# UNITED STATES SECURITIES AND EXCHANGE COMMISSION 

WASHINGTON, D.C. 20549

## FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 29, 2008

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from $\qquad$ to $\qquad$

# INGLES MARKETS, INCORPORATED 

North Carolina
(State or other jurisdiction of
incorporation or organization)
P.O. Box 6676, Asheville NC
(Address of principal executive offices)

56-0846267
(I.R.S. Employer

Identification No.)

28816
(Zip Code)
(828) 669-2941

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 x No ${ }^{.}$.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ${ }^{*}$ Accelerated filer $x$ Non-accelerated filer ${ }^{*}$ Smaller reporting company ${ }^{*}$.

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

As of April 28, 2008, the Registrant had $12,454,260$ shares of Class A Common Stock, $\$ 0.05$ par value per share, outstanding and $12,058,001$ shares of Class B Common Stock, $\$ 0.05$ par value per share, outstanding.

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Part I. Financial Information

## Item 1. Financial Statements

## INGLES MARKETS, INCORPORATED AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

|  |  | $\begin{gathered} \text { MARCH } 29, \\ 2008 \end{gathered}$ | $\begin{gathered} \text { SEPTEMBER 29, } \\ 2007 \end{gathered}$ |  |
| :---: | :---: | :---: | :---: | :---: |
| ASSETS |  |  |  |  |
| Current Assets: |  |  |  |  |
| Cash and cash equivalents | \$ | 12,917,796 | \$ | 16,839,621 |
| Notes and accounts receivable, net |  | 49,932,010 |  | 44,640,660 |
| Inventories |  | 246,988,475 |  | 233,464,859 |
| Other current assets |  | 10,024,049 |  | 10,648,217 |
| Total Current Assets |  | 319,862,330 |  | 305,593,357 |
| Property and Equipment Net |  | 923,766,850 |  | 839,732,082 |
| Other Assets |  | 9,850,746 |  | 9,946,986 |


| LIABILITIES AND STOCKHOLDERS | EQUITY |  |  |
| :--- | :--- | ---: | ---: |
| Current Liabilities: | $\mathbf{3 2 , 9 5 5 , 9 1 6}$ | $\$$ | $31,306,955$ |
| Current portion of long-term debt | $\mathbf{1 5 4 , 0 6 3 , 1 0 7}$ | $143,935,192$ |  |
| Accounts payable - trade | $\mathbf{6 1 , 4 9 6 , 1 2 6}$ | $75,225,938$ |  |
| Accrued expenses and current portion of other long-term liabilities | $\mathbf{2 4 8 , 5 1 5 , 1 4 9}$ | $250,468,085$ |  |
|  | $\mathbf{3 9 , 6 9 7 , 5 7 8}$ | $38,176,578$ |  |
| Total Current Liabilities | $\mathbf{5 9 3 , 1 4 5 , 7 3 6}$ | $511,950,127$ |  |
| Deferred Income Taxes | $\mathbf{6 , 0 1 4 , 6 3 0}$ | $6,533,659$ |  |
| Long-Term Debt |  |  |  |
| Other Long-Term Liabilities | $\mathbf{8 8 7 , 3 7 3 , 0 9 3}$ | $807,128,449$ |  |


| Stockholders Equity: |  |  |  |
| :---: | :---: | :---: | :---: |
| Preferred stock, \$0.05 par value; 10,000,000 shares authorized; no shares issued |  |  |  |
| Common stocks: |  |  |  |
| Class A, \$0.05 par value; 150,000,000 shares authorized; $12,454,258$ shares issued and outstanding |  |  |  |
| Class B, convertible to Class A, $\$ 0.05$ par value; $100,000,000$ shares authorized; $12,058,001$ shares issued and outstanding March 29, 2008; 12,156,476 shares issued and outstanding September 29, 2007 | 602,900 |  | 607,824 |
| Paid-in capital in excess of par value | 118,184,132 |  | 118,184,132 |
| Retained earnings | 246,697,088 |  | 228,734,231 |
| Total Stockholders Equity | 366,106,833 | 348,143,976 |  |
| Total Liabilities and Stockholders Equity | \$ 1,253,479,926 | \$ 1,155,272,425 |  |

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## INGLES MARKETS, INCORPORATED AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

|  | THREE MO MARCH 29, 2008 | THS ENDED MARCH 31, 2007 |
| :---: | :---: | :---: |
| Net sales | \$ 782,787,385 | \$ 681,164,012 |
| Cost of goods sold | 598,291,757 | 514,596,035 |
| Gross profit | 184,495,628 | 166,567,977 |
| Operating and administrative expenses | 153,063,120 | 139,497,979 |
| Rental income, net | 880,280 | 1,280,749 |
| Loss from sale or disposal of assets | $(487,352)$ | $(328,032)$ |
| Income from operations | 31,825,436 | 28,022,715 |
| Other income, net | 826,751 | 574,498 |
| Interest expense | 11,645,269 | 11,935,469 |
| Income before income taxes | 21,006,918 | 16,661,744 |
| Income tax expense (benefit): |  |  |
| Current | 7,075,000 | 5,623,000 |
| Deferred | 937,000 | $(2,468,000)$ |
|  | 8,012,000 | 3,155,000 |
| Net income | \$ 12,994,918 | \$ 13,506,744 |
| Per share amounts: |  |  |
| Class A Common Stock |  |  |
| Basic earnings per common share | \$ 0.56 | \$ 0.58 |
| Diluted earnings per common share | \$ 0.53 | \$ 0.55 |
| Class B Common Stock |  |  |
| Basic earnings per common share | \$ 0.51 | \$ 0.53 |
| Diluted earnings per common share | \$ 0.51 | \$ 0.53 |
| Cash dividends per common share: |  |  |
| Class A Common Stock | \$ 0.165 | \$ 0.165 |
| Class B Common Stock | \$ 0.150 | \$ 0.150 |

See notes to unaudited interim financial statements.

