ADVANCE AUTO PARTS INC
Form 10-Q
May 31, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended April 21, 2007
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 001-16797

ADVANCE AUTO PARTS, INC.
(Exact name of registrant as specified in its charter)

Delaware	**54-2049910**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

5008 Airport Road, Roanoke, Virginia 24012
(Address of Principal Executive Offices)
(Zip Code)

(540) 362-4911
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report).

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 x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act. Large accelerated filer x Accelerated filer p Non-accelerated filer p

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

As of May 29, 2007, the registrant had outstanding 106,457,647 shares of Common Stock, par value $0.0001 per share (the only class of common stock of the registrant outstanding).

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PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS OF ADVANCE AUTO PARTS, INC. AND SUBSIDIARIES

Advance Auto Parts, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets
April 21, 2007 and December 30, 2006
(in thousands, except per share data)
(unaudited)

Assets		April 21, 2007		December 30, 2006
Current assets:				
Cash and cash equivalents	$	16,983	$	11,128
Receivables, net		89,754		97,046
Inventories, net		1,556,052		1,463,340
Other current assets		29,418		40,459
Total current assets		1,692,207		1,611,973
Property and equipment, net of accumulated depreciation of $706,731 and $670,571		1,016,046		994,977
Assets held for sale		1,448		1,548
Goodwill		33,718		33,718
Intangible assets, net		27,596		27,926
Other assets, net		10,299		12,539
	$	2,781,314	$	2,682,681
Liabilities and Stockholders' Equity				
Current liabilities:				
Bank overdrafts	$	5,707	$	34,206
Current portion of long-term debt		62		67
Financed vendor accounts payable		118,246		127,543
Accounts payable		768,621		651,587
Accrued expenses		254,859		252,975
Other current liabilities		47,173		47,042
Total current liabilities		1,194,668		1,113,420
Long-term debt		404,150		477,173
Other long-term liabilities		64,537		61,234
Commitments and contingencies				
Stockholders' equity:				
Preferred stock, nonvoting, $0.0001 par value, 10,000 shares authorized; no shares issued or outstanding		-		-
Common stock, voting, $0.0001 par value, 200,000 shares authorized; 106,058 shares issued and outstanding in 2007 and 105,351 issued and outstanding in 2006		11		11
Additional paid-in capital		434,420		414,153

Accumulated other comprehensive income		2,846		3,472
Retained earnings		680,682		613,218
Total stockholders' equity		1,117,959		1,030,854
	$	2,781,314	$	2,682,681

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

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Advance Auto Parts, Inc. and Subsidiaries
Condensed Consolidated Statements of Operations
For the Sixteen Week Periods Ended
April 21, 2007 and April 22, 2006
(in thousands, except per share data)
(unaudited)

	Sixteen Week Periods Ended	
	April 21, 2007	April 22, 2006
Net sales	$ 1,468,120	$ 1,393,010
Cost of sales, including purchasing and warehousing costs	758,717	727,842
Gross profit	709,403	665,168
Selling, general and administrative expenses	574,710	538,870
Operating income	134,693	126,298
Other, net:		
Interest expense	(11,274)	(10,163)
Other income, net	342	620
Total other, net	(10,932)	(9,543)
Income before provision for income taxes	123,761	116,755
Provision for income taxes	47,660	42,674
Net income	$ 76,101	$ 74,081
Basic earnings per share	$ 0.72	$ 0.69
Diluted earnings per share	$ 0.71	$ 0.68
Average common shares outstanding	105,694	107,879
Dilutive effect of share-based compensation	951	1,376
Average common shares outstanding - assuming dilution	106,645	109,255

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

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Advance Auto Parts, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows
For the Sixteen Week Periods Ended
April 21, 2007 and April 22, 2006
(in thousands)
(unaudited)

