (576)	\$
Noncompete agreements	5 years	1,300	(1,223)	(77)	
Customer relationships	3-10 years	49,676	(27,583)	(10,057)	12,036
		\$ 61,546	\$ (38,800)	\$ (10,710)	12,036
Non-amortizing intangible asset:					
Trade name				\$ (26,900)	
Total intangible assets other than goodwill					\$ 12,036

(1) See Note L Asset Impairments for further discussion.

Amortization expense of intangible assets for the twelve and twenty-four week periods ended February 10, 2018 was \$1.4 million and \$2.8 million, respectively. Amortization expense of intangible assets for the twelve and twenty-four week periods ended February 11, 2017 was \$1.9 million and \$4.0 million, respectively.

Note L Asset Impairments

During the second quarter, the Company recorded impairment charges related to its IMC and AutoAnything businesses totaling \$193.2 million as the Company determined that the approximate fair value less costs to sell the businesses was significantly lower than the carrying value of the net assets based on recent offers received for these businesses as of the quarter ended February 10, 2018.

The impairment charge for the IMC business, which is reflected as a component of Auto Parts Locations in our segment reporting, includes \$48.3 million related to inventory, \$24.1 million related to goodwill, \$18.0 million related to property and equipment, and \$3.2 million related to other intangible assets. The impairment charge for AutoAnything, which is reflected as a component of the Other category in our segment reporting, includes \$65.2 million related to goodwill and \$34.4 million related to other intangible assets. The Company recorded these impairment charges within Operating, selling, general and administrative expenses in its condensed consolidated statements of income.

The carrying value for the assets and liabilities remaining after these impairment charges total \$97.4 million and \$59.0 million as of February 10, 2018 and are included in our condensed consolidated balance sheet at that date. The major classes of assets and liabilities included in those amounts consisted of accounts receivable of \$22.2 million, merchandise inventories of \$64.6 million and accounts payable of \$47.7 million as of February 10, 2018.

Note M Litigation

In July 2014, the Company received a subpoena from the District Attorney of the County of Alameda, along with other environmental prosecutorial offices in the State of California, seeking documents and information related to the handling, storage and disposal of hazardous waste. The Company received notice that the District Attorney will seek injunctive and monetary relief. The Company is cooperating fully with the request and cannot predict the ultimate outcome of these efforts, although the Company has accrued all amounts it believes to be probable and reasonably estimable. The Company does not believe the ultimate resolution of this matter will have a material adverse effect on its consolidated financial position, results of operations or cash flows.

The Company is involved in various other legal proceedings incidental to the conduct of its business, including, but not limited to, several lawsuits containing class-action allegations in which the plaintiffs are current and former hourly and salaried employees who allege various wage and hour violations and unlawful termination practices. The Company does not currently believe that, either individually or in the aggregate, these matters will result in liabilities material to its consolidated financial condition, results of operations or cash flows.

Note N Segment Reporting

The Company's four operating segments (Domestic Auto Parts, Mexico, Brazil and IMC) are aggregated as one reportable segment: Auto Parts Locations. The criteria the Company used to identify the reportable segment are primarily the nature of the products the Company sells and the operating results that are regularly reviewed by the Company's chief operating decision maker to make decisions about the resources to be allocated to the business units and to assess performance. The accounting policies of the Company's reportable segment are the same as those described in Note A in its Annual Report on Form 10-K for the year ended August 26, 2017.

Table of Contents

The Auto Parts Locations segment is a retailer and distributor of automotive parts and accessories through the Company's 6,088 locations in the United States, Puerto Rico, Mexico and Brazil. Each location carries an extensive product line for cars, sport utility vehicles, vans and light trucks, including new and remanufactured automotive hard parts, maintenance items, accessories and non-automotive products.

The Other category reflects business activities of three operating segments that are not separately reportable due to the materiality of these operating segments. The operating segments include ALLDATA, which produces, sells and maintains diagnostic and repair information software used in the automotive repair industry; E-commerce, which includes direct sales to customers through www.autozone.com; and AutoAnything, which includes direct sales to customers through www.autoanything.com.

The Company evaluates its reportable segment primarily on the basis of net sales and segment profit, which is defined as gross profit. Segment results for the periods presented were as follows:

<i>(in thousands)</i>	Twelve Weeks Ended		Twenty-Four Weeks Ended	
	February 10, 2018	February 11, 2017	February 10, 2018	February 11, 2017
Net Sales				
Auto Parts Locations	\$ 2,331,572	\$ 2,205,562	\$ 4,841,700	\$ 4,595,123
Other	81,454	83,657	160,456	161,942
Total	\$ 2,413,026	\$ 2,289,219	\$ 5,002,156	\$ 4,757,065
Segment Profit				
Auto Parts Locations	\$ 1,233,008	\$ 1,160,923	\$ 2,555,452	\$ 2,418,689
Other	44,038	44,613	87,441	88,388
Gross profit	1,277,046	1,205,536	2,642,893	2,507,077
Operating, selling, general and administrative expenses ⁽¹⁾	(1,071,948)	(821,567)	(1,969,041)	(1,664,206)
Interest expense, net	(39,340)	(34,198)	(78,229)	(67,504)
Income before income taxes	\$ 165,758	\$ 349,771	\$ 595,623	\$ 775,367

(1) Includes impairment charges of \$193.2 million. See Note L Asset Impairments for further discussion.

Note O Income Taxes

Our effective income tax rate was (74.7%) of pretax income for the twelve weeks ended February 10, 2018. The effective tax rate was lower than the U.S. statutory federal rate primarily due to a \$111.9 million provisional tax benefit resulting from the enactment of the Tax Reform as described in further detail below; \$32.1 million of excess tax benefits from option exercises; a \$35.3 million benefit from the previously reported quarter one tax expense due to the reduction of the U.S. statutory rate from 35% to approximately 25.9%; and a second quarter tax benefit of \$24.2 million due to the reduction of the U.S. statutory rate from 35% to approximately 25.9%.

Our effective income tax rate was 4.2% of pretax income for the twenty-four weeks ended February 10, 2018. The effective tax rate was lower than the U.S. statutory federal rate primarily due to a \$111.9 million provisional tax benefit resulting from the enactment of Tax Reform as described in further detail below; \$34.3 million of excess tax benefits from option exercises; and a \$59.5 million benefit from the reduction of the U.S. statutory rate from 35% to approximately 25.9%.

At the end of each interim period, the Company estimates its effective tax rate and applies that rate to its ordinary quarterly earnings. The tax expense or benefit related to significant, unusual, or extraordinary items that will be separately reported or reported net of their related tax effect are individually computed and recognized in the interim period in which those items occur. In addition, the effects of changes in enacted tax laws or rates or tax status are recognized in the interim period in which the change occurs.

