

SPARTAN STORES INC
Form 10-Q
February 07, 2008

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

FORM 10-Q

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

For the quarterly period ended January 5, 2008.

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: 000-31127

SPARTAN STORES, INC.
(Exact Name of Registrant as Specified in Its Charter)

Michigan
(State or Other Jurisdiction
of Incorporation or Organization)

38-0593940
(I.R.S. Employer
Identification No.)

850 76th Street, S.W.
P.O. Box 8700
Grand Rapids, Michigan
(Address of Principal Executive Offices)

49518
(Zip Code)

(616) 878-2000

(Registrant's Telephone Number, Including Area Code)

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act).

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act)

Yes ☐ No ☒

As of January 29, 2008 the registrant had 21,905,617 outstanding shares of common stock, no par value.

FORWARD-LOOKING STATEMENTS

The matters discussed in this Quarterly Report on Form 10-Q, in our press releases and in our publicly accessible conference calls include "forward-looking statements" about the plans, strategies, objectives, goals or expectations of Spartan Stores, Inc. (together with its subsidiaries, "Spartan Stores"). These forward-looking statements are identifiable by words or phrases indicating that Spartan Stores or management "expects," "anticipates," "plans," "believes," "estimates," that a particular occurrence "may," "could," or "will likely" result or that a particular event "will," "may," "could," "should" or "will likely" occur or "continue" in the future, that the "outlook," "strategy," or "trend" is toward a particular result or occurrence, or similarly stated expectations. Accounting estimates, such as those described under the heading "Critical Accounting Policies" in Item 2 of this Form 10-Q, are inherently forward-looking. You should not place undue reliance on these forward-looking statements, which speak only as of the date of the Quarterly Report, release or statement.

In addition to other risks and uncertainties described in connection with the forward-looking statements contained in this Quarterly Report on Form 10-Q, Spartan Stores' Annual Report on Form 10-K for the year ended March 31, 2007 (in particular, you should refer to the discussion of "Risk Factors" in Item 1A of our Annual Report on Form 10-K) and other periodic reports filed with the Securities and Exchange Commission, there are many important factors that could cause actual results to differ materially. Our ability to maintain and strengthen our retail-store performance; assimilate acquired stores; maintain or grow sales; respond successfully to competitors; maintain or increase gross margin; anticipate and successfully respond to openings of competitors; maintain and improve customer and supplier relationships; realize expected benefits of new relationships; realize growth opportunities; expand our customer base; reduce operating costs; sell on favorable terms assets classified as held for sale; generate cash; continue to meet the terms of our debt covenants; continue to pay dividends; and, implement the other programs, plans, priorities, strategies, objectives, goals or expectations described in this Quarterly Report, our press releases and our public comments will be affected by changes in economic conditions generally or in the markets and geographic areas that we serve, adverse effects of the changing food and distribution industries and other factors including, but not limited to, those discussed below.

Anticipated future sales are subject to competitive pressures from many sources. Our Distribution and Retail businesses compete with many supercenters, warehouse discount stores, supermarkets, pharmacies and product manufacturers. Future sales will be dependent on the number of retail stores that we own and operate, our ability to retain and add to the retail stores to whom we distribute, competitive pressures in the retail industry generally and our geographic markets specifically and our ability to implement effective new marketing and merchandising programs. Competitive pressures in these and other business segments may result in unexpected reductions in sales volumes, product prices or service fees.

Our operating and administrative expenses, and as a result, our net earnings and cash flows, may be adversely affected by changes in costs associated with, among other factors: difficulties in the operation of our business segments; future business acquisitions; adverse effects on business relationships with independent retail grocery store customers; difficulties in the retention or hiring of employees; labor shortages, stoppages or disputes; business and asset divestitures; increased transportation or fuel costs; current or future lawsuits and administrative proceedings; and losses of, or financial difficulties of, customers or suppliers. Our future costs for pension and postretirement benefit costs may be adversely affected by changes in actuarial assumptions and methods, investment return and the composition of the group of employees and retirees covered, changes in our business that result in a withdrawal liability under multi-employer plans, and the actions and contributions of other employers who participate in multi-employer plans to which we contribute. Our future income tax expense, and as a result, our net earnings and cash flows, could be adversely affected by changes in tax laws. Our accounting estimates could change due to changes in facts, assumptions, or acceptable methods, and actual results may vary materially from our estimates. Our operating

