

Edgar Filing: Core-Mark Holding Company, Inc. - Form 10-K

Core-Mark Holding Company, Inc.
Form 10-K
March 02, 2015
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

Annual Report Pursuant to Section 13 OR 15(d) of the Securities Exchange Act of 1934
For the Fiscal Year Ended December 31, 2014
 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: 000-51515
Core-Mark Holding Company, Inc.
(Exact name of registrant as specified in its charter)

Delaware 20-1489747
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

395 Oyster Point Boulevard, Suite 415 (650) 589-9445
South San Francisco, California 94080
(Address of Principal Executive Offices, including Zip Code) (Registrant's Telephone Number, including Area Code)

Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
---------------------	---

Common Stock, par value \$0.01 per share	NASDAQ Global Market
--	----------------------

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Edgar Filing: Core-Mark Holding Company, Inc. - Form 10-K

Non-accelerated filer

Smaller reporting company

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of June 30, 2014, the last business day of the registrant's most recently completed second fiscal quarter: \$1,022,791,293

As of February 13, 2015, the registrant had 23,167,525 shares of its common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

The information called for by Part III of this Form 10-K will be included in an amendment to this Form 10-K or incorporated by reference to the registrant's 2015 definitive proxy statement to be filed pursuant to Regulation 14A.

FORM 10-K
 FOR THE YEAR ENDED DECEMBER 31, 2014
 TABLE OF CONTENTS

	Page
<u>PART I</u>	
<u>ITEM 1. BUSINESS</u>	1
<u>ITEM 1A. RISK FACTORS</u>	9
<u>ITEM 1B. UNRESOLVED STAFF COMMENTS</u>	15
<u>ITEM 2. PROPERTIES</u>	16
<u>ITEM 3. LEGAL PROCEEDINGS</u>	17
<u>ITEM 4. MINE SAFETY DISCLOSURES</u>	17
<u>PART II</u>	
<u>ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES</u>	18
<u>ITEM 6. SELECTED FINANCIAL DATA</u>	21
<u>ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	23
<u>ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	40
<u>ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA</u>	42
<u>ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE</u>	79
<u>ITEM 9A. CONTROLS AND PROCEDURES</u>	79
<u>ITEM 9B. OTHER INFORMATION</u>	79
<u>PART III</u>	
<u>ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE</u>	80
<u>ITEM 11. EXECUTIVE COMPENSATION</u>	80
<u>ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS</u>	80
<u>ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE</u>	80

<u>ITEM 14.</u>	<u>PRINCIPAL ACCOUNTING FEES AND SERVICES</u>	<u>80</u>
<u>PART IV</u>		
<u>ITEM 15.</u>	<u>EXHIBITS, FINANCIAL STATEMENT SCHEDULES</u>	<u>82</u>

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Statements in this Annual Report on Form 10-K that are not statements of historical fact are forward-looking statements made pursuant to the safe-harbor provisions of the Exchange Act of 1934 and the Securities Act of 1933.

Forward-looking statements in some cases can be identified by the use of words such as “may,” “will,” “should,” “potential,” “intend,” “expect,” “seek,” “anticipate,” “estimate,” “believe,” “could,” “would,” “project,” “predict,” “continue,” “plan,” “pro” similar words or expressions. Forward-looking statements are made only as of the date of this Form 10-K and are based on our current intent, beliefs, plans and expectations. They involve risks and uncertainties that could cause actual results to differ materially from historical results or those described in or implied by such forward-looking statements.

A detailed discussion of risks and uncertainties that could cause actual results and events to differ materially from such forward-looking statements is included in Part I, Item 1A, “Risk Factors” of this Form 10-K. Except as required by law, we undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

SEC Regulation - Non-GAAP Information

The financial statements in this Annual Report are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). Core-Mark Holding Company, Inc. (Core-Mark) uses certain non-GAAP financial measures including remaining gross profit, remaining gross profit margin, Adjusted EBITDA and net sales, less excise taxes. We believe these non-GAAP financial measures provide meaningful supplemental information for investors regarding the performance of our business and facilitate a meaningful period to period evaluation. Management uses these non-GAAP financial measures in order to have comparable financial results to analyze changes in Core-Mark’s underlying business. These non-GAAP measures should be considered as a supplement to, and not as a substitute for, or superior to, financial measures calculated in accordance with GAAP.