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## INGLES MARKETS, INCORPORATED AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)



See notes to unaudited interim financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY (UNAUDITED)
SIX MONTHS ENDED MARCH 29, 2008 AND MARCH 31, 2007

|  | PAID-IN |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  |  |  | CAPITAL IN |  |  |
|  | CLASS A <br> COMMON STOCK |  | $\begin{aligned} & \text { CLAS } \\ & \text { COMMON } \\ & \text { SHARES } \end{aligned}$ | S B STOCK AMOUNT | EXCESS OF <br> PAR VALUE | RETAINED EARNINGS | TOTAL |
| Balance, September 30, 2006 | 12,176,485 | \$ 608,824 | 12,321,774 | \$ 616,089 | \$ 117,911,423 | \$ 185,536,551 | \$ 304,672,887 |
| Net income |  |  |  |  |  | 24,674,329 | 24,674,329 |
| Cash dividends |  |  |  |  |  | $(7,716,659)$ | $(7,716,659)$ |
| Exercise of stock options | 11,000 | 550 |  |  | 211,692 |  | 212,242 |
| Common stock conversions | 151,298 | 7,565 | $(151,298)$ | $(7,565)$ |  |  |  |
| Balance, March 31, 2007 | 12,338,783 | \$ 616,939 | 12,170,476 | \$ 608,524 | \$ 118,123,115 | \$ 202,494,221 | \$ 321,842,799 |
| Balance, September 29, 2007 | 12,355,783 | \$ 617,789 | 12,156,476 | \$ 607,824 | \$ 118,184,132 | \$ 228,734,231 | \$ 348,143,976 |
| Net income |  |  |  |  |  | 25,687,727 | 25,687,727 |
| Cash dividends |  |  |  |  |  | $(7,724,870)$ | $(7,724,870)$ |
| Exercise of stock options |  |  |  |  |  |  |  |
| Common stock conversions | 98,475 | 4,924 | $(98,475)$ | $(4,924)$ |  |  |  |
| Balance, March 29, 2008 | 12,454,258 | \$ 622,713 | 12,058,001 | \$ 602,900 | \$ 118,184,132 | \$ 246,697,088 | \$ 366,106,833 |

See notes to unaudited interim financial statements.

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## INGLES MARKETS, INCORPORATED AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)



See notes to unaudited interim financial statements.

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## INGLES MARKETS, INCORPORATED AND SUBSIDIARIES

## NOTES TO UNAUDITED INTERIM FINANCIAL STATEMENTS

Six Months Ended March 29, 2008 and March 31, 2007

## A. BASIS OF PREPARATION

In the opinion of management, the accompanying unaudited interim financial statements contain all adjustments necessary to present fairly the financial position of Ingles Markets, Incorporated and Subsidiaries (the Company) as of March 29, 2008, the results of operations for the three-month and six-month periods ended March 29, 2008 and March 31, 2007, and the changes in stockholders equity and cash flows for the six-month periods ended March 29, 2008 and March 31, 2007. The adjustments made are of a normal recurring nature. Certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission for Form $10-\mathrm{Q}$. It is suggested that these unaudited interim financial statements be read in conjunction with the audited financial statements and the notes thereto included in the Annual Report on Form 10-K for the year ended September 29, 2007 and the Form 10-Q for the fiscal quarter ended March 31, 2007, filed by the Company under the Securities Exchange Act of 1934 on November 28, 2007 and May 4, 2007, respectively.

The results of operations for the three-month and six-month periods ended March 29, 2008 are not necessarily indicative of the results to be expected for the full fiscal year.

Certain amounts for the three-month and six-month periods ended March 31, 2007 have been reclassified to conform to the current year presentation in the accompanying financial statements.

## B. NEW ACCOUNTING PRONOUNCEMENTS

On July 13, 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 a company s financial statements by prescribing a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken on a tax return. Additionally, FIN 48 provides guidance on de-recognition of tax benefits previously recognized and additional disclosures for unrecognized tax benefits, interest and penalties. Effective September 30, 2007, the beginning of fiscal year 2008, the Company adopted the provisions of FIN 48.

The adoption of FIN 48 did not have a material impact on the Company s financial statements. After assessing certain tax positions taken by the Company, the Company determined that it was not necessary to recognize a cumulative effect adjustment as required by FIN 48 . As of the adoption date, the Company had gross unrecognized tax benefits of $\$ 842,000$, all of which, if recognized, would affect the effective tax rate. The Company does not expect that the total amounts of unrecognized tax benefits will significantly increase or decrease within the next twelve months.

The Company files income tax returns with federal and various state jurisdictions. With few exceptions, the Company is no longer subject to state income tax examinations by tax authorities for the years before 2004. Additionally, the Internal Revenue Service has completed its examination of the Company s U.S. Federal income tax returns filed through fiscal year 2005.

The Company s continuing practice is to recognize interest and penalties related to uncertain tax positions and related matters in income tax expense. As of December 29, 2007, the Company had approximately $\$ 364,000$ accrued for interest and penalties, of which $\$ 10,000$ was a current period expense.