On December 22, 2017, Tax Reform was enacted by the U.S. government. Tax Reform contains several key provisions that affected the Company. The enacted provisions impacting the current financial statements include a mandatory one-time transition tax on certain earnings of foreign subsidiaries and a permanent reduction of the U.S. corporate income tax rate from 35 to 21 percent, effective January 1, 2018. As the Company has an August 25th fiscal year-end, the impact of the lower rate will be phased in resulting in a U.S. statutory federal tax rate of approximately 25.9% for the fiscal year ending August 25, 2018 and a 21% U.S. statutory federal rate for fiscal years thereafter. Other enacted provisions which may impact the Company beginning in fiscal 2019 include: limitations on the deductibility of executive compensation, eliminating U.S. federal taxation of future remitted foreign earnings, and other new provisions requiring current inclusion of certain earnings of controlled foreign corporations. The Company maintained its permanent reinvestment assertion for non-U.S. subsidiary earnings but will continue to evaluate and analyze potential impacts of any additional foreign and/or state income taxes on cash repatriation. The Company has not recorded deferred taxes attributable to its foreign operations at this time. Based on information currently available and subject to change, the Company currently forecasts its long-term effective tax rate to be approximately 24.5 percent.

Table of Contents

The Securities and Exchange Commission (SEC) staff issued Staff Accounting Bulletin No. 118 (SAB 118) to address the application of U.S. GAAP in situations where a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of Tax Reform. To the extent that a company's accounting for certain income tax effects of Tax Reform is incomplete but it is able to determine a reasonable estimate, it must record a provisional estimate in the financial statements. If a company cannot determine a provisional estimate to be included in the financial statements, it should continue to apply ASC 740 on the basis of the provisions of the tax laws that were in effect immediately before the enactment of Tax Reform.

The ultimate impact may differ from provisional amounts recorded, possibly materially, due to, among other things, additional analysis, changes in interpretations and assumptions the Company has made, and additional regulatory guidance that may be issued. The accounting is expected to be completed within one year from the enactment date of Tax Reform.

Based on the current analysis, the Company recorded a provisional income tax benefit of \$111.9 million in its consolidated financial statements for the quarter ended February 10, 2018. The Company was able to determine a reasonable estimate for the mandatory one-time transition tax to increase tax expense by \$24.8 million and for the re-measurement of the Company's net U.S. federal deferred tax liability at the lower rate to reduce tax expense by \$136.7 million. The Company's analysis of these items is incomplete at this time. The Company will complete the accounting for these items during the measurement period, which will not exceed beyond one year from the enactment date.

As of February 10, 2018, the Company has estimated the following obligations with respect to the mandatory deemed repatriation of the Company's foreign subsidiaries. The estimate may change, possibly materially, due to among other things, further refinement of the Company's calculations, changes in interpretations and assumptions the Company has made, guidance that may be issued and actions the Company may take as a result of Tax Reform.

<i>(in thousands)</i>	Scheduled Payments
2018	\$ 3,507
2019	1,847
2020	1,847
2021	1,847
2022	1,847
2023	3,464
2024	4,619
2025	5,773
Total One-Time Transition Tax Forecasted Obligation Payments	\$ 24,751

Note P Subsequent Events

Subsequent to the balance sheet date, on February 22, 2018, the Company entered into an asset purchase agreement to sell substantially all of the assets, net of assumed liabilities related to its IMC operations for consideration that

approximates the remaining net book value of the business. The transaction is expected to close in the third quarter of fiscal 2018. On February 26, 2018, the Company sold substantially all of the assets, net of assumed liabilities, related to its AutoAnything operations for consideration that approximates the remaining net book value of the business.

Table of Contents

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

AutoZone, Inc.

We have reviewed the condensed consolidated balance sheet of AutoZone, Inc. as of February 10, 2018, the related condensed consolidated statements of income for the twelve and twenty-four week periods ended February 10, 2018 and February 11, 2017, the condensed consolidated statements of comprehensive income for the twelve and twenty-four week periods ended February 10, 2018 and February 11, 2017, and the condensed consolidated statements of cash flows for the twenty-four week periods ended February 10, 2018 and February 11, 2017. These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the condensed consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of AutoZone, Inc. as of August 26, 2017, and the related consolidated statements of income, comprehensive income, stockholders' deficit, and cash flows for the year then ended, not presented herein, and, in our report dated October 25, 2017, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of August 26, 2017, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP

Memphis, Tennessee

March 16, 2018

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

In Management's Discussion and Analysis, we provide a historical and prospective narrative of our general financial condition, results of operations, liquidity and certain other factors that may affect our future results. The review of Management's Discussion and Analysis should be made in conjunction with our condensed consolidated financial statements, related notes and other financial information, forward-looking statements and other risk factors included elsewhere in this quarterly report.

Forward-Looking Statements

Certain statements contained in this Quarterly Report on Form 10-Q are forward-looking statements. Forward-looking statements typically use words such as believe, anticipate, should, intend, plan, will, expect, estimate, positioned, strategy and similar expressions. These are based on assumptions and assessments made by our management in light of experience and perception of historical trends, current conditions, expected future developments and other factors that we believe to be appropriate. These forward-looking statements are subject to a number of risks and uncertainties, including without limitation: product demand; energy prices; weather; competition; credit market conditions; access to available and feasible financing; the impact of recessionary conditions; consumer debt levels; changes in laws or regulations; war and the prospect of war, including terrorist activity; inflation; the ability to hire and retain qualified employees; construction delays; the compromising of confidentiality, availability, or integrity of information, including cyber attacks; and raw material costs of suppliers. Certain of these risks are discussed in more detail in the Risk Factors section contained in Item 1A under Part 1 of our Annual Report on Form 10-K for the year ended August 26, 2017, and these Risk Factors should be read carefully. Forward-looking statements are not guarantees of future performance, and actual results, developments and business decisions may differ from those contemplated by such forward-looking statements, and events described above and in Risk Factors could materially and adversely affect our business. Forward-looking statements speak only as of the date made. Except as required by applicable law, we undertake no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise. Actual results may materially differ from anticipated results.

Overview

We are the nation's leading retailer, and a leading distributor, of automotive replacement parts and accessories in the United States. We began operations in 1979 and at February 10, 2018, operated 5,514 AutoZone stores in the United States, including Puerto Rico; 532 in Mexico; 16 in Brazil; and 26 IMC branches. Each AutoZone store carries an extensive product line for cars, sport utility vehicles, vans and light trucks, including new and remanufactured automotive hard parts, maintenance items, accessories and non-automotive products. At February 10, 2018, in 4,645 of our domestic AutoZone stores, we also had a commercial sales program that provides commercial credit and prompt delivery of parts and other products to local, regional and national repair garages, dealers, service stations and public sector accounts. We also have commercial programs in AutoZone stores in Mexico and Brazil. We sell the ALLDATA brand automotive diagnostic and repair software through www.alldata.com and www.alldatadiy.com. Additionally, we sell automotive hard parts, maintenance items, accessories and non-automotive products through www.autozone.com and our commercial customers can make purchases through www.autozonepro.com. We do not derive revenue from automotive repair or installation services.

