BIG LOTS INC
Form 10-Q
December 12, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended November 3, 2018
or

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

For the transition period from __________ to __________

Commission File Number 1-8897
BIG LOTS, INC.
(Exact name of registrant as specified in its charter)

Ohio	06-1119097
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
4900 E. Dublin-Granville Road, Columbus, Ohio	43081
(Address of principal executive offices)	(Zip Code)

(614) 278-6800
(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 period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yesþ Noo

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files).

Yesþ Noo

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a 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 þ	Accelerated filer o	Non-accelerated filer o	Smaller reporting company o	Emerging growth company o

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o Noþ

The number of the registrant's common shares, $0.01 par value, outstanding as of December 7, 2018, was 40,048,581.

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FORM 10-Q
FOR THE FISCAL QUARTER ENDED NOVEMBER 3, 2018

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Part I. Financial Information

Item 1. Financial Statements

BIG LOTS, INC. AND SUBSIDIARIES
Consolidated Statements of Operations and Comprehensive Income (Unaudited)
(In thousands, except per share amounts)

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	November 3, 2018	October 28, 2017	November 3, 2018	October 28, 2017
Net sales	$1,149,402	$1,109,184	$3,639,554	$3,623,751
Cost of sales (exclusive of depreciation expense shown separately below)	690,228	665,558	2,177,003	2,163,350
Gross margin	459,174	443,626	1,462,551	1,460,401
Selling and administrative expenses	436,826	408,314	1,301,523	1,239,440
Depreciation expense	31,911	29,508	90,936	87,489
Operating (loss) profit	(9,563)	5,804	70,092	133,472
Interest expense	(3,138)	(2,077)	(7,121)	(4,705)
Other income (expense)	59	405	716	323
(Loss) income before income taxes	(12,642)	4,132	63,687	129,090
Income tax (benefit) expense	(6,086)	(240)	14,840	44,086
Net (loss) income and comprehensive (loss) income	$(6,556)	$4,372	$48,847	$85,004
Earnings (loss) per common share:				
Basic	$(0.16)	$0.10	$1.19	$1.97
Diluted	$(0.16)	$0.10	$1.19	$1.95
Weighted-average common shares outstanding:				
Basic	40,021	41,967	41,065	43,155
Dilutive effect of share-based awards	—	557	138	409
Diluted	40,021	42,524	41,203	43,564
Cash dividends declared per common share	$0.30	$0.25	$0.90	$0.75

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

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BIG LOTS, INC. AND SUBSIDIARIES
Consolidated Balance Sheets (Unaudited)
(In thousands, except par value)

	November 3, 2018	February 3, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	$61,938	$51,176
Inventories	1,073,885	872,790
Other current assets	141,424	98,007
Total current assets	1,277,247	1,021,973
Property and equipment - net	782,771	565,977
Deferred income taxes	22,923	13,986
Other assets	50,075	49,790
Total assets	$2,133,016	$1,651,726
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$479,634	$351,226
Property, payroll, and other taxes	85,775	80,863
Accrued operating expenses	112,458	72,013
Insurance reserves	38,070	38,517
Accrued salaries and wages	28,342	39,321
Income taxes payable	1,295	7,668
Total current liabilities	745,574	589,608
Long-term obligations	488,000	199,800
Deferred rent	61,054	58,246
Insurance reserves	55,769	55,015
Unrecognized tax benefits	12,738	14,929
Synthetic lease obligation	131,644	15,606
Other liabilities	45,505	48,935
Shareholders' equity:		
Preferred shares - authorized 2,000 shares; $0.01 par value; none issued	—	—
Common shares - authorized 298,000 shares; $0.01 par value; issued 117,495 shares; outstanding 40,042 shares and 41,925 shares, respectively	1,175	1,175
Treasury shares - 77,453 shares and 75,570 shares, respectively, at cost	(2,506,088)	(2,422,396)
Additional paid-in capital	618,079	622,550
Retained earnings	2,479,566	2,468,258
Total shareholders' equity	592,732	669,587
Total liabilities and shareholders' equity	$2,133,016	$1,651,726

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

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BIG LOTS, INC. AND SUBSIDIARIES
Consolidated Statements of Shareholders' Equity (Unaudited)
(In thousands)

