

ROSS STORES INC  
Form 10-Q  
September 09, 2015

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q  
(Mark one)

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

For the quarterly period ended August 1, 2015

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: 0-14678

Ross Stores, Inc.  
(Exact name of registrant as specified in its charter)  
Delaware  
(State or other jurisdiction of incorporation or organization)

94-1390387  
(I.R.S. Employer Identification No.)

5130 Hacienda Drive, Dublin, California  
(Address of principal executive offices)

94568-7579  
(Zip Code)

Registrant's telephone number, including area code

(925) 965-4400

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

N/A

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

The number of shares of Common Stock, with \$.01 par value, outstanding on August 19, 2015 was 408,072,468.

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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## Condensed Consolidated Statements of Earnings

(\$000, except stores and per share data, unaudited)	Three Months Ended		Six Months Ended	
	August 1, 2015	August 2, 2014	August 1, 2015	August 2, 2014
Sales	\$2,968,270	\$2,729,566	\$5,906,418	\$5,410,159
Costs and Expenses				
Cost of goods sold	2,119,480	1,944,017	4,186,935	3,852,202
Selling, general and administrative	435,226	395,225	844,524	775,027
Interest expense (income), net	1,652	(95	) 3,655	(200
Total costs and expenses	2,556,358	2,339,147	5,035,114	4,627,029
Earnings before taxes	411,912	390,419	871,304	783,130
Provision for taxes on earnings	153,273	150,858	330,460	299,656
Net earnings	\$258,639	\$239,561	\$540,844	\$483,474
Earnings per share				
Basic	\$0.64	\$0.58	\$1.33	\$1.16
Diluted	\$0.63	\$0.57	\$1.32	\$1.15
Weighted average shares outstanding (000)				
Basic	404,760	415,130	406,211	416,514
Diluted	407,693	419,305	409,562	421,213
Dividends				
Cash dividends declared per share	\$0.1175	\$0.1000	\$0.2350	\$0.2000
Stores open at end of period	1,424	1,338	1,424	1,338

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

Condensed Consolidated Statements of Comprehensive Income

(\$000, unaudited)	Three Months Ended		Six Months Ended	
	August 1, 2015	August 2, 2014	August 1, 2015	August 2, 2014
Net earnings	\$258,639	\$239,561	\$540,844	\$483,474
Other comprehensive (loss) income:				
Change in unrealized loss on investments, net of tax	(25 )	(14 )	(107 )	(47 )
Comprehensive income	\$258,614	\$239,547	\$540,737	\$483,427

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

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Condensed Consolidated Balance Sheets

(\$000, unaudited)	August 1, 2015	January 31, 2015	August 2, 2014
<b>Assets</b>			
<b>Current Assets</b>			
Cash and cash equivalents	\$630,288	\$696,608	\$549,784
Short-term investments	999	500	—
Accounts receivable	88,443	73,278	85,218
Merchandise inventory	1,509,752	1,372,675	1,258,820
Prepaid expenses and other	129,819	106,778	115,953
Deferred income taxes	10,732	12,951	14,090
<b>Total current assets</b>	<b>2,370,033</b>	<b>2,262,790</b>	<b>2,023,865</b>
<b>Property and Equipment</b>			
Land and buildings	1,083,430	952,428	626,708
Fixtures and equipment	2,091,316	1,933,383	1,760,417
Leasehold improvements	889,893	854,572	827,073
Construction-in-progress	95,178	293,715	416,810
	4,159,817	4,034,098	3,631,008
Less accumulated depreciation and amortization	1,870,339	1,760,346	1,651,720
<b>Property and equipment, net</b>	<b>2,289,478</b>	<b>2,273,752</b>	<b>1,979,288</b>
Long-term investments	2,613	3,110	3,660
Other long-term assets	162,180	160,669	160,727
<b>Total assets</b>	<b>\$4,824,304</b>	<b>\$4,700,321</b>	<b>\$4,167,540</b>
<b>Liabilities and Stockholders' Equity</b>			
<b>Current Liabilities</b>			
Accounts payable	\$1,044,875	\$1,000,700	\$967,915
Accrued expenses and other	405,629	385,325	367,451
Accrued payroll and benefits	225,153	256,141	189,585
Income taxes payable	—	17,202	7,170
<b>Total current liabilities</b>	<b>1,675,657</b>	<b>1,659,368</b>	<b>1,532,121</b>
Long-term debt	395,793	395,562	149,708
Other long-term liabilities	287,406	279,500	283,584
Deferred income taxes	78,934	86,681	52,800
<b>Commitments and contingencies</b>			
<b>Stockholders' Equity</b>			
Common stock	4,087	4,149	4,204
Additional paid-in capital	1,080,108	1,013,607	978,748
Treasury stock	(224,194	) (160,600	) (159,164
Accumulated other comprehensive income	223	330	342
Retained earnings	1,526,290	1,421,724	1,325,197
<b>Total stockholders' equity</b>	<b>2,386,514</b>	<b>2,279,210</b>	<b>2,149,327</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$4,824,304</b>	<b>\$4,700,321</b>	<b>\$4,167,540</b>