Operating results for the twelve and twenty-four weeks ended February 10, 2018 are not necessarily indicative of the results that may be expected for the fiscal year ending August 25, 2018. Each of the first three quarters of our fiscal year consists of 12 weeks, and the fourth quarter consists of 16 or 17 weeks. The fourth quarters for fiscal 2017 and 2018 each have 16 weeks. Our 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.

Executive Summary

Net sales were up 5.4% for the quarter driven by sales of \$43.1 million from new domestic AutoZone stores and an increase in domestic same store sales (sales from stores open at least one year) of 2.2%. Earnings per share increased 28.5% for the quarter and were significantly impacted by the Tax Reform and asset impairments recorded during the quarter.

Our business is impacted by various factors within the economy that affect both our consumer and our industry, including but not limited to fuel costs, unemployment rates, foreign exchange and interest rates, and other economic conditions. Given the nature of these macroeconomic factors, we cannot predict whether or for how long certain trends will continue, nor can we predict to what degree these trends will impact us in the future.

During the second quarter of fiscal 2018, failure and maintenance related categories represented the largest portion of our sales mix, at approximately 85% of total sales, which was consistent to the prior year period, with failure related categories continuing to be our largest set of categories. We did not experience any fundamental shifts in our category sales mix as compared to the previous year. Our sales mix can be impacted by severe or unusual weather over a short term period. Over the long term, we believe the impact of the weather on our sales mix is not significant.

Our primary response to fluctuations in the demand for the products we sell is to adjust our advertising message, store staffing and product assortment. In recent years, we initiated a variety of strategic tests focused on increasing inventory availability in our domestic stores. As part of those tests, we closely studied our hub distribution model, store inventory levels and product assortment, which led to strategic tests on

Table of Contents

increased frequency of delivery to our domestic stores and significantly expanding parts assortment in select domestic stores we call mega hubs. During fiscal 2016 and most of fiscal 2017, we continued the implementation of more frequent deliveries from our distribution centers to improve the in-stock levels for SKUs stocked in our stores. In the latter part of fiscal 2017, we made substantial changes to test different scenarios to determine the optimal approach around increased delivery frequency. We completed our testing and determined that at certain volumes more frequent deliveries make economic sense. We will be implementing the new frequencies over the next several months. Once completed, approximately 25% of our stores representing 40% of our sales volume, and nearly 50% of our commercial sales, will receive distribution center deliveries three or more times per week.

The two statistics we believe have the most positive correlation to our market growth over the long-term are miles driven and the number of seven year old or older vehicles on the road. While over the long-term we have seen a positive correlation between our net sales and the number of miles driven, we have also seen time frames of minimal correlation in sales performance and miles driven. During the periods of minimal correlation between net sales and miles driven, we believe net sales have been positively impacted by other factors, including the number of seven year old or older vehicles on the road. The average age of the U.S. light vehicle fleet continues to trend in our industry's favor. Since the beginning of 2017 and through December 2017 (latest publicly available information), miles driven increased by 1.2%.

Twelve Weeks Ended February 10, 2018**Compared with Twelve Weeks Ended February 11, 2017**

Net sales for the twelve weeks ended February 10, 2018 increased \$123.8 million to \$2.413 billion, or 5.4%, over net sales of \$2.289 billion for the comparable prior year period. Total auto parts sales increased by 5.7%, primarily driven by net sales of \$43.1 million from new domestic AutoZone stores and an increase in domestic same store sales of 2.2%. Domestic commercial sales increased \$24.8 million, or 5.7%, over the comparable prior year period.

Gross profit for the twelve weeks ended February 10, 2018 was \$1.277 billion, or 52.9% of net sales, compared with \$1.206 billion, or 52.7% of net sales, during the comparable prior year period. The increase in gross margin was attributable to lower distribution costs (17 basis points) and higher merchandise margins.

Operating, selling, general and administrative expenses for the twelve weeks ended February 10, 2018 were \$1.072 billion, or 44.4% of net sales and included impairment charges of approximately \$193.2 million, or 8.0% of sales, compared with \$821.6 million, or 35.9% of net sales, during the comparable prior year period. Operating expenses before impairment charges, as a percentage of sales, were higher than last year primarily due to incentive compensation (-16 basis points), higher advertising costs (-12 basis points) and deleverage on occupancy costs (-10 basis points).

Net interest expense for the twelve weeks ended February 10, 2018 was \$39.3 million compared with \$34.2 million during the comparable prior year period. The increase was primarily due to higher weighted average borrowing rates over the comparable prior year period. Average borrowings for the twelve weeks ended February 10, 2018 were \$5.033 billion, compared with \$5.133 billion for the comparable prior year period. Weighted average borrowing rates were 3.1% for the twelve weeks ended February 10, 2018 and 2.6% for the twelve weeks ended February 11, 2017.

Net income for the twelve week period ended February 10, 2018 increased by \$52.4 million to \$289.5 million due to the factors set forth above, and diluted earnings per share increased by 28.5% to \$10.38 from \$8.08 in the comparable prior year period. Adjusted for impairment charges, Tax Reform, excess tax benefits from option exercises and operating results from IMC and AutoAnything, adjusted net income for the twelve week period ended February 10,

2018 increased by \$8.8 million to \$236.3 million, while adjusted diluted earnings per share increased by 9.3% to \$8.47 from \$7.75 in the comparable prior year period. The impact on current quarter diluted earnings per share from stock repurchases since the end of the comparable prior year period was an increase of \$0.40.

Twenty-Four Weeks Ended February 10, 2018

Compared with Twenty-Four Weeks Ended February 11, 2017

Net sales for the twenty-four weeks ended February 10, 2018 increased \$245.1 million to \$5.002 billion, or 5.2%, over net sales of \$4.757 billion for the comparable prior year period. Total auto parts sales increased by 5.4%, primarily driven by net sales of \$87.5 million from new domestic AutoZone stores and an increase in domestic same store sales of 2.3%. Domestic commercial sales increased \$55.4 million, or 6.2%, over the comparable prior year period.

Gross profit for the twenty-four weeks ended February 10, 2018 was \$2.643 billion, or 52.8% of net sales, compared with \$2.507 billion, or 52.7% of net sales, during the comparable prior year period. The increase in gross margin was attributable to lower distribution costs (13 basis points) and higher merchandise margins.

Operating, selling, general and administrative expenses for the twenty-four weeks ended February 10, 2018 were \$1.969 billion, or 39.4% of net sales, and included impairment charges of approximately \$193.2 million, or 3.9% of sales, compared with \$1.664 billion, or 35.0% of net sales, during the comparable prior year period. Operating expenses before impairment charges, as a percentage of sales, were higher than last year primarily due to hurricane-related expenses incurred during the first quarter (-17 basis points), higher incentive compensation (-17 basis points), deleverage on occupancy (-15 basis points) and higher advertising costs (-5 basis points).

