LOWES COMPANIES INC
Form 10-Q
June 03, 2014

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

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

For the quarterly period ended May 2, 2014
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 1-7898

LOWE'S COMPANIES, INC.
(Exact name of registrant as specified in its charter)

NORTH CAROLINA	56-0578072
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1000 Lowe's Blvd., Mooresville, NC	28117
(Address of principal executive offices)	(Zip Code)
Registrant's telephone number, including area code	(704) 758-1000

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.
ý Yes o 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).
ý Yes o 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 ý	Accelerated filer o
Non-accelerated filer o	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
oYes ý No
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

CLASS	OUTSTANDING AT May 30, 2014
Common Stock, $.50 par value	997,316,166

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Part I - FINANCIAL INFORMATION
Item 1. Financial Statements
Lowe's Companies, Inc.
Consolidated Balance Sheets
In Millions, Except Par Value Data

		(Unaudited) May 2, 2014	(Unaudited) May 3, 2013	January 31, 2014
Assets				
Current assets:				
Cash and cash equivalents		$658	$1,081	$391
Short-term investments		110	118	185
Merchandise inventory - net		10,515	10,274	9,127
Deferred income taxes - net		283	228	252
Other current assets		386	313	341
Total current assets		11,952	12,014	10,296
Property, less accumulated depreciation		20,617	21,257	20,834
Long-term investments		360	272	279
Other assets		1,300	1,188	1,323
Total assets		$34,229	$34,731	$32,732
Liabilities and shareholders' equity				
Current liabilities:				
Short-term borrowings		$—	$—	$386
Current maturities of long-term debt		47	47	49
Accounts payable		7,051	7,041	5,008
Accrued compensation and employee benefits		501	467	785
Deferred revenue		1,055	1,008	892
Other current liabilities		2,160	1,876	1,756
Total current liabilities		10,814	10,439	8,876
Long-term debt, excluding current maturities		10,080	9,026	10,086
Deferred income taxes - net		261	440	291
Deferred revenue - extended protection plans		730	717	730
Other liabilities		862	857	896
Total liabilities		22,747	21,479	20,879
Shareholders' equity:				
Preferred stock - $5 par value, none issued		—	—	—
Common stock - $.50 par value;				
Shares issued and outstanding				
May 2, 2014	1,012			
May 3, 2013	1,088			
January 31, 2014	1,030	506	544	515
Capital in excess of par value		—	38	—
Retained earnings		10,985	12,618	11,355
Accumulated other comprehensive (loss)/income		(9)	52	(17)
Total shareholders' equity		11,482	13,252	11,853
Total liabilities and shareholders' equity		$34,229	$34,731	$32,732

See accompanying notes to the consolidated financial statements (unaudited).

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Lowe's Companies, Inc.
Consolidated Statements of Current and Retained Earnings (Unaudited)
In Millions, Except Per Share and Percentage Data

	Three Months Ended			
	May 2, 2014		May 3, 2013	
Current Earnings	Amount	Percent	Amount	Percent
Net sales	$13,403	100.00	$13,088	100.00
Cost of sales	8,645	64.50	8,533	65.20
Gross margin	4,758	35.50	4,555	34.80
Expenses:				
Selling, general and administrative	3,319	24.76	3,222	24.62
Depreciation	373	2.78	352	2.69
Interest - net	124	0.93	113	0.86
Total expenses	3,816	28.47	3,687	28.17
Pre-tax earnings	942	7.03	868	6.63
Income tax provision	318	2.37	328	2.50
Net earnings	$624	4.66	$540	4.13
Weighted average common shares outstanding - basic	1,015		1,088	
Basic earnings per common share	$0.61		$0.49	
Weighted average common shares outstanding - diluted	1,017		1,090	
Diluted earnings per common share	$0.61		$0.49	
Cash dividends per share	$0.18		$0.16	
Retained Earnings				
Balance at beginning of period	$11,355		$13,224	
Net earnings	624		540	
Cash dividends	(183	)	(174	)
Share repurchases	(811	)	(972	)
Balance at end of period	$10,985		$12,618	

See accompanying notes to the consolidated financial statements (unaudited).