	Sixteen Week Periods Ended	
	April 21, 2007	**April 22, 2006**
Cash flows from operating activities:		
Net income	$ 76,101	$ 74,081
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	45,426	39,833
Amortization of deferred debt issuance costs	69	193
Share-based compensation	5,398	5,045
Loss on disposal of property and equipment, net	3,370	173
Benefit for deferred income taxes	(6,087)	(1,163)
Excess tax benefit from share-based compensation	(3,607)	(2,663)
Net decrease (increase) in:		
Receivables, net	4,041	9,716
Inventories, net	(92,712)	(53,790)
Other assets	13,316	15,454
Net increase in:		
Accounts payable	117,034	67,311
Accrued expenses	21,491	10,130
Other liabilities	3,035	1,974
Net cash provided by operating activities	186,875	166,294
Cash flows from investing activities:		
Purchases of property and equipment	(75,940)	(77,954)
Insurance proceeds related to damaged property	3,251	-
Proceeds from sales of property and equipment	239	5,111
Net cash used in investing activities	(72,450)	(72,843)
Cash flows from financing activities:		
Decrease in bank overdrafts	(28,499)	(28,247)
(Decrease) increase in financed vendor accounts payable	(9,297)	6,082
Dividends paid	(12,682)	(6,479)
Borrowings under credit facilities	136,800	-
Payments on credit facilities	(209,800)	(8,175)
Proceeds from the issuance of common stock, primarily exercise of stock options	11,262	8,576
Excess tax benefit from share-based compensation	3,607	2,663
Repurchase of common stock	-	(53,327)
Other	39	23
Net cash used in financing activities	(108,570)	(78,884)
Net increase in cash and cash equivalents	5,855	14,567
Cash and cash equivalents, beginning of period	11,128	40,783

Cash and cash equivalents, end of period	$	16,983	$	55,350
Supplemental cash flow information:				
Interest paid	$	12,861	$	7,373
Income tax payments, net		40,665		20,622
Non-cash transactions:				
Accrued purchases of property and equipment		17,948		36,852
Repurchases of common stock not settled		-		13,154
Retirement of common stock		-		79,177
Reclassification of other comprehensive income		(626)		1,440
Adoption of FIN No. 48, net of tax		2,275		-

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

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Advance Auto Parts, Inc. and Subsidiaries
Notes to the Condensed Consolidated Financial Statements
For the Sixteen Week Periods Ended April 21, 2007 and April 22, 2006
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(unaudited)

1. Basis of Presentation:

The accompanying condensed consolidated financial statements include the accounts of Advance Auto Parts, Inc. and its wholly owned subsidiaries, or the Company. All significant intercompany balances and transactions have been eliminated in consolidation.

The condensed consolidated balance sheets as of April 21, 2007 and December 30, 2006, the condensed consolidated statements of operations for the sixteen week periods ended April 21, 2007 and April 22, 2006, and the condensed consolidated statements of cash flows for the sixteen week periods ended April 21, 2007 and April 22, 2006, have been prepared by the Company. In the opinion of management, all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the financial position of the Company, the results of its operations and cash flows have been made.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. These financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's consolidated financial statements for the fiscal year ended December 30, 2006.

The results of operations for the interim periods are not necessarily indicative of the operating results to be expected for the full fiscal year.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cost of Sales and Selling, General and Administrative Expenses

The following table illustrates the primary costs classified in each major expense category:

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Cost of Sales

Total cost of merchandise sold including:

– Freight expenses associated with moving merchandise inventories from our vendors to our distribution center;

– Vendor incentives;

– Cash discounts on payments to vendors;

Inventory shrinkage;

Warranty costs;

Costs associated with operating our distribution network, including payroll and benefit costs, occupancy costs and depreciation; and

Freight expenses associated with moving merchandise inventories from our distribution center to our retail stores.

SG&A

Payroll and benefit costs for retail and corporate team members, including share-based compensation;

Occupancy costs of retail and corporate facilities;

Depreciation related to retail and corporate assets;

Advertising;

Costs associated with our commercial delivery program, including payroll and benefit costs, and transportation expenses associated with moving merchandise inventories from our retail stores to our customer locations;

Freight expenses associated with moving merchandise inventories from our Local Area Warehouses, or LAWs, and Parts Delivered Quickly warehouses, or PDQs, to our retail stores after the customer has special ordered the merchandise;

Self-insurance costs;

Professional services; and

Other administrative costs, such as credit card service fees, supplies, travel and lodging.

