

Dorman Products, Inc.
Form 10-Q
October 30, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 29, 2018

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: 0-18914

Dorman Products, Inc.

(Exact name of registrant as specified in its charter)

Pennsylvania
(State or other jurisdiction of
incorporation or organization)

23-2078856
(I.R.S. Employer
Identification No.)

3400 East Walnut Street, Colmar, Pennsylvania
(Address of principal executive offices)

18915
(Zip Code)

(215) 997-1800

(Registrant's telephone number, including area code)

Edgar Filing: Dorman Products, Inc. - Form 10-Q

N/A

(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 No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit 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, a smaller reporting company or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Emerging growth company

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

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

As of October 26, 2018, the registrant had 33,046,291 shares of common stock, par value \$0.01 per share, outstanding.

DORMAN PRODUCTS, INC. AND SUBSIDIARIES

INDEX TO QUARTERLY REPORT ON FORM 10-Q

September 29, 2018

	Page
Part I — FINANCIAL INFORMATION	
Item 1. Financial Statements (unaudited)	
Consolidated Statements of Income:	
<u>Thirteen Weeks Ended September 29, 2018 and September 30, 2017</u>	3
<u>Thirty-Nine Weeks Ended September 29, 2018 and September 30, 2017</u>	4
<u>Consolidated Balance Sheets</u>	5
<u>Consolidated Statements of Cash Flows</u>	6
<u>Notes to Consolidated Financial Statements</u>	7
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	15
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	19
Item 4. <u>Controls and Procedures</u>	19
Part II — OTHER INFORMATION	
Item 1. <u>Legal Proceedings</u>	20
Item 1A. <u>Risk Factors</u>	20
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	20
Item 3. <u>Defaults Upon Senior Securities</u>	20
Item 4. <u>Mine Safety Disclosures</u>	20
Item 5. <u>Other Information</u>	20
Item 6. <u>Exhibits</u>	21
<u>Exhibit Index</u>	22

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

DORMAN PRODUCTS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(UNAUDITED)

(in thousands, except per share data)	Thirteen Weeks Ended	
	September 2018	September 30, 2017
Net sales	\$247,954	\$ 224,615
Cost of goods sold	152,957	136,489
Gross profit	94,997	88,126
Selling, general and administrative expenses	51,264	45,336
Income from operations	43,733	42,790
Other income, net	61	168
Income before income taxes	43,794	42,958
Provision for income taxes	9,777	15,950
Net income	\$34,017	\$ 27,008
Earnings Per Share:		
Basic	\$1.03	\$ 0.80
Diluted	\$1.03	\$ 0.80
Weighted Average Shares Outstanding:		
Basic	32,985	33,822
Diluted	33,095	33,909

See accompanying Notes to Consolidated Financial Statements

DORMAN PRODUCTS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(UNAUDITED)

(in thousands, except per share data)	Thirty-Nine Weeks Ended	
	September 30, 2018	September 30, 2017
Net sales	\$713,363	\$ 675,502
Cost of goods sold	437,029	407,781
Gross profit	276,334	267,721
Selling, general and administrative expenses	149,828	134,890
Income from operations	126,506	132,831
Other income, net	286	472
Income before income taxes	126,792	133,303
Provision for income taxes	27,789	48,671
Net income	\$99,003	\$ 84,632
Earnings Per Share:		
Basic	\$2.98	\$ 2.48
Diluted	\$2.98	\$ 2.47
Weighted Average Shares Outstanding:		
Basic	33,177	34,111
Diluted	33,267	34,202

See accompanying Notes to Consolidated Financial Statements

DORMAN PRODUCTS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

(in thousands, except for share data)	September 29, 2018	December 30, 2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 53,113	\$ 71,691
Accounts receivable, less allowance for doubtful accounts and customer credits of \$99,847 and \$97,193	301,049	241,880
Inventories	239,957	212,149
Prepays and other current assets	7,838	7,129
Total current assets	601,957	532,849
Property, plant and equipment, net	96,794	92,692
Goodwill	80,065	65,999
Intangible assets, net	20,707	22,158
Deferred tax asset, net	4,297	7,884
Other assets	45,242	44,342
Total	\$ 849,062	\$ 765,924
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable	\$ 97,937	\$ 80,218
Accrued compensation	11,859	12,162
Other accrued liabilities	18,063	18,401
Total current liabilities	127,859	110,781
Other long-term liabilities	13,840	13,732
Deferred tax liabilities, net	5,410	6,604
Commitments and contingencies		
Shareholders' Equity:		
Common stock, par value \$0.01; authorized 50,000,000 shares; issued and outstanding 33,139,997 and 33,571,524 in 2018 and 2017, respectively	331	336
Additional paid-in capital	47,314	44,812
Retained earnings	654,308	589,659
Total shareholders' equity	701,953	634,807
Total	\$ 849,062	\$ 765,924

See accompanying Notes to Consolidated Financial Statements

DORMAN PRODUCTS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

(in thousands)	Thirty-Nine Weeks Ended	
	September 30, 2018	September 30, 2017
Cash Flows from Operating Activities:		
Net income	\$99,003	\$ 84,632
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation, amortization and accretion	19,673	15,968
Provision for doubtful accounts	(586)	225
Provision (benefit) for deferred income taxes	3,584	(3,998)
Provision for non-cash stock compensation	3,129	2,282
Changes in assets and liabilities:		
Accounts receivable	(56,484)	(793)
Inventories	(16,146)	(30,990)
Prepays and other current assets	(2,071)	(1,232)
Other assets	(261)	(5,644)
Accounts payable	15,262	310
Accrued compensation and other liabilities	110	(1,398)
Cash provided by operating activities	65,213	59,362
Cash Flows from Investing Activities:		
Acquisitions, net of cash acquired	(28,040)	(3,128)
Property, plant and equipment additions	(18,099)	(17,436)
Purchase of investments	-	(10,000)
Cash used in investing activities	(46,139)	(30,564)
Cash Flows from Financing Activities:		
Contingent consideration	(2,036)	-
Other stock related activity	(364)	(997)
Purchase and cancellation of common stock	(35,224)	(60,133)
Cash used in financing activities	(37,624)	(61,130)
Effect of exchange rate changes on Cash and Cash Equivalents	(28)	-
Net Decrease in Cash and Cash Equivalents	(18,578)	(32,332)
Cash and Cash Equivalents, Beginning of Period	71,691	149,121
Cash and Cash Equivalents, End of Period	\$53,113	\$ 116,789
Supplemental Cash Flow Information		
Cash paid for interest expense	\$191	\$ 218
Cash paid for income taxes	\$21,722	\$ 55,713

See accompanying Notes to Consolidated Financial Statements

DORMAN PRODUCTS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE THIRTY-NINE WEEKS ENDED SEPTEMBER 29, 2018 AND SEPTEMBER 30, 2017

(UNAUDITED)

1. Basis of Presentation

As used herein, unless the context otherwise requires, “Dorman”, the “Company”, “we”, “us”, or “our” refers to Dorman Products, Inc. and its subsidiaries. Our ticker symbol on the NASDAQ Global Select Market is “DORM”.

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the U.S. for interim financial information and in accordance with the rules and regulations of the U.S. Securities and Exchange Commission (“SEC”). However, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of only normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the thirty-nine weeks ended September 29, 2018 are not necessarily indicative of the results that may be expected for the fiscal year ending December 29, 2018. We may experience significant fluctuations from quarter to quarter in our results of operations due to the timing of orders placed by our customers. The introduction of new products and product lines to customers may cause significant fluctuations from quarter to quarter. These financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto included in our Annual Report on Form 10-K for the fiscal year ended December 30, 2017.