Lowe's Companies, Inc.
Consolidated Statements of Comprehensive Income (Unaudited)
In Millions, Except Percentage Data

	Three Months Ended			
	May 2, 2014		May 3, 2013	
	Amount	Percent	Amount	Percent
Net earnings	$624	4.66	$540	4.13
Foreign currency translation adjustments - net of tax	8	0.06	—	—
Other comprehensive income	8	0.06	—	—
Comprehensive income	$632	4.72	$540	4.13

See accompanying notes to the consolidated financial statements (unaudited).

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Lowe's Companies, Inc.
Consolidated Statements of Cash Flows (Unaudited)
In Millions

	Three Months Ended	
	May 2, 2014	May 3, 2013
Cash flows from operating activities:		
Net earnings	$624	$540
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	398	376
Deferred income taxes	(67)	(26)
Loss on property and other assets - net	24	5
Loss on equity method investments	17	15
Share-based payment expense	28	18
Changes in operating assets and liabilities:		
Merchandise inventory - net	(1,384)	(1,674)
Other operating assets	44	(5)
Accounts payable	2,041	2,381
Other operating liabilities	269	362
Net cash provided by operating activities	1,994	1,992
Cash flows from investing activities:		
Purchases of investments	(163)	(84)
Proceeds from sale/maturity of investments	157	89
Capital expenditures	(194)	(196)
Contributions to equity method investments - net	(91)	(73)
Proceeds from sale of property and other long-term assets	16	6
Other - net	(5)	(5)
Net cash used in investing activities	(280)	(263)
Cash flows from financing activities:		
Net decrease in short-term borrowings	(386)	—
Repayment of long-term debt	(12)	(11)
Proceeds from issuance of common stock under share-based payment plans	24	40
Cash dividend payments	(186)	(178)
Repurchase of common stock	(910)	(1,046)
Other - net	23	5
Net cash used in financing activities	(1,447)	(1,190)
Effect of exchange rate changes on cash	—	1
Net increase in cash and cash equivalents	267	540
Cash and cash equivalents, beginning of period	391	541
Cash and cash equivalents, end of period	$658	$1,081

See accompanying notes to the consolidated financial statements (unaudited).

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Lowe's Companies, Inc.
Notes to Consolidated Financial Statements (Unaudited)
Note 1: Basis of Presentation - The accompanying consolidated financial statements (unaudited) and notes to the consolidated financial statements (unaudited) are presented in accordance with the rules and regulations of the Securities and Exchange Commission and do not include all the disclosures normally required in annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America. The consolidated financial statements (unaudited), in the opinion of management, contain all adjustments necessary to present fairly the financial position as of May 2, 2014, and May 3, 2013, and the results of operations, comprehensive income and cash flows for the three months ended May 2, 2014, and May 3, 2013.

These interim consolidated financial statements (unaudited) should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Lowe's Companies, Inc. (the Company) Annual Report on Form 10-K for the fiscal year ended January 31, 2014 (the Annual Report). The financial results for the interim periods may not be indicative of the financial results for the entire fiscal year.

Note 2: Fair Value Measurements - Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The authoritative guidance for fair value measurements establishes a three-level hierarchy, which encourages an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The three levels of the hierarchy are defined as follows:

- Level 1 - inputs to the valuation techniques that are quoted prices in active markets for identical assets or liabilities
- Level 2 - inputs to the valuation techniques that are other than quoted prices but are observable for the assets or liabilities, either directly or indirectly
- Level 3 - inputs to the valuation techniques that are unobservable for the assets or liabilities

Assets and Liabilities that are Measured at Fair Value on a Recurring Basis

The following tables present the Company’s financial assets measured at fair value on a recurring basis as of May 2, 2014, May 3, 2013, and January 31, 2014, classified by fair value hierarchy:

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		Fair Value Measurements at Reporting Date Using		
(In millions)	May 2, 2014	Level 1	Level 2	Level 3
Available-for-sale securities:				
Money market funds	$51	$51	$—	$—
Certificates of deposit	21	21	—	—
Municipal floating rate obligations	20	—	20	—
Municipal obligations	18	—	18	—
Total short-term investments	$110	$72	$38	$—
Available-for-sale securities:				
Municipal floating rate obligations	$347	$—	$347	$—
Municipal obligations	13	—	13	—
Total long-term investments	$360	$—	$360	$—

		Fair Value Measurements at Reporting Date Using		
(In millions)	May 3, 2013	Level 1	Level 2	Level 3
Available-for-sale securities:				
Money market funds	$51	$51	$—	$—
Municipal floating rate obligations	15	—	15	—
Municipal obligations	52	—	52	—
Total short-term investments	$118	$51	$67	$—
Available-for-sale securities:				
Municipal floating rate obligations	$231	$—	$231	$—
Municipal obligations	41	—	41	—
Total long-term investments	$272	$—	$272	$—

		Fair Value Measurements at Reporting Date Using		
(In millions)	January 31, 2014	Level 1	Level 2	Level 3
Available-for-sale securities:				
Money market funds	$128	$128	$—	$—
Certificates of deposit	21	21	—	—
Municipal floating rate obligations	18	—	18	—
Municipal obligations	18	—	18	—
Total short-term investments	$185	$149	$36	$—
Available-for-sale securities:				
Municipal floating rate obligations	$265	$—	$265	$—
Municipal obligations	14	—	14	—
Total long-term investments	$279	$—	$279	$—

There were no transfers between Levels 1, 2 or 3 during any of the periods presented.

When available, quoted prices were used to determine fair value. When quoted prices in active markets were available, investments were classified within Level 1 of the fair value hierarchy. When quoted prices in active markets were not available, fair values were determined using pricing models, and the inputs to those pricing models were based on observable market inputs. The inputs to the pricing models were typically benchmark yields, reported trades, broker-dealer quotes, issuer spreads and benchmark securities, among others.

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Assets and Liabilities that are Measured at Fair Value on a Nonrecurring Basis

During the three months ended May 2, 2014 and May 3, 2013, the Company's only significant assets or liabilities measured at fair value on a nonrecurring basis subsequent to their initial recognition were certain assets subject to long-lived asset impairment.

The Company reviews the carrying amounts of long-lived assets whenever certain events or changes in circumstances indicate that the carrying amounts may not be recoverable. With input from retail store operations, the Company's accounting and finance personnel that organizationally report to the chief financial officer, assess the performance of retail stores quarterly against historical patterns and projections of future profitability for evidence of possible impairment. An impairment loss is recognized when the carrying amount of the asset (disposal) group is not recoverable and exceeds its fair value. The Company estimated the fair values of assets subject to long-lived asset impairment based on the Company's own judgments about the assumptions that market participants would use in pricing the assets and on observable market data, when available. The Company classified these fair value measurements as Level 3.

In the determination of impairment for operating locations, the Company determined the fair values of individual operating locations using an income approach, which required discounting projected future cash flows. When determining the stream of projected future cash flows associated with an individual operating location, management made assumptions, incorporating local market conditions and inputs from retail store operations, about key variables including the following unobservable inputs: sales growth rates, gross margin, controllable expenses, such as payroll and occupancy expense, and asset residual values. In order to calculate the present value of those future cash flows, the Company discounted cash flow estimates at a rate commensurate with the risk that selected market participants would assign to the cash flows. In general, the selected market participants represented a group of other retailers with a location footprint similar in size to the Company's.

During the three months ended May 2, 2014, four operating locations experienced a triggering event and were evaluated for recoverability. Two of these four operating locations were determined to be impaired due to a decline in cash flow trends and an unfavorable sales outlook at these two locations, resulting in an impairment loss of $23 million. The discounted cash flow model used to estimate the fair value of the two impaired operating locations assumed average annual sales growth rates ranging from 3.5% to 6.0% over the remaining lives of the locations and applied a discount rate of approximately 6.5%.