Table of Contents

PART I

ITEM 1. BUSINESS

Unless the context indicates otherwise, all references in this Annual Report on Form 10-K to “Core-Mark,” “the Company,” “we,” “us,” or “our” refer to Core-Mark Holding Company, Inc. and its subsidiaries.

Company Overview

Core-Mark is one of the largest wholesale distributors to the convenience retail industry in North America, providing sales, marketing, distribution and logistics services to over 35,000 customer locations across the United States (U.S.) and Canada through 29 distribution centers (excluding two distribution facilities we operate as a third party logistics provider). Our origins date back to 1888, when Glaser Bros., a family-owned-and-operated candy and tobacco distribution business, was founded in San Francisco, California.

Our mission is to be the most valued marketer of fresh and broad-line supply solutions to the convenience retail industry. While the past century has brought incredible changes to our business and the world in which we operate, our goal is the same today as it was over 125 years ago - to provide customers with the best possible service and to help them grow their sales and profits. We have grown our business organically and through acquisitions which have expanded our distribution network, product selection and customer base.

Core-Mark has become one of two national distributors to the convenience store industry in the U.S. and is one of the largest distributors in Canada. The national market presence we have established rests primarily with our ability to service customers in every geographic region within the U.S. through 25 distribution centers and servicing customers in Canada with our four Canadian distribution centers.

We operate in an industry, where in 2013, based on the National Association of Convenience Stores (NACS) State of the Industry (SOI) report, total in-store sales at convenience retail locations in the U.S. increased 2.4% to approximately \$204 billion and were generated through approximately 151,000 stores. Over the ten years from 2004 through 2014, U.S. convenience in-store sales have increased by a compounded annual growth rate of approximately 4.4%. Based on the Canadian Convenience Store Association (CCSA) 2013 Industry report, we estimate that total Canadian in-store sales at convenience locations were approximately C\$23.1 billion generated through approximately 23,100 stores.

Table of Contents

2014 Company Highlights

Our net sales grew from \$8.1 billion in 2011 to \$10.3 billion in 2014, yielding an annual compounded growth rate of approximately 8%, while our annual Adjusted EBITDA⁽¹⁾ increased from \$91.9 million to \$122.7 million, or approximately 10%, compounded annually during the same period. Our growth has been driven primarily by our business strategies described more fully below. We believe these strategies have positioned us to continue to grow our approximate 5% market share of total in-store sales within the convenience store channel in North America and to take advantage of growth opportunities with other retail store formats. Below are key highlights of the year:

- In February 2015, we acquired substantially all the assets of Karrys Bros. Limited (Karrys Bros.), a regional distributor servicing customers in Ontario, and the surrounding provinces. The initial purchase price was approximately \$10 million Canadian dollars or \$8 million U.S. dollars. Annual sales for the acquired business are approximately \$100 million Canadian dollars. The acquisition of Karrys Bros. will expand our presence in eastern Canada.
- In September 2014, we opened a new distribution facility in Glenwillow, Ohio to support customer growth in this region. From this new facility we successfully rolled out service to approximately 800 Rite Aid Corporation (Rite Aid) stores and transferred 600 existing stores from other Core-Mark distribution centers as of December 31, 2014. We expect to transfer additional stores to the new facility in 2015. The addition of this distribution center is expected to allow us to serve our customers in this region more efficiently and could likely result in transportation cost savings as we reduce mileage to service existing customers.
- In June 2014, we signed a three year contract with Rite Aid. We are currently servicing approximately 4,500 Rite Aid stores across the U.S. with fresh, refrigerated, bakery and frozen products. We are committed to our long-term partnership with Rite Aid to help them maximize supply chain efficiencies and optimize product sales to satisfy the needs of their customers.
- In May 2014, the Board of Directors declared a two-for-one stock split of our outstanding common stock which was effected through a stock dividend. The additional shares were distributed on June 26, 2014 to stockholders of record at the close of business on June 9, 2014.
- We continue to transition portions of our fleet to Compressed Natural Gas (CNG) which allows us to reduce our carbon footprint and lower our transportation costs. To date, we have opened five CNG stations, two of the stations we own, located in Wilkes Barre, Pennsylvania and Corona, California, and the other three stations are operated in partnership with U.S. Oil and are located in Aurora, Colorado, Forrest City, Arkansas and Sanford, North Carolina under the name GAIN Clean Fuel (GAIN). In addition to providing fuel to our fleet, the GAIN stations are also open to all other CNG fleets and the public. We expect to open two more GAIN stations near other distribution centers in 2015.