The Company s effective tax rate of $38.68 \%$ differs from the federal statutory rate primarily as a result of state income taxes.

## C. ALLOWANCE FOR DOUBTFUL ACCOUNTS

Receivables are presented net of an allowance for doubtful accounts of \$899,000 and \$962,000 at March 29, 2008 and September 29, 2007, respectively.

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## D. ACCRUED EXPENSES AND CURRENT PORTION OF OTHER LONG-TERM LIABILITIES

Accrued expenses and current portion of other long-term liabilities consist of the following:

|  | MARCH 29, | SEPTEMBER 29, |  |
| :--- | ---: | ---: | ---: |
|  | $\mathbf{2 0 0 8}$ | $\mathbf{2 0 0 7}$ |  |
| Property, payroll, and other taxes payable | $\mathbf{9 , 6 9 6 , 1 8 7}$ | $\$$ | $17,173,995$ |
| Salaries, wages and bonuses payable | $\mathbf{1 8 , 2 3 9 , 3 4 4}$ | $22,285,059$ |  |
| Self-insurance reserves | $\mathbf{9 , 4 3 3 , 9 5 3}$ | $9,379,454$ |  |
| Interest | $\mathbf{1 2 , 0 1 1 , 9 7 3}$ | $11,511,939$ |  |
| Income taxes | $\mathbf{1 2 , 1 1 4 , 6 6 9}$ | $14,174,937$ |  |
| Other |  |  |  |
|  | $\mathbf{\$ 6 1 , 4 9 6 , 1 2 6}$ | $\$$ | $75,225,938$ |

Self-insurance liabilities are established for workers compensation and employee group medical and dental benefits based on claims filed and estimates of claims incurred but not reported. The Company is insured for covered costs in excess of $\$ 750,000$ per occurrence for workers compensation and $\$ 250,000$ per covered person for medical care benefits for a policy year. Employee insurance expense, including workers compensation and medical care benefits, net of employee contributions, totaled $\$ 7.2$ million and $\$ 6.2$ million for the three-month periods ended March 29, 2008 and March 31, 2007, respectively. For the six-month periods ended March 29, 2008 and March 31, 2007, employee insurance expense, net of employee contributions, totaled $\$ 12.6$ million and $\$ 11.7$ million, respectively.

## E. LONG-TERM DEBT

At March 29, 2008, the Company had lines of credit with five banks totaling $\$ 185.0$ million, of which $\$ 13.5$ million was outstanding at March 29, 2008. The lines of credit mature between October 2008 and November 2010. The lines provide the Company with various interest rate options generally at rates less than the prime rate. The Company also has a facility with a bank to issue up to $\$ 30.0$ million of unused letters of credit, of which $\$ 20.7$ million of unused letters of credit were issued at March 29, 2008. This facility matures in October 2009. The Company is not required to maintain compensating balances in connection with these lines of credit. The lines of credit contain provisions that under certain circumstances would permit lending institutions to terminate or withdraw their respective extensions of credit to the Company. Included among the triggering factors permitting the termination or withdrawal of lines of credit to the Company are certain events of default, including both monetary and non-monetary defaults, the initiation of bankruptcy or insolvency proceedings, and the failure of the Company to meet certain financial covenants designated in its respective loan documents. The Company was in compliance with all financial covenants related to these lines of credit at March 29, 2008.

During the six months ended March 29, 2008, the Company entered into new long-term debt arrangements totaling approximately $\$ 87.1$ million of new borrowings secured by certain of the Company s store properties and equipment. These arrangements reduced the Company s line of credit borrowings and funded capital expenditures.

Long-term debt and lines of credit agreements contain various restrictive covenants requiring, among other things, minimum levels of net worth and maintenance of certain financial ratios. One of the covenants has the effect of restricting funds available for dividends to approximately $\$ 159.1$ million, based on tangible net worth at March 29, 2008. As of March 29, 2008, the Company was in compliance with these covenants.

## F. DIVIDENDS

The Company paid cash dividends of $\$ 0.165$ for each share of Class A Common Stock and $\$ 0.15$ for each share of Class B Common Stock on January 24, 2008 and October 25, 2007 to stockholders of record on January 14, 2008 and October 15, 2007, respectively.

## G. COMMON STOCK AND CALCULATION OF EARNINGS PER COMMON SHARE

The Company has two classes of common stock: Class A which is publicly traded, and Class B, which has no public market. The Class B Common Stock has restrictions on transfer; however, each share is convertible into one share of Class A Common Stock at any time. Each share of Class A Common Stock has one vote per share and each share of Class B Common Stock has ten votes per share. Each share of Class A Common Stock is entitled to receive cash dividends equal to $110 \%$ of any cash dividend paid on Class B Common Stock.

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The Company calculates earnings per share for its Class A Common Stock and Class B Common Stock using the two-class method in accordance with Emerging Issues Task Force (EITF) Issue 03-6, Participating Securities and the Two-Class Method under FASB Statement No. 128, Earnings per Share.

