

SPARTAN STORES INC
Form 10-Q
October 14, 2005

**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 September 10, 2005.

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 an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act).

Yes No

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 October 7, 2005 the registrant had 20,814,593 outstanding shares of Common Stock, no par value.

FORWARD-LOOKING STATEMENTS

The matters discussed in this Quarterly Report on Form 10-Q 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," "projects," "plans," "believes," "estimates," "intends," is "optimistic" or "confident" that a particular occurrence "will," "may," "could," "should" or "will likely" result or that a particular event "will," "may," "could," "should" or "will likely" occur in the future, that the "outlook" 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.

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 26, 2005 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 strengthen our retail-store performance; maintain or grow sales; maintain or increase gross margin; maintain and improve customer and supplier relationships; successfully realize expected benefits of new relationships; realize growth opportunities; expand our customer base; anticipate and successfully respond to openings of competitors'; reduce operating costs; sell on favorable terms assets classified as held for sale; generate cash; continue to meet the terms of our debt covenants; and implement the other programs, plans, 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 Grocery 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 may be adversely affected by unexpected 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 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 we anticipate. Acts of terrorism or war have in the past and may in the future result in considerable economic and political uncertainties that could have adverse effects on consumer buying behavior, fuel costs, shipping and transportation, product imports 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; 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.

This section is intended to provide meaningful cautionary statements for purposes of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. 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. Other risk factors exist and new risk factors may emerge at any time. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements as predictions of future results. 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>	<u>September 10, 2005</u>	<u>March 26, 2005</u>
Current assets		
Cash and cash equivalents	\$ 13,494	\$ 14,880
Accounts receivable, net	42,468	43,445
Inventories, net	98,544	95,988
Prepaid expenses and other current assets	6,437	7,884
Deferred taxes on income	5,158	5,396
Property and equipment held for sale	5,566	3,855
Total current assets	171,667	171,448
Other assets		
Goodwill	72,465	72,315
Deferred taxes on income	14,092	18,680
Other, net	13,175	13,135
Total other assets	99,732	104,130
Property and equipment, net	106,702	108,879
Total assets	\$ 378,101	\$ 384,457
 <u>Liabilities and Shareholders' Equity</u>		
Current liabilities		
Accounts payable	\$ 88,687	\$ 82,391
Accrued payroll and benefits	24,212	30,775
Other accrued expenses	24,990	25,176
Current maturities of long-term debt	1,624	2,848
Total current liabilities	139,513	141,190
Other long-term liabilities	13,315	16,814
Postretirement benefits	9,773	9,097
Long-term debt	79,914	91,946

Shareholders' equity

Common stock, voting, no par value; 50,000 shares authorized; 20,812 and 20,524 shares outstanding	121,501	118,144
Preferred stock, no par value, 10,000 shares authorized; no shares outstanding	-	-
Deferred stock-based compensation	(3,405)	(719)
Accumulated other comprehensive loss	(203)	(203)
Retained Earnings	17,693	8,188
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Total shareholders' equity	135,586	125,410
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Total liabilities and shareholders' equity	\$ 378,101	\$ 384,457
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See accompanying notes to consolidated financial statements.

SPARTAN STORES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS

(In thousands, except per share data)

(Unaudited)

	12 Weeks Ended		24 Weeks Ended	
	September 10, 2005	September 11, 2004	September 10, 2005	September 11, 2004
Net sales	\$ 485,541	\$ 486,701	\$ 944,861	\$ 961,026
Cost of sales	391,995	391,610	765,508	780,035
Gross margin	93,546	95,091	179,353	180,991
Selling, general and administrative expenses	81,303	81,845	161,112	162,868
Operating earnings	12,243	13,246	18,241	18,123
Other income and expenses				
Interest expense	1,763	2,277	3,532	4,569
Other, net	(3)	58	(55)	29
Total other income and expenses	1,760	2,335	3,477	4,598
Earnings before income taxes and discontinued operations	10,483	10,911	14,764	13,525
Income taxes	3,415	3,817	4,881	4,732
Earnings from continuing operations	7,068	7,094	9,883	8,793
Loss from discontinued operations, net of taxes	(215)	(143)	(378)	(289)
Net earnings	\$ 6,853	\$ 6,951	\$ 9,505	\$ 8,504
Basic earnings per share:				
Earnings from continuing operations	\$ 0.34	\$ 0.35	\$ 0.48	\$ 0.43
Loss from discontinued operations	(0.01)	(0.01)	(0.02)	(0.01)
Net earnings	\$ 0.33	\$ 0.34	\$ 0.46	\$ 0.42
Diluted earnings per share:				
Earnings from continuing operations	\$ 0.33	\$ 0.35	\$ 0.47	\$ 0.42
Loss from discontinued operations	(0.01)	(0.01)	(0.02)	(0.01)
Net earnings	\$ 0.32	\$ 0.34	\$ 0.45	\$ 0.41

Weighted average shares outstanding:

Basic	20,808	20,468	20,722	20,361
Diluted	21,437	20,694	21,338	20,572

See accompanying notes to consolidated financial statements.