Table of Contents

Net interest expense for the twenty-four weeks ended February 10, 2018 was \$78.2 million compared with \$67.5 million during the comparable prior year period. The increase was primarily due to higher weighted average borrowing rates over the comparable year period. Average borrowings for the twenty-four weeks ended February 10, 2018 were \$4.990 billion, compared with \$5.034 billion for the comparable prior year period. Weighted average borrowing rates were 3.1% for the twenty-four weeks ended February 10, 2018 and 2.6% for the twenty-four weeks ended February 11, 2017.

Net income for the twenty-four weeks ended February 10, 2018 increased by \$55.3 million to \$570.5 million due to the factors set forth above, and diluted earnings per share increased by 16.8% to \$20.38 from \$17.45 in the comparable prior year period. Adjusted for impairment charges, Tax Reform, excess tax benefits from option exercises and operating results from IMC and AutoAnything, adjusted net income for the twenty-four weeks period ended February 10, 2018 increased by \$11.4 million to \$517.2 million, while adjusted diluted earnings per share increased by 7.8% to \$18.47 from \$17.13 in the comparable prior year period. The impact on year to date diluted earnings per share from stock repurchases since the end of the comparable prior year period was an increase of \$0.91.

Income Taxes

On December 22, 2017, the U.S. government enacted the Tax Reform legislation. The Tax Reform contains several key provisions that affected the Company. The enacted provisions impacting the current financial statements include a mandatory one-time transition tax on certain earnings of foreign subsidiaries and a permanent reduction of the U.S. corporate income tax rate from 35 to 21 percent, effective January 1, 2018. As the Company has an August 25th fiscal year-end, the impact of the lower rate will be phased in resulting in a U.S. statutory federal tax rate of approximately 25.9% for the fiscal year ending August 25, 2018 and a 21% U.S. statutory federal rate for fiscal years thereafter. Other enacted provisions which may impact the Company beginning in fiscal 2019 include limitations on the deductibility of executive compensation, eliminating U.S. federal taxation of future remitted foreign earnings, and other new provisions requiring current inclusion of certain earnings of controlled foreign corporations. The Company maintained its permanent reinvestment assertion for non-U.S. subsidiary earnings but will continue to evaluate and analyze potential impacts of any additional foreign and/or state income taxes on cash repatriation. We have not recorded deferred taxes attributable to its foreign operations at this time. Based on information currently available and subject to change, we currently forecasts its long-term effective tax rate to be approximately 24.5 percent.

The Securities and Exchange Commission (SEC) staff issued Staff Accounting Bulletin No. 118 (SAB 118) to address the application of U.S. GAAP in situations where a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of Tax Reform. To the extent that a company's accounting for certain income tax effects of Tax Reform is incomplete but it is able to determine a reasonable estimate, it must record a provisional estimate in the financial statements. If a company cannot determine a provisional estimate to be included in the financial statements, it should continue to apply ASC 740 on the basis of the provisions of the tax laws that were in effect immediately before the enactment of Tax Reform. The ultimate impact may differ from provisional amounts recorded, possibly materially, due to, among other things, additional analysis, changes in interpretations and assumptions the Company has made, and additional regulatory guidance that may be issued. The accounting is expected to be completed within one year from the enactment date of Tax Reform.

Based on our current analysis, we recorded a provisional income tax benefit of \$111.9 million in its consolidated financial statements for the quarter ended February 10, 2018. We were able to determine a reasonable estimate for the mandatory one-time transition tax to increase tax expense by \$24.8 million and for the re-measurement of our net U.S. federal deferred tax liability at the lower rate to reduce tax expense by \$136.7 million. Our analysis of these items is incomplete at this time. We will complete the accounting for these items during the measurement period, which will

not extend beyond one year from the enactment date.

Our effective income tax rate was (74.7%) of pretax income for the twelve weeks ended February 10, 2018 and 32.2% for the comparable prior year period. The lower tax rate resulted from the \$111.9 million provisional amount discussed above, \$32.1 million of excess tax benefits from option exercises, \$35.3 million benefit from the previously reported 2018 first quarter tax expense due to the reduction of the U.S. statutory rate from 35% to approximately 25.9% and a 2018 second quarter tax benefit of \$24.2 million due to the reduction of the U.S. statutory rate from 35% to approximately 25.9%.

Our effective income tax rate was 4.2% of pretax income for the twenty-four weeks ended February 10, 2018 and 33.5% for the comparable prior year period. The lower tax rate resulted from the \$111.9 million provisional amount discussed above, \$34.3 million of excess tax benefits from option exercises and a \$59.5 million benefit from the reduction of the U.S. statutory rate from 35% to approximately 25.9%.

Liquidity and Capital Resources

The primary source of our liquidity is our cash flows realized through the sale of automotive parts, products and accessories. For the twenty-four weeks ended February 10, 2018, our net cash flows from operating activities provided \$752.3 million, as compared with \$563.9 million provided during the comparable prior year period. The increase is primarily due to increased earnings and favorable changes in taxes payable.

Our net cash flows used in investing activities for the twenty-four weeks ended February 10, 2018 was \$230.6 million as compared with \$202.7 million in the comparable prior year period. Capital expenditures for the twenty-four weeks ended February 10, 2018 were \$214.7 million compared to \$216.1 million for the comparable prior year period. During the twenty-four week period ended February 10, 2018, we opened 59 net new locations. In the comparable prior year period, we opened 58 net new locations. Investing cash flows were impacted by our wholly owned captive, which purchased \$80.8 million and sold \$63.1 million in marketable securities during the twenty-four weeks ended

Table of Contents

February 10, 2018. During the comparable prior year period, the captive purchased \$27.8 million in marketable securities and sold \$40.5 million in marketable securities.

Our net cash flows used in financing activities for the twenty-four weeks ended February 10, 2018 were \$524.3 million compared to \$336.6 million in the comparable prior year period. During the twenty-four week period ended February 10, 2018, we repaid no debt. During the comparable prior year period, we repaid our \$400 million 1.35% Senior Notes due in January 2017 using commercial paper borrowings. For the twenty-four week period ended February 10, 2018, our commercial paper activity resulted in \$39.6 million in net repayments of commercial paper, as compared to \$625.6 million in net proceeds in the comparable prior year period. Stock repurchases were \$527.5 million in the current twenty-four week period as compared with \$560.6 million in the comparable prior year period. For the twenty-four weeks ended February 10, 2018, proceeds from the sale of common stock and exercises of stock options provided \$65.2 million. In the comparable prior year period, proceeds from the sale of common stock and exercises of stock options provided \$23.3 million.

During fiscal 2018, we expect to invest in our business at a rate consistent with fiscal 2017. Our investments continue to be directed primarily to new locations, supply chain infrastructure, enhancements to existing locations and investments in technology. The amount of our investments in our new locations is impacted by different factors, including such factors as whether the building and land are purchased (requiring higher investment) or leased (generally lower investment), located in the United States, Mexico or Brazil, or located in urban or rural areas.