The two-class method of computing basic earnings per share for each period reflects the cash dividends paid per share for each class of stock, plus the amount of allocated undistributed earnings per share computed using the participation percentage, which reflects the

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dividend rights of each class of stock. Diluted earnings per share is calculated assuming the exercise of dilutive stock options outstanding and the conversion of all shares of Class B Common Stock to shares of Class A Common Stock on a share-for-share basis. The tables below reconcile the numerators and denominators of basic and diluted earnings per share for current periods.

|  | Three Months Ended <br> March 29, 2008 |  |  |  | Six Months Ended <br> March 29, 2008 |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | Class A |  | Class B | Class A | Class B |
| Numerator: Allocated net income |  |  |  |  |  |  |
| Net income allocated, basic | \$ | 6,889,632 | \$ | 6,105,286 | \$ 13,590,000 | \$ 12,097,727 |
| Conversion of Class B to Class A shares |  | 6,105,286 |  |  | 12,097,727 |  |
| Net income allocated, diluted |  | 12,994,918 | \$ | 6,105,286 | \$ 25,687,727 | \$ 12,097,727 |
| Denominator: Weighted average shares outstanding |  |  |  |  |  |  |
| Weighted average shares outstanding, basic |  | 12,422,195 |  | 12,090,066 | 12,389,938 | 12,122,323 |
| Conversion of Class B to Class A shares |  | 12,090,066 |  |  | 12,122,323 |  |
| Weighted average shares outstanding, diluted |  | 24,512,261 |  | 12,090,066 | 24,512,261 | 12,122,323 |
| Earnings per share |  |  |  |  |  |  |
| Basic | \$ | 0.56 | \$ | 0.51 | \$ 1.10 | \$ 1.00 |
| Diluted | \$ | 0.53 | \$ | 0.51 | \$ 1.05 | \$ 1.00 |


|  | Three Months Ended <br> March 31, 2007 <br> Class B | Six Months Ended <br> March 31, 2007 <br> Class B |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Class A A |  |  |

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## H. LINES OF BUSINESS

The Company operates three lines of business: retail grocery sales, shopping center rentals, and a fluid dairy processing plant. All of the Company s operations are domestic. Information about the Company s operations by lines of business (in thousands) is as follows:

|  | Three Months Ended |  |  | Six Months Ended |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | $\begin{gathered} \text { MARCH } 29, \\ 2008 \end{gathered}$ |  | $\begin{gathered} \text { ARCH 31, } \\ 2007 \end{gathered}$ | $\begin{gathered} \text { MARCH } 29, \\ 2008 \end{gathered}$ | $\begin{gathered} \text { MARCH 31, } \\ 2007 \end{gathered}$ |
| Revenues from unaffiliated customers: |  |  |  |  |  |
| Grocery sales | \$ 750,572 | \$ | 652,050 | \$ 1,494,996 | \$ 1,310,433 |
| Shopping center rentals | 2,925 |  | 3,198 | 6,008 | 6,393 |
| Fluid dairy | 32,215 |  | 29,115 | 64,913 | 56,430 |
| Total revenues from unaffiliated customers | \$ 785,712 | \$ | 684,363 | \$ 1,565,917 | \$ 1,373,256 |
| Income from operations: |  |  |  |  |  |
| Grocery sales | \$ 28,063 | \$ | 23,311 | \$ 55,615 | \$ 48,613 |
| Shopping center rentals | 881 |  | 1,281 | 2,113 | 2,304 |
| Fluid dairy | 2,882 |  | 3,430 | 5,629 | 6,365 |
| Total income from operations | \$ 31,826 | \$ | 28,022 | \$ 63,357 | \$ 57,282 |


|  | MARCH 29, <br> $\mathbf{2 0 0 8}$ | SEPTEMBER 29, <br> $\mathbf{2 0 0 7}$ |
| :--- | :---: | :---: |
| Assets: | $\mathbf{\$ 1 , 1 0 0 , 8 0 7}$ | $\$$ |
| Grocery sales | $\mathbf{1 2 4 , 7 6 7}$ | $\mathbf{3 0 1 3 , 7 8 8}$ |
| Shopping center rentals | $\mathbf{( 2 , 2 4 0}$ | 29,851 |
| Fluid dairy |  | $(2,418)$ |
| Elimination of intercompany receivable | $\mathbf{\$ 1 , 2 5 3 , 4 8 0}$ | $\$$ |
| Total assets | $1,155,272$ |  |

Revenue from shopping center rentals is reported on the rental income, net line of the Condensed Consolidated Statements of Income. Grocery and fluid dairy revenues comprise net sales on the Condensed Consolidated Statements of Income.

For the three-month periods ended March 29, 2008 and March 31, 2007, respectively, the fluid dairy segment had $\$ 15.7$ million and $\$ 13.4$ million in sales to the grocery sales segment. The fluid dairy segment had $\$ 32.0$ million and $\$ 26.2$ million in sales to the grocery sales segment for the six-month periods ended March 29, 2008 and March 31, 2007, respectively. These sales have been eliminated in consolidation and are excluded from the amounts in the table above.

## I. TAX CONTINGENCY SETTLEMENT

During the quarter ended March 31, 2007 the Company settled a tax position under an initiative offered by one of the states in which the Company conducts its operations. As a result of this settlement, the Company reduced its reserve for uncertain tax positions by $\$ 3.2$ million. This reduction is reflected as a reduction of income tax expense for the three- and six-month periods ended March 31, 2007. Without this reduction, the effective tax rate would have been $38.1 \%$ for the six months ended March 31, 2007.

Item 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS Overview

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Ingles, a leading supermarket chain in the Southeast, operates 197 supermarkets in Georgia (73), North Carolina (65), South Carolina (36), Tennessee (20), Virginia (2) and Alabama (1). The Company locates its supermarkets primarily in suburban areas, small towns and rural communities. Ingles supermarkets offer customers a wide variety of nationally advertised food products, including grocery, meat and dairy products, produce, frozen foods and other perishables and non-food products, including health and beauty care products and general merchandise, as well as quality private label items. In addition, the Company focuses on selling high-growth, high-margin products to its customers through the development of book sections, media centers, floral departments, premium coffee kiosks, certified organic products, bakery departments and prepared foods including delicatessen sections. During fiscal 2000, the Company began adding fuel centers and pharmacies at select store locations. As of March 29, 2008, the Company operated 55 in-store pharmacies and 49 fuel centers.