2. Business Acquisitions and Investments

On August 31, 2018, we acquired 100% of the outstanding stock of Flight Systems Automotive Group LLC (“Flight Systems” or “Flight”), a privately-held manufacturer and remanufacturer of complex automotive electronics and diesel fuel system components, based in Lewisberry, Pennsylvania. We paid \$27.5 million in cash which is subject to customary purchase price adjustments. In connection with this acquisition, we preliminary recorded \$13.3 million in goodwill and \$14.2 million of other net assets, primarily \$2.0 million of accounts receivables, \$11.6 million of inventory, and \$0.6 million of net other assets and liabilities. We expect that, upon completion of our valuation, we will recognize intangible assets with an offsetting reduction in the preliminary goodwill that was recognized as of September 29, 2018. The purchase price allocation is preliminary and subject to adjustment as we complete our assessment of the fair values of acquired assets and assumed liabilities. We believe that the goodwill and intangible assets resulting from the acquisition will be deductible for tax purposes. The financial results of the acquisition have been included in the Consolidated Financial Statements since the date of acquisition. Flight generated \$1.7 million of net sales and an immaterial amount of net income since the date of acquisition. We believe complex electronics and diesel fuel system components represent important growth opportunities for us and Flight’s product portfolio delivers valuable alternatives to aftermarket professionals.

On October 26, 2017, we acquired 100% of the outstanding stock of MAS Automotive Distribution Inc. (“MAS Industries” or “MAS”), a privately-held manufacturer of premium chassis and control arms based in Montreal, Canada. The purchase price was \$67.2 million net of \$3.3 million of cash acquired and including contingent consideration at fair value and other purchase price adjustments.

We believe MAS is complementary to our business and growth strategy. We see opportunities to leverage MAS’ existing presence in the automotive aftermarket, as well as our product development capabilities and financial resources to accelerate the growth of MAS’ premium chassis and control arm products.

Edgar Filing: Dorman Products, Inc. - Form 10-Q

We have included the results of MAS in our Consolidated Financial Statements since the acquisition date of October 26, 2017. The Consolidated Statement of Operations for the thirty-nine weeks ended September 29, 2018 includes \$30.0 million of net sales and an immaterial amount of net income related to MAS. The Consolidated Balance Sheets as of September 29, 2018 and December 30, 2017 reflects the acquisition of MAS Industries, effective October 26, 2017.

The following table summarizes the fair value of the total consideration related to MAS:

(in thousands)	Total Acquisition Date Fair Value
Cash consideration (net of \$3.3 million cash acquired)	\$ 56,859
Contingent cash consideration	7,982
Seller liability assumed	896
Working capital adjustment	1,486
Total consideration assigned to net assets acquired	\$ 67,223

Included in the table above is \$8.0 million of estimated contingent payments which represents the fair value of the estimated payments which will become due if certain sales thresholds are achieved through December 2020. The fair value of the contingent cash consideration was estimated by using an option pricing model framework, which represents our own assumptions and data, and is based on our best available information. As of September 29, 2018, we had \$8.2 million recorded which includes \$0.2 million of accretion which was included in Selling, General and Administrative expenses for the thirty-nine weeks ended September 29, 2018, related to this payment. The maximum contingent payment would be \$11.7 million. Additionally, during the thirty-nine weeks ended September 29, 2018, we finalized working capital and other

Edgar Filing: Dorman Products, Inc. - Form 10-Q

purchase price adjustments based on the MAS standalone audited 2017 financial statements, resulting in a payment to the former shareholder of \$1.5 million. This amount had previously been accrued on our Consolidated Balance Sheet.

The transaction was accounted for as a business combination under the acquisition method of accounting. Accordingly, the assets acquired and liabilities assumed were recorded at fair value, with the remaining purchase price recorded as goodwill. The following table summarizes the fair values of the assets acquired and liabilities assumed as of October 26, 2017:

	October 26, 2017	Measurement period adjustments	October 26, 2017 (As adjusted)
(in thousands)	(As initially reported)		
Current assets (net of \$3.3 million cash acquired)	\$ 21,756	\$ 90	\$ 21,846
Property, plant and equipment	1,615	-	1,615
Intangible assets	20,440	-	20,440
Goodwill	35,624	(193)	35,431
Total assets acquired	79,435	(103)	79,332
Current liabilities	5,691	(50)	5,641
Long-term liabilities	6,468	-	6,468
Total liabilities assumed	12,159	(50)	12,109
Net assets acquired	\$ 67,276	\$ (53)	\$ 67,223

Our measurement period adjustments for MAS were complete as of September 29, 2018.

The valuation of the intangible assets acquired and related amortization periods are as follows:

(in thousands)	Valuation	Amortization Period (in years)
Customer relationships	\$ 14,840	8-12
Tradenames	5,600	15
Total	\$ 20,440	

The fair values of the Customer Relationships and Tradenames were estimated using a discounted present value income approach. Under this method, an intangible asset's fair value is equal to the present value of the incremental after-tax cash flows (excess earnings) attributable solely to the intangible asset over its remaining useful life. To calculate fair value, we used cash flows discounted at rates ranging from 15% to 17%, which were considered appropriate given the inherent risk associated with each type of asset. We believe that the level and timing of cash flows appropriately reflect market participant assumptions.

The goodwill recognized is attributable primarily to strategic and synergistic opportunities related to existing automotive aftermarket businesses, the assembled workforce of MAS and other factors. The goodwill is expected to be deductible for tax purposes.

Pro Forma Financial Information (Unaudited)

The unaudited pro forma information for the periods set forth below give effect to the MAS acquisition as if it occurred as of December 27, 2015, the start of our 2016 fiscal year. The pro forma information is presented for informational purposes only and is not necessarily indicative of the results of the operations that actually would have

been achieved had the acquisition been consummated as of that time:

(in thousands)	Thirty-Nine Weeks Ended September 30, 2017
Net sales	\$ 702,811
Net income	\$ 85,307
Diluted earnings per share	\$ 2.49

The unaudited pro forma net income for the thirty-nine weeks ended September 30, 2017 was adjusted to include amortization of intangible assets, accretion for contingent consideration liabilities and to exclude financing costs of MAS which we do not believe would have occurred.

3. Sales of Accounts Receivable

We have entered into several customer sponsored programs administered by unrelated financial institutions that permit us to sell certain accounts receivable at discounted rates to the financial institutions. Transactions under these agreements were accounted for as sales of accounts receivable and were removed from our Consolidated Balance Sheet at the time of the sales transactions. Pursuant to these agreements, we sold \$438.6 million and \$442.5 million of accounts receivable during the thirty-nine weeks ended September 29, 2018 and September 30, 2017, respectively. If receivables had not been sold, \$333.6 million and \$380.8 million of additional accounts receivable would have been outstanding at September 29, 2018 and December 30, 2017, respectively, based on standard payment terms. Selling, general and administrative expenses for the thirty-nine weeks ended September 29, 2018 and September 30, 2017 included \$10.0 million and \$8.4 million, respectively, in financing costs associated with these accounts receivable sales programs.