Vendor Incentives

The Company receives incentives in the form of reductions to amounts owed and/or payments from vendors related to cooperative advertising allowances, volume rebates and other promotional considerations. The Company accounts for vendor incentives in accordance with Emerging Issues Task Force, or EITF, No. 02-16, “Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor.” Many of the incentives are under long-term

agreements (terms in excess of one year), while others are negotiated on an annual basis. Cooperative advertising allowances and volume rebates are earned based on inventory purchases and initially recorded as a reduction to inventory. The deferred amounts are included as a reduction to cost of sales as the inventory is sold.

The Company recognizes other promotional incentives earned under long-term agreements as a reduction to cost of sales. These incentives are recognized based on the cumulative net purchases as a percentage of total estimated net purchases over the life of the agreement. The Company's margins could be impacted positively or negatively if actual purchases or results from any one year differ from its estimates; however, the impact over the life of the agreement would be the same. Short-term incentives (terms less than one year) are recognized as a reduction to cost of sales over the course of the agreements.

Amounts received or receivable from vendors that are not yet earned are reflected as deferred revenue in the accompanying condensed consolidated balance sheets. Management's estimate of the portion of deferred revenue that will be realized within one year of the balance sheet date has been included in other current liabilities in the accompanying condensed consolidated balance sheets. Earned amounts that are receivable from vendors are included in receivables, net on the accompanying condensed consolidated balance sheets, except for that portion expected to be received after one year, which is included in other assets, net on the accompanying condensed consolidated balance sheets.

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Preopening Expenses

Preopening expenses, which consist primarily of payroll and occupancy costs, are expensed as incurred.

Warranty Costs

The Company's vendors are primarily responsible for warranty claims. Warranty costs relating to merchandise (primarily batteries) sold under warranty, which are not covered by vendors' warranties, are estimated based on the Company's historical experience and are recorded in the period the product is sold. The following table presents changes in the Company's warranty reserves.

	April 21, 2007 *(16 weeks ended)*	**December 30, 2006** *(52 weeks ended)*
Warranty reserve, beginning of period	$ 13,069	$ 11,352
Reserves established	6,394	17,352
Reserves utilized	(5,408)	(15,635)
Warranty reserve, end of period	$ 14,055	$ 13,069

Sales Returns and Allowances

The Company's accounting policy for sales returns and allowances consists of establishing reserves for estimated returns at the time of sale. The Company anticipates returns based on current sales levels and the Company's historical return experience on a specific product basis.

Earnings Per Share of Common Stock

Basic earnings per share of common stock has been computed based on the weighted-average number of common shares outstanding, less stock held in treasury and shares of non-vested restricted stock, during the period. Diluted earnings per share of common stock reflects the increase in the weighted-average number of shares of common stock outstanding, outstanding deferred stock units and the impact of outstanding stock options, stock appreciation rights and shares of non-vested restricted stock, calculated on the treasury stock method.

Hedge Activities

The Company utilizes interest rate swaps to limit its cash flow risk on its variable rate debt. In accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," the fair value of the Company's outstanding hedges is recorded as an asset or liability in the accompanying condensed consolidated balance sheets at April 21, 2007 and December 30, 2006, respectively. The Company uses the "matched terms" accounting method as provided by

Derivative Implementation Group Issue No. G9, “Assuming No Ineffectiveness When Critical Terms of the Hedging Instrument and the Hedge Transaction Match in a Cash Flow Hedge” for the interest rate swaps. Accordingly, the Company has matched the critical terms of each hedge instrument to the hedged debt. The Company uses the adjusted LIBOR interest rate and has the intent and ability to continue to use the adjusted LIBOR interest rate on its hedged borrowings. Therefore, the Company has recorded all adjustments to the fair value of the hedge instruments in accumulated other comprehensive income through the maturity date of the applicable hedge arrangement.

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The fair value of the interest rate swaps at April 21, 2007 and December 30, 2006 was a liability of $595 and an asset of $251, respectively. Any amounts received or paid under these hedges will be recorded in the statement of operations as earned or incurred.

Based on the estimated current and future fair values of the hedge arrangements at April 21, 2007, the Company estimates amounts currently included in accumulated other comprehensive income that will be reclassified to earnings in the next 12 months will consist of a gain of $579 associated with the interest rate swaps.