and administrative expenses, net earnings and cash flow could also be adversely affected by changes in our sales mix. Our ongoing cost reduction initiatives and changes in our marketing and merchandising programs may not be as successful as anticipated. Acts of terrorism, war, natural disaster, fire, accident, or other circumstances beyond our control could have adverse effects on the availability of and our ability to operate our warehouse and other facilities, consumer buying behavior, fuel costs, shipping and transportation, product imports, product cost inflation and its impact on LIFO expense and other factors affecting our company and the grocery industry generally. Our asset impairment and exit cost provisions are estimates and actual costs may be more or less than these estimates.

Our future interest expense and income also may differ from current expectations, depending upon, among other factors: the amount of additional borrowings; changes in our borrowing agreements; changes in the interest rate environment; changes in accounting pronouncements; and changes in the amount of fees received or paid. The availability of our secured loan agreement depends on compliance with the terms of the loan agreement.

Our ability to realize increased sales and earnings as a result of our recent acquisition of certain of the assets of G&R Felpausch Company and its affiliates ("Felpausch") depends on our ability to integrate the acquired assets successfully and to implement our plans and business practices at the acquired locations. Combining the operations of Felpausch with our existing operations is expected to require significant effort and expense. If we are unable to integrate the Felpausch assets as planned, we may not realize the synergies, business opportunities, and growth prospects anticipated in connection with this transaction.

Our dividend policy does not commit the Board of Directors to declare future dividends. Each future dividend will be considered and declared by the Board of Directors in its discretion. The ability of the Board of Directors to continue to declare dividends will depend on a number of factors, including our future financial condition and profitability and compliance with the terms of our credit facilities.

This section is intended to provide meaningful cautionary statements. This should not be construed as a complete list of all economic, competitive, governmental, technological and other factors that could adversely affect our expected consolidated financial position, results of operations or liquidity. We undertake no obligation to update or revise our forward-looking statements to reflect developments that occur or information obtained after the date of this Quarterly Report.

PART I
FINANCIAL INFORMATION

ITEM 1. Financial Statements

SPARTAN STORES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)
(Unaudited)

<u>Assets</u>	January 5, 2008	March 31, 2007
	<hr/>	<hr/>
Current assets		
Cash and cash equivalents	\$ 11,396	\$ 12,063
Accounts receivable, net	53,196	45,347
Inventories, net	133,494	106,854
Prepaid expenses and other current assets	9,563	7,122
Deferred taxes on income	5,501	10,214
Property and equipment held for sale	840	3,595
	<hr/>	<hr/>
Total current assets	213,990	185,195
Other assets		
Goodwill	176,383	142,888
Other, net	31,967	16,203
	<hr/>	<hr/>
Total other assets	208,350	159,091
Property and equipment, net	175,732	143,213
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Total assets	\$ 598,072	\$ 487,499
	<hr/>	<hr/>
<u>Liabilities and Shareholders' Equity</u>		
Current liabilities		
Accounts payable	\$ 93,939	\$ 93,729
Accrued payroll and benefits	31,940	33,367
Other accrued expenses	21,142	19,503
Current portion of exit costs	8,641	8,889
Current maturities of long-term debt and capital lease obligations	10,567	2,494
	<hr/>	<hr/>
Total current liabilities	166,229	157,982
Long-term liabilities		
Postretirement benefits	8,608	9,208
Other long-term liabilities	26,003	17,413
Exit costs	23,798	23,814

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Long-term debt and capital lease obligations	173,032	106,341
Total long-term liabilities	231,441	156,776
Commitments and contingencies (Note 8)		
Shareholders' equity		
Common stock, voting, no par value; 50,000 shares authorized; 21,905 and 21,658 shares outstanding	130,197	126,447
Preferred stock, no par value, 10,000 shares authorized; no shares outstanding	-	-
Accumulated other comprehensive income	126	126
Retained earnings	70,079	46,168
Total shareholders' equity	200,402	172,741
Total liabilities and shareholders' equity	\$ 598,072	\$ 487,499

See accompanying notes to condensed consolidated financial statements.