In addition to the building and land costs, our new locations require working capital, predominantly for inventories. Historically, we have negotiated extended payment terms from suppliers, reducing the working capital required and resulting in a high accounts payable to inventory ratio. We plan to continue leveraging our inventory purchases; however, our ability to do so may be limited by our vendors' capacity to factor their receivables from us. Certain vendors participate in financing arrangements with financial institutions whereby they factor their receivables from us, allowing them to receive payment on our invoices at a discounted rate. In recent years, we initiated a variety of strategic tests focused on increasing inventory availability, which increased our inventory per location. Many of our vendors have supported our initiative to update our product assortments by providing extended payment terms. These extended payment terms have allowed us to continue our high accounts payable to inventory ratio. Accounts payable, as a percentage of gross inventory, was 106.9% at February 10, 2018, compared to 105.5% at February 11, 2017. The slight increase in this ratio is due to inventory impairment charges related to IMC and increases in accounts payable due to favorable vendor payment terms.

Depending on the timing and magnitude of our future investments (either in the form of leased or purchased properties or acquisitions), we anticipate that we will rely primarily on internally generated funds and available borrowing capacity to support a majority of our capital expenditures, working capital requirements and stock repurchases. The balance may be funded through new borrowings. We anticipate that we will be able to obtain such financing in view of our current credit ratings and favorable experiences in the debt markets in the past.

Tax Reform was enacted on December 22, 2017. As part of the transition to the new territorial tax system, Tax Reform imposes a tax on the mandatory deemed repatriation of earnings of the Company's foreign subsidiaries. It is estimated that the deemed repatriation tax will be approximately \$24.8 million, which has been recorded to income tax expense. The estimate may change, possibly materially, due to among other things, further refinement of the Company's calculations, changes in interpretations and assumptions the Company has made, guidance that may be issued and actions the Company may take as a result of Tax Reform.

For the trailing four quarters ended February 10, 2018, our after-tax return on invested capital (ROIC) was 30.2% as compared to 31.0% for the comparable prior year period. We use ROIC to evaluate whether we are effectively using

our capital resources and believe it is an important indicator of our overall operating performance. Refer to the Reconciliation of Non-GAAP Financial Measures section for further details of our calculation.

Debt Facilities

We entered into a Master Extension, New Commitment and Amendment Agreement dated as of November 18, 2017 (the Extension Amendment) to the Third Amended and Restated Credit Agreement dated as of November 18, 2016, as amended, modified, extended or restated from time to time. Under the Extension Amendment: (i) our borrowing capacity under the Revolving Credit Agreement was increased from \$1.6 billion to \$2.0 billion; (ii) our option to increase the borrowing capacity under the Revolving Credit Agreement was refreshed and the amount of such option remained at \$400 million; the maximum borrowing under the Revolving Credit Agreement may, at our option, subject to lenders approval, be increased from \$2.0 billion to \$2.4 billion; (iii) the termination date of the Revolving Credit Agreement was extended from November 18, 2021 until November 18, 2022; and (iv) we have the option to make one additional written request of the lenders to extend the termination date then in effect for an additional one year. Under the revolving credit facility, we may borrow funds consisting of Eurodollar loans, base rate loans or a combination of both. Interest accrues on Eurodollar loans at a defined Eurodollar rate, defined as LIBOR plus the applicable percentage, as defined in the revolving credit facility, depending upon our senior, unsecured, (non-credit enhanced) long-term debt rating. Interest accrues on base rate loans as defined in the credit facility. As of February 10, 2018, we had \$3.3 million of outstanding letters of credit under the Revolving Credit Agreement.

On November 18, 2016, we amended and restated our existing 364-Day revolving credit facility (the New 364-Day Credit Agreement) by decreasing the committed credit amount from \$500 million to \$400 million, extending the expiration date by one year and renegotiating other terms and conditions. The credit facility was available to primarily support commercial paper borrowings and other short-term unsecured bank loans. Under the credit facility, we could borrow funds consisting of Eurodollar loans, base rate loans or a combination of both.

Table of Contents

Interest accrued on Eurodollar loans at a defined Eurodollar rate, defined as LIBOR plus the applicable margin, as defined in the revolving credit facility, depending upon our senior, unsecured, (non-credit enhanced) long-term debt rating. Interest accrued on base rate loans as defined in the credit facility. The New 364-Day Credit Agreement expired on November 17, 2017, and we did not renew this revolving credit facility.

We also maintain a letter of credit facility that allows us to request the participating bank to issue letters of credit on our behalf up to an aggregate amount of \$75 million. The letter of credit facility is in addition to the letters of credit that may be issued under the Revolving Credit Agreement. As of February 10, 2018, we had \$75.0 million in letters of credit outstanding under the letter of credit facility, which expires in June 2019.

In addition to the outstanding letters of credit issued under the committed facilities discussed above, we had \$30.1 million in letters of credit outstanding as of February 10, 2018. These letters of credit have various maturity dates and were issued on an uncommitted basis.

All senior notes are subject to an interest rate adjustment if the debt ratings assigned to the senior notes are downgraded (as defined in the agreements). Further, the senior notes contain a provision that repayment of the senior notes may be accelerated if we experience a change in control (as defined in the agreements). Our borrowings under our senior notes contain minimal covenants, primarily restrictions on liens. Under our revolving credit facilities, covenants include restrictions on liens, a maximum debt to earnings ratio, a minimum fixed charge coverage ratio and a change of control provision that may require acceleration of the repayment obligations under certain circumstances. All of the repayment obligations under our borrowing arrangements may be accelerated and come due prior to the scheduled payment date if covenants are breached or an event of default occurs. As of February 10, 2018, we were in compliance with all covenants and expect to remain in compliance with all covenants under our borrowing arrangements.

As of February 10, 2018, \$1.116 billion of commercial paper borrowings and the \$250 million 7.125% Senior Notes due August 2018 were classified as long-term in the Consolidated Balance Sheets as we had the ability and intent to refinance them on a long-term basis through available capacity in our revolving credit facility. As of February 10, 2018, we had \$1.997 billion of availability under our \$2.0 billion revolving credit facilities, which would allow us to replace these short-term obligations with long-term financing facility.

Our adjusted debt to earnings before impairment, interest, taxes, depreciation, amortization, rent and share-based expense (EBITDAR) ratio was 2.5:1 as of February 10, 2018, and was 2.6:1 as of February 11, 2017. We calculate adjusted debt as the sum of total debt, capital lease obligations and rent times six; and we calculate EBITDAR by adding impairment before tax impact, interest, taxes, depreciation, amortization, rent and share-based expenses to net income. Adjusted debt to EBITDAR is calculated on a trailing four quarter basis. We target our debt levels to a ratio of adjusted debt to EBITDAR in order to maintain our investment grade credit ratings. We believe this is important information for the management of our debt levels. To the extent EBITDAR continues to grow in future years, we expect our debt levels to increase; conversely, if EBITDAR declines, we would expect our debt levels to decrease. Refer to the *Reconciliation of Non-GAAP Financial Measures* section for further details of our calculation.

