

RITE AID CORP
Form 10-Q
October 02, 2014

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended August 30, 2014

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: 1-5742

RITE AID CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

23-1614034
(I.R.S. Employer Identification No.)

**30 Hunter Lane,
Camp Hill, Pennsylvania**
(Address of principal executive offices)

17011
(Zip Code)

Registrant's telephone number, including area code: **(717) 761-2633**.

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report):

Not Applicable

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, and (2) has been subject to such filing requirements for the past 90 days. Yes No

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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 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

(Do not check if a
smaller reporting company)

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

The registrant had 981,430,837 shares of its \$1.00 par value common stock outstanding as of September 18, 2014.

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This report, as well as our other public filings or public statements, include forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are often identified by terms and phrases such as "anticipate," "believe," "intend," "estimate," "expect," "continue," "should," "could," "may," "plan," "project," "predict," "will" and similar expressions and include references to assumptions and relate to our future prospects, developments and business strategies.

Factors that could cause actual results to differ materially from those expressed or implied in such forward-looking statements include, but are not limited to:

our high level of indebtedness;

our ability to make interest and principal payments on our debt and satisfy the other covenants contained in our credit facilities and other debt agreements;

general economic conditions (including the impact of continued high unemployment and changing consumer behavior), inflation and interest rate movements;

the continued impact of private and public third party payors reduction in prescription drug reimbursement and efforts to encourage mail order and limit access to payor networks;

our ability to achieve the benefits of our efforts to reduce the costs of our generic and other drugs;

our ability to continue to improve the operating performance of our stores in accordance with our long term strategy;

our ability to maintain or grow prescription count and realize front-end sales growth;

our ability to hire and retain qualified personnel;

competitive pricing pressures, including aggressive promotional activity from our competitors;

decisions to close additional stores and distribution centers or undertake additional refinancing activities, which could result in further charges to our operating statement;

our ability to manage expenses and working capital;

continued consolidation of the drugstore and the pharmacy benefit management industries;

changes in state or federal legislation or regulations, and the continued impact from the ongoing implementation of the Patient Protection and Affordable Care Act as well as other healthcare reform;

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the outcome of lawsuits and governmental investigations; and

other risks and uncertainties described from time to time in our filings with the Securities and Exchange Commission (the "SEC").

We undertake no obligation to update or revise the forward-looking statements included in this report, whether as a result of new information, future events or otherwise, after the date of this report. Our actual results, performance or achievements could differ materially from the results expressed in, or implied by, these forward-looking statements. Factors that could cause or contribute to such differences are discussed in the sections entitled "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" either included herein or in our Annual Report on Form 10-K for the fiscal year ended March 1, 2014 (the "Fiscal 2014 10-K") which we filed with the SEC on April 23, 2014, and our Quarterly Report on Form 10-Q for the thirteen weeks ended May 31, 2014 (the "First Quarter 2015 10-Q") which we filed on July 3, 2014. These documents are available on the SEC's website at www.sec.gov.

Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. Financial Statements**

RITE AID CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share amounts)

(unaudited)

	August 30, 2014	March 1, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 185,758	\$ 146,406
Accounts receivable, net	954,785	949,062
Inventories, net of LIFO reserve of \$1,021,670 and \$1,018,581	2,922,203	2,993,948
Prepaid expenses and other current assets	131,281	195,709
Total current assets	4,194,027	4,285,125
Property, plant and equipment, net	2,006,872	1,957,329
Goodwill	73,103	
Other intangibles, net	411,295	431,227
Other assets	274,047	271,190
Total assets	\$ 6,959,344	\$ 6,944,871
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Current maturities of long-term debt and lease financing obligations	\$ 113,070	\$ 49,174
Accounts payable	1,205,834	1,292,419
Accrued salaries, wages and other current liabilities	1,092,072	1,165,859
Total current liabilities	2,410,976	2,507,452
Long-term debt, less current maturities	5,570,583	5,632,798
Lease financing obligations, less current maturities	68,633	75,171
Other noncurrent liabilities	815,677	843,152
Total liabilities	8,865,869	9,058,573
Commitments and contingencies		
Stockholders' deficit:		
Common stock, par value \$1 per share; 1,500,000 authorized; shares issued and outstanding 981,339 and 971,331	981,339	971,331

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Additional paid-in capital	4,494,704	4,468,149
Accumulated deficit	(7,346,553)	(7,515,848)
Accumulated other comprehensive loss	(36,015)	(37,334)
Total stockholders' deficit	(1,906,525)	(2,113,702)
Total liabilities and stockholders' deficit	\$ 6,959,344	\$ 6,944,871

See accompanying notes to condensed consolidated financial statements.