4. Inventories

Inventories include the cost of material, freight, direct labor and overhead utilized in the processing of our products, and are stated at the lower of cost or net realizable value. Inventories were as follows:

	September 29, December 30,	
(in thousands)	2018	2017
Bulk product	\$ 93,142	\$ 82,010
Finished product	143,118	126,827
Packaging materials	3,697	3,312
Total	\$ 239,957	\$ 212,149

5. Goodwill and Intangible Assets

Goodwill

Goodwill included the following:

	September 29, December 30,	
(in thousands)	2018	2017
Balance at beginning of period	\$ 65,999	\$ 28,146
Goodwill acquired	14,368	37,853
Measurement period adjustments	(302)	-
Balance at end of period	\$ 80,065	\$ 65,999

Intangible Assets

Intangible assets included the following:

(in thousands)	Weighted Average Amortization Period	September 29, 2018			December 30, 2017		
		Gross Carrying Value	Accumulated Amortization	Net Carrying Value	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
Intangible assets subject to amortization							
Tradenames	14.1	\$5,600	\$ 373	\$5,227	\$5,600	\$ 62	\$5,538
Customer relationships	9.5	17,049	1,893	15,156	17,049	772	16,277
Technology	13.3	367	43	324	367	24	343
Total		\$23,016	\$ 2,309	\$20,707	\$23,016	\$ 858	\$22,158

Amortization expense was \$1.6 million and less than \$0.1 million for the thirty-nine weeks ended September 29, 2018 and September 30, 2017, respectively.

6. Revenue Recognition

The FASB issued an accounting standard update in May 2014 regarding the accounting for and disclosure of revenue. Specifically, the update outlined a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers, which is common to both U.S. GAAP and International Financial Reporting Standards.

Our primary source of revenue is from contracts with and purchase orders from customers. Revenue is recognized from product sales when goods are shipped, title and risk of loss and control have been transferred to the customer, and collection is reasonably assured. We estimate the transaction price at the inception of a contract or upon fulfilling a purchase order, including any variable consideration, and will update the estimate for changes in circumstances. We utilize the most likely amount method consistently to estimate the effect of uncertainty on the amount of variable consideration to which we would be entitled. The most likely amount method considers the single most likely amount from a range of possible consideration amounts. This method is utilized for all of our variable consideration.

We record estimates for cash discounts, product returns, promotional rebates, core return deposits and other discounts in the period the related product revenue is recognized ("Customer Credits"). The provision for Customer Credits is recorded as a reduction from gross sales and reserves for Customer Credits are shown as a reduction of accounts receivable. Accrued customer rebates which we expect to settle in cash are classified as other accrued liabilities. Actual Customer Credits have not differed materially from estimated amounts for each period presented. Amounts billed to customers for shipping and handling are included in net sales. Costs associated with shipping and handling are included in cost of goods sold. We have concluded that our estimates of variable consideration are not constrained according to the definition of the new standard.

All of our revenue was recognized under the point of time approach in accordance with the revenue standard during the thirty-nine weeks ended September 29, 2018 and September 30, 2017, respectively. Also, we do not have significant financing arrangements with our customers, as our credit terms are all less than one year. Lastly, we do not receive noncash consideration (such as materials or equipment) from our customers to facilitate the fulfillment of our contracts.

Five-step model

We apply the FASB's guidance on revenue recognition, which requires us to recognize the amount of revenue and consideration which we expect to receive in exchange for goods or services transferred to our customers. To do this, we apply the five-step model prescribed by the FASB, which requires us to: (i) identify the contract with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when, or as, we satisfy a performance obligation.

Contract Assets and Liabilities

We recognize a receivable or contract asset when we perform a service or transfer a good in advance of receiving consideration.

- A receivable is recorded when our right to consideration is unconditional and only the passage of time is required before payment of that consideration is due.

- A contract asset is recorded when our right to consideration in exchange for goods or services that we have transferred to a customer is conditional on something other than the passage of time. We did not have any contract assets recorded as of September 29, 2018 or December 30, 2017.

We recognize a contract liability when we receive consideration, or if we have the unconditional right to receive consideration, in advance of satisfying the performance obligation. A contract liability is our obligation to transfer goods or services to a customer for which we have received consideration, or an amount of consideration is due from the customer. We did not have any contract liabilities recorded as of September 29, 2018 or December 30, 2017.

Disaggregated Revenue

The following tables present our disaggregated net sales by Type of Major Good / Product Line, and Geography.

(in thousands)	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Powertrain	\$ 100,994	\$ 94,177	\$ 295,363	\$ 284,393
Chassis	69,214	57,281	206,483	173,498
Automotive Body	67,000	62,791	179,539	185,804
Hardware	10,746	10,366	31,978	31,807
Net Sales	\$ 247,954	\$ 224,615	\$ 713,363	\$ 675,502

(in thousands)	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Net Sales to U.S. Customers	\$ 229,761	\$ 210,347	\$ 663,212	\$ 634,422
Net Sales to Non-U.S. Customers	18,193	14,268	50,151	41,080
Net Sales	\$ 247,954	\$ 224,615	\$ 713,363	\$ 675,502

7. Stock-Based Compensation

On May 16, 2018, our shareholders approved our 2018 Stock Option and Stock Incentive Plan (the “2018 Plan” or the “Plan”), which supersedes our 2008 Stock Option and Stock Incentive Plan. All future stock compensation grants will be issued under the 2018 Plan. Under the terms of the Plan, our Board of Directors may grant up to 1,200,000 shares of common stock in the form of shares of restricted stock, restricted stock units, stock appreciation rights and stock options or combinations thereof to officers, directors, employees, important consultants and advisors. Grants under the Plan must be made within ten years of the date the Plan was approved. Stock options are exercisable upon the terms set forth in each grant agreement approved by the Board of Directors, but in no event more than ten years from the date of grant. Restricted stock and restricted stock units vest in accordance with the terms set forth in each applicable award agreement approved by our Board of Directors. At September 29, 2018, 1,184,305 shares were available for grant under the 2018 Plan.

Restricted Stock

We grant restricted stock to certain employees and members of our Board of Directors. The value of restricted stock issued is based on the fair value of our common stock on the grant date. Vesting of restricted stock is conditional based on continued employment or service for a specified period and, in certain circumstances, the attainment of financial goals. We retain the restricted stock, and any dividends paid thereon, until the vesting conditions have been met. For awards with a service condition only, compensation cost related to the stock is recognized on a

Edgar Filing: Dorman Products, Inc. - Form 10-Q

straight-line basis over the vesting period. For awards that have a service condition and require the attainment of financial goals, compensation cost related to the stock is calculated based upon the probable outcome of the performance conditions on the date of grant and is recognized over the performance period. Compensation cost related to restricted stock was \$2.5 million and \$2.1 million for the thirty-nine weeks ended September 29, 2018 and September 30, 2017, respectively.

The following table summarizes our restricted stock activity for the thirty-nine weeks ended September 29, 2018:

	Shares	Weighted Average Price
Balance at December 30, 2017	153,727	\$ 59.96
Granted	80,872	\$ 72.19
Vested	(38,631)	\$ 61.07
Cancelled	(6,237)	\$ 75.59
Balance at September 29, 2018	189,731	\$ 64.43

As of September 29, 2018, there was \$5.2 million of unrecognized compensation cost related to nonvested restricted stock, which is expected to be recognized over a weighted-average period of approximately 2.3 years.

Cash flows resulting from tax deductions in excess of the tax effect of compensation cost recognized in the financial statements are classified as operating cash flows. The excess tax benefit generated from restricted shares which vested in the thirty-nine weeks ended September 29, 2018 was less than \$0.1 million and was credited to income tax expense. The excess tax benefit generated from restricted shares which vested in the thirty-nine weeks ended September 30, 2017 was \$0.3 million and was credited to income tax expense.