Stock Repurchases

From January 1, 1998 to February 10, 2018, we have repurchased a total of 143.1 million shares of our common stock at an aggregate cost of \$18.354 billion, including 824,733 shares of our common stock at an aggregate cost of \$527.5 million during the twenty-four week period ended February 10, 2018. On March 21, 2017, the Board voted to increase the authorization by \$750 million. This raised the total value of shares authorized to be repurchased to \$18.65 billion. Considering cumulative repurchases as of February 10, 2018, we had \$296.2 million remaining under

the Board's authorization to repurchase our common stock.

During the twenty-four week period ended February 10, 2018, we retired 1.5 million shares of treasury stock which had previously been repurchased under our share repurchase program. The retirement increased Retained deficit by \$918.5 million and decreased Additional paid-in capital by \$60.5 million. During the comparable prior year period, we retired 1.8 million shares of treasury stock, which increased Retained deficit by \$1.321 billion and decreased Additional paid-in capital by \$64.9 million.

Subsequent to February 10, 2018, we have repurchased 382,928 shares of our common stock at an aggregate cost of \$264.9 million.

Off-Balance Sheet Arrangements

Since our fiscal year end, we have cancelled, issued and modified stand-by letters of credit that are primarily renewed on an annual basis to cover deductible payments to our casualty insurance carriers. Our total stand-by letters of credit commitment at February 10, 2018, was \$108.4 million compared with \$88.6 million at August 26, 2017, and our total surety bonds commitment at February 10, 2018, was \$32.5 million compared with \$28.8 million at August 26, 2017.

Table of Contents**Financial Commitments**

Except for the previously discussed amendments to our existing revolving credit facilities, debt issuance and retirement, as of February 10, 2018, there were no significant changes to our contractual obligations as described in our Annual Report on Form 10-K for the year ended August 26, 2017.

Reconciliation of Non-GAAP Financial Measures

Management's Discussion and Analysis of Financial Condition and Results of Operations includes certain financial measures not derived in accordance with GAAP. These non-GAAP financial measures provide additional information for determining our optimum capital structure and are used to assist management in evaluating performance and in making appropriate business decisions to maximize stockholders' value.

Non-GAAP financial measures should not be used as a substitute for GAAP financial measures, or considered in isolation, for the purpose of analyzing our operating performance, financial position or cash flows. However, we have presented the non-GAAP financial measures, as we believe they provide additional information that is useful to investors. Furthermore, our management and the Compensation Committee of the Board use the abovementioned non-GAAP financial measures to analyze and compare our underlying operating results and to determine payments of performance-based compensation. We have included a reconciliation of this information to the most comparable GAAP measures in the following reconciliation tables.

Reconciliation of Non-GAAP Financial Measure: After-Tax Return on Invested Capital (ROIC)

The following tables calculate the percentages of ROIC for the trailing four quarters ended February 10, 2018 and February 11, 2017.

	A	B	A-B=C	D	C+D
	Fiscal Year Ended	Twenty-Four Weeks Ended	Twenty-Eight Weeks Ended	Twenty-Four Weeks Ended	Trailing Four Quarters Ended
<i>(in thousands, except percentage)</i>	August 26, 2017	February 11, 2017	August 26, 2017	February 10, 2018	February 10, 2018
Net income	\$ 1,280,869	\$ 515,270	\$ 765,599	\$ 570,533	\$ 1,336,132
Adjustments:					
Impairment before tax impact				193,162	193,162
Interest expense	154,580	67,504	87,076	78,229	165,305
Rent expense	302,928	135,859	167,069	142,712	309,781
Tax effect ⁽¹⁾	(153,265)	(69,957)	(83,308)	(112,656)	(195,964)
Deferred tax remeasurement				(136,679)	(136,679)
After-tax return	\$ 1,585,112	\$ 648,676	\$ 936,436	\$ 735,301	\$ 1,671,737

Edgar Filing: AUTOZONE INC - Form 10-Q

Average debt ⁽²⁾	\$ 5,082,494
Average deficit ⁽³⁾	(1,565,135)
Rent x 6 ⁽⁴⁾	1,858,686
Average capital lease obligations ⁽⁵⁾	153,599
Invested capital	\$ 5,529,644
ROIC	30.2%

	A	B	A-B=C	D	C+D
	Fiscal Year Ended	Twenty-Four Weeks Ended	Twenty-Eight Weeks Ended	Twenty-Four Weeks Ended	Trailing Four Quarters Ended
<i>(in thousands, except percentage)</i>	August 27, 2016	February 13, 2016	August 27, 2016	February 11, 2017	February 11, 2017
Net income	\$ 1,241,007	\$ 486,725	\$ 754,282	\$ 515,270	\$ 1,269,552
Adjustments:					
Interest expense	147,681	67,842	79,839	67,504	147,343
Rent expense	280,490	128,897	151,593	135,859	287,452
Tax effect ⁽¹⁾	(147,291)	(67,678)	(79,613)	(69,957)	(149,570)
After-tax return	\$ 1,521,887	\$ 615,786	\$ 906,101	\$ 648,676	\$ 1,554,777
Average debt ⁽²⁾					\$ 4,974,468
Average deficit ⁽³⁾					(1,822,960)
Rent x 6 ⁽⁴⁾					1,724,712
Average capital lease obligations ⁽⁵⁾					140,851
Invested capital					\$ 5,017,071
ROIC					31.0%

Table of Contents

- (1) The effective tax rate was 29.9%, excluding the impact of the revaluation of net deferred tax liabilities, and 34.4% over the trailing four quarters ended February 10, 2018 and February 11, 2017, respectively.
- (2) Average debt is equal to the average of our debt measured as of the previous five quarters.
- (3) Average equity is equal to the average of our stockholders' deficit measured as of the previous five quarters.
- (4) Rent is multiplied by a factor of six to capitalize operating leases in the determination of pre-tax invested capital.
- (5) Average capital lease obligations are equal to the average of our capital lease obligations measured as of the previous five quarters.

Reconciliation of Non-GAAP Financial Measure: Adjusted Debt to Earnings before Impairment, Interest, Taxes, Depreciation, Rent and Share-Based Expense EBITDAR

The following tables calculate the ratio of adjusted debt to EBITDAR for the trailing four quarters ended February 10, 2018 and February 11, 2017.