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RITE AID CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(unaudited)

	Thirteen Week Period Ended	
	August 30, 2014	August 31, 2013
Revenues	\$ 6,522,584	\$ 6,278,165
Costs and expenses:		
Cost of goods sold	4,628,005	4,461,804
Selling, general and administrative expenses	1,640,524	1,602,931
Lease termination and impairment charges	7,111	11,390
Interest expense	100,950	106,716
Loss on debt retirements, net		62,172
Gain on sale of assets, net	(1,715)	(1,885)
	6,374,875	6,243,128
Income before income taxes	147,709	35,037
Income tax expense	19,860	2,210
Net income	\$ 127,849	\$ 32,827
Computation of income attributable to common stockholders:		
Net income	\$ 127,849	\$ 32,827
Accretion of redeemable preferred stock		(26)
Cumulative preferred stock dividends		(2,772)
Income attributable to common stockholders basic	127,849	30,029
Add back interest on convertible notes	1,364	
Income attributable to common stockholders diluted	\$ 129,213	\$ 30,029
Basic income per share	\$ 0.13	\$ 0.03

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Diluted income per share	\$	0.13	\$	0.03
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See accompanying notes to condensed consolidated financial statements.

Table of Contents**RITE AID CORPORATION AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****(In thousands)****(unaudited)**

	Thirteen Week Period Ended	
	August 30, 2014	August 31, 2013
Net income	\$ 127,849	\$ 32,827
Other comprehensive income:		
Defined benefit pension plans:		
Amortization of prior service cost, net transition obligation and net actuarial losses included in net periodic pension cost	660	1,262
Total other comprehensive income	660	1,262
Comprehensive income	\$ 128,509	\$ 34,089

See accompanying notes to condensed consolidated financial statements.

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RITE AID CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(unaudited)

	Twenty-Six Week Period Ended	
	August 30, 2014	August 31, 2013
Revenues	\$ 12,988,115	\$ 12,571,222
Costs and expenses:		
Cost of goods sold	9,290,557	8,933,870
Selling, general and administrative expenses	3,284,878	3,212,192
Lease termination and impairment charges	11,959	22,362
Interest expense	201,770	219,780
Loss on debt retirements, net		62,172
Gain on sale of assets, net	(2,085)	(7,065)
	12,787,079	12,443,311
Income before income taxes	201,036	127,911
Income tax expense	31,741	5,422
Net income	\$ 169,295	\$ 122,489
Computation of income attributable to common stockholders:		
Net income	\$ 169,295	\$ 122,489
Accretion of redeemable preferred stock		(51)
Cumulative preferred stock dividends		(5,504)
Income attributable to common stockholders basic	\$ 169,295	\$ 116,934
Add back interest on convertible notes	2,728	2,728
Income attributable to common stockholders diluted	\$ 172,023	\$ 119,662
Basic income per share	\$ 0.18	\$ 0.13

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Diluted income per share	\$	0.17	\$	0.12
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See accompanying notes to condensed consolidated financial statements.

Table of Contents**RITE AID CORPORATION AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****(In thousands)****(unaudited)**

	Twenty-Six Week Period Ended	
	August 30, 2014	August 31, 2013
Net income	\$ 169,295	\$ 122,489
Other comprehensive income:		
Defined benefit pension plans:		
Amortization of prior service cost, net transition obligation and net actuarial losses included in net periodic pension cost	1,319	2,525
Total other comprehensive income	\$ 1,319	\$ 2,525
 Comprehensive income	 \$ 170,614	 \$ 125,014

See accompanying notes to condensed consolidated financial statements.

Table of Contents**RITE AID CORPORATION AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)****(unaudited)**

	Twenty-Six Week Period Ended	
	August 30, 2014	August 31, 2013
Operating activities:		
Net income	\$ 169,295	\$ 122,489
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation and amortization	204,589	200,493
Lease termination and impairment charges	11,959	22,362
LIFO charges	3,089	35,000
Gain on sale of assets, net	(2,085)	(7,065)
Stock-based compensation expense	9,892	8,077
Loss on debt retirements, net		62,172
Excess tax benefit on stock options and restricted stock	(27,058)	
Changes in operating assets and liabilities:		
Accounts receivable	441	6,743
Inventories	68,917	(95,926)
Accounts payable	(26,750)	36,200
Other assets and liabilities, net	(50,058)	(126,633)
Net cash provided by operating activities	362,231	263,912
Investing activities:		
Payments for property, plant and equipment	(193,633)	(170,850)
Intangible assets acquired	(40,023)	(35,651)
Acquisition of Health Dialog and RediClinic, net of cash acquired	(69,793)	
Proceeds from sale-leaseback transactions		3,989
Proceeds from dispositions of assets and investments	6,102	9,698
Net cash used in investing activities	(297,347)	(192,814)
Financing activities:		
Proceeds from issuance of long-term debt	1,152,293	1,310,000
Net proceeds from revolver	5,000	12,000
Principal payments on long-term debt	(1,165,623)	(1,321,971)
Change in zero balance cash accounts	(57,545)	(5,319)
Net proceeds from issuance of common stock	14,791	12,263
Financing fees paid for early debt redemption		(45,636)
Excess tax benefit on stock options and restricted stock	27,058	
Deferred financing costs paid	(1,506)	(17,720)
Net cash used in financing activities	(25,532)	(56,383)