Stock Options

We grant stock options to certain employees. We expense the grant-date fair value of stock options. Compensation cost is recognized on a straight-line basis over the vesting period for which related services are performed. The compensation cost charged against income was \$0.4 million and \$0.2 million for the thirty-nine weeks ended September 29, 2018 and September 30, 2017, respectively. The compensation costs were classified as Selling, general and administrative expense in the Consolidated Statements of Income. No cost was capitalized during the thirty-nine weeks ended September 29, 2018 and September 30, 2017.

We use the Black-Scholes option valuation model to estimate the fair value of stock options granted. Expected volatility and expected dividend yield are based on the actual historical experience of our common stock. The expected life represents the period of time that options granted are expected to be outstanding and was calculated using historical option exercise data. The risk-free rate was based on a U.S. Treasury security with terms equal to the expected time of exercise as of the grant date. During the thirty-nine weeks ended September 29, 2018 and September 30, 2017 we granted 69,014 and 58,024 stock options, respectively.

The following table summarizes our stock option activity for the thirty-nine weeks ended September 29, 2018:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Term (In years)	Aggregate Intrinsic Value
Balance at December 30, 2017	122,547	\$ 57.74		
Granted	69,014	\$ 72.32		
Exercised	(4,000)	\$ 5.67		
Balance at September 29, 2018	187,561	\$ 64.21	3.7	\$2,490,355
Options exercisable at September 29, 2018	47,079	\$ 51.55	2.6	\$1,220,858

Edgar Filing: Dorman Products, Inc. - Form 10-Q

There were 4,000 options exercised during the thirty-nine weeks ended September 29, 2018. There were 32,000 options exercised in the thirty-nine weeks ended September 30, 2017. As of September 29, 2018, there was \$1.6 million of unrecognized compensation cost related to non-vested stock options, which is expected to be recognized over a weighted-average period of 2.9 years.

There was no cash generated from stock option exercises in the thirty-nine weeks ended September 29, 2018. The cash received from stock option exercises was \$0.1 million in the thirty-nine weeks ended September 30, 2017.

There was no excess tax benefit generated from stock options exercised in the thirty-nine weeks ended September 29, 2018. There was \$0.6 million of excess tax benefit generated from stock option exercises in the thirty-nine weeks ended September 30, 2017 and was credited to income tax expense.

Employee Stock Purchase Plan

In May 2017, our shareholders' approved the Dorman Products, Inc. Employee Stock Purchase Plan (the "ESPP"), which makes available 1,000,000 shares of our common stock for sale to eligible employees. There were 7,382 shares purchased under this plan in the thirty-nine weeks ended September 29, 2018. During the thirty-nine weeks ended September 29, 2018, compensation cost under the Plan was \$0.2 million.

8. Earnings Per Share

Basic earnings per share is calculated by dividing our net income by the weighted average number of common shares outstanding during the period, excluding nonvested restricted stock which is considered to be contingently issuable. To calculate diluted earnings per share, common share equivalents are added to the weighted average number of common shares outstanding. Common share equivalents are calculated using the treasury stock method and are computed based on outstanding stock-based awards. Stock-based awards of 63,000 shares and 47,500 shares were excluded from the calculation of diluted earnings per share as of September 29, 2018 and September 30, 2017, respectively, as their effect would have been anti-dilutive.

The following table sets forth the computation of basic earnings per share and diluted earnings per share:

(in thousands, except per share data)	Thirteen Weeks Ended		Thirty-Nine Weeks	
	September 29, 2018	September 30, 2017	Ended September 29, 2018	Ended September 30, 2017
Numerator				
Net income	\$34,017	\$ 27,008	\$99,003	\$ 84,632
Denominator:				
Weighted average basic shares outstanding	32,985	33,822	33,177	34,111
Effect of stock-based compensation awards	110	87	90	91
Weighted average diluted shares outstanding	33,095	33,909	33,267	34,202
Earnings Per Share:				
Basic	\$1.03	\$ 0.80	\$2.98	\$ 2.48
Diluted	\$1.03	\$ 0.80	\$2.98	\$ 2.47

9. Common Stock Repurchases

We periodically repurchase, at the then current market price, and cancel common stock issued to the Dorman Products, Inc. 401(k) Retirement Plan and Trust (the "401(k) Plan"). Shares are generally purchased from the 401(k) Plan when participants sell units as permitted by the 401(k) Plan or elect to leave the 401(k) Plan upon retirement,

termination or other reasons. For the thirty-nine weeks ended September 29, 2018, we repurchased and cancelled 20,160 shares of common stock for \$1.5 million at an average price of \$73.35 per share. During the fifty-two weeks ended December 30, 2017, we repurchased and cancelled 19,110 shares of common stock for \$1.4 million at an average price of \$73.34 per share.

Our Board of Directors authorized a share repurchase program of up to \$250 million through December 31, 2018. Under this program, share repurchases may be made from time to time depending on market conditions, share price, share availability and other factors at our discretion. The share repurchase program does not obligate us to acquire any specific number of shares. For the thirty-nine weeks ended September 29, 2018, we repurchased and cancelled 486,487 shares of common stock for \$33.8 million at an average price of \$69.41 per share under this program. For the fifty-two weeks ended December 30, 2017, we repurchased and cancelled 1,006,365 shares of common stock for \$74.7 million at an average price of \$74.26 per share under this program.

10. Related-Party Transactions

We have a non-cancelable operating lease for our primary operating facility with a partnership in which Steven L. Berman, our Executive Chairman, and his family members, are partners. Based upon the terms of the lease, payments will be \$1.6 million in fiscal 2018 and were \$1.6 million in fiscal 2017. This lease will expire on December 31, 2022. In the opinion of our Audit Committee, the terms and rates of this lease are no less favorable than those which could have been obtained from an unaffiliated party when the lease was renewed during November 2016.

Additionally, we have a non-cancelable operating lease for our Canadian operating facility from a corporation of which an employee, who is also the former owner of MAS, and his family members are owners. Based upon the terms of the lease, payments will be \$0.5 million in fiscal 2018 and were \$0.1 million in fiscal 2017. This lease will expire on January 31, 2019.

We are a partner in a joint venture with one of our suppliers and own minority interests in two other suppliers. Each of these investments is accounted for according to the equity method. In June 2018 we acquired the remaining outstanding shares of a previously unconsolidated entity. The estimated fair value of the net assets acquired was less than our prior investment in the entity. As a result, we recorded an impairment charge of \$1.1 million which is included within Selling, General, and Administrative expenses in the Consolidated Statement of Income during the thirty-nine weeks ended September 29, 2018.

11. Income Taxes

At September 29, 2018, we had \$2.5 million of net unrecognized tax benefits, \$2.2 million of which would affect our effective tax rate if recognized. We recognize interest and penalties related to uncertain tax positions in income tax expense. As of September 29, 2018 we had approximately \$0.7 million of accrued interest and penalties related to uncertain tax positions.

We file income tax returns in the United States, Canada, India, and Mexico. All years before 2015 are closed for federal tax purposes. Tax years before 2013 are closed for the all states in which we file. We filed tax returns in Sweden through 2012 and all years prior to 2010 are closed. It is reasonably possible that audit settlements, the conclusion of current examinations or the expirations of the statute of limitations could impact the Company's unrecognized tax benefits.