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



## Condensed Consolidated Statements of Cash Flows

(\$000, unaudited)	Six Months Ended	
	August 1, 2015	August 2, 2014
<b>Cash Flows From Operating Activities</b>		
Net earnings	\$540,844	\$483,474
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	128,729	110,670
Stock-based compensation	29,881	25,095
Deferred income taxes	(5,528)	(9,934)
Tax benefit from equity issuance	37,431	24,061
Excess tax benefit from stock-based compensation	(37,352)	(23,755)
Change in assets and liabilities:		
Merchandise inventory	(137,077)	(1,665)
Other current assets	(38,097)	(34,536)
Accounts payable	64,802	189,896
Other current liabilities	111	(12,101)
Other long-term, net	6,627	(9,414)
Net cash provided by operating activities	590,371	741,791
<b>Cash Flows From Investing Activities</b>		
Additions to property and equipment	(193,108)	(253,350)
Increase in restricted cash and investments	(73)	(7,043)
Purchases of investments	(718)	—
Proceeds from investments	602	12,022
Net cash used in investing activities	(193,297)	(248,371)
<b>Cash Flows From Financing Activities</b>		
Excess tax benefit from stock-based compensation	37,352	23,755
Issuance of common stock related to stock plans	11,312	9,318
Treasury stock purchased	(63,601)	(37,605)
Repurchase of common stock	(351,515)	(277,391)
Dividends paid	(96,942)	(84,881)
Net cash used in financing activities	(463,394)	(366,804)
Net (decrease) increase in cash and cash equivalents	(66,320)	126,616
<b>Cash and cash equivalents:</b>		
Beginning of period	696,608	423,168
End of period	\$630,288	\$549,784
<b>Supplemental Cash Flow Disclosures</b>		
Interest paid	\$8,982	\$4,834
Income taxes paid	\$322,294	\$299,762
The accompanying notes are an integral part of these condensed consolidated financial statements.		

## Notes to Condensed Consolidated Financial Statements

Three and Six Months Ended August 1, 2015 and August 2, 2014  
(Unaudited)

## Note A: Summary of Significant Accounting Policies

Basis of presentation. The accompanying unaudited interim condensed consolidated financial statements have been prepared from the records of Ross Stores, Inc. and subsidiaries (the "Company") without audit and, in the opinion of management, include all adjustments (consisting of only normal, recurring adjustments) necessary to present fairly the Company's financial position as of August 1, 2015 and August 2, 2014, the results of operations and comprehensive income for the three and six month periods ended August 1, 2015 and August 2, 2014, and cash flows for the six month periods ended August 1, 2015 and August 2, 2014. The Condensed Consolidated Balance Sheet as of January 31, 2015, presented herein, has been derived from the Company's audited consolidated financial statements for the fiscal year then ended.

Accounting policies followed by the Company are described in Note A to the audited consolidated financial statements for the fiscal year ended January 31, 2015. Certain information and disclosures normally included in the notes to annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted for purposes of these interim condensed consolidated financial statements. The interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements, including notes thereto, contained in the Company's Annual Report on Form 10-K for the year ended January 31, 2015.

The results of operations and comprehensive income for the three and six month periods ended August 1, 2015 and August 2, 2014 presented herein are not necessarily indicative of the results to be expected for the full fiscal year.

Stock dividend. On March 24, 2015, the Company's Board of Directors declared a two-for-one split of the Company's common stock issued in the form of a stock dividend. Stockholders of record as of April 22, 2015 were issued one additional share of common stock on June 11, 2015 for each share held. All share and per share amounts have been adjusted to reflect the stock split.