Ingles also operates two other lines of business, fluid dairy processing and shopping center rentals. The fluid dairy processing segment sells approximately $33 \%$ of its products to the retail grocery segment and approximately $67 \%$ of its products to third parties. Real estate ownership (including the shopping center rental segment) is an important component of the Company soperations, providing both operational and economic benefit.

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## Critical Accounting Policies

Critical accounting policies are those accounting policies that management believes are important to the portrayal of Ingles financial condition and results of operations, and require management s most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain.

## Self-Insurance

The Company is self-insured for workers compensation and group medical and dental benefits. Risks and uncertainties are associated with self-insurance; however, the Company has limited its exposure by maintaining excess liability coverages. Self-insurance liabilities are established based on claims filed and estimates of claims incurred but not reported. The estimates are based on data provided by the respective claims administrators. These estimates can fluctuate if historical trends are not predictive of the future. The majority of the Company s properties are self-insured for casualty losses and business interruption; however, liability coverage is maintained.

## Asset Impairments

The Company accounts for the impairment of long-lived assets in accordance with Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. For assets to be held and used, the Company tests for impairment using undiscounted cash flows and calculates the amount of impairment using discounted cash flows. For assets held for sale, impairment is recognized based on the excess of remaining book value over expected recovery value. The recovery value is the fair value as determined by independent quotes or expected sales prices developed by internal associates. Estimates of future cash flows and expected sales prices are judgments based upon the Company s experience and knowledge of local operations and cash flows that are projected for several years into the future. These estimates can fluctuate significantly due to changes in real estate market conditions, the economic environment, capital spending decisions and inflation. The Company monitors the carrying value of long-lived assets for potential impairment each quarter based on whether any indicators of impairment have occurred.

## Closed Store Accrual

For properties closed prior to December 31, 2002 that were under long-term lease agreements, the present value of any remaining liability under the lease, discounted using risk-free rates and net of expected sublease recovery, is recognized as a liability and expensed. For all store closures subsequent to the adoption of SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities, effective December 31, 2002, the liability is recognized and expensed based on the difference between the present value of any remaining liability under the lease and the present value of the estimated market rate at which the Company expects to be able to sublease the properties. The Company s estimates of market rates are based on its experience, knowledge and typical third-party advice or market data. If the real estate and leasing markets change, sublease recovery could vary significantly from the recoveries originally assumed, resulting in a material change in the Company s recorded liability. The closed store accrual is included in the line item Accrued expenses and current portion of other long-term liabilities on the Condensed Consolidated Balance Sheet.

## Vendor Allowances

The Company receives funds for a variety of merchandising activities from the many vendors whose products the Company buys for resale in its stores. These incentives and allowances are primarily comprised of volume or purchase based incentives, advertising allowances, slotting fees, and promotional discounts. The purpose of these incentives and allowances is generally to help defray the costs incurred by the Company for stocking, advertising, promoting and selling the vendor s products. These allowances generally relate to short term arrangements with vendors, often relating to a period of a month or less, and are negotiated on a purchase-by-purchase or transaction-by-transaction basis. Whenever possible, vendor discounts and allowances that relate to buying and merchandising activities are recorded as a component of item cost in inventory and recognized in merchandise costs when the item is sold. Due to system constraints and the nature of certain allowances, it is sometimes not practicable to apply allowances to the item cost of inventory. In those instances, the allowances are applied as a reduction of merchandise costs using a rational and systematic methodology, which results in the recognition of these incentives when the inventory related to the vendor consideration received is sold. Vendor allowances applied as a reduction of merchandise costs totaled $\$ 25.6$ million and $\$ 24.3$ million for the fiscal quarters ended March 29, 2008 and March 31, 2007, respectively. For the six-month periods ended March 29, 2008 and March 31, 2007, vendor allowances applied as a reduction of merchandise costs totaled $\$ 50.5$ million and $\$ 45.9$ million, respectively. Vendor advertising allowances that represent a reimbursement of specific identifiable incremental costs of advertising the vendor specific products are recorded as a reduction to the related expense in the period that the related expense is incurred. Vendor advertising allowances recorded as a reduction of advertising expense totaled $\$ 4.1$ million for the fiscal quarter ended March 29, 2008 and $\$ 2.4$ million for the fiscal quarter ended March 31, 2007. For the six-month periods ended March 29, 2008 and March 31, 2007, vendor advertising allowances recorded as a reduction of
advertising expense totaled $\$ 6.7$ million and $\$ 4.8$ million, respectively.

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If vendor advertising allowances were substantially reduced or eliminated, the Company would likely consider other methods of advertising as well as the volume and frequency of its product advertising, which could increase or decrease our expenditures.

Similarly, the Company is not able to assess the impact of vendor advertising allowances on the creation of additional revenues, as it has no way to measure whether such allowances directly generate revenue for its stores.