On December 22, 2017, the Tax Cuts and Jobs Act (the "TCJA") was enacted. The TCJA includes a number of changes to existing U.S. tax laws that impact the Company, most notably a reduction of the U.S. corporate tax rate from 35% to 21%, for tax years beginning after December 31, 2017. The TCJA also provides for acceleration of depreciation for certain assets placed into service after September 27, 2017, as well as prospective changes beginning in 2018, including additional limitations on deductibility of executive compensation and employee meal benefits.

As permitted by SEC Staff Accounting Bulletin ("SAB No. 118"), the net tax expense recorded in our financial statements for the fourth fiscal quarter of 2017 due to the enactment of the TCJA is considered "provisional" based on reasonable estimates. The net tax expense recorded was \$4.4 million. We are continuing to collect and analyze detailed information that could impact this amount, and may record adjustments to refine those estimates during the measurement period defined in SAB No. 118, as additional analysis is completed. No adjustments to the provisional expense related to the enactment of the TCJA were recorded in the thirty-nine weeks ended September 29, 2018.

12. Fair Value Disclosures

The carrying value of financial instruments such as cash, accounts receivable, accounts payable, and other current assets and liabilities approximate their fair value based on the short-term nature of these instruments.

13. New and Recently Adopted Accounting Pronouncements

On December 31, 2017, the beginning of our 2018 fiscal year, we adopted ASU No. 2014-09, Revenue from Contracts with Customers, which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. Topic 606 is based on the principle that an entity should recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Topic 606 also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to fulfill a contract. We adopted the standard on December 31, 2017 using the modified retrospective transaction method and the adoption did not have a material effect on our financial position, results of operations and internal controls over financial reporting. See Note 6 for additional information on revenue recognition.

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments – Overall, which relates to the recognition and measurement of financial assets and liabilities. The new guidance makes targeted improvements to GAAP impacting equity investments (other than those accounted for under the equity method or consolidated), financial liabilities accounted for under the fair value election, and presentation and disclosure requirements for financial instruments, among other changes. The new guidance is effective for annual periods beginning after December 15, 2017, with early adoption prohibited other than for certain provisions. Adoption of this ASU did not have a material impact on our consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases, which replaces existing lease guidance. The ASU is intended to provide enhanced transparency and comparability by requiring lessees to record right-of-use assets and corresponding lease liabilities on the balance sheet. The new guidance will continue to classify leases as either finance or operating, with classification affecting the pattern of expense recognition in the statement of operations. Additionally, in August 2018, the FASB issued ASU 2018-11, Targeted Improvements to ASC 842,

which includes an option to not restate comparative periods in transition and elect to use the effective date of ASC 842 as the date of initial application of transition. The new guidance is effective for annual periods beginning after December 15, 2018, with early application permitted. The new standard is required to be applied with a modified retrospective approach. We are evaluating the effect that the new guidance will have on our consolidated financial statements and related disclosures, which includes adoption of practical expedients, review of lease agreements, review of services contracts and other supplier agreements for embedded leases and calculation of transition adjustments.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments, which clarifies and provides guidance on eight cash flow classification issues and is intended to reduce existing diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. ASU 2016-15 is effective for annual periods beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. Adoption of this ASU did not have a material impact on our consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Simplifying the Test for Goodwill Impairment, which eliminates the need to perform a hypothetical purchase price allocation to measure goodwill impairment. ASU 2017-04 is effective for annual periods beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. We are evaluating the new guidance, however, we do not believe the new guidance will have a material impact on our consolidated financial statements and related disclosures.

In June 2018, the FASB issued ASU 2018-07, Improvements to Nonemployee Share-Based Payment Accounting, which expands the scope of the current employee share-based payment guidance to include share-based payments issued to nonemployees to substantially aligns the accounting for share-based payments for nonemployees with those made to employees including, the fair value measurement, measurement date and classification of certain awards. The new guidance is effective for fiscal years beginning after December 15, 2018, with early application permitted. We are evaluating the new guidance, however, we do not believe the new guidance will have a material impact on our consolidated financial statements and related disclosures.

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Cautionary Statement Regarding Forward Looking Statements

Certain statements in this document constitute "forward-looking statements" within the meaning of the Federal Private Securities Litigation Reform Act of 1995. While forward-looking statements sometimes are presented with numerical specificity, they are based on various assumptions made by management regarding future circumstances over many of which the Company has little or no control. Forward-looking statements may be identified by words including "anticipate," "believe," "estimate," "expect," and similar expressions. The Company cautions readers that forward-looking statements, including, without limitation, those relating to future business prospects, revenues, working capital, liquidity, and income, are subject to certain risks and uncertainties that would cause actual results to differ materially from those indicated in the forward-looking statements. Factors that could cause actual results to differ from forward-looking statements include but are not limited to competition in the automotive aftermarket industry, unfavorable economic conditions, concentration of the Company's sales and accounts receivable among a small number of customers, the impact of consolidation in the automotive aftermarket industry, foreign currency fluctuations, loss of key suppliers, space limitations on our customer shelves, delay in the development and design of new products, improvements in new vehicle quality, claims of intellectual property infringement, quality problems, loss of third-party transportation providers, unfavorable results of legal proceedings, concentration of ownership, disruption from events beyond the Company's control, risks associated with conflict minerals, risks associated with cyber-attacks, the imposition of new taxes or duties, the termination or modification of accounts receivable sales agreements, common stock market price volatility, loss of highly qualified Contributors, inability to acquire other businesses or integrate acquisitions successfully, and other risks and factors identified from time to time in the reports the Company files with the SEC. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated or projected. For additional information concerning factors that could cause actual results to differ materially from the information contained in this report, reference is made to the information in "Part I, Item 1A Risk Factors." in the Company's Annual Report on Form 10-K for the fiscal year ended December 30, 2017. You should not place an undue reliance on forward-looking statements. Such statements speak only as to the date on which they are made, and we undertake no obligation to update publicly or revise any forward-looking statement, regardless of future developments or the availability of new information.

Introduction

The following discussion and analysis, as well as other sections in this Quarterly Report on Form 10-Q, should be read in conjunction with the unaudited consolidated financial statements and footnotes thereto of Dorman Products, Inc. and its subsidiaries included in "Item 1. Financial Statements" of this Quarterly Report on Form 10-Q and with Management's Discussion and Analysis of Financial Condition and Results of Operations and the audited consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 30, 2017.

Overview

We believe we are a leading supplier of replacement parts and fasteners for passenger cars, light trucks, and heavy duty trucks in the automotive aftermarket. We distribute and market approximately 216,000 different SKU's of automotive replacement parts, many of which we design and engineer. These SKU's are sold under our various brand names, under our customers' private label brands or in bulk. We believe we are a leading aftermarket supplier of original equipment "dealer exclusive" items. Original equipment "dealer exclusive" parts are those parts which were traditionally available to consumers only from original equipment manufacturers or salvage yards. These parts include, among other parts, intake manifolds, exhaust manifolds, window regulators, radiator fan assemblies, tire pressure monitor sensors, complex electronics modules, and exhaust gas recirculation (EGR) coolers.

We generate virtually all of our revenues from customers in the North American automotive aftermarket, primarily in the United States. Our products are sold primarily through automotive aftermarket retailers; national, regional and local warehouse distributors and specialty markets; and salvage yards. We also distribute automotive replacement parts outside the United States, with sales primarily into Canada, Mexico, Europe, the Middle East, and Australia.

We may experience significant fluctuations from quarter to quarter in our results of operations due to the timing of orders placed by our customers. Generally, the second and third quarters have the highest level of net sales. The introduction of new products and product lines to customers may cause significant fluctuations from quarter to quarter.