SPARTAN STORES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS

(In thousands, except per share data)

(Unaudited)

	16 Weeks Ended		40 Weeks Ended	
	January 5, 2008	December 30, 2006	January 5, 2008	December 30, 2006
Net sales	\$ 826,096	\$ 714,414	\$ 2,003,269	\$ 1,787,954
Cost of sales	663,663	578,988	1,605,345	1,439,923
Gross margin	162,433	135,426	397,924	348,031
Operating expenses				
Selling, general and administrative expenses	146,804	122,076	349,261	305,769
Provision for asset impairments and exit costs	-	-	-	4,464
Total operating expenses	146,804	122,076	349,261	310,233
Operating earnings	15,629	13,350	48,663	37,798
Other income and expenses				
Interest expense	3,818	3,873	8,813	9,601
Other, net	(153)	(27)	(331)	(113)
Total other income and expenses	3,665	3,846	8,482	9,488
Earnings before income taxes and discontinued operations	11,964	9,504	40,181	28,310
Income taxes:				
Net impact of enactment of Michigan Business Tax (Note 11)	(2,748)	-	-	-
Federal, net of Michigan Business Tax impact	4,229	3,293	14,104	9,876
Total income taxes	1,481	3,293	14,104	9,876
Earnings from continuing operations	10,483	6,211	26,077	18,434
Earnings (loss) from discontinued operations, net of taxes	119	(317)	143	(517)
Net earnings	\$ 10,602	\$ 5,894	\$ 26,220	\$ 17,917

Basic earnings per share:

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Earnings from continuing operations	\$	0.49	\$	0.30	\$	1.22	\$	0.88
Earnings (loss) from discontinued operations		0.01		(0.02)		0.01		(0.02)
Net earnings	\$	0.50	\$	0.28	\$	1.23	\$	0.86

Diluted earnings per share:

Earnings from continuing operations	\$	0.48	\$	0.28	\$	1.20	\$	0.86
Earnings (loss) from discontinued operations		0.01		(0.01)		0.01		(0.02)
Net earnings	\$	0.49	\$	0.27	\$	1.21	\$	0.84

Weighted average shares outstanding:

Basic	21,318	21,014	21,260	20,859
Diluted	21,660	21,455	21,668	21,260

See accompanying notes to condensed consolidated financial statements.

SPARTAN STORES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

(In thousands)

(Unaudited)

	Shares Outstanding	Common Stock	Accumulated Other Comprehensive Income	Retained Earnings	Total
Balance - April 1, 2007	21,658	\$ 126,447	\$ 126	\$ 46,168	\$ 172,741
Adjustment to initially apply FIN 48	-	-	-	967	967
Comprehensive earnings-					
Net earnings	-	-	-	26,220	26,220
Dividends - \$.15 per share	-	-	-	(3,276)	(3,276)
Stock-based employee compensation	-	2,267	-	-	2,267
Issuances of common stock and related tax benefits on stock option exercises	115	1,552	-	-	1,552
Issuances of restricted stock and related income tax benefits	177	1,034	-	-	1,034
Cancellations of restricted stock	(45)	(1,103)	-	-	(1,103)
Balance - January 5, 2008	21,905	\$ 130,197	\$ 126	\$ 70,079	\$ 200,402

See accompanying notes to condensed consolidated financial statements.

SPARTAN STORES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	40 Weeks Ended	
	January 5, 2008	December 30, 2006
Cash flows from operating activities		
Net earnings	\$ 26,220	\$ 17,917
(Earnings) loss from discontinued operations	(143)	517
Earnings from continuing operations	26,077	18,434
Adjustments to reconcile net earnings from continuing operations to net cash provided by operating activities:		
Provision for asset impairments and exit costs	-	4,464
Depreciation and amortization	18,914	16,578
Postretirement benefits expense	1,927	1,909
Deferred taxes on income	13,975	8,827
Stock-based compensation expense	2,262	1,481
Other	24	254
Change in operating assets and liabilities:		
Accounts receivable	(10,038)	760
Inventories	(18,800)	(16,337)
Prepaid expenses and other assets	(3,839)	(1,173)
Accounts payable	4,392	5,868
Accrued payroll and benefits	(2,577)	691
Postretirement benefits payments	(6,764)	(2,982)
Other accrued expenses and other liabilities	(2,421)	(2,129)
Net cash provided by operating activities	23,132	36,645
Cash flows from investing activities		
Purchases of property and equipment	(30,081)	(20,352)
Net proceeds from the sale of assets	24	468
Acquisitions, net of cash acquired	(49,413)	(53,600)
Other	(17)	245
Net cash used in investing activities	(79,487)	(73,239)
Cash flows from financing activities		
Net (payments on) proceeds from revolving credit facility	(47,757)	43,131
Proceeds from long-term borrowings	110,000	-
Repayment of long-term borrowings	(2,703)	(1,727)
Financing fees paid	(3,751)	-
Proceeds from sale of common stock	729	2,944
Dividends paid	(3,276)	(3,219)