	Common Shares	Common Amount	Treasury Shares	Treasury Amount	Additional Paid-In Capital	Retained Earnings	Total
Balance - January 28, 2017	44,259	$ 1,175	73,236	$ (2,291,379)	$ 617,516	$ 2,323,318	$ 650,630
Comprehensive income	—	—	—	—	—	85,004	85,004
Dividends declared ($0.75 per share)	—	—	—	—	—	(33,843)	(33,843)
Adjustment for ASU 2016-09	—	—	—	—	241	(146)	95
Purchases of common shares	(3,437)	—	3,437	(165,732)	—	—	(165,732)
Exercise of stock options	222	—	(222)	7,023	1,391	—	8,414
Restricted shares vested	367	—	(367)	11,520	(11,520)	—	—
Performance shares vested	431	—	(431)	13,523	(13,523)	—	—
Share activity related to deferred compensation plan	—	—	—	(4)	—	—	(4)
Other	—	—	—	—	—	—	—
Share-based employee compensation expense	—	—	—	—	21,100	—	21,100
Balance - October 28, 2017	41,842	1,175	75,653	(2,425,049)	615,205	2,374,333	565,664
Comprehensive income	—	—	—	—	—	104,828	104,828
Dividends declared ($0.25 per share)	—	—	—	—	—	(10,903)	(10,903)
Purchases of common shares	—	—	—	(25)	—	—	(25)
Exercise of stock options	82	—	(82)	2,636	662	—	3,298
Restricted shares vested	1	—	(1)	42	(42)	—	—
Performance shares vested	—	—	—	—	—	—	—
Share activity related to deferred compensation plan	—	—	—	—	—	—	—
Other	—	—	—	—	—	—	—
Share-based employee compensation expense	—	—	—	—	6,725	—	6,725
Balance - February 3, 2018	41,925	1,175	75,570	(2,422,396)	622,550	2,468,258	669,587
Comprehensive income	—	—	—	—	—	48,847	48,847
Dividends declared ($0.90 per share)	—	—	—	—	—	(37,539)	(37,539)
Purchases of common shares	(2,635)	—	2,635	(107,827)	(3,920)	—	(111,747)
Exercise of stock options	43	—	(43)	1,395	464	—	1,859
Restricted shares vested	413	—	(413)	13,263	(13,263)	—	—
Performance shares vested	296	—	(296)	9,475	(9,475)	—	—
Share activity related to deferred compensation plan	—	—	—	2	1	—	3
Other	—	—	—	—	—	—	—
Share-based employee compensation expense	—	—	—	—	21,722	—	21,722
Balance - November 3, 2018	40,042	$ 1,175	77,453	$ (2,506,088)	$ 618,079	$ 2,479,566	$ 592,732

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

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BIG LOTS, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows (Unaudited)
(In thousands)

	Thirty-Nine Weeks Ended	
	November 3, 2018	October 28, 2017
Operating activities:		
Net income	$48,847	$ 85,004
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	82,666	79,404
Deferred income taxes	(8,937)	(463)
Loss (Gain) on disposition of property and equipment	350	(48)
Non-cash share-based compensation expense	21,722	21,100
Unrealized gain on fuel derivative instruments	(460)	(961)
Change in assets and liabilities, excluding effects of foreign currency adjustments:		
Inventories	(201,095)	(179,466)
Accounts payable	128,409	92,603
Current income taxes	(35,540)	(54,016)
Other current assets	(15,626)	(11,994)
Other current liabilities	7,943	(12,355)
Other assets	1,253	(5,884)
Other liabilities	10,888	16,148
Net cash provided by operating activities	40,420	29,072
Investing activities:		
Capital expenditures	(165,396)	(95,081)
Cash proceeds from sale of property and equipment	367	1,798
Assets acquired under synthetic lease	(116,039)	—
Other	35	(10)
Net cash used in investing activities	(281,033)	(93,293)
Financing activities:		
Net proceeds from borrowings under bank credit facility	288,200	265,500
Payment of capital lease obligations	(2,899)	(2,916)
Dividends paid	(38,592)	(34,193)
Proceeds from the exercise of stock options	1,859	8,414
Payment for treasury shares acquired	(111,747)	(165,732)
Proceeds from synthetic lease	116,039	—
Deferred bank credit facility fees paid	(1,488)	—
Other	3	(4)
Net cash provided by financing activities	251,375	71,069
Increase in cash and cash equivalents	10,762	6,848
Cash and cash equivalents:		
Beginning of period	51,176	51,164
End of period	$61,938	$ 58,012

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

BIG LOTS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)

NOTE 1 – BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

All references in this report to "we," "us," or "our" are to Big Lots, Inc. and its subsidiaries. We are a community retailer operating in the United States ("U.S."). At November 3, 2018, we operated 1,415 stores in 47 states. We make available, free of charge, through the "Investor Relations" section of our website (www.biglots.com) under the "SEC Filings" caption, our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended ("Exchange Act"), as soon as reasonably practicable after we file such material with, or furnish it to, the Securities and Exchange Commission ("SEC"). The contents of our websites are not part of this report.