We operate on a fifty-two, fifty-three week period ended on the last Saturday of the calendar year. Our 2018 fiscal year will be a fifty-two week period that will end on December 29, 2018. The fiscal year ended December 30, 2017 was a fifty-two week period.

New Product Development

New product development is a critical success factor for us and is our primary vehicle for growth. We have made incremental investments to increase our new product development efforts each year since 2003 in an effort to grow our business and strengthen our relationships with our customers. The investments are primarily in the form of increased product development resources, increased customer and end-user awareness programs and customer service improvements. These investments have enabled us to provide an expanding array of new product offerings and grow revenues at levels that exceed market growth rates. As a result of these investments, we introduced 4,980 new products to our customers and end users in the thirty-nine weeks ended September 29, 2018, including 1,244 “New to the Aftermarket” SKU’s. We introduced 4,079 new products to our customers and end users in the fiscal year ended December 30, 2017, including 1,192 “New to the Aftermarket” SKU’s.

Our complex electronics program capitalizes on the growing number of electronic components being utilized on today’s Original Equipment platforms. Current production models contain an average of approximately thirty-five electronic modules, with some high-end luxury vehicles containing over one hundred modules. Our complex electronics products are designed and developed in house and extensively tested to ensure consistent performance, and, our product portfolio is focused on further developing Dorman’s leadership position in the category.

In 2012, we introduced Dorman Heavy Duty Solutions, a line of products to be marketed for the medium and heavy duty truck aftermarket. We believe that this market provides many of the same opportunities for growth that the automotive aftermarket has provided us over the past several years. Our focus here is on formerly “dealer only” parts similar to the automotive side of the business. We launched the initial program with a limited offering, but have made additional investments in new product development efforts to expand our product offering. We currently have approximately 1,191 SKU’s in this product line. We will continue to invest aggressively in the medium and heavy duty product line.

Acquisitions

Our growth is also impacted by acquisitions. For example, in August of 2018, we acquired Flight Systems Automotive Group LLC (“Flight Systems” or “Flight”). Additionally, in October 2017, we acquired MAS Automotive Distributors, Inc. (“MAS Industries” or “MAS”). We believe Flight and MAS are highly complementary to our business and growth strategy. We may acquire businesses in the future to supplement our financial growth, distribution capabilities, or product development resources.

Economic Factors

Vehicle owners operate their current vehicles longer than they did several years ago. As a result, owners perform necessary repairs and maintenance in order to keep those vehicles well maintained. According to data published by Polk, a division of IHS Automotive, the average age of vehicles was 11.7 years as of January 2017, which is an increase from 11.6 years as of November 2016 despite increasing new car sales. Additionally, the number of vehicles in operation in the United States continues to increase, growing 2.4% in 2017 to 278.6 million from 272.0 million in 2016. Approximately 48% of vehicles in operation are 11 years old or older. Vehicle scrappage rates have also decreased over the last several years. The number of miles driven is another important statistic that impacts our business. According to the United States Department of Transportation, the number of miles driven has increased each year since 2011 with miles driven having increased 1.3% as of December 2017 as compared to December 2016. Generally, as vehicles are driven more miles, the more likely it is that parts will fail. The combination of the factors above has accounted for a portion of our sales growth.

Competition among our customer base continues to increase. As a result, our customers regularly seek more favorable pricing and product return provisions, and extended payment terms when negotiating with us. We attempt to avoid or minimize these concessions as much as possible, but we have granted pricing concessions, extended customer payment terms and allowed a higher level of product returns in certain cases. These concessions impact our profit levels and may require additional capital to finance the business. We expect our customers to continue to exert pressure on our margins.

Effective September 24th, the Office of the United States Trade Representative (USTR) imposed an additional tariff on approximately \$200 billion worth of Chinese imports. The tariff will be approximately 10% until December 31, 2018 and will increase to 25% effective January 1, 2019. The tariffs enacted to date will increase the cost of many products that are manufactured for Dorman in China. We are taking several actions to fully mitigate the impact of the tariffs including, but not limited to, price increases to our customers and cost concessions from our suppliers. We do not anticipate that the tariffs will materially impact gross profit in the fourth quarter of 2018. Although we expect to mitigate the impact of tariffs in fiscal 2019, we expect selling price increases associated with the tariffs to be fully offset by the higher tariffs incurred.

Foreign Currency

Our recent acquisition of MAS increases our exposures to foreign currencies. MAS is headquartered in Montreal, Canada, and its financial transactions occur in both U.S. Dollars and Canadian Dollars. Since our consolidated financial statements are denominated in U.S. Dollars, the assets, liabilities, net sales, and expenses of MAS which are

denominated in currencies other than the U.S. Dollar must be converted into U.S. Dollars using exchange rates for the current period. As a result, fluctuations in foreign currency exchange rates may impact our financial results.

In fiscal 2017, approximately 71% of our products were purchased from suppliers in a variety of foreign countries. The products generally are purchased through purchase orders with the purchase price specified in U.S. Dollars. Accordingly, we generally do not have exposure to fluctuations in the relationship between the U.S. Dollar and various foreign currencies between the time of execution of the purchase order and payment for the product. To the extent that the U.S. Dollar changes in value relative to foreign currencies in the future, the price of the product for new purchase orders may change in equivalent U.S. Dollars.

The largest portion of our overseas purchases comes from China. The Chinese Yuan to U.S. Dollar exchange rate has fluctuated over the past several years. Any future changes in the value of the Chinese Yuan relative to the U.S. Dollar may result in a change in the cost of products that we purchase from China. However, the cost of the products we procure is also affected by other factors including raw material availability, labor cost, transportation costs, and other factors.

Impact of Inflation

The overall impact of inflation has not resulted in a significant change in labor costs or the cost of general services utilized.

The cost of many commodities that are used in our products has fluctuated over time resulting in increases and decreases in the cost of our products. In addition, we have periodically experienced increased transportation costs as a result of higher fuel prices, capacity constraints, and other factors. We will attempt to offset cost increases by passing along selling price increases to customers, using alternative suppliers and by sourcing purchases from other countries. However there can be no assurance that we will be successful in these efforts.

Results of Operations

The following table sets forth, for the periods indicated, the percentage of net sales represented by certain items in our Consolidated Statements of Income:

(in millions)	Thirteen Weeks Ended*				Thirty-Nine Weeks Ended*			
	September 29, 2018		September 30, 2017		September 29, 2018		September 30, 2017	
Net sales	\$248.0	100.0%	\$224.6	100.0%	\$713.4	100.0%	\$675.5	100.0%
Cost of goods sold	\$153.0	61.7 %	\$136.5	60.8 %	\$437.0	61.3 %	\$407.8	60.4 %
Gross profit	\$95.0	38.3 %	\$88.1	39.2 %	\$276.3	38.7 %	\$267.7	39.6 %
Selling, general and administrative expenses	\$51.3	20.7 %	\$45.3	20.2 %	\$149.8	21.0 %	\$134.9	19.9 %
Income from operations	\$43.7	17.6 %	\$42.8	19.1 %	\$126.5	17.7 %	\$132.8	19.7 %
Interest income, net	\$0.1	0.0 %	\$0.2	0.1 %	\$0.3	0.0 %	\$0.5	0.0 %
Income before income taxes	\$43.8	17.7 %	\$43.0	19.1 %	\$126.8	17.8 %	\$133.3	19.7 %
Provision for income taxes	\$9.8	3.9 %	\$16.0	7.1 %	\$27.8	3.9 %	\$48.7	7.2 %
Net income	\$34.0	13.7 %	\$27.0	12.0 %	\$99.0	13.9 %	\$84.6	12.5 %

* Information in table does not add due to rounding

Thirteen Weeks Ended September 29, 2018 Compared to Thirteen Weeks Ended September 30, 2017

Net sales increased 10% to \$248.0 million for the thirteen weeks ended September 29, 2018 from \$224.6 million for the thirteen weeks ended September 30, 2017. The increase in net sales is due to increased demand for our products, approximately \$10 million of net sales attributed to MAS and approximately \$1.7 million of sales attributed to Flight.