	A	B	A-B=C	D	C+D
	Fiscal Year Ended	Twenty-Four Weeks Ended	Twenty-Eight Weeks Ended	Twenty-Four Weeks Ended	Trailing Four Quarters Ended
<i>(in thousands, except ratio)</i>	August 26, 2017	February 11, 2017	August 26, 2017	February 10, 2018	February 10, 2018
Net income	\$ 1,280,869	\$ 515,270	\$ 765,599	\$ 570,533	\$ 1,336,132
Add: Impairment before tax impact				193,162	193,162
Interest expense	154,580	67,504	87,076	78,229	165,305
Income tax expense	644,620	260,097	384,523	25,090	409,613
Adjusted EBIT	2,080,069	842,871	1,237,198	867,014	2,104,212
Add: Depreciation expense	323,051	144,645	178,406	157,337	335,743
Rent expense	302,928	135,859	167,069	142,712	309,781
Share-based expense	38,244	20,711	17,533	23,764	41,297
EBITDAR	\$ 2,744,292	\$ 1,144,086	\$ 1,600,206	\$ 1,190,827	\$ 2,791,033
Debt					\$ 5,043,541
Capital lease obligations					156,238
Rent x 6 ⁽¹⁾					1,858,686
Adjusted debt					\$ 7,058,465
Adjusted debt /					2.5

EBITDAR

	A	B	A-B=C	D	C+D
	Fiscal Year Ended	Twenty-Four Weeks Ended	Twenty-Eight Weeks Ended	Twenty-Four Weeks Ended	Trailing Four Quarters Ended
<i>(in thousands, except ratio)</i>	August 27, 2016	February 13, 2016	August 27, 2016	February 11, 2017	February 11, 2017
Net income	\$ 1,241,007	\$ 486,725	\$ 754,282	\$ 515,270	\$ 1,269,552
Interest expense	147,681	67,842	79,839	67,504	147,343
Income tax expense	671,707	266,088	405,619	260,097	665,716
EBIT	2,060,395	820,655	1,239,740	842,871	2,082,611
Add: Depreciation expense	297,397	134,936	162,461	144,645	307,106
Rent expense	280,490	128,897	151,593	135,859	287,452
Share-based expense	39,825	18,547	21,278	20,711	41,989
EBITDAR	\$ 2,678,107	\$ 1,103,035	\$ 1,575,072	\$ 1,144,086	\$ 2,719,158
Debt					\$ 5,151,862
Capital lease obligations					149,802
Rent x 6 ⁽¹⁾					1,724,712
Adjusted debt					\$ 7,026,376
Adjusted debt / EBITDAR					2.6

(1) Rent is multiplied by a factor of six to capitalize operating leases in the determination of adjusted debt.

Table of Contents*Reconciliation of Non-GAAP Financial Measure: Adjusted Operating Profit*

The following table calculates adjusted operating profit. Adjusted operating profit is calculated to exclude the impact of impairment charges and operating results of IMC and AutoAnything:

<i>(in thousands)</i>	Twelve Weeks Ended		Twenty-Four Weeks Ended	
	February 10, 2018	February 11, 2017	February 10, 2018	February 11, 2017
Operating profit	\$ 205,098	\$ 383,969	\$ 673,852	\$ 842,871
Impairment	193,162		193,162	
Operating results IMC and AutoAnything	5,234	4,814	8,270	9,901
Adjusted operating profit	\$ 403,494	\$ 388,783	\$ 875,284	\$ 852,772

Reconciliation of Non-GAAP Financial Measure: Adjusted Net Income

The following table calculates adjusted net income. Adjusted net income is calculated to exclude the impact of impairment charges, Tax Reform, excess tax benefits from option exercises and operating results of IMC and AutoAnything:

<i>(in thousands)</i>	Twelve Weeks Ended		Twenty-Four Weeks Ended	
	February 10, 2018	February 11, 2017	February 10, 2018	February 11, 2017
Net income	\$ 289,530	\$ 237,145	\$ 570,533	\$ 515,270
Impairment, net of \$46.6MM income tax benefit	146,512		146,512	
Tax Reform	(171,398)		(171,398)	
Impact of excess tax benefits from option exercises	(32,076)	(12,698)	(34,328)	(15,646)
Operating results IMC and AutoAnything ⁽¹⁾	3,712	2,990	5,859	6,157
Adjusted net income	\$ 236,280	\$ 227,437	\$ 517,178	\$ 505,781

Reconciliation of Non-GAAP Financial Measure: Adjusted Diluted Earnings Per Share

The following table calculates the adjusted diluted earnings per share. Adjusted diluted earnings per share is calculated to exclude the impact of impairment charges, Tax Reform, excess tax benefits from option exercises and operating results of IMC and AutoAnything:

Twelve Weeks Ended **Twenty-Four Weeks Ended**

	February 10, 2018	February 11, 2017	February 10, 2018	February 11, 2017
Diluted earnings per share	\$ 10.38	\$ 8.08	\$ 20.38	\$ 17.45
Impairment, net of \$46.6MM income tax benefit	5.25		5.23	
Tax Reform	(6.14)		(6.12)	
Impact of excess tax benefits from option exercises	(1.15)	(0.43)	(1.23)	(0.53)
Operating results IMC and AutoAnything ⁽¹⁾	0.13	0.10	0.21	0.21
Adjusted diluted earnings per share	\$ 8.47	\$ 7.75	\$ 18.47	\$ 17.13

(1) Operating results IMC and AutoAnything are net of tax benefit.

Recent Accounting Pronouncements

Refer to Note A of the Notes to Condensed Consolidated Financial Statements for the discussion of recent accounting pronouncements.

Critical Accounting Policies and Estimates

Preparation of our consolidated financial statements requires us to make estimates and assumptions affecting the reported amounts of assets and liabilities at the date of the financial statements, reported amounts of revenues and expenses during the reporting period and related disclosures of contingent liabilities. Our policies are evaluated on an ongoing basis, and our significant judgments and estimates are drawn from historical experience and other assumptions that we believe to be reasonable under the circumstances. Actual results could differ under different assumptions or conditions.

Our critical accounting policies are described in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended August 26, 2017. Our critical accounting policies have not changed since the filing of our Annual Report on Form 10-K for the year ended August 26, 2017.

Table of Contents

Item 3. Quantitative and Qualitative Disclosures about Market Risk

At February 10, 2018, the only material change to our instruments and positions that are sensitive to market risk since the disclosures in our 2017 Annual Report to Stockholders was the \$39.6 million net decrease in commercial paper.

The fair value of our debt was estimated at \$5.049 billion as of February 10, 2018 and \$5.171 billion as of August 26, 2017, based on the quoted market prices for the same or similar debt issues or on the current rates available to AutoZone for debt of the same terms (Level 2). Such fair value was greater than the carrying value of debt by \$5.4 million at February 10, 2018 and \$90.3 million at August 26, 2017. We had \$1.116 billion of variable rate debt outstanding at February 10, 2018 and \$1.155 billion of variable rate debt outstanding at August 26, 2017. At these borrowing levels for variable rate debt, a one percentage point increase in interest rates would have had an unfavorable annual impact on our pre-tax earnings and cash flows of \$11.2 million in fiscal 2018. The primary interest rate exposure on variable rate debt is based on LIBOR. We had outstanding fixed rate debt of \$3.928 billion, net of unamortized debt issuance costs of \$22.0 million at February 10, 2018 and \$3.926 billion, net of unamortized debt issuance costs of \$23.9 million at August 26, 2017. A one percentage point increase in interest rates would reduce the fair value of our fixed rate debt by \$175.1 million at February 10, 2018.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of February 10, 2018, an evaluation was performed under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, as amended. Based on that evaluation, our management, including the Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective as of February 10, 2018.