The other two operating locations that experienced a triggering event during 2014 were determined to be recoverable and, therefore, were not impaired. For these two locations, the expected undiscounted cash flows substantially exceeded the net book value of each location's assets. A 10% reduction in projected sales used to estimate future cash flows at the latest date these two operating locations were evaluated for impairment would have resulted in their impairment and increased recognized impairment losses by $28 million. We analyzed other assumptions made in estimating the future cash flows of these other two operating locations evaluated for impairment, but the sensitivity of those assumptions was not significant to the estimates.

The following table presents the Company's non-financial assets measured at estimated fair value on a nonrecurring basis and the resulting long-lived asset impairment losses included in earnings. Because assets subject to long-lived asset impairment were not measured at fair value on a recurring basis, certain fair value measurements presented in the table may reflect values at earlier measurement dates and may no longer represent the fair values at May 2, 2014 and May 3, 2013.

Fair Value Measurements - Nonrecurring Basis

Three Months Ended

(In millions)	May 2, 2014 Fair Value Measurements	May 2, 2014 Impairment Losses	May 3, 2013 Fair Value Measurements	May 3, 2013 Impairment Losses
Assets-held-for-use:				
Operating locations	$9	$(23)	$—	$—
Total	$9	$(23)	$—	$—

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Fair Value of Financial Instruments

The Company’s financial instruments not measured at fair value on a recurring basis include cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities and long-term debt and are reflected in the financial statements at cost. With the exception of long-term debt, cost approximates fair value for these items due to their short-term nature. The fair values of the Company’s unsecured notes classified as Level 1 were estimated using quoted market prices. The fair values of the Company’s mortgage notes classified as Level 2 were estimated using discounted cash flow analyses, based on the future cash outflows associated with these arrangements and discounted using the applicable risk-free borrowing rate.

Carrying amounts and the related estimated fair value of the Company’s long-term debt, excluding capitalized lease obligations, are as follows:

	May 2, 2014		May 3, 2013	
(In millions)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Unsecured notes (Level 1)	$9,617	$10,777	$8,628	$10,089
Mortgage notes (Level 2)	17	19	18	22
Long-term debt (excluding capitalized lease obligations)	$9,634	$10,796	$8,646	$10,111

Note 3: Restricted Investment Balances - Short-term and long-term investments include restricted balances pledged as collateral primarily for the Company’s extended protection plan program. Restricted balances included in short-term investments were $87 million at May 2, 2014, $116 million at May 3, 2013, and $162 million at January 31, 2014. Restricted balances included in long-term investments were $328 million at May 2, 2014, $265 million at May 3, 2013, and $268 million at January 31, 2014.

Note 4: Property - Property is shown net of accumulated depreciation of $14.6 billion at May 2, 2014, $13.4 billion at May 3, 2013, and $14.2 billion at January 31, 2014.

Note 5: Extended Protection Plans - The Company sells separately-priced extended protection plan contracts under a Lowe’s-branded program for which the Company is ultimately self-insured. The Company recognizes revenue from extended protection plan sales on a straight-line basis over the respective contract term. Extended protection plan contract terms primarily range from one to four years from the date of purchase or the end of the manufacturer’s warranty, as applicable. Changes in deferred revenue for extended protection plan contracts are summarized as follows:

	Three Months Ended	
(In millions)	May 2, 2014	May 3, 2013
Deferred revenue - extended protection plans, beginning of period	$730	$715
Additions to deferred revenue	75	70
Deferred revenue recognized	(75)	(68)
Deferred revenue - extended protection plans, end of period	$730	$717

Incremental direct acquisition costs associated with the sale of extended protection plans are also deferred and recognized as expense on a straight-line basis over the respective contract term. Deferred costs associated with extended protection plan contracts were $46 million at May 2, 2014, $83 million at May 3, 2013, and $53 million at January 31, 2014. The Company’s extended protection plan deferred costs are included in other assets (noncurrent) on the consolidated balance sheets. All other costs, such as costs of services performed under the contract, general and administrative expenses and advertising expenses are expensed as incurred.