Gross profit margin was 38.3% of net sales for the thirteen weeks ended September 29, 2018 compared to 39.2% of net sales for the thirteen weeks ended September 30, 2017. The decrease in gross profit margin was primarily a result of the impact of acquisitions which carry lower gross margins compared to historical levels.

Selling, general and administrative expenses were \$51.3 million for the thirteen weeks ended September 29, 2018 compared to \$45.3 million for the thirteen weeks ended September 30, 2017. The increase in expense during the thirteen weeks ended September 29, 2018 was primarily due to the inclusion of the expenses of acquired operations, the reinvestment of tax savings in our product development and sales organizations, increased wage and benefit costs, and increase costs associated with our accounts receivable sales program.

Our effective tax rate was 22.3% for the thirteen weeks ended September 29, 2018 compared to 37.1% for the thirteen weeks ended September 30, 2017. The effective tax rate decreased primarily due to the Tax Cuts and Jobs Act enacted in the United States in December 2017, which lowered the U.S Corporate federal income tax rate to 21% beginning in 2018.

Thirty-Nine Weeks Ended September 29, 2018 Compared to Thirty-Nine Weeks Ended September 30, 2017

Net sales increased 6% to \$713.4 million for the thirty-nine weeks ended September 29, 2018 from \$675.5 million for the thirty-nine weeks ended September 30, 2017. The increase in net sales is primarily due to approximately \$30.0 million of net sales attributed to MAS and increased demand for our products, which was partially offset by the negative effects of a brand protection policy implemented in the fourth fiscal quarter of 2017.

Gross profit margin was 38.7% of net sales for the thirty-nine weeks ended September 29, 2018 compared to 39.6% of net sales for the thirty-nine weeks ended September 30, 2017. The decrease in gross profit margin was primarily

attributable to lower overall selling prices, a \$1.8 million inventory fair value adjustment resulting from the MAS acquisition, the impact of acquisitions which carry lower gross margins compared to historical levels, and an unfavorable sales mix towards lower margin products.

Selling, general and administrative expenses were \$149.8 million for the thirty-nine weeks ended September 29, 2018 compared to \$134.9 million for the thirty-nine weeks ended September 30, 2017. The increase in expense during the thirty-nine weeks ended September 29, 2018 was primarily due to the inclusion of the expenses of acquired operations, reinvestment of tax savings in product development and other areas, an increase in wage and benefit costs, and a \$1.1 million non-cash impairment related to the acquisition of the remaining outstanding shares of a previously unconsolidated entity. In addition, accounts receivable sales costs increased \$1.6 million due to increased interest rates associated with the program.

Our effective tax rate was 21.9% for the thirty-nine weeks ended September 29, 2018 compared to 36.5% for the thirty-nine weeks ended September 30, 2017. The effective tax rate decreased primarily due to the Tax Cuts and Jobs Act enacted in the United States in December 2017, which lowered the U.S Corporate federal income tax rate to 21% beginning in 2018.

Liquidity and Capital Resources

Historically, our primary sources of liquidity have been our invested cash and the cash flow we generate from our operations, including accounts receivable sales programs provided by our customers. Cash and cash equivalents at September 29, 2018 decreased to \$53.1 million from \$71.7 million at December 30, 2017. Working capital was \$474.1 million at September 29, 2018 compared to \$422.1 million at December 30, 2017. Shareholders' equity was \$702.0 million at September 29, 2018 and \$634.8 million at December 30, 2017. Based on our current operating plan, we believe that our sources of available capital are adequate to meet our ongoing cash needs for at least the next twelve months. However, our liquidity could be negatively affected by extending payment terms to customers, a decrease in demand for our products, or other factors.

Over the past several years we have continued to extend payment terms to certain customers as a result of customer requests and market demands. These extended terms have resulted in increased accounts receivable levels and significant uses of cash flows. We participate in

Edgar Filing: Dorman Products, Inc. - Form 10-Q

accounts receivable sales programs with several customers which allow us to sell our accounts receivable to financial institutions to offset the negative cash flow impact of these payment terms extensions. During the thirty-nine weeks ended September 29, 2018 and September 30, 2017, we sold approximately \$438.6 million and \$442.5 million, respectively, under these programs. We had the ability to sell significantly more accounts receivable under these programs if the needs of the business warranted. Further extensions of customer payment terms will result in additional uses of cash flow or increased costs associated with the sales of accounts receivable.

In December 2017, we entered into a credit agreement which will expire in December 2022. This agreement provides for an initial revolving credit facility of \$100.0 million and gives us the ability to request increases of up to an incremental \$100.0 million. Borrowings under the facility are on an unsecured basis with interest rates ranging from LIBOR plus 65 basis points to LIBOR plus 125 basis points based upon the ratio of consolidated funded debt to consolidated EBITDA, as defined by the credit agreement. The interest rate at September 29, 2018 was LIBOR plus 65 basis points (2.91%). The credit agreement also contains other covenants, including those related to the ratio of certain consolidated fixed charges to consolidated EBITDA, capital expenditures, and share repurchases, each as defined by the credit agreement. The credit agreement also requires us to pay an unused fee of 0.10% on the average daily unused portion of the facility. As of September 29, 2018, there were no borrowings under the facility and we had two outstanding letters of credit for approximately \$0.8 million in the aggregate which were issued to secure ordinary course of business transactions. Net of these letters of credit, we had approximately \$99.2 million available under the facility at September 29, 2018.

Cash Flows

The following summarizes the activities included in the Consolidated Statements of Cash Flows:

(in thousands)	Thirty-Nine Weeks Ended	
	September 29, 2018	September 30, 2017
Cash provided by operating activities	\$65,213	\$ 59,362
Cash used in investing activities	(46,139)	(30,564)
Cash used in financing activities	(37,624)	(61,130)
Net decrease in cash and cash equivalents	\$(18,550)	\$ (32,332)

During the thirty-nine weeks ended September 29, 2018, cash provided by operating activities was \$65.2 million primarily as a result of \$99.0 million in net income, non-cash adjustments to net income of \$25.8 million and a net increase in operating assets and liabilities of \$59.6 million. Compared to the Consolidated Balance Sheet at December 30, 2017 and including the impact of acquisitions, accounts receivable increased \$56.5 million due to the timing of cash receipts. Inventory increased \$16.1 million due to increased inventory purchases. Accounts payable increased \$15.3 million due to the timing of payments to our vendors. The change in prepaids, other assets, and accrued compensation and other liabilities was not material.

During the thirty-nine weeks ended September 30, 2017, cash provided by operating activities was \$59.4 million primarily as a result of \$84.6 million in net income, non-cash adjustments to net income of \$14.5 million and a net increase in operating assets and liabilities of \$39.7 million. Compared to the Consolidated Balance Sheet at December 31, 2016, inventory increased \$31.0 million due to higher inventory purchases to support new product launches and customer fill rates. Other assets and liabilities, net, increased by \$13.3 million primarily due to an increase in long-term core inventory and payments related to accrued income taxes and accrued compensation. The change in accounts receivable and accounts payable was not material.