Adjusted EBITDA is a non-GAAP measure and should be considered as a supplement to, and not as a substitute for, or superior to, financial measures calculated in accordance with GAAP. Adjusted EBITDA is equal to net (1) income adding back net interest expense, provision for income taxes, depreciation and amortization, LIFO expense, stock-based compensation expense and net foreign currency transaction gains or losses. See Item 6 - Selected Financial Data for the reconciliation of Adjusted EBITDA to net income.

Business Strategy

Our objective is to increase overall return to stockholders by growing our market share, revenues and profitability. As one of the largest marketers of fresh and broad-line supply solutions to the convenience retail industry in North America, with the proven capability of effectively selling into other retail channels, we believe we are well-positioned to continue meeting this objective. Our business strategy also includes the following initiatives, designed to further enhance the value we provide to our retail customers:

Leverage our Vendor Consolidation Initiative (VCI). We expect our VCI program will allow us to continue to grow our sales by capitalizing on the highly fragmented supply chain that services the convenience retail industry. A convenience retailer generally receives store merchandise through a large number of direct-store deliveries. This represents a highly inefficient and costly process for retailers. Our VCI program targets inefficiencies in the convenience store supply chain by offering the retailer the ability to receive multiple weekly deliveries for the bulk of their products, including dairy and other merchandise they would historically purchase from direct-store-delivery companies. This simplifies the supply chain and provides retailers with an opportunity to improve inventory turns and working capital, reduce operational and transaction costs, and greatly diminish their out-of-stocks on best-selling items.

Deliver Fresh Products (Fresh). We believe there is an increasing trend among consumers to purchase fresh food from convenience and other retail formats. To meet this demand, we have modified and upgraded our refrigerated capacity, including investing in chill docks and tri-temperature (tri-temp) trailers, which provides the infrastructure to deliver a significant range of chilled items including milk, produce and other fresh foods to retail outlets. We have established partnerships with strategically-located dairies, fresh kitchens and bakeries to further enable us to deliver the freshest product possible, with premium consumer items such as sandwiches, wraps, cut-fruit, parfaits, pastries, doughnuts, bread and home meal replacement solutions. We continue to expand the array of fresh products through the development of unique and comprehensive marketing and equipment programs that assist the retailer in showcasing their fresh product offering. We believe our investments in infrastructure, combined with our strategically located suppliers and in-house expertise, position us as the leader in providing fresh products and programs to the convenience retail industry. Proper execution of VCI, with the cornerstone being dairy distribution, provides Core-Mark the critical mass necessary to offer retailers a multiple weekly delivery platform, which facilitates the proper handling and dating of fresh products. We believe that fresh items are increasingly driving consumer decisions, and will continue to be an important category.

Acquisitions and Expansion. We believe there is significant opportunity to increase our market presence and revenue growth through strategic and opportunistic acquisitions, including continued expansion of our presence nationally. We completed five acquisitions and added three additional warehouses between 2006 and 2014, which expanded our distribution network, product selection and customer base. Our new distribution center in Ohio will further expand our distribution network and increase our geographic presence in the Midwest. We will also pursue opportunistic acquisitions in areas with significant population but limited infrastructure. In addition, our new three year contract with Rite Aid has expanded our customer base and affords us an opportunity to grow this alternative channel of business.