Restricted cash, cash equivalents, and investments. The Company has restricted cash, cash equivalents, and investments that serve as collateral for certain insurance obligations of the Company. These restricted funds are invested in bank deposits, money market mutual funds, U.S. Government and agency securities, and corporate securities and cannot be withdrawn from the Company's account without the prior written consent of the secured parties. The following table summarizes total restricted cash, cash equivalents, and investments which were included in Prepaid expenses and other and Other long-term assets in the Condensed Consolidated Balance Sheets as of August 1, 2015, January 31, 2015, and August 2, 2014:

Restricted Assets (\$000)	August 1, 2015	January 31, 2015	August 2, 2014
Prepaid expenses and other	\$ 19,719	\$ 19,713	\$ 22,766
Other long-term assets	56,125	56,107	55,737
Total	\$ 75,844	\$ 75,820	\$ 78,503

The classification between current and long-term is based on the timing of expected payments of the insurance obligations.



Property and equipment. As of August 1, 2015 and August 2, 2014, the Company had \$10.0 million and \$22.6 million, respectively, of property and equipment purchased but not yet paid. These purchases are included in Property and Equipment, Accounts payable, and Accrued expenses and other in the accompanying Condensed Consolidated Balance Sheets.

Sales mix. The Company's sales mix is shown below for the three and six month periods ended August 1, 2015 and August 2, 2014:

	Three Months Ended		Six Months Ended		
	August 1, 2015	August 2, 2014	August 1, 2015	August 2, 2014	
Ladies	30	% 31	% 30	% 31	%
Home Accents and Bed and Bath	23	% 22	% 23	% 22	%
Men's	14	% 14	% 13	% 13	%
Shoes	13	% 13	% 13	% 13	%
Accessories, Lingerie, Fine Jewelry, and Fragrances	13	% 12	% 13	% 13	%
Children's	7	% 8	% 8	% 8	%
Total	100	% 100	% 100	% 100	%

Cash Dividends. Dividends included in the Condensed Consolidated Statements of Cash Flows reflect cash dividends paid during the periods shown. Dividends per share reported on the Condensed Consolidated Statements of Earnings reflect cash dividends declared during the periods shown.

The Company's Board of Directors declared cash dividends of \$0.1175 per common share in February and May 2015, respectively, and \$0.1000 per common share in February, May, August, and November 2014, respectively.

In August 2015, the Company's Board of Directors declared a cash dividend of \$0.1175 per common share, payable on September 30, 2015.

Litigation, claims, and assessments. Like many retailers, the Company has been named in class action lawsuits, primarily in California, alleging violation of wage and hour laws and consumer protection laws. Class action litigation remains pending as of August 1, 2015.

The Company is also party to various other legal and regulatory proceedings arising in the normal course of business. Actions filed against the Company may include commercial, product and product safety, customer, intellectual property, and labor and employment-related claims, including lawsuits in which private plaintiffs or governmental agencies allege that the Company violated federal, state, and/or local laws. Actions against the Company are in various procedural stages. Many of these proceedings raise factual and legal issues and are subject to uncertainties.

In the opinion of management, the resolution of pending class action litigation and other currently pending legal and regulatory proceedings will not have a material adverse effect on the Company's financial condition, results of operations, or cash flows.

Recently issued and adopted accounting standards. In April 2015, the FASB issued Accounting Standards Update 2015-03, Simplifying the Presentation of Debt Issuance Costs (ASU 2015-03). The standard amends existing guidance to require the presentation of debt issuance costs in the balance sheet as a deduction from the carrying amount of the related debt liability instead of as an asset. ASU 2015-03 is effective for annual and interim reporting periods after December 15, 2015, with early adoption permitted. The Company early adopted ASU 2015-03 retrospectively in its first fiscal quarter ended May 2, 2015. As a result of the retrospective adoption, the Company reclassified unamortized debt issuance costs of \$2.8 million and \$0.3 million as of January 31, 2015 and August 2, 2014, respectively, from Other long-term assets to a reduction in Long-term debt on the condensed consolidated balance sheets. Adoption of this standard did not impact results of operations, retained earnings, or cash flows in the current or previous interim

and annual reporting periods.

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## Note B: Fair Value Measurements

The carrying value of cash and cash equivalents, short- and long-term investments, restricted cash and cash equivalents, restricted investments, accounts receivable, other long-term assets, accounts payable, and other long-term liabilities approximates their estimated fair value.