Edgar Filing: Dorman Products, Inc. - Form 10-Q

Investing activities used \$46.1 million of cash in the thirty-nine weeks ended September 29, 2018 and \$30.6 million in the thirty-nine weeks ended September 30, 2017.

Capital spending in the thirty-nine weeks ended September 29, 2018 was primarily related to \$6.4 million in tooling associated with new products and \$4.2 million in enhancements and upgrades to our information systems.

Capital spending in the thirty-nine weeks ended September 30, 2017 was primarily related to \$7.8 million in tooling associated with new products and \$5.8 million in enhancements and upgrades to our information systems.

During the thirty-nine weeks ended September 29, 2018, we used \$27.5 million to acquire all of the outstanding equity of Flight Systems Automotive Group.

Additionally, during the thirty-nine weeks ended September 30, 2017, we used \$3.1 million to acquire certain assets of Ingalls Engineering Co., Inc. and \$10.0 million to acquire a minority equity interest in a supplier.

The remaining capital spending in both periods resulted from scheduled equipment replacements, certain facility improvements and other capital projects.

Financing activities used \$37.6 million of cash in the thirty-nine weeks ended September 29, 2018 and \$61.1 million in the thirty-nine weeks ended September 30, 2017.

In the thirty-nine weeks ended September 29, 2018, we paid \$33.8 million to repurchase 486,487 common shares. In the thirty-nine weeks ended September 30, 2017, we paid \$59.0 million to repurchase 782,425 common shares.

The remaining uses of cash from financing activities in each period result from payment of contingent consideration, stock compensation plan activity and the repurchase of common stock from our 401(k) Plan.

Edgar Filing: Dorman Products, Inc. - Form 10-Q

Based on our current operating plan, we believe that our sources of available capital are adequate to meet our ongoing cash needs for at least the next twelve months.

During the thirty-nine weeks ended September 29, 2018, we experienced no material changes to our contractual obligations as disclosed in our Annual Report on Form 10-K for the year ended December 30, 2017.

New and Recently Adopted Accounting Pronouncements

Please refer to Note 13, New and Recently Adopted Accounting Pronouncements, to the Notes to Consolidated Financial Statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our market risk is the potential loss arising from adverse changes in interest rates. Substantially all of our available credit and our accounts receivable sale programs bear interest at rates tied to LIBOR. Under the terms of our revolving credit facility and customer-sponsored programs to sell accounts receivable, a change in the lender's base rate, LIBOR or discount rates under our accounts receivable sale programs would affect the rate at which we could access funds thereunder. A one percentage point increase in LIBOR or the discount rates under the accounts receivable sales programs would increase our interest expense on our variable rate debt, if any, and our financing costs associated with our sales of accounts receivable by approximately \$3.3 million annually. This estimate assumes that our variable rate debt balance and the level of sales of accounts receivable remains constant for an annual period and the interest rate change occurs at the beginning of the period. The hypothetical changes and assumptions may be different from what actually occurs in the future.

We have not historically and do not intend to use derivative financial instruments for trading or to speculate on changes in interest rates or commodity prices. We are not exposed to any significant market risks, foreign currency exchange risk or interest rate risk from the use of derivative instruments.

Item 4. Controls and Procedures

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

We maintain disclosure controls and procedures designed to provide reasonable assurance that information required to be disclosed in reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosures.

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, conducted an evaluation, as of the end of the period covered by this report, of the effectiveness of our disclosure controls and procedures, as such term is defined in Exchange Act Rule 13a-15(e). Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures, as defined in Rule 13a-15(e), were effective at the reasonable assurance level.

Changes in Internal Control Over Financial Reporting

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, also conducted an evaluation of our internal control over financial reporting to determine whether any changes occurred during the quarter ended September 29, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Based on that evaluation, there was no such change during the quarter ended September 29, 2018.

Limitations on the Effectiveness of Controls

Control systems, no matter how well conceived and operated, are designed to provide a reasonable, but not an absolute, level of assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. The Company conducts periodic evaluations of its internal controls to enhance, where necessary, its procedures and controls.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We are a party to or otherwise involved in legal proceedings that arise in the ordinary course of business, such as various claims and legal actions involving contracts, competitive practices, intellectual property infringement, product liability claims and other matters arising out of the conduct of our business. In the opinion of management, none of the actions, individually or in the aggregate, would likely have a material financial impact on the Company and we believe the range of reasonably possible losses from current matters is immaterial.

Item 1A. Risk Factors

You should carefully consider the factors discussed in Part I, “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 30, 2017, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Issuer Purchases of Equity Securities

During the thirteen weeks ended September 29, 2018, we purchased shares of our common stock as follows:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Part of Publicly Announced Plans or Programs (2)	Maximum
				Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs (2)
July 1, 2018 through July 28, 2018	47,920	\$ 70.46	43,500	\$ 46,233,590
July 29, 2018 through August 25, 2018	31,893	\$ 77.19	29,448	\$ 43,966,427
August 26, 2018 through September 29, 2018	17,231	\$ 79.11	13,151	\$ 42,934,590
Total	97,044	\$ 74.21	86,099	\$ 42,934,590

(1) Includes 10,660 shares purchased from the Dorman Products, Inc. 401(k) Plan and Trust (as described in Note 9 to the Notes to Consolidated Financial Statements in this Quarterly Report on Form 10-Q). Also includes 285 shares of our common stock withheld from participants for income tax withholding purposes in connection with the vesting of restricted stock grants during the period. The restricted stock was issued to participants pursuant to our

2008 Stock Option and Incentive Plan.

(2) On December 12, 2013 we announced that our Board of Directors authorized a share repurchase program, authorizing the repurchase of up to \$10 million of our outstanding common stock by the end of 2014. Through several expansions and extensions, our Board of Directors expanded the program up to \$250 million and extended the program through December 31, 2018. Under this program, share repurchases may be made from time to time depending on market conditions, share price, share availability and other factors at our discretion. The share repurchase program does not obligate us to acquire any specific number of shares. We repurchased 486,487 shares under this program during the thirty-nine weeks ended September 29, 2018.

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not Applicable

Item 5. Other Information

None

20

Item 6. Exhibits

(a) Exhibits

The Exhibits included in this report are listed in the Exhibit Index on page 22, which is incorporated herein by reference.

EXHIBIT INDEX

- 31.1 Certification of Chief Executive Officer as required by Section 302 of the Sarbanes-Oxley Act of 2002 (filed with this report).
- 31.2 Certification of Chief Financial Officer as required by Section 302 of the Sarbanes-Oxley Act of 2002 (filed with this report).
- 32 Certification of Chief Executive and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished with this report).
- 101 The following financial statements from the Dorman Products, Inc. Quarterly Report on Form 10-Q as of and for the quarter ended September 29, 2018, formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Statements of Income; (ii) the Consolidated Balance Sheets; (iii) the Consolidated Statements of Cash Flows and (iv) the Notes to Consolidated Financial Statements.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dorman Products, Inc.

October 30, 2018

/s/ Mathias J. Barton
Mathias J. Barton
Chief Executive Officer
(principal executive officer)

October 30, 2018

/s/ Michael P. Ginnetti
Michael P. Ginnetti
Chief Financial Officer and
Corporate Controller
(principal financial and accounting officer)