Financed Vendor Accounts Payable

The Company is party to a short-term financing program with a bank allowing it to extend its payment terms on certain merchandise purchases. The substance of the program is for the Company to borrow money from the bank to finance purchases from vendors. The Company records any discount given by the vendor to the value of its inventory and accretes this discount to the resulting short-term payable to the bank through interest expense over the extended term. At April 21, 2007 and December 30, 2006, $118,246 and $127,543, respectively, was payable to the bank by the Company under this program and is included in the accompanying consolidated balance sheets as Financed Vendor Accounts Payable.

New Accounting Pronouncements

In February 2007, the FASB issued SFAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities.” SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of SFAS No. 159.

In September 2006, the FASB issued SFAS No. 158, “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R).” SFAS No. 158 requires recognition of the overfunded or underfunded status of defined benefit postretirement plans as an asset or liability in the statement of financial position and to recognize changes in that funded status in comprehensive income in the year in which the changes occur. SFAS No. 158 also requires measurement of the funded status of a plan as of the date of the statement of financial position. The Company adopted the recognition provisions of SFAS No. 158 on December 30, 2006. SFAS No. 158 is effective for the measurement date provisions for fiscal years ending after December 15, 2008. The Company is currently evaluating the impact of adopting the measurement date provisions of SFAS No. 158.

In September 2006, the FASB issued SFAS No. 157, “Fair Value Measurements.” SFAS No. 157 clarifies the definition of fair value, establishes a framework for measuring fair value, and expands the disclosures on fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of SFAS No. 157.

In March 2006, the FASB issued SFAS No. 156, “Accounting for Servicing of Financial Assets - an amendment of FASB Statement No. 140.” SFAS No. 156 amends SFAS No. 140, “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,” with respect to the accounting for separately recognized servicing assets and servicing liabilities. SFAS No. 156 is effective for fiscal years beginning after September 15, 2006. Effective

December 31, 2006, the Company adopted SFAS No. 156 with no material impact on its financial condition, results of operations or cash flows.

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In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments - an amendment of FASB Statements No. 133 and 140." SFAS No. 155 simplifies accounting for certain hybrid instruments currently governed by SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," or SFAS No. 133, by allowing fair value remeasurement of hybrid instruments that contain an embedded derivative that otherwise would require bifurcation. SFAS No. 155 also eliminates the guidance in SFAS No. 133 Implementation Issue No. D1, "Application of Statement 133 to Beneficial Interests in Securitized Financial Assets," which provides such beneficial interests are not subject to SFAS No. 133. This statement amends SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities - a Replacement of FASB Statement No. 125," by eliminating the restriction on passive derivative instruments that a qualifying special-purpose entity may hold. SFAS No. 155 is effective for financial instruments acquired or issued after the beginning of the Company's fiscal year 2007. Effective December 31, 2006, the Company adopted SFAS No. 155 with no material impact on its financial condition, results of operations or cash flows.

2. Income Taxes:

On December 31, 2006, the Company adopted the provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes," or FIN 48. FIN 48 clarifies the accounting and reporting for income taxes recognized in accordance with SFAS No. 109, "Accounting for Income Taxes." The interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken in income tax returns.

As a result of the adoption of FIN 48 on December 31, 2006, the Company recorded an increase of $2,275 to the liability for unrecognized tax benefits and a corresponding decrease in its balance of retained earnings. As of December 31, 2006, the gross amount of unrecognized tax benefits was $16,453. The entire amount, if recognized, would affect the effective tax rate.

The Company previously classified interest associated with tax contingencies in interest expense. The Company has not previously provided for any penalties associated with tax contingencies unless considered probable. With the adoption of FIN 48, the Company will provide for interest and penalties as a part of income tax expense. As of December 31, 2006, the gross amount of interest and penalties related to unrecognized tax benefits was $4,172.

During the next 12 months, it is possible that the Company could conclude on $3,000 to $4,000 of the contingencies associated with tax uncertainties (including unrecognized tax benefits, interest and penalties). The majority of these resolutions would be achieved through the completion of current income tax examinations.

The Company and its subsidiaries file a consolidated U.S. federal income tax return and state returns, some of which are on a consolidated basis, in the 40 states which have retail operations, plus Puerto Rico and the Virgin Islands. Numerous localities require income tax returns. The examination of the Company's U.S. federal tax returns for the 3-year period ending 2003 was completed in March 2006. With respect to state and local jurisdictions, the Company and its subsidiaries are generally not subject to exam for any years prior to 2001.