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Increase in cash and cash equivalents	39,352	14,715
Cash and cash equivalents, beginning of period	146,406	129,452
Cash and cash equivalents, end of period	\$ 185,758	\$ 144,167
Supplementary cash flow data:		
Cash paid for interest (net of capitalized amounts of \$90 and \$106, respectively)	\$ 192,319	\$ 219,240
Cash payments of income taxes, net of refunds	\$ 4,118	\$ 401
Equipment financed under capital leases	\$ 3,925	\$ 13,117
Equipment received for non-cash consideration	\$ 1,337	\$
Preferred stock dividends paid in additional shares	\$	\$ 5,504
Gross borrowings from revolver	\$ 1,556,000	\$ 1,542,000
Gross repayments to revolver	\$ 1,551,000	\$ 1,530,000

See accompanying notes to condensed consolidated financial statements.

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RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Thirteen and Twenty-Six Week Periods Ended August 30, 2014 and August 31, 2013

(Dollars and share information in thousands, except per share amounts)

(unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X and therefore do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete annual financial statements. The accompanying financial information reflects all adjustments which are of a recurring nature and, in the opinion of management, are necessary for a fair presentation of the results for the interim periods. The results of operations for the thirteen and twenty-six week periods ended August 30, 2014 are not necessarily indicative of the results to be expected for the full year. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Rite Aid Corporation and Subsidiaries (the "Company") Fiscal 2014 10-K.

New Accounting Pronouncements

In July 2013, the FASB issued ASU No. 2013-11, *Presentation of an Unrecognized Tax Benefit when a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. ASU No. 2013-11 requires an entity to present unrecognized tax benefits as a reduction to deferred tax assets when a net operating loss carryforward, similar tax loss or a tax credit carryforward exists, with limited exceptions. ASU No. 2013-11 is effective for fiscal years beginning on or after December 15, 2013, and for interim periods within those fiscal years. This pronouncement had no effect on the financial statements as the Company has historically presented uncertain tax positions in accordance with ASU No. 2013-11.

In May 2013, the FASB issued a proposed Accounting Standards Update, *Leases (Topic 842)*: a revision of the 2010 proposed Accounting Standards Update, *Leases (Topic 840)*, that would require an entity to recognize assets and liabilities arising under lease contracts on the balance sheet. The proposed standard, as currently drafted, will have a material impact on the Company's reported results of operations and financial position.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers*. This ASU supersedes the revenue recognition requirements in Accounting Standards Codification 605 Revenue Recognition and most industry-specific guidance throughout the Codification. The standard requires that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. This ASU is effective for fiscal years beginning after December 15, 2016, and for interim periods within those fiscal years. The Company is in the process of assessing the impact of the adoption of ASU 2014-09 on its financial position, results of operations and cash flows.

In June 2014, the FASB issued ASU No. 2014-11, *Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures*. The standard requires the accounting for repurchase-to-maturity transactions to be treated in the same manner as secured

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RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the Thirteen and Twenty-Six Week Periods Ended August 30, 2014 and August 31, 2013

(Dollars and share information in thousands, except per share amounts)

(unaudited)

1. Basis of Presentation (Continued)

borrowing accounting, making the accounting consistent with other repurchase agreements. In addition, the standard requires separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty, resulting in the accounting remaining consistent with other repurchase agreements. This ASU is effective for fiscal years beginning after December 15, 2014, and for interim periods within those fiscal years. The Company is in the process of assessing the impact of the adoption of ASU 2014-11 on its financial position, results of operations and cash flows.

In June 2014, the FASB issued ASU No. 2014-12, *Compensation - Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved After the Requisite Service Period*. The standard requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition, and compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved. This ASU is effective for fiscal years beginning after December 15, 2015, and for interim periods within those fiscal years. The Company is in the process of assessing the impact of the adoption of ASU 2014-12 on its financial position, results of operations and cash flows.

2. Acquisitions

On April 1, 2014, the Company acquired Boston based Health Dialog Services Corporation, which is engaged in providing health coaching, shared decision making and healthcare analytics from Bupa, a London based international healthcare services group. Health Dialog operates as a 100 percent owned subsidiary of the Company.

On April 10, 2014, the Company acquired Houston based RediClinic, which is engaged in the operation of retail clinics in the greater Houston and San Antonio areas. RediClinic operates as a 100 percent owned subsidiary of the Company. As part of the acquisition of RediClinic, the Company acquired an immaterial equity investment in RediClinic Austin, LLC, which operates as a joint venture in the greater Austin area.