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Net cash provided by financing activities	53,242	41,129
Cash flows from discontinued operations		
Net cash used in operating activities	(998)	(2,110)
Net cash provided by investing activities	3,444	3,080
Net cash used in financing activities	-	-
	<hr/>	<hr/>
Net cash provided by discontinued operations	2,446	970
	<hr/>	<hr/>
Net (decrease) increase in cash and cash equivalents	(667)	5,505
Cash and cash equivalents at beginning of period	12,063	7,655
	<hr/>	<hr/>
Cash and cash equivalents at end of period	\$ 11,396	\$ 13,160
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See accompanying notes to condensed consolidated financial statements.

SPARTAN STORES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1

Basis of Presentation and Significant Accounting Policies

The accompanying unaudited Condensed Consolidated Financial Statements include the accounts of Spartan Stores, Inc. and its subsidiaries ("Spartan Stores"). All significant intercompany accounts and transactions have been eliminated.

In the opinion of management, the accompanying condensed consolidated financial statements, taken as a whole, contain all adjustments, which are of a normal recurring nature, necessary to present fairly the financial position of Spartan Stores as of January 5, 2008 and the results of its operations and cash flows for the interim periods presented. Interim results are not necessarily indicative of results for a full year.

Note 2

New Accounting Standards

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes", and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Further, FIN 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The provisions of FIN 48 are to be applied prospectively. FIN 48 became effective at the beginning of Spartan Stores' fiscal year 2008, and the effect of adoption of FIN 48 increased retained earnings by \$1.0 million as of the beginning of fiscal year 2008. The adoption of FIN 48 and its effects are more fully described in Note 11.

In June 2006, the FASB ratified the consensus reached on Emerging Issues Task Force (EITF) Issue No. 06-03, "How Sales Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That is, Gross Versus Net Presentation)" (EITF 06-03). The EITF reached a consensus that the presentation of taxes on either a gross or net basis is an accounting policy decision that requires disclosure. EITF 06-03 was effective at the beginning of Spartan Stores' fiscal 2008 first quarter. An entity is not required to reevaluate its existing policies related to taxes assessed by a governmental authority as a result of this consensus. Amounts collected from customers, which under common trade practices are referred to as sales taxes, are and have been recorded on a net basis. Spartan Stores has no intention of modifying this accounting policy; therefore, the adoption of EITF 06-03 did not have any effect on Spartan Stores' financial position or results of operations.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles, and expands disclosures about fair value measurements. This statement does not require any new fair value measurements, but applies under other accounting pronouncements that require or permit fair value measurements. The provisions of the Statement are to be applied prospectively, except for limited retrospective application permitted for certain items. Spartan Stores is currently evaluating the impact, if any, that SFAS 157 will have on the consolidated financial statements.