3. Share-Based Compensation:

The Company accounts for its share-based compensation plans in accordance with the provisions of SFAS No. 123R, "Share-Based Payment." Historically, the Company has granted fixed stock options and deferred stock units to its employees under these plans. During the sixteen weeks ended April 21, 2007, the Company granted stock appreciation rights, or SARs, and shares of restricted stock as allowed under the Company's long-term incentive

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plan. Total share-based compensation expense included in selling, general and administrative expenses in the accompanying condensed consolidated statements of operations for the sixteen weeks ended April 21, 2007 and April 22, 2006 was $5,398 and $5,045, respectively.

SARs

During the sixteen weeks ended April 21, 2007, the Company granted 1,429 SARs to employees at a conversion price of $38.03. The Company calculated the fair value of the granted SARs using the Black-Scholes pricing model and will amortize the fair value compensation over the requisite service period using the straight-line method. The SARs vest over a three-year period in equal installments beginning on the first anniversary of the grant date and contain no post-vesting restrictions other than normal trading black-out periods prescribed by the Company’s corporate governance policies. Additionally, the SARs expire on the seventh anniversary of the grant date.

The grant-date fair value of each SAR was $11.36. At April 21, 2007, the remaining compensation expense to be recognized for this grant, net of estimated forfeitures, is $14,283. The Company used the following Black-Scholes option-pricing assumptions to determine the fair value of each SAR and stock option during the sixteen weeks ended April 21, 2007 and April 22, 2006, respectively:

Black-Scholes Option Valuation Assumptions [1]	**April 21, 2007**	**April 22, 2006**
Risk-free interest rate [2]	4.8%	4.6%
Expected dividend yield [3]	0.6%	0.6%
Expected stock price volatility [4]	29.0%	28.0%
Expected life of stock options and SARs (in months) [5]	51	44

(1) Forfeitures are based on historical experience.

(2) The risk-free interest rate is based on a U.S. Treasury constant maturity interest rate whose term is consistent with the expected life of the Company’s stock options.

(3) The Company declared its first ever cash dividend beginning in its first quarter of 2006.

(4) Expected volatility is based on the historical volatility of the Company’s common stock for the period consistent with the expected life of the Company’s stock options and SARs.

(5) The expected life of the Company’s stock options and SARs represents the estimated period of time until exercise and is based on the Company’s historical experience of such stock options.

Restricted Stock

During the sixteen weeks ended April 21, 2007, the Company granted 142 shares of restricted stock to employees. These shares vest over a three-year period. During this period, holders of the restricted stock are entitled to dividend and voting rights. Shares of the restricted stock are restricted until they vest and cannot be sold by the recipient until the restriction has lapsed at the end of the three-year period.

The grant-date fair value of each share of restricted stock was $38.03, which was equal to the market price of the Company’s stock on the date of grant. At April 21, 2007, the remaining compensation expense to be recognized for this grant, net of estimated forfeitures, is $4,760. As the compensation is amortized over the vesting

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period, additional paid-in capital is recognized accordingly. Shares of restricted stock are not included as shares outstanding in the calculation of basic earnings per share, but are included in the number of shares used to calculate diluted earnings per share, if dilutive.

4. Goodwill and Intangible Assets:

The carrying amount and accumulated amortization of acquired intangible assets as of April 21, 2007 include:

	As of April 21, 2007		
Acquired intangible assets subject to amortization:	**Gross Carrying Amount**	**Accumulated Amortization**	**Net Book Value**
Customer relationships	$ 9,600	$ (1,472)	$ 8,128
Other	885	(217)	668
Total	$ 10,485	$ (1,689)	$ 8,796
Acquired intangible assets not subject to amortization:			
Trademark and tradenames	$ 18,800	$ -	$ 18,800
Intangible assets, net	$ 29,285	$ (1,689)	$ 27,596

The Company recorded amortization expense of $330 for acquired intangible assets for the sixteen weeks ended April 21, 2007. The table below shows expected amortization expense for the next five years for acquired intangible assets recorded as of April 21, 2007.