The accompanying consolidated financial statements and these notes have been prepared in accordance with the rules and regulations of the SEC for interim financial information. The consolidated financial statements reflect all normal recurring adjustments which management believes are necessary to present fairly our financial condition, results of operations, and cash flows for all periods presented. The consolidated financial statements, however, do not include all information necessary for a complete presentation of financial condition, results of operations, and cash flows in conformity with accounting principles generally accepted in the United States of America ("GAAP"). Interim results may not necessarily be indicative of results that may be expected for, or actually result during, any other interim period or for the year as a whole. We have historically experienced, and expect to continue to experience, seasonal fluctuations, with a larger percentage of our net sales and operating profit realized in our fourth fiscal quarter. The accompanying consolidated financial statements and these notes should be read in conjunction with the audited consolidated financial statements and notes included in our Annual Report on Form 10-K for the fiscal year ended February 3, 2018 ("2017 Form 10-K").

Fiscal Periods
Our fiscal year ends on the Saturday nearest to January 31, which results in fiscal years consisting of 52 or 53 weeks. Unless otherwise stated, references to years in this report relate to fiscal years rather than calendar years. Fiscal year 2018 ("2018") is comprised of the 52 weeks that began on February 4, 2018 and will end on February 2, 2019. Fiscal year 2017 ("2017") was comprised of the 53 weeks that began on January 29, 2017 and ended on February 3, 2018. The fiscal quarters ended November 3, 2018 ("third quarter of 2018") and October 28, 2017 ("third quarter of 2017") were both comprised of 13 weeks. The year-to-date periods ended November 3, 2018 ("year-to-date 2018") and October 28, 2017 ("year-to-date 2017") were both comprised of 39 weeks.

Selling and Administrative Expenses
Selling and administrative expenses include store expenses (such as payroll and occupancy costs) and costs related to warehousing, distribution, outbound transportation to our stores, advertising, purchasing, insurance, non-income taxes, accepting credit/debit cards, and overhead. Our selling and administrative expense rates may not be comparable to those of other retailers that include warehousing, distribution, and outbound transportation costs in cost of sales. Warehousing, distribution, and outbound transportation costs included in selling and administrative expenses were $45.5 million and $39.4 million for the third quarter of 2018 and the third quarter of 2017, respectively, and $131.1 million and $115.6 million for the year-to-date 2018 and the year-to-date 2017, respectively.

Advertising Expense
Advertising costs, which are expensed as incurred, consist primarily of television and print advertising, digital or internet marketing and advertising, and in-store point-of-purchase presentations. Advertising expenses are included in selling and administrative expenses. Advertising expenses were $16.4 million and $15.3 million for the third quarter of 2018 and the third quarter of 2017, respectively, and $54.7 million and $51.1 million for the year-to-date 2018 and

the year-to-date 2017, respectively.

Derivative Instruments

We use derivative instruments to mitigate the risk of market fluctuations in the price of diesel fuel that we expect to consume to support our outbound transportation of inventory to our stores. We do not enter into derivative instruments for speculative purposes. Our derivative instruments may consist of collar or swap contracts. Our current derivative instruments do not meet the requirements for cash flow hedge accounting. Instead, our derivative instruments are marked-to-market to determine their fair value and any gains or losses are recognized currently in other income (expense) on our consolidated statements of operations and comprehensive income.