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In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements Nos. 87, 88, 106 and 132(R)" (SFAS 158). SFAS 158 required Spartan Stores to recognize the funded status of defined benefit postretirement plans as an asset or liability in the consolidated balance sheet and to recognize changes in funded status through comprehensive income as of March 31, 2007. SFAS 158 also requires that employers measure plan assets and obligations as of the date of their year-end financial statements beginning with Spartan Stores' fiscal year ending March 28, 2009. Spartan Stores is currently evaluating the impact of changing the measurement date on the consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB No. 115" (SFAS 159). Under SFAS 159, entities may irrevocably elect to measure many financial instruments and certain other items at fair value on an instrument-by-instrument basis, with changes in fair value recognized in earnings each reporting period. SFAS 159 is effective for fiscal years beginning after November 15, 2007. Spartan Stores does not expect to adopt SFAS 159.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), "Business Combinations" (SFAS 141R), which replaces SFAS No. 141. SFAS 141R establishes principles and requirements for the reporting entity in a business combination, including recognition and measurement in the financial statements of the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. The statement also establishes disclosure requirements to enable financial statement users to evaluate the nature and financial effects of the business combination. SFAS 141R will become effective for Spartan Stores at the beginning of fiscal year 2010, and must be applied prospectively to business combinations for which the acquisition date is on or after the beginning of fiscal year 2010. Spartan Stores is currently evaluating the impact that SFAS 141R will have on future consolidated financial statements.

Note 3

Acquisition of Assets

On June 15, 2007, Spartan Stores acquired certain assets and assumed certain liabilities related to 20 retail grocery stores, two fuel centers and three convenience stores from G&R Felpausch Company and affiliated companies ("Felpausch"), a privately-held retail grocery operator and customer of its Distribution segment. The Felpausch supermarkets include the operations of nine in-store pharmacies. The cash purchase price paid to Felpausch was \$38.0 million plus \$12.7 million for inventories. Spartan Stores acquired the store locations and operations of Felpausch in an effort to increase its leading market share position in West Michigan and expand its market presence in central Michigan. The purchased assets included leasehold improvements, fixtures, tangible personal property, equipment, intangible property and inventories. Spartan Stores assumed Felpausch's lease obligations for the 20 stores, two fuel centers and three convenience stores.

The following table summarizes the preliminary estimated fair values of the assets acquired and liabilities assumed at the date of acquisition. The preliminary purchase price allocations are estimates as of January 5, 2008 based on a combination of third-party valuations and internal analyses and may be further adjusted during the allocation period, as defined by SFAS No. 141. The primary areas of the purchase price allocation that are not yet finalized relate to the valuation of property and equipment, other intangible assets and residual goodwill. We expect the purchase price allocation to be finalized by the end of fiscal 2008.

(In thousands)	June 15, 2007
	<hr/>
Current assets	\$ 13,271
Goodwill	31,653
Favorable leases	2,503
Customer lists	2,953
Other intangible assets	723
Property and equipment	11,150
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Total assets acquired	62,253
Current liabilities	1,638
Capital lease obligations, less current portion	4,285
Exit cost reserves, less current portion	3,796
Other long-term liabilities	1,827
	<hr/>
Total liabilities assumed	11,546
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Net assets acquired	\$ 50,707
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Goodwill of \$21.4 million and \$10.3 million was assigned to the Retail and Distribution segments, respectively, based upon the expected benefits to be derived from the business combination. Additionally, \$1.8 million in costs directly related to the acquisition have been included in goodwill, of which \$1.2 million and \$0.6 million were assigned to the Retail and Distribution segments, respectively. Goodwill of \$33.5 million is expected to be deductible for tax purposes.

Amortizable intangible assets acquired consisted of favorable leases and customer lists and amounted to \$2.5 million and \$3.0 million, respectively. The weighted average amortization period is 11.7 years for favorable leases and seven years for customer lists. Other intangible assets acquired include \$0.7 million of licenses for the sale of alcoholic beverages. The licenses have an indefinite life and therefore are not amortized.

Note 4

Goodwill and Other Intangible Assets

Changes in the carrying amount of goodwill were as follows:

(In thousands)	Retail	Distribution	Total
Balance at April 1, 2007	\$ 89,181	\$ 53,707	\$ 142,888
Felpausch stores acquisition	22,596	10,861	33,457
Other	38	-	38
Balance at January 5, 2008	\$ 111,815	\$ 64,568	\$ 176,383

The following table reflects the components of amortized intangible assets, included in "Other, net" on the Consolidated Balance Sheets:

(In thousands)	January 5, 2008		March 31, 2007	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Non-compete agreements	\$ 3,874	\$ 1,604	\$ 3,234	\$ 2,096
Favorable leases	6,488	2,098	4,025	1,655
Customer lists	6,439	819	3,293	239
Franchise fees and other				