2007	757
2008	1,087
2009	1,087
2010	1,059
2011	967

The changes in the carrying amount of goodwill for the sixteen weeks ended April 21, 2007 are as follows:

	AAP Segment	AI Segment	Total
Balance at December 30, 2006	$ 16,093	$ 17,625	$ 33,718
Fiscal 2007 activity	-	-	-
Balance at April 21, 2007	$ 16,093	$ 17,625	$ 33,718

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5. Receivables:

Receivables consist of the following:

	April 21, 2007	December 30, 2006
Trade	$ 14,210	$ 13,149
Vendor	70,897	73,724
Installment	975	2,336
Insurance recovery	5,193	9,676
Other	3,607	2,801
Total receivables	94,882	101,686
Less: Allowance for doubtful accounts	(5,128)	(4,640)
Receivables, net	$ 89,754	$ 97,046

6. Inventories, net:

Inventories are stated at the lower of cost or market, cost being determined using the last-in, first-out ("LIFO") method for approximately 93% of inventories at both April 21, 2007 and December 30, 2006. Under the LIFO method, the Company's cost of sales reflects the costs of the most currently purchased inventories while the inventory carrying balance represents the costs relating to prices paid in prior years. The Company's costs to acquire inventory have been generally decreasing in recent years as a result of its significant growth. Accordingly, the cost to replace inventory is less than the LIFO balances carried for similar product. As a result of the LIFO method and the ability to obtain lower product costs, the Company recorded reductions to cost of sales of $10,319 and $2,940 for the sixteen weeks ended April 21, 2007 and April 22, 2006, respectively.

An actual valuation of inventory under the LIFO method can be made only at the end of each fiscal year based on the inventory levels and costs at that time. Accordingly, interim LIFO calculations must be based on management's estimates of expected fiscal year-end inventory levels and costs.

The remaining inventories are comprised of product cores, which consist of the non-consumable portion of certain parts and batteries and are valued under the first-in, first-out ("FIFO") method. Core values are included as part of the Company's merchandise costs and are either passed on to the customer or returned to the vendor. Additionally, these products are not subject to the frequent cost changes like the Company's other merchandise inventory, thus there is no material difference from applying either the LIFO or FIFO valuation methods.

The Company capitalizes certain purchasing and warehousing costs into inventory. Purchasing and warehousing costs included in inventory, at FIFO, at April 21, 2007 and December 30, 2006, were $99,989 and $95,576, respectively. Inventories consist of the following:

	April 21, 2007	December 30, 2006
Inventories at FIFO	$ 1,462,966	$ 1,380,573
Adjustments to state inventories at LIFO	93,086	82,767
Inventories at LIFO	$ 1,556,052	$ 1,463,340

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Replacement cost approximated FIFO cost at April 21, 2007, and December 30, 2006.

Inventory quantities are tracked through a perpetual inventory system. The Company uses a cycle counting program in all distribution centers, PDQs, LAWs and retail stores to ensure the accuracy of the perpetual inventory quantities of both merchandise and core inventory.

The Company establishes reserves for estimated shrink based on historical accuracy and effectiveness of the cycle counting program. The Company also establishes reserves for potentially excess and obsolete inventories based on current inventory levels and the historical analysis of product sales and current market conditions. The nature of the Company's inventory is such that the risk of obsolescence is minimal and excess inventory has historically been returned to the Company's vendors for credit. The Company provides reserves when less than full credit is expected from a vendor or when liquidating product will result in retail prices below recorded costs. The Company's reserves against inventory for these matters were $31,602 and $31,376 at April 21, 2007 and December 30, 2006, respectively.

7. Long-term Debt:

Long-term debt consists of the following:

	April 21, 2007	December 30, 2006
Senior Debt:		
Revolving facility at variable interest rates (6.17% and 6.13% at April 21, 2007 and December 30, 2006, respectively) due October 2011	$ 403,800	$ 476,800
Other	412	440
	404,212	477,240
Less: Current portion of long-term debt	(62)	(67)
Long-term debt, excluding current portion	$ 404,150	$ 477,173

As of April 21, 2007, the Company had outstanding $403,800 under its revolving credit facility and had $66,768 in letters of credit outstanding, which reduced availability under the revolving credit facility to $279,432. In addition to the letters of credit, the Company maintains approximately $2,527 in surety bonds issued by its insurance provider primarily to utility providers and the departments of revenue for certain states. These letters of credit and surety bonds generally have a term of one year or less. The Company entered into its current $750,000 unsecured five-year revolving credit facility in October 2006 with Advance Stores Company, Incorporated, a subsidiary of the Company, serving as the borrower. The revolver replaced the Company's term loans and revolver under the previous credit facility.