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Supplemental Cash Flow Disclosures

The following table provides supplemental cash flow information for the year-to-date 2018 and the year-to-date 2017:

(In thousands)	Thirty-Nine Weeks Ended November 3, 2018	October 28, 2017
Supplemental disclosure of cash flow information:		
Cash paid for interest, including capital leases	$6,494	$ 3,835
Cash paid for income taxes, excluding impact of refunds	59,600	99,037
Gross proceeds from borrowings under bank credit facility	1,376,400	1,246,300
Gross repayments of borrowings under bank credit facility	1,088,200	980,800
Non-cash activity:		
Assets acquired under capital leases	785	90
Accrued property and equipment	$37,440	$ 15,224

Reclassifications

Merchandise Categories

We periodically assess, and make minor adjustments to, our product hierarchy, which can impact the roll-up of our merchandise categories. Our financial reporting process utilizes the most current product hierarchy in reporting net sales by merchandise category for all periods presented. Therefore, there may be minor reclassifications of net sales by merchandise category compared to previously reported amounts.

Recent Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-02, Leases (Topic 842). The update requires a lessee to recognize, on the balance sheet, a liability to make lease payments and a right-of-use asset representing a right to use the underlying asset for the lease term. The ASU is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018, with early adoption permitted. The ASU allows for either the modified or full retrospective method of adoption. However, the FASB issued ASU No. 2018-11, Leases (Topic 842), Targeted Improvements, which allows entities to apply the transition provisions of the new standard at its adoption date instead of at the earliest comparative period presented in the consolidated financial statements. ASU 2018-11 will allow entities to continue to apply the legacy guidance in Topic 840, Leases, including its disclosure requirements, in the comparative periods presented in the year the new leases standard is adopted. Entities that elect this option would still adopt the new leases standard using a modified retrospective transition method, but would recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption rather than in the earliest period presented. We have elected to use the modified retrospective transition method as allowed by ASU 2018-11. We will not early adopt this standard. We are still evaluating the impact that this standard will have on our consolidated financial statements, as we complete the implementation of a new lease system. Currently we anticipate the impact on our balance sheet will be material.

Recently Adopted Accounting Standards

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). This update provided a comprehensive new revenue recognition model that 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. Additionally, this guidance expanded related disclosure requirements. During the first quarter of 2018, we adopted the new standard on the retrospective method. The adoption had no impact on the timing of the recognition of our revenue or costs. The adoption did result in an immaterial adjustment to the amount of gross revenue and costs that we had previously reported, as certain of our vendor relationships had different principal versus agent treatment under the new standard. Additionally, we considered the disclosure requirements of the standard and determined that no additional disclosures were necessary.

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NOTE 2 – BANK CREDIT FACILITY

On July 22, 2011, we entered into a $700 million five-year unsecured credit facility, which was amended on May 30, 2013 and May 28, 2015 (as amended, the “2011 Credit Agreement”).

On August 31, 2018, we amended and restated the 2011 Credit Agreement. The amended and restated credit agreement (the “2018 Credit Agreement”) provides for a $700 million five-year unsecured credit facility. The 2011 Credit Agreement was scheduled to expire on May 30, 2020. The 2018 Credit Agreement expires on August 31, 2023. In connection with our entry into the 2018 Credit Agreement, we paid bank fees and other expenses in the aggregate amount of $1.5 million, which are being amortized over the term of the agreement.

Borrowings under the 2018 Credit Agreement are available for general corporate purposes, working capital, and to repay certain of our indebtedness. The 2018 Credit Agreement includes a $30 million swing loan sublimit, a $75 million letter of credit sublimit, a $75 million sublimit for loans to foreign borrowers, and a $200 million optional currency sublimit. The interest rates, pricing and fees under the 2018 Credit Agreement fluctuate based on our debt rating. The 2018 Credit Agreement allows us to select our interest rate for each borrowing from multiple interest rate options. The interest rate options are generally derived from the prime rate or LIBOR. We may prepay revolving loans made under the 2018 Credit Agreement. The 2018 Credit Agreement contains financial and other covenants, including, but not limited to, limitations on indebtedness, liens and investments, as well as the maintenance of two financial ratios - a leverage ratio and a fixed charge coverage ratio. A violation of any of the covenants could result in a default under the 2018 Credit Agreement that would permit the lenders to restrict our ability to further access the 2018 Credit Agreement for loans and letters of credit and require the immediate repayment of any outstanding loans under the 2018 Credit Agreement. At November 3, 2018, we had $488.0 million of borrowings outstanding under the 2018 Credit Agreement and $8.6 million was committed to outstanding letters of credit, leaving $203.4 million available under the 2018 Credit Agreement.