Changes in Internal Controls

There were no changes in our internal control over financial reporting that occurred during the quarter ended February 10, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents**PART II. OTHER INFORMATION****Item 1. Legal Proceedings**

In 2004, we acquired a store site in Mount Ephraim, New Jersey that had previously been the site of a gasoline service station and contained evidence of groundwater contamination. Upon acquisition, we voluntarily reported the groundwater contamination issue to the New Jersey Department of Environmental Protection (NJDEP) and entered into a Voluntary Remediation Agreement providing for the remediation of the contamination associated with the property. We have conducted and paid for (at an immaterial cost to us) remediation of contamination on the property. We have also voluntarily investigated and addressed potential vapor intrusion impacts in downgradient residences and businesses. The NJDEP has asserted, in a Directive and Notice to Insurers dated February 19, 2013 and again in an Amended Directive and Notice to Insurers dated January 13, 2014 (collectively the Directives), that we are liable for the downgradient impacts under a joint and severable liability theory. By letter dated April 23, 2015, NJDEP has demanded payment from us, and other parties, in the amount of approximately \$296 thousand for costs incurred by NJDEP in connection with contamination downgradient of the property. By letter dated January 29, 2016, we were informed that NJDEP has filed a lien against the property in connection with approximately \$355 thousand in costs incurred by NJDEP in connection with contamination downgradient of the property. We have contested, and will continue to contest, any such assertions due to the existence of other entities/sources of contamination, some of which are named in the Directives and the April 23, 2015 Demand, in the area of the property. Pursuant to the Voluntary Remediation Agreement, upon completion of all remediation required by the agreement, we believe we should be eligible to be reimbursed up to 75 percent of qualified remediation costs by the State of New Jersey. We have asked the state for clarification that the agreement applies to off-site work, and the state is considering the request. Although the aggregate amount of additional costs that we may incur pursuant to the remediation cannot currently be ascertained, we do not currently believe that fulfillment of our obligations under the agreement or otherwise will result in costs that are material to our financial condition, results of operations or cash flows.

In July 2014, we received a subpoena from the District Attorney of the County of Alameda, along with other environmental prosecutorial offices in the State of California, seeking documents and information related to the handling, storage and disposal of hazardous waste. We received notice that the District Attorney will seek injunctive and monetary relief. We are cooperating fully with the request and cannot predict the ultimate outcome of these efforts, although we have accrued all amounts we believe to be probable and reasonably estimable. We do not believe the ultimate resolution of this matter will have a material adverse effect on the consolidated financial position, results of operations or cash flows.

In April 2016, we received a letter from the California Air Resources Board seeking payment for alleged violations of the California Health and Safety Code related to the sale of certain aftermarket emission parts in the State of California. We do not believe that any resolution of the matter will have a material adverse effect on our consolidated financial position, results of operations or cash flows.

We are involved in various other legal proceedings incidental to the conduct of our business, including, but not limited to, several lawsuits containing class-action allegations in which the plaintiffs are current and former hourly and salaried employees who allege various wage and hour violations and unlawful termination practices. We do not currently believe that, either individually or in the aggregate, these matters will result in liabilities material to our financial condition, results of operations or cash flows.

Item 1A. Risk Factors

As of the date of this filing, there have been no material changes in our risk factors from those disclosed in Part I, Item 1A, of our Annual Report on Form 10-K for the fiscal year ended August 26, 2017.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Shares of common stock repurchased by the Company during the quarter ended February 10, 2018 were as follows:

Issuer Repurchases of Equity Securities				
Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Dollar Value that May Yet Be Purchased Under the Plans or Programs
November 19, 2017 to December 16, 2017	13,002	\$ 616.38	13,002	\$ 463,116,160
December 17, 2017 to January 13, 2018	32,537	768.29	32,537	438,118,450
January 14, 2018 to February 10, 2018	181,764	780.52	181,764	296,247,583
Total	227,303	\$ 769.38	227,303	\$ 296,247,583

During 1998, we announced a program permitting us to repurchase a portion of our outstanding shares not to exceed a dollar maximum established by our Board of Directors. This program was most recently amended on March 21, 2017 to increase the repurchase authorization by \$750 million. This brings the total value of shares to be repurchased to \$18.65 billion. All of the above repurchases were part of this program. Subsequent to February 10, 2018, we have repurchased 382,928 shares of our common stock at an aggregate cost of \$264.9 million.

Table of Contents

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

Table of Contents

Item 6. Exhibits

The following exhibits are being filed herewith:

- 3.1 Restated Articles of Incorporation of AutoZone, Inc. incorporated by reference to Exhibit 3.1 to the Quarterly Report on Form 10-Q for the quarter ended February 13, 1999.
- 3.2 Sixth Amended and Restated By-laws of AutoZone, Inc. incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K dated October 7, 2015.
- 4.1 Master Extension, New Commitment and Amendment Agreement dated as of November 18, 2017 among AutoZone, Inc. as Borrower; Bank of America, N.A. as Administrative Agent and Swingline Lender; JPMorgan Chase Bank, N.A. as Syndication Agent; Merrill Lynch, Pierce, Fenner & Smith Incorporated and J.P. Morgan Chase Bank, N.A. as Joint Lead Arrangers; Merrill Lynch, Pierce, Fenner & Smith Incorporated, J.P. Morgan Chase Bank, N.A., SunTrust Robinson Humphrey, Inc., U.S. Bank National Association, Wells Fargo Securities, LLC and Barclays Capital as Joint Book Runners; SunTrust Bank, U.S. Bank National Association, Wells Fargo Bank, National Association and Barclays Bank PLC as Documentation Agents; and the several lenders party thereto. Incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K dated November 18, 2017.
- 12.1 Computation of Ratio of Earnings to Fixed Charges.
- 15.1 Letter Regarding Unaudited Interim Financial Statements.
- 31.1 Certification of Principal Executive Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Principal Financial Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Principal 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 Principal Financial Officer Pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Document
- 101.LAB XBRL Taxonomy Extension Labels Document
- 101.PRE XBRL Taxonomy Extension Presentation Document
- 101.DEF XBRL Taxonomy Extension Definition Document

Table of Contents

SIGNATURES

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.

AUTOZONE, INC.

By: /s/ WILLIAM T. GILES

William T. Giles

Chief Financial Officer and Executive Vice
President

Finance and Information Technology
(Principal Financial Officer)

By: /s/ CHARLIE PLEAS, III

Charlie Pleas, III

Senior Vice President, Controller
(Principal Accounting Officer)

Dated: March 16, 2018