Competitive Strengths

We believe we have the following fundamental competitive strengths, which form the foundation for our business strategy:

Innovation and Flexibility. Wholesale distributors typically provide convenience retailers access to a broad product line, the ability to place small quantity orders, inventory management and access to trade credit. Our capability to increase sales and profitability with existing and new customers is based on our ability to deliver consistently high levels of service, innovative marketing programs, technology solutions and logistics support. We believe we were one of the first to recognize emerging trends and to offer retailers our unique strategic solutions such as VCI and Fresh. In addition, we continue to leverage our Focused Marketing Initiative (FMI), which is designed to enhance our relationship with our independent customer base and to further differentiate us in the market place. The FMI program is centered on increasing the sales and profitability of the independent store through improved category insights, optimized retail price strategy and demographic decision-making along with providing Core-Mark's marketing

solutions to create a comprehensive retail marketing strategy. We believe our innovative approach, which focuses on building a trusted partnership with our customers, has established us as the market leader in providing valuable marketing and supply chain solutions to the convenience retail industry.

Distribution Capabilities. The wholesale distribution industry is highly fragmented and historically has consisted of a large number of small, privately-owned businesses and a small number of large, full-service wholesale distributors serving multiple geographic regions. Relative to smaller competitors, large national distributors such as Core-Mark benefit from several competitive advantages including: increased purchasing power, the ability to service large national chain accounts, economies of scale in sales and operations, and the resources to invest in information technology and other productivity-enhancing technologies. Our wholesale distributing capabilities provide valuable services to both manufacturers of consumer products and convenience retailers. Manufacturers benefit from our broad retail coverage, inventory management, efficiency in processing small orders and frequency

Table of Contents

of deliveries. Convenience retailers benefit from our distribution capabilities by gaining access to a broad product line, optimizing inventory management and accessing trade credit. Our average distribution in-stock service level for 2014, measured as the percentage of items ordered by customers that are delivered by the requested delivery date (excluding manufacturer out-of-stocks and discontinued items), was approximately 99%.

Customers

We service over 35,000 customer locations in 50 states in the U.S. and five Canadian provinces. Our primary customer base consists of traditional convenience stores as well as alternative outlets selling consumer packaged goods. Our traditional convenience store customers include many of the major national and super-regional convenience store operators, as well as independently owned convenience stores. Our alternative outlet customers comprise a variety of store formats, including grocery stores, drug stores, liquor stores, cigarette and tobacco shops, hotel gift shops, military exchanges, college and corporate campuses, casinos, hardware stores, airport concessions and other specialty and small format stores that carry convenience products.

Our top ten customers accounted for 36.7% of our net sales in 2014 including Alimentation Couche-Tard, Inc. (Couche-Tard), our largest customer, which accounted for 14.5% of our total net sales.

Products

We purchase a variety of brand name and private label products, in excess of 53,000 SKUs, from suppliers and manufacturers. Cigarette products represent less than 5% of our total SKUs purchased. We offer customers a variety of food/non-food products, including fast food, candy, snacks, groceries, fresh products, dairy, bread, beverages, other tobacco products, general merchandise and health and beauty care products.

Below is a comparison of our net sales mix by primary product category for the last three years (in millions):

Product Category	Year Ended December 31,		2013		2012			
	2014	% of Net Sales	Net Sales	% of Net Sales	Net Sales	% of Net Sales		
Cigarettes	\$6,942.0	67.5	% \$6,642.0	68.0	% \$6,139.4	69.0	%	
Food	1,462.0	14.2	1,342.3	13.7	1,178.6	13.4		
Candy ⁽¹⁾	534.3	5.2	513.2	5.3	476.6	5.3		
Other tobacco products	827.5	8.1	787.8	8.1	687.8	7.7		
Health, beauty & general ⁽¹⁾	361.0	3.5	341.3	3.5	282.1	3.2		
Beverages	151.8	1.5	139.1	1.4	125.6	1.4		
Equipment/other	1.5	—	1.9	—	2.3	—		
Total food/non-food products	3,338.1	32.5	% \$3,125.6	32.0	% 2,753.0	31.0	%	
Total net sales	\$10,280.1	100.0	%					