## Uncertain Tax Positions

Despite the Company s belief that its tax positions are consistent with applicable tax laws, the Company believes that certain positions are likely to be challenged by taxing authorities. Settlement of any challenge can result in no change, a complete disallowance, or some partial adjustment reached through negotiations or litigation. Significant judgment is required in evaluating the Company $s$ tax positions. The Company spositions are evaluated in light of changing facts and circumstances, such as the progress of its tax audits as well as evolving case law. Income tax expense includes the impact of position provisions for and changes to uncertain tax positions as the Company considers appropriate. Unfavorable settlement of any particular position would require use of cash. Favorable resolution would be recognized as a reduction to income tax expense at the time of resolution.

During the quarter ended March 31, 2007 the Company settled a tax position under an initiative offered by one of the states in which the Company conducts its operations. As a result of this settlement, the Company reduced its reserve for uncertain income tax positions by $\$ 3.2$ million. This reduction is reflected as a reduction of income tax expense for the three- and six-month periods ended March 31, 2007.

## New Accounting Pronouncements

On July 13, 2006, the 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 a company sfinancial statements by prescribing a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken on a tax return. Additionally, FIN 48 provides guidance on de-recognition of tax benefits previously recognized and additional disclosures for unrecognized tax benefits, interest and penalties. FIN 48 is effective for fiscal years beginning after December 15, 2006, and was required to be adopted by the Company beginning September 30, 2007. As discussed in the Company s Notes to the Condensed Consolidated Financial Statements, the adoption of FIN 48 did not have a material impact.

## Results of Operations

Ingles operates on a 52- or 53-week fiscal year ending on the last Saturday in September. There are 13 and 26 weeks of operations included in the unaudited condensed consolidated statements of income for the three- and six-month periods ended March 29, 2008 and March 31, 2007. Comparable store sales are defined as sales by grocery stores in operation for the entire duration of the previous and current fiscal periods. Sales from replacement stores, major remodels, minor remodels and the addition of fuel stations to existing stores are included in the comparable store sales calculation from the date thereof. A replacement store is a new store that is opened to replace an existing nearby store that is closed. A major remodel entails substantial remodeling of an existing store and may include additional retail square footage. A minor remodel includes repainting, remodeling and updating the lighting and equipment throughout an existing store. For the three- and six-month periods ended March 29, 2008 and March 31, 2007, comparable store sales include 194 stores.

The following table sets forth, for the periods indicated, selected financial information as a percentage of net sales. For information regarding the various segments of the business, see Note H Lines of Business to the Unaudited Consolidated Financial Statements.

|  | Three Months Ended |  | Six Months Ended |  |
| :---: | :---: | :---: | :---: | :---: |
|  | $\begin{gathered} \text { MARCH } 29, \\ 2008 \end{gathered}$ | $\begin{gathered} \text { MARCH 31, } \\ 2007 \end{gathered}$ | $\begin{gathered} \text { MARCH } 29, \\ 2008 \end{gathered}$ | $\underset{2007}{\text { MARCH }} \mathbf{}$ |
| Net sales | 100.0\% | 100.0\% | 100.0\% | 100.0\% |
| Gross profit | 23.6\% | 24.5\% | 23.4\% | 24.2\% |
| Operating and administrative expenses | 19.6\% | 20.5\% | 19.4\% | 20.2\% |
| Rental income, net | 0.1\% | 0.2\% | 0.1\% | 0.2\% |
| Income from operations | 4.1\% | 4.2\% | 4.1\% | 4.2\% |
| Other income, net | 0.1\% | 0.1\% | 0.1\% | 0.1\% |
| Interest expense | 1.5\% | 1.8\% | 1.5\% | 1.8\% |

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| Income before income taxes | $\mathbf{2 . 7 \%}$ | $2.5 \%$ | $\mathbf{2 . 7 \%}$ | $2.5 \%$ |
| :--- | :--- | :--- | :--- | :--- |
| Income taxes | $\mathbf{1 . 0 \%}$ | $0.5 \%$ | $\mathbf{1 . 0 \%}$ | $0.7 \%$ |
| Net income | $\mathbf{1 . 7 \%}$ | $2.0 \%$ | $\mathbf{1 . 7 \%}$ | $1.8 \%$ |

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## Three Months Ended March 29, 2008 Compared to the Three Months Ended March 31, 2007

Net income for the second quarter of fiscal 2008 totaled $\$ 13.0$ million, a decrease of $\$ 0.5$ million from net income of $\$ 13.5$ million earned for the second quarter of fiscal 2007. Pre-tax income for the second quarter of fiscal 2008 totaled $\$ 21.0$ million, an increase of $26.1 \%$ over pre-tax income of $\$ 16.7$ million earned for the second quarter of fiscal 2007. Settlement of a state income tax position decreased income tax expense and increased net income by approximately $\$ 3.2$ million during the second quarter of fiscal 2007 . Food and energy inflation exceeded $5 \%$ and $8 \%$, respectively, during the three months ended March 2008. The Company s total and comparable store sales increases exceeded these CPI increases and resulted in higher gross profits and expense leverage.

Net Sales. Net sales increased $14.9 \%$ to $\$ 782.8$ million for the three months ended March 29, 2008 from $\$ 681.2$ million for the three months ended March 31, 2007. Ingles operated 197 stores at March 29, 2008, compared to 196 stores at March 31, 2007. Retail square footage was approximately 9.8 million at March 29, 2008 and 9.6 million at March 31, 2007. Sales improved in each department except video, with the largest percentage increases in the gasoline, deli, grocery and meat departments. The Company operated 10 additional fuel centers at March 29, 2008 compared to March 31, 2007. Total gasoline gallons sold increased approximately $19 \%$ while the average price per gas gallon increased 85 cents comparing the March fiscal 2008 quarter to the same period of fiscal 2007. Overall grocery sales were affected by rising costs during the quarter, which affected every area of the retail grocery segment.