SPARTAN STORES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
(In thousands)
(Unaudited)

	Shares Outstanding	Common Stock	Deferred Stock-Based Compensation	Accumulated Other Comprehensive Loss	(Accumulated Deficit) Retained Earnings	Total
Balance - March 27, 2005	20,524	\$ 118,144	\$ (719)	\$ (203)	\$ 8,188	\$ 125,410
Comprehensive income, net of tax:						
Net earnings for fiscal 2006	-	-	-	-	9,505	9,505
Issuances of common stock	38	305	-	-	-	305
Issuances of restricted stock	252	3,060	(3,060)	-	-	-
Cancellations of restricted stock	(2)	(8)	8	-	-	-
Amortization of restricted stock	-	-	366	-	-	366
Balance - September 10, 2005	20,812	\$ 121,501	\$ (3,405)	\$ (203)	\$ 17,693	\$ 135,586

See accompanying notes to consolidated financial statements.

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

(In thousands)

(Unaudited)

	24 Weeks Ended	
	September 10, 2005	September 11, 2004
Cash flows from operating activities		
Net earnings	\$ 9,505	\$ 8,504
Loss from discontinued operations	378	289
	9,883	8,793
Earnings from continuing operations	9,883	8,793
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	10,154	10,846
Postretirement benefits	676	1,045
Deferred taxes on income	4,786	4,559
Restricted stock amortization	366	76
Other	440	78
Changes in operating assets and liabilities:		
Accounts receivable	951	(3,130)
Inventories	(2,556)	5,085
Prepaid expenses and other assets	(21)	2,601
Accounts payable	5,072	6,656
Accrued payroll and benefits	(6,379)	(1,575)
Other accrued expenses and other liabilities	(997)	(2,256)
	22,375	32,778
Net cash provided by operating activities	22,375	32,778
Cash flows from investing activities		
Purchases of property and equipment	(9,151)	(8,210)
Net proceeds from the sale of assets	10	89
Other	384	288
	(8,757)	(7,833)
Net cash used in investing activities	(8,757)	(7,833)
Cash flows from financing activities		
Net payments on revolver	(11,301)	(20,733)
Repayment of long-term debt	(1,446)	(1,607)
Proceeds from sale of common stock	305	562
	(12,442)	(21,778)
Net cash used in financing activities	(12,442)	(21,778)
Discontinued operations:		
Net cash used in discontinued operations	(2,562)	(2,555)

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Net (decrease) increase in cash and cash equivalents	(1,386)	612
Cash and cash equivalents at beginning of period	14,880	12,838
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Cash and cash equivalents at end of period	\$ 13,494	\$ 13,450
	<hr/>	<hr/>

See accompanying notes to consolidated financial statements.

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

Note 1**Basis of Presentation and Significant Accounting Policies**

The 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 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 September 10, 2005 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.

Stock-Based Compensation

Spartan Stores has a stock incentive plan, which is more fully described in Note 10 of the 2005 Annual Report on Form 10-K. Spartan Stores accounts for the plan under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations. No stock-based compensation cost for stock options is reflected in the Consolidated Statements of Earnings, as all options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net earnings and earnings per share as if Spartan Stores had applied the fair value recognition principles of Statement of Financial Accounting Standards Statement No. 123, "Accounting for Stock-Based Compensation," to stock options granted to employees:

(In thousands, except per share data)

	12 Weeks Ended	
	September 10, 2005	September 11, 2004
Net earnings, as reported	\$ 6,853	\$ 6,951
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(89)	(71)
Pro forma net earnings	\$ 6,764	\$ 6,880
Basic earnings per share - as reported	\$ 0.33	\$ 0.34
Basic earnings per share - pro forma	0.33	0.34
Diluted earnings per share - as reported	\$ 0.32	\$ 0.34
Diluted earnings per share - pro forma	0.32	0.33

	24 Weeks Ended	
	September 10, 2005	September 11, 2004
Net earnings, as reported	\$ 9,505	\$ 8,504
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(169)	(163)
Pro forma net earnings	<u>\$ 9,336</u>	<u>\$ 8,341</u>
Basic earnings per share - as reported	\$ 0.46	\$ 0.42
Basic earnings per share - pro forma	0.45	0.41
Diluted earnings per share - as reported	\$ 0.45	\$ 0.41
Diluted earnings per share - pro forma	0.44	0.41

Reclassifications

Certain reclassifications have been made to the fiscal 2005 consolidated financial statements to conform to the fiscal 2006 presentation.