Accounting standards pertaining to fair value measurements establish a three-tier fair value hierarchy which prioritizes the inputs used in measuring fair value. The inputs used to measure fair value include: Level 1, observable inputs such as quoted prices in active markets; Level 2, inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, unobservable inputs in which little or no market data exists. This fair value hierarchy requires the Company to develop its own assumptions and maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

There were no transfers between Level 1 and Level 2 categories during the three and six month periods ended August 1, 2015. The fair value of the Company's financial instruments are as follows:

(\$000)	August 1, 2015	January 31, 2015	August 2, 2014
Cash and cash equivalents			
Level 1	\$ 630,288	\$ 696,608	\$ 549,784
Investments			
Level 2	3,612	3,610	3,660
Restricted cash and cash equivalents			
Level 1	\$ 72,076	\$ 71,992	\$ 74,586
Restricted investments			
Level 1	\$ 3,768	\$ 3,828	\$ 3,805
Level 2	—	—	112

The underlying assets in the Company's non-qualified deferred compensation program as of August 1, 2015, January 31, 2015, and August 2, 2014 (included in Other long-term assets and in Other long-term liabilities) primarily consist of participant-directed money market, stable value, stock, and bond funds. The fair value measurement for funds with quoted market prices in active markets (Level 1) and for funds without quoted market prices in active markets (Level 2) are as follows:

(\$000)	August 1, 2015	January 31, 2015	August 2, 2014
Level 1	\$ 82,953	\$ 81,926	\$ 79,753
Level 2	12,842	12,128	13,638
Total	\$ 95,795	\$ 94,054	\$ 93,391

## Note C: Stock-Based Compensation

Stock-based compensation. For the three and six month periods ended August 1, 2015 and August 2, 2014, the Company recognized stock-based compensation expense as follows:

(\$000)	Three Months Ended		Six Months Ended	
	August 1, 2015	August 2, 2014	August 1, 2015	August 2, 2014
Restricted stock	\$9,395	\$8,550	\$17,969	\$16,502
Performance awards	5,537	3,960	10,642	7,485
Employee stock purchase plan	662	550	1,270	1,108
Total	\$15,594	\$13,060	\$29,881	\$25,095

Total stock-based compensation recognized in the Company's Condensed Consolidated Statements of Earnings for the three and six month periods ended August 1, 2015 and August 2, 2014 is as follows:

Statements of Earnings Classification (\$000)	Three Months Ended		Six Months Ended	
	August 1, 2015	August 2, 2014	August 1, 2015	August 2, 2014
Cost of goods sold	\$7,420	\$7,085	\$14,483	\$13,263
Selling, general and administrative	8,174	5,975	15,398	11,832
Total	\$15,594	\$13,060	\$29,881	\$25,095

Restricted stock. The Company grants shares of restricted stock or restricted stock units to directors, officers, and key employees. The market value of shares of restricted stock and of the stock underlying restricted stock units at the date of grant is amortized to expense over the vesting period of generally three to five years.

During the three and six month periods ended August 1, 2015 and August 2, 2014, shares purchased by the Company for tax withholding totaled 33,705 and 1,206,903 and 62,544 and 1,031,252, respectively, and are considered treasury shares which are available for reissuance.

Performance shares. The Company has a performance share award program for senior executives. A performance share award represents a right to receive shares of restricted stock or restricted stock units on a specified settlement date based on the Company's attainment of a profitability-based performance goal during the performance period, which is the Company's fiscal year. If attained, the restricted stock or units then vest over a service period, generally two to three years from the date the performance award was granted. The release of shares related to restricted stock units earned are deferred generally for one year from the date earned.

As of August 1, 2015, shares related to unvested restricted stock and performance share awards totaled 6.0 million shares. A summary of restricted stock and performance share award activity for the six month period ended August 1, 2015 is presented below:

(000, except per share data)	Number of shares	Weighted average grant date fair value
Unvested at January 31, 2015	6,982	\$24.01
Awarded	1,830	51.95
Released	(2,480	) 16.71

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Forfeited	(354	) 29.43
Unvested at August 1, 2015	5,978	\$33.61

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The unamortized compensation expense at August 1, 2015 was \$110.7 million which is expected to be recognized over a weighted-average remaining period of 2.1 years. The unamortized compensation expense at August 2, 2014 was \$106.6 million, which was expected to be recognized over a weighted-average remaining period of 2.2 years.