Grocery segment comparable store sales grew $\$ 97.0$ million, or $15.0 \%$, in the second quarter of fiscal 2008 compared to the second quarter of fiscal 2007. Sales comparisons are also affected by the timing of the Easter holiday. In fiscal 2008, Easter fell in the Company s second fiscal quarter, but occurred in the third fiscal 2007 quarter. Excluding the effect of additional Easter sales in the second fiscal year 2008 quarter, the Company estimates comparable store sales increased $13.8 \%$.

Excluding gasoline and additional Easter sales, comparable store sales increased $\$ 49.4$ million, or $8.4 \%$, for the three months ended March 29 , 2008. The number of customer transactions (excluding gasoline) increased $9.7 \%$, while the average transaction changed by less than one-half of one percent. The Company believes this transaction data may reflect cost-conscious customers dining out less and changing purchasing habits towards lower priced items.

Changes in grocery segment sales for the quarter ended March 29, 2008 are summarized as follows (in thousands):

| Total grocery sales for the three months ended March 31,2007 | $\mathbf{\$ 6 5 2 , 0 5 0}$ |
| :--- | :---: |
| Comparable store sales increase (including gasoline) | $\mathbf{9 7 , 0 0 8}$ |
| Impact of stores opened in fiscal 2007 and 2008 | $\mathbf{2 , 6 6 1}$ |
| Impact of stores closed in fiscal 2007 and 2008 | $\mathbf{( 1 , 1 8 0 )}$ |
| Other | $\mathbf{3 3}$ |

Total grocery sales for the three months ended March 29, 2008
\$ 750,572

Net sales to outside parties for the Company s milk processing subsidiary increased $\$ 3.1$ million or $10.6 \%$ in the March 2008 quarter compared to the March 2007 quarter. The sales increase is primarily attributable to higher raw milk costs, which are generally passed on to customers in the pricing of milk products, offset by a decrease in case volume sales. For example, the Company s cost of $3.5 \%$ fat content raw milk was 52 cents per gallon higher, an increase of approximately $31 \%$, during the second quarter of fiscal 2008 compared to the second quarter of fiscal 2007.

Gross Profit. Gross profit for the three-month period ended March 29, 2008 increased $\$ 17.9$ million, or $10.8 \%$, to $\$ 184.5$ million, or $23.6 \%$ of sales, compared to $\$ 166.6$ million, or $24.5 \%$ of sales, for the three-month period ended March 31, 2007.

Gross profit dollars increased due to the higher sales volume in the grocery segment. The majority of grocery segment sales growth in dollars occurred in gasoline and non-perishable grocery. Gasoline generally earns a lower gross margin than the Company sother departments and non-perishable departments such as grocery generally earn lower gross margins than perishable departments. Excluding gasoline sales, grocery segment gross profit as a percentage of sales was $27.4 \%$ for the three months ended March 29,2008 compared to $27.0 \%$ for the same quarter of last fiscal year. During periods of rising prices, margins may temporarily increase due to the sale of goods purchased before cost increases.

Gross profit for the Company s milk processing subsidiary for the March 2008 quarter decreased $\$ 1.0$ million, or $15.6 \%$, to $\$ 5.3$ million, or $11.1 \%$ of sales, compared to $\$ 6.3$ million, or $14.8 \%$ of sales, for the March 2007 quarter. Rapidly rising raw milk prices decreased gross profit as a percentage of sales, as relatively stable per-gallon milk profit margins were applied to a higher sales price, and influenced a decrease in overall

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case volume sales.

In addition to the direct product cost, the cost of goods sold line item for the grocery segment includes inbound freight charges. The milk processing segment is a manufacturing process; therefore, the inbound freight charges as well as purchasing and receiving costs, production costs, inspection costs, warehousing costs, internal transfer costs, and other costs of distribution incurred by the milk processing segment are included in the cost of goods sold line item, while these items are included in operating and administrative expenses by the grocery segment.

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The Company s gross margins may not be comparable to those of other retailers, since some retailers include all of the costs related to their distribution network in cost of goods sold and others, like the Company, exclude a portion of the costs from gross profit, characterizing the costs as operating and administrative expenses.

Operating and Administrative Expenses. Operating and administrative expenses increased $\$ 13.6$ million, or $9.7 \%$, to $\$ 153.1$ million for the three months ended March 29, 2008, from $\$ 139.5$ million for the three months ended March 31, 2007. As a percentage of sales, operating and administrative expenses decreased to $19.6 \%$ for the three months ended March 29, 2008 compared to $20.5 \%$ for the three months ended March 31, 2007. A variety of factors contributed to the dollar increase.

A breakdown of the major increases (decreases) in operating and administrative expenses is as follows:

|  | Increase <br> (decrease) <br> in millions | Increase <br> (decrease) <br> as a $\%$ <br> of sales |
| :--- | :---: | :---: |
| Salaries and wages | $\$$ | 7.2 |

Salaries and wages increased in dollars due to additional labor hours required for the increased sales volume, but decreased as a percentage of sales due to the allocation of management salaries over higher sales dollars and sales growth in less labor-intensive departments such as gasoline.

Insurance expense increased due to increased employee health insurance and workers compensation claims.
Depreciation and amortization increased as a result of the Company s higher level of capital expenditures beginning in fiscal year 2006.
Advertising and promotion costs decreased as a higher percentage of costs were repaid by vendors in exchange for promoting products in the Company s print and broadcast advertising.