Note 2**New Accounting Standards**

In December 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 123(R), "Share-Based Payment" that will require compensation costs related to share-based payment transactions to be recognized in the consolidated financial statements. With limited exceptions, the amount of compensation cost will be measured based on the grant date fair value of the equity or liability instruments issued. In addition, liability awards will be remeasured each reporting period. Compensation cost will be recognized over the period that an employee provides services in exchange for the award. SFAS No. 123(R) replaces SFAS No. 123, and supercedes APB Opinion No. 25. This Statement becomes effective for Spartan Stores at the beginning of fiscal 2007. Spartan Stores expects that the impact of adopting SFAS No. 123(R) will be consistent with the pro forma expense that has been previously disclosed, adjusted for future grants, cancellations and exercises of stock options in accordance with the Statement.

In June 2005, the Emerging Issues Task Force ("EITF") reached a consensus on EITF Issue No. 05-6, "Determining the Amortization Period for Leasehold Improvements Purchased after Lease Inception or Acquired in a Business Combination" ("EITF 05-6"). EITF 05-6 requires that leasehold improvements acquired in a business combination be amortized over the shorter of the useful life of the assets or a term that includes required lease periods and renewals that are deemed to be reasonably assured at the date of acquisition. EITF 05-6 also requires that leasehold improvements that are placed in service significantly after and not contemplated at or near the beginning of the lease term be amortized over the shorter of the useful life of the assets or a term that includes required lease periods and renewals that are deemed to be reasonably assured at the date the leasehold improvements are purchased. EITF 05-6 is effective for Spartan Stores' fiscal quarter beginning September 11, 2005. The impact of EITF 05-6 is not expected to have a material effect on Spartan Stores' consolidated financial statements.

Note 3**Discontinued Operations**

Spartan Stores' former convenience distribution operations, insurance operations and certain of its retail, grocery distribution and real estate operations have been recorded as discontinued operations. Results of the discontinued operations are excluded from the accompanying notes to the consolidated financial statements for all periods presented, unless otherwise noted.

Discontinued operations had no sales during the second quarter and year-to-date periods ended September 10, 2005 and September 11, 2004. The operating losses in discontinued operations for the second quarters ended September 10, 2005 and September 11, 2004 of \$0.3 million and \$0.2 million were partially offset by income tax benefits of \$0.1 million for both periods. The operating losses in discontinued operations for the year-to-date periods ended September 10, 2005 and September 11, 2004 of \$0.6 million and \$0.5 million were partially offset by income tax benefits of \$0.2 million for both periods.

Total assets of discontinued operations decreased from \$6.1 million at March 26, 2005 to \$5.9 million at September 10, 2005. Total liabilities of discontinued operations decreased from \$14.4 million at March 26, 2005 to \$12.2 million at September 10, 2005.

Spartan Stores anticipates that it will be subject to a partial withdrawal liability from a multi-employer pension plan related to the 2003 closures of certain of its discontinued *Food Town* stores when a final determination is made after June 30, 2006. Recent estimates provided by the trustees of the multi-employer pension plan indicate that there will be an underfunded liability which we believe to have resulted from a change in actuarial assumptions, investment performance, other employers' withdrawals, or a combination of these factors, occurring subsequent to the closure of these stores. Spartan Stores intends to challenge such a determination prior to settling the partial withdrawal liability when assessed after June 2006. At this time the amount of the liability is not reasonably estimable, however, Spartan Stores does not expect it will exceed \$2.0 million. No provision for this potential liability has been included in the accompanying consolidated financial statements due to the inability to reasonably estimate the amount.

Note 4**Exit Costs**

The following table provides the activity of exit costs for fiscal year 2005 and the twenty-four weeks ended September 10, 2005. Exit costs recorded in the Consolidated Balance Sheets are included in Other accrued expenses in current liabilities and Other long-term liabilities based on when the obligations are expected to be paid.

(In thousands)

	Lease and Ancillary Costs
Balance at March 27, 2005	\$ 15,520
Provision for lease and related ancillary costs, net of estimated sublease recoveries	189
Payments, net of interest accretion	(1,833)
Balance at September 10, 2005	\$ 13,876

Note 5
Associate Retirement Plans

The following table provides the components of net periodic pension and postretirement benefit costs for the second quarter and year-to-date periods ended September 10, 2005 and September 11, 2004:

(In thousands)

12 Weeks Ended	Pension Benefits		SERP Benefits		Postretirement Benefits	
	Sept. 10, 2005	Sept. 11, 2004	Sept. 10, 2005	Sept. 11, 2004	Sept. 10, 2005	Sept. 11, 2004
Service cost	\$ 753	\$ 1,047	\$ 4	\$ 5	\$ 53	\$ 57
Interest cost	577	651	8	9	96	97
Expected return on plan assets	(723)	(859)	-	-	-	-
Net amortization and deferral	(98)	(137)	4	3	(5)	(7)
	-	-	-	-	-	-
Net periodic benefit cost	\$ 509					