The Company paid a combined amount of \$69,793, net of cash acquired of \$19,945, related to the acquisitions of Health Dialog and RediClinic (collectively "acquisitions"). The preliminary purchase accounting for these acquisitions resulted in goodwill of \$73,103, relating to expected future synergies and operating efficiencies, with the remaining amount allocated to tangible assets, less liabilities assumed. Such amounts are not significant. This allocation is subject to change as the Company finalizes purchase accounting.

Operating results of the acquisitions have been included in the Condensed Consolidated Statements of Operations from their respective acquisition dates forward in the Company's sole retail drug segment. Pro forma information for the acquisitions is not presented as their results are immaterial to the Company's condensed consolidated financial statements.

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RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the Thirteen and Twenty-Six Week Periods Ended August 30, 2014 and August 31, 2013

(Dollars and share information in thousands, except per share amounts)

(unaudited)

3. Income Per Share

Basic income per share is computed by dividing income available to common stockholders by the weighted average number of shares of common stock outstanding for the period. Diluted income per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the income of the Company subject to anti-dilution limitations.

	Thirteen Week Period Ended		Twenty-Six Week Period Ended	
	August 30, 2014	August 31, 2013	August 30, 2014	August 31, 2013
Numerator for income per share:				
Net income	\$ 127,849	\$ 32,827	\$ 169,295	\$ 122,489
Accretion of redeemable preferred stock		(26)		(51)
Cumulative preferred stock dividends		(2,772)		(5,504)
Income attributable to common stockholders basic	\$ 127,849	\$ 30,029	\$ 169,295	\$ 116,934
Add back interest on convertible notes	1,364		2,728	2,728
Income attributable to common stockholders diluted	\$ 129,213	\$ 30,029	\$ 172,023	\$ 119,662
Denominator:				
Basic weighted average shares	970,664	901,992	966,997	897,993
Outstanding options and restricted shares, net	26,132	44,726	26,141	40,143
Convertible notes	24,796		24,796	24,800
Diluted weighted average shares	1,021,592	946,718	1,017,934	962,936
Basic income per share	\$ 0.13	\$ 0.03	\$ 0.18	\$ 0.13
Diluted income per share	\$ 0.13	\$ 0.03	\$ 0.17	\$ 0.12

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Due to their antidilutive effect, the following potential common shares have been excluded from the computation of diluted income per share as of August 30, 2014 and August 31, 2013:

	Thirteen Week Period Ended		Twenty-Six Week Period Ended	
	August 30, 2014	August 31, 2013	August 30, 2014	August 31, 2013
Stock options	2,836	39,014	2,836	43,668
Convertible notes		24,800		
Convertible preferred stock		34,109		34,109
	2,836	97,923	2,836	77,777

Table of Contents**RITE AID CORPORATION AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****For the Thirteen and Twenty-Six Week Periods Ended August 30, 2014 and August 31, 2013****(Dollars and share information in thousands, except per share amounts)****(unaudited)****4. Lease Termination and Impairment Charges**

Lease termination and impairment charges consist of amounts as follows:

	Thirteen Week Period Ended		Twenty-Six Week Period Ended	
	August 30, 2014	August 31, 2013	August 30, 2014	August 31, 2013
Impairment charges	\$ 132	\$ 265	\$ 283	\$ 4,866
Lease termination charges	6,979	11,125	11,676	17,496
	\$ 7,111	\$ 11,390	\$ 11,959	\$ 22,362

Impairment Charges

These amounts include the write-down of long-lived assets at locations that were assessed for impairment because of management's intention to relocate or close the location or because of changes in circumstances that indicated the carrying value of an asset may not be recoverable.

Lease Termination Charges

As part of the Company's ongoing business activities, the Company assesses stores and distribution centers for potential closure or relocation. Decisions to close or relocate stores or distribution centers in future periods would result in lease termination charges, lease exit costs and inventory liquidation charges, as well as impairment of assets at these locations. The following table reflects the closed store and distribution center charges that relate to new closures, changes in assumptions and interest accretion:

	Thirteen Week Period Ended		Twenty-Six Week Period Ended	
	August 30, 2014	August 31, 2013	August 30, 2014	August 31, 2013
Balance beginning of period	\$ 270,322	\$ 312,011	\$ 284,270	\$ 323,758
Provision for present value of noncancellable lease payments of closed stores	294	5,981	436	6,374
Changes in assumptions about future sublease income, terminations and changes in interest rates	1,844	(308)	1,417	213
Interest accretion	4,845	5,452	9,827	10,909
Cash payments, net of sublease income	(16,175)	(19,499)	(34,820)	(37,617)
Balance end of period	\$ 261,130	\$ 303,637	\$ 261,130	\$ 303,637

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