The interest rates on borrowings under the revolving credit facility will be based, at the Company's option, on an adjusted LIBOR rate, plus a margin, or an alternate base rate, plus a margin. After an initial interest period, the Company may elect to convert a particular borrowing to a different type. The current margin is 0.75% and 0.0% per annum for the adjusted LIBOR and alternate base rate borrowings, respectively. A commitment fee will be charged on the unused portion of the revolver, payable in arrears. The current commitment fee rate is 0.150% per annum. Under the terms of the new revolving credit facility, the interest rate spread and commitment fee will be based on the Company's credit rating. The revolving facility terminates on October 5, 2011.

The revolving credit facility is fully and unconditionally guaranteed by Advance Auto Parts, Inc. The

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facility contains covenants restricting the ability of the Company and its subsidiaries to, among other things, (1) create, incur or assume additional debt (including hedging arrangements), (2) incur liens or engage in sale-leaseback transactions, (3) make loans and investments, (4) guarantee obligations, (5) engage in certain mergers, acquisitions and asset sales, (6) engage in transactions with affiliates, (7) change the nature of the Company's business and the business conducted by its subsidiaries and (8) change the holding company status of the Company. The Company is required to comply with financial covenants with respect to a maximum leverage ratio and a minimum coverage ratio. The new revolving credit facility also provides for customary events of default, including non-payment defaults, covenant defaults and cross-defaults to the Company's other material indebtedness.

The Company was in compliance with the above covenants under the revolving credit facility at April 21, 2007.

8. Comprehensive Income:

Comprehensive income includes changes in fair value of the Company's interest rate swaps. Beginning in fiscal 2007, comprehensive income also includes the amortization of prior service credits related to its postretirement plan as a result of adopting of SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)" at December 30, 2006.

Comprehensive income for the sixteen weeks ended April 21, 2007 and April 22, 2006 is as follows:

	April 21, 2007	April 22, 2006
Net income	$ 76,101	$ 74,081
Unrealized (loss) gain on hedge arrangements, net of tax	(516)	1,440
Amortization of negative prior service cost, net of tax	(110)	-
Comprehensive income	$ 75,475	$ 75,521

9. Postretirement Plan:

The Company provides certain health and life insurance benefits for eligible retired team members through a postretirement plan, or the Plan. These benefits are subject to deductibles, co-payment provisions and other limitations. The Plan has no assets and is funded on a cash basis as benefits are paid. The Company's postretirement liability is calculated annually by a third-party actuary. The discount rate utilized at December 30, 2006 was 5.5%, and remained unchanged through the sixteen weeks ended April 21, 2007. The Company expects fiscal 2007 plan contributions to completely offset benefits paid, consistent with fiscal 2006.

The components of net periodic postretirement benefit cost for the sixteen weeks ended April 21, 2007, and April 22, 2006 respectively, are as follows:

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	Sixteen Weeks Ended	
	April 21, 2007	April 22, 2006
Interest cost	$ 169	$ 223
Amortization of negative prior service cost	(179)	(178)
Amortization of unrecognized net losses	-	64
	$ (10)	$ 109

10. Segment and Related Information:

The Company has the following two reportable segments: Advance Auto Parts, or AAP, and Autopart International, or AI. The AAP segment is comprised of store operations within the United States, Puerto Rico and the Virgin Islands which operate under the trade names “Advance Auto Parts,” “Advance Discount Auto Parts” and “Western Auto.” These stores offer a broad selection of brand name and proprietary automotive replacement parts, accessories and maintenance items for domestic and imported cars and light trucks, with no significant concentration in any specific product area.

The AI segment consists solely of the operations of Autopart International, which operates as an independent, wholly-owned subsidiary. AI’s business serves the growing commercial market in addition to warehouse distributors and jobbers located throughout the Northeastern region of the United States.