The liability for extended protection plan claims incurred is included in other current liabilities on the consolidated balance sheets. Changes in the liability for extended protection plan claims are summarized as follows:

	Three Months Ended	
(In millions)	May 2, 2014	May 3, 2013
Liability for extended protection plan claims, beginning of period	$18	$20
Accrual for claims incurred	29	27
Claim payments	(30)	(27)
Liability for extended protection plan claims, end of period	$17	$20

Note 6: Shareholders' Equity - The Company has a share repurchase program that is executed through purchases made from time to time either in the open market, which may be made under pre-set trading plans meeting the requirements of Rule 10b5-1(c) of the Securities Exchange Act of 1934, or through private off-market transactions. Shares purchased under the repurchase program are retired and returned to authorized and unissued status. On February 1, 2013, the Company's Board of Directors authorized a $5.0 billion share repurchase program with no expiration. On January 31, 2014, the Company's Board of Directors authorized an additional $5.0 billion share repurchase program with no expiration. As of May 2, 2014, the Company had total share repurchase authorization remaining available of $5.4 billion. We expect to repurchase $3.4 billion in shares during fiscal year 2014, spread evenly across the quarters.

The Company also withholds shares from employees to satisfy either the exercise price of stock options exercised or the statutory withholding tax liability resulting from the vesting of restricted stock awards.

Shares repurchased for the three months ended May 2, 2014, and May 3, 2013 were as follows:

	Three Months Ended			
	May 2, 2014		May 3, 2013	
(In millions)	Shares	Cost [1]	Shares	Cost [1]
Share repurchase program	17.9	$850	23.5	$1,010
Shares withheld from employees	0.9	42	0.9	36
Total share repurchases	18.8	$892	24.4	$1,046

[1] Reductions of $811 million and $972 million were recorded to retained earnings, after capital in excess of par value was depleted, for the three months ended May 2, 2014 and May 3, 2013, respectively.

Note 7: Income Taxes - The Company is subject to examination by various foreign and domestic taxing authorities. During the three months ended May 2, 2014, the Company began participating in the Internal Revenue Service (IRS) Compliance Assurance Program, which enables the Company to work with the IRS in an effort to resolve issues relating to the Company's current federal tax liability prior to the filing of the Company's federal tax return.

During the three months ended May 2, 2014, the Company resolved various federal items identified through a previous audit cycle, which resulted in the reduction of its unrecognized tax benefit by $57 million. At May 2, 2014, the Company had remaining unrecognized tax benefits of $5 million. The Company's Canadian operations are currently under audit by the Canada Revenue Agency for fiscal years 2009 and 2010. The Company also has ongoing U.S. state audits covering tax years 2006 through 2012. It is reasonably possible that the Company will resolve $5 million in state related audit items within the next 12 months. The Company believes appropriate provisions for all outstanding issues have been made for all jurisdictions and all open years.

Note 8: Earnings Per Share - The Company calculates basic and diluted earnings per common share using the two-class method. Under the two-class method, net earnings are allocated to each class of common stock and participating security as if all of the net earnings for the period had been distributed. The Company's participating securities consist of share-based payment awards that contain a nonforfeitable right to receive dividends and therefore are considered to participate in undistributed earnings with common shareholders.

Basic earnings per common share excludes dilution and is calculated by dividing net earnings allocable to common shares by the weighted-average number of common shares outstanding for the period. Diluted earnings per common share is calculated by dividing net earnings allocable to common shares by the weighted-average number of common shares as of the balance sheet date, as adjusted for the potential dilutive effect of non-participating share-based awards. The following table reconciles earnings per common share for the three months ended May 2, 2014, and May 3, 2013.

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(In millions, except per share data)	Three Months Ended May 2, 2014	May 3, 2013
Basic earnings per common share:		
Net earnings	$624	$540
Less: Net earnings allocable to participating securities	(4)	(3)
Net earnings allocable to common shares	$620	$537
Weighted-average common shares outstanding	1,015	1,088
Basic earnings per common share	$0.61	$0.49
Diluted earnings per common share:		
Net earnings	$624	$540
Less: Net earnings allocable to participating securities	(4)	(3)