NOTE 3 – FAIR VALUE MEASUREMENTS

In connection with our nonqualified deferred compensation plan, we had mutual fund investments of $32.4 million and $33.0 million at November 3, 2018 and February 3, 2018, respectively, which were recorded in other assets. These investments were classified as trading securities and were recorded at their fair value. The fair values of mutual fund investments were Level 1 valuations under the fair value hierarchy because each fund’s quoted market value per share was available in an active market.

The fair values of our long-term obligations are estimated based on the quoted market prices for the same or similar issues and the current interest rates offered for similar instruments. These fair value measurements are classified as Level 2 within the fair value hierarchy. Given the variable rate features and relatively short maturity of the instruments underlying our long-term obligations, the carrying value of these instruments approximates the fair value.

The carrying value of accounts receivable, accounts payable, and accrued expenses approximates fair value because of the relatively short maturity of these items.

NOTE 4 – SHAREHOLDERS’ EQUITY

Earnings per Share

There were no adjustments required to be made to the weighted-average common shares outstanding for purposes of computing basic and diluted earnings per share and there were no securities outstanding at November 3, 2018 or October 28, 2017 which were excluded from the computation of earnings per share other than antidilutive stock options, restricted stock awards, restricted stock units, and performance share units. For the third quarter of 2018, there were 0.1 million stock options outstanding that were antidilutive and excluded from the computation of diluted earnings. For the third quarter of 2017, the year-to-date 2018, and the year-to-date 2017, the stock options outstanding that were antidilutive and excluded from the computation of diluted earnings per share were immaterial. Antidilutive stock options generally consist of outstanding stock options with an exercise price per share that is greater than the weighted-average market price per share for our common shares for each period. Antidilutive stock options, restricted stock units, and performance share units are excluded from the calculation because they decrease the number of diluted shares outstanding under the treasury stock method. The restricted stock awards, restricted stock units, and performance share units that were antidilutive, as determined under the treasury stock method, were immaterial for all periods presented.

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Share Repurchase Programs

On March 7, 2018, our Board of Directors authorized a share repurchase program providing for the repurchase of up to $100 million of our common shares (“2018 Repurchase Program”). The 2018 Repurchase Program was exhausted during the second quarter of 2018.

On June 5, 2018, we utilized the entire authorization under our 2018 Repurchase Program to execute a $100.0 million accelerated share repurchase transaction (“ASR Transaction”), which reduced our common shares outstanding by 2.4 million during the second quarter of 2018.

Dividends

The Company declared and paid cash dividends per common share during the periods presented as follows:

2018:	Dividends Per Share	Amount Declared (In thousands)	Amount Paid (In thousands)
First quarter	$ 0.30	$ 12,744	$ 14,386
Second quarter	0.30	12,474	12,141
Third quarter	0.30	12,321	12,065
Total	$ 0.90	$ 37,539	$ 38,592

The amount of dividends declared may vary from the amount of dividends paid in a period based on certain instruments with restrictions on payment, including restricted stock units and performance share units. The payment of future dividends will be at the discretion of our Board of Directors and will depend on our financial condition, results of operations, capital requirements, compliance with applicable laws and agreements and any other factors deemed relevant by our Board of Directors.

NOTE 5 – SHARE-BASED PLANS

We have issued nonqualified stock options, restricted stock awards, restricted stock units, and performance share units under our shareholder-approved equity compensation plans. Our restricted stock awards and restricted stock units, as described below and/or in note 7 to the consolidated financial statements in our 2017 Form 10-K, are expensed and reported as non-vested shares. We recognized share-based compensation expense of $4.5 million and $6.6 million in the third quarter of 2018 and the third quarter of 2017, respectively, and $21.7 million and $21.1 million for the year-to-date 2018 and the year-to-date 2017, respectively.

Non-vested Restricted Stock

The following table summarizes the non-vested restricted stock awards and restricted stock units activity for the year-to-date 2018:

	Number of Shares	Weighted Average Grant-Date Fair Value Per Share
Outstanding non-vested restricted stock at February 3, 2018	589,843	$ 44.77
Granted	212,456	47.36
Vested	(365,667)	42.19
Forfeited	(26,597)	43.51
Outstanding non-vested restricted stock at May 5, 2018	410,035	$ 47.92
Granted	36,243	40.75

Vested	(22,343)	48.52
Forfeited	(10,139)	43.03
Outstanding non-vested restricted stock at August 4, 2018	413,796	$