The Company evaluates each of its segment’s financial performance based on net sales and operating profit for purposes of making decisions and allocating resources. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies in Note 1.

The following table summarizes financial information for each of the Company's business segments for the sixteen weeks ended April 21, 2007 and April 22, 2006, respectively.

April 21, 2007	**AAP**	**AI**	**Eliminations**	**Totals**
Net sales	$ 1,432,113	$ 36,007	$ -	$ 1,468,120
Operating income (loss)	136,363	(1,670)	-	134,693
Segment assets	2,648,576	132,738	-	2,781,314

April 22, 2006	**AAP**	**AI**	**Eliminations**	**Totals**
Net sales	$ 1,361,645	$ 31,365	$ -	$ 1,393,010

Operating income	125,640	658	-	126,298
Segment assets	2,513,651	102,077	-	2,615,728

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of our consolidated historical results of operations and financial condition should be read in conjunction with our unaudited condensed consolidated financial statements and the notes thereto included elsewhere in this report. Our first quarter consists of 16 weeks and our other three quarters consist of 12 weeks each.

Certain statements in this report are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which are usually identified by the use of words such as "will," "anticipates," "believes," "estimates," "expects," "projects," "forecasts," "plans," "intends," "should" or similar expressions. We intend those forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 and are included in this statement for purposes of complying with these safe harbor provisions.

These forward-looking statements reflect current views about our plans, strategies and prospects, which are based on the information currently available and on current assumptions.

Although we believe that our plans, intentions and expectations as reflected in or suggested by those forward-looking statements are reasonable, we can give no assurance that the plans, intentions or expectations will be achieved. Listed below and discussed in our annual report on Form 10-K for the year ended December 30, 2006 are some important risks, uncertainties and contingencies which could cause our actual results, performances or achievements to be materially different from the forward-looking statements made in this report. These risks, uncertainties and contingencies include, but are not limited to, the following:

- the implementation of our business strategies and goals;
- our ability to expand our business;
- competitive pricing and other competitive pressures;
- a decrease in demand for our products;
- the occurrence of natural disasters and/or extended periods of unfavorable weather;
- our ability to obtain affordable insurance against the financial impacts of natural disasters;
- the availability of suitable real estate locations;
- our overall credit rating;
- deterioration in general economic conditions;
- our ability to attract and retain qualified team members;
- integration of acquisitions;
- our relationship with our vendors;
- our involvement as a defendant in litigation or incurrence of judgments, fines or legal costs;
- adherence to the restrictions and covenants imposed under our revolving credit facility; and
- acts of terrorism.

We assume no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise. In evaluating forward-looking statements, you should consider these risks and uncertainties, together with the other risks described from time to time in our other reports and documents filed with the Securities and Exchange Commission, and you should not place undue reliance on those statements.

Management Overview

During the first quarter of fiscal 2007, we recorded earnings per diluted share of $0.71 compared to $0.68 for the same quarter of fiscal 2006. These results were primarily driven by increased sales and higher gross margin offset by an

increase in certain fixed operating expenses.

Although we continue to produce positive results, we believe that through our talented and experienced management team we have many opportunities to continue our growth and improve our performance. As previously

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announced during fourth quarter 2006, we are well underway with our comprehensive strategy review where we are taking an in-depth look at the automotive aftermarket industry and our customers. In connection with this review, we have already developed four key goals which we believe will begin our process of improving our operating and financial performance:

1. Drive sales to both “do-it-yourself,” or DIY, and “do-it-for-me,” or DIFM, customers, including an increased focus on parts;
2. Accelerate plans to reduce selling, general and administrative expenses, some of which are already underway;
3. Re-examine all capital projects; and
4. Begin implementation of certain initiatives identified in our comprehensive strategy review.

Consolidated Operating Results and Key Metrics

The following table highlights certain consolidated operating results and key metrics for the sixteen weeks ended April 21, 2007, and April 22, 2006.

	Sixteen Weeks Ended	
	April 21, 2007	**April 22, 2006**
Total net sales *(in thousands)*	$ 1,468,120	$ 1,393,010
Total commercial net sales *(in thousands)*	$ 383,293	$ 348,850
Comparable store net sales growth	1.1%	3.9%
DIY comparable store net sales growth	(0.2%)	0.5%