Employee stock purchase plan. Under the Employee Stock Purchase Plan ("ESPP"), eligible employees participating in the quarterly offering period can choose to spend up to the lesser of 10% of their annual base earnings or the IRS annual share purchase limit of \$25,000 in aggregate market value to purchase the Company's common stock each year. The purchase price of the stock is 85% of the closing market price on the date of purchase. Purchases occur on the last trading day of each calendar quarter. The Company recognizes expense for ESPP purchase rights equal to the value of the 15% discount given on the purchase date.

Stock option activity. A summary of the stock option activity for the six month period ended August 1, 2015 is presented below:

(000, except per share data)	Number of shares	Weighted average exercise price	Weighted average remaining contractual term	Aggregate intrinsic value
Outstanding at January 31, 2015	1,038	\$7.05		
Granted	—	—		
Exercised	(594)	6.95		
Forfeited	—	—		
Outstanding at August 1, 2015, all vested	444	\$7.19	0.89	\$20,402

No stock options were granted during the six month periods ended August 1, 2015 and August 2, 2014.

The following table summarizes information about the weighted average remaining contractual life (in years) and the weighted average exercise prices for stock options both outstanding and exercisable as of August 1, 2015 (number of shares in thousands):

Exercise price range	Options outstanding and exercisable		
	Number of shares	Remaining life	Exercise price
\$5.90 to \$6.89	118	0.65	\$6.68
6.95 to 6.95	161	0.62	6.95
7.04 to 7.63	61	0.55	7.19
7.66 to 7.66	7	1.21	7.66
8.19 to 8.19	97	1.81	8.19
\$5.90 to \$8.19	444	0.89	\$7.19

#### Note D: Earnings Per Share

The Company computes and reports both basic earnings per share ("EPS") and diluted EPS. Basic EPS is computed by dividing net earnings by the weighted average number of common shares outstanding for the period. Diluted EPS is computed by dividing net earnings by the sum of the weighted average number of common shares and dilutive common stock equivalents outstanding during the period. Diluted EPS reflects the total potential dilution that could occur from outstanding equity plan awards, including unexercised stock options, and unvested shares of both performance and non-performance based awards of restricted stock and restricted stock units.

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For the three and six month periods ended August 1, 2015, approximately 2,100 and 2,900 weighted average shares, respectively, were excluded from the calculation of diluted EPS because their effect would have been anti-dilutive for those periods presented. For the three and six month periods ended August 2, 2014, approximately 22,400 and 12,300 weighted average shares, respectively, were excluded from the calculation of diluted EPS because their effect would have been anti-dilutive for those periods presented.



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The following is a reconciliation of the number of shares (denominator) used in the basic and diluted EPS computations:

Shares in (000s)	Three Months Ended			Six Months Ended		
	Basic EPS	Effect of dilutive common stock equivalents	Diluted EPS	Basic EPS	Effect of dilutive common stock equivalents	Diluted EPS
August 1, 2015						
Shares	404,760	2,933	407,693	406,211	3,351	409,562
Amount	\$0.64	\$(0.01)	) \$0.63	\$1.33	\$(0.01)	) \$1.32
August 2, 2014						
Shares	415,130	4,175	419,305	416,514	4,699	421,213
Amount	\$0.58	\$(0.01)	) \$0.57	\$1.16	\$(0.01)	) \$1.15

Note E: Debt

Senior notes. Unsecured senior debt, net of unamortized discounts and debt issuance costs, consists of the following:

(\$000)	August 1, 2015	January 31, 2015	August 2, 2014
6.38% Series A Senior Notes due 2018	\$84,889	\$84,873	\$84,857
6.53% Series B Senior Notes due 2021	64,872	64,861	64,851
3.375% Senior Notes due 2024	246,032	245,828	—
Total	\$395,793	\$395,562	\$149,708

In September 2014, the Company issued unsecured 3.375% Senior Notes due September 2024 (the “2024 Notes”) with an aggregate principal amount of \$250 million. Interest on the 2024 Notes is payable semi-annually.

As of August 1, 2015, the Company also had outstanding two other series of unsecured senior notes in the aggregate principal amount of \$150 million, held by various institutional investors. The Series A notes totaling \$85 million are due in December 2018 and bear interest at a rate of 6.38%. The Series B notes totaling \$65 million are due in December 2021 and bear interest at a rate of 6.53%. Borrowings under these senior notes are subject to certain financial covenants, including interest coverage and other financial ratios. As of August 1, 2015, the Company was in compliance with these covenants.

As of August 1, 2015, January 31, 2015, and August 2, 2014, total unamortized discount and debt issuance costs were \$4.2 million, \$4.4 million, and \$0.3 million