Utilities and fuel expense increased due to increases in market energy costs. These market increases affect the cost of store utilities as well as distribution costs.

Bank charges rose primarily due to increased fees for processing debit and credit cards. The increase is a result of both increased usage of cards and increased transaction fees related to the usage.

Rental Income, Net. Rental income, net totaled $\$ 0.9$ million for the quarter ended March 29, 2008 and $\$ 1.3$ million for the quarter ended March 31, 2007. The Company s expansion and relocation activities have resulted in less tenant space available for lease.

Gain (Loss) From Sale or Disposal of Assets. Losses from the sale or disposal of assets totaled $\$ 0.5$ million and $\$ 0.3$ million for the three months ended March 29, 2008 and March 31, 2007, respectively. There were no significant asset sale or disposal transactions in either fiscal quarter.

Other Income, Net. Other income, net increased $\$ 0.2$ million to $\$ 0.8$ million for the three-month period ended March 29, 2008 from $\$ 0.6$ million for the three-month period ended March 31, 2007. The increase was due primarily to increased sales of waste paper and packaging, offset by decreased interest income.

Interest Expense. Interest expense decreased $\$ 0.3$ million for the three-month period ended March 29, 2008 to $\$ 11.6$ million from $\$ 11.9$ million for the three-month period ended March 31, 2007. Total debt at March 29, 2008 was $\$ 626.1$ million compared to $\$ 548.1$ million at March 31, 2007. Interest expense decreased as new borrowings were at lower interest rates, reflecting decreases in market interest rates and the addition of borrowing collateralized by certain store properties and equipment. Interest capitalized as construction costs increased due to the greater number

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of new store, remodel and relocation projects undertaken by the Company in recent months.

Income Taxes. Income tax expense as a percentage of pre-tax income increased to $38.1 \%$ in the quarter ended March 29, 2008 compared to $18.9 \%$ in the quarter ended March 31, 2007 due to the settlement of a tax position under an initiative offered by one of the states in which the Company conducts its operations. As a result of this settlement the Company reduced its reserve for uncertain tax positions by $\$ 3.2$ million and reduced income tax expense by the same amount during the three months ended March 31, 2007. Without this reduction, the effective tax rate would have been $38.3 \%$ for the three months ended March 31, 2007.

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Net Income. Net income decreased $\$ 0.5$ million, or 3.8\%, for the three-month period ended March 29, 2008 to $\$ 13.0$ million compared to $\$ 13.5$ million for the three-month period ended March 31, 2007. Net income, as a percentage of sales, was $1.7 \%$ for the quarter ended March 29, 2008 and $2.0 \%$ for the quarter ended March 31, 2007. Basic and diluted earnings per share for Class A Common Stock were $\$ 0.56$ and $\$ 0.53$ for the quarter ended March 29, 2008 compared to $\$ 0.58$ and $\$ 0.55$, respectively, for the quarter ended March 31, 2007. Basic and diluted earnings per share for Class B Common Stock were each $\$ 0.51$ for the quarter ended March 29, 2008 compared to $\$ 0.53$ of basic and diluted earnings per share for the quarter ended March 31, 2007.

## Six Months Ended March 29, 2008 Compared to the Six Months Ended March 31, 2007

Net income for the first six months of fiscal 2008 totaled $\$ 25.7$ million, $4.1 \%$ higher than net income of $\$ 24.7$ million earned for the first six months of fiscal 2007. Pre-tax income for the first six months of fiscal 2008 totaled $\$ 41.7$ million, an increase of $20.3 \%$ over pre-tax income of $\$ 34.7$ million earned for the same period of fiscal 2007. Settlement of a state income tax position decreased income tax expense by approximately $\$ 3.2$ million during the first six months of fiscal 2007. Total and comparable store sales increased and gross profit dollars grew. Excluding lower margin gasoline sales, gross profit as a percentage of sales increased.

Net Sales. Net sales for the six months ended March 29, 2008 increased $14.1 \%$ to $\$ 1.56$ billion, compared to $\$ 1.37$ billion for the six months ended March 31, 2007. Sales improved in each department except video, with the largest percentage increases in the gasoline, deli, bakery, grocery and produce departments. Total gasoline gallons sold increased approximately $19 \%$ while the average price per gas gallon increased approximately $37 \%$ comparing the March fiscal 2008 six month period to the same period of fiscal 2007. Overall grocery sales were affected by rising costs during the fiscal 2008 six month period. The food category of the consumer price index increased $2.3 \%$ during the Company s first fiscal quarter and $5.3 \%$ during the Company s second fiscal quarter. These increases affected every area of the retail grocery segment. Overall, the Company s sales growth excluding gasoline exceeded food inflation.

Grocery segment comparable store sales grew $\$ 181.1$ million, or $13.9 \%$, for the six months ended March 2008 compared to the same period of fiscal 2007. Sales comparisons are also affected by the timing of the Easter holiday. In fiscal 2008, Easter fell in the Company s second fiscal quarter, but occurred in the third fiscal 2007 quarter. Excluding the effect of additional Easter sales on the first half of fiscal year 2008 quarter, the Company estimates comparable store sales increased $13.3 \%$.

Excluding gasoline and additional Easter sales, comparable store sales increased $\$ 99.1$ million, or $8.4 \%$, for the six months ended March 29, 2008. The number of customer transactions (excluding gasoline) increased $9.6 \%$, while the average transaction changed by less than one-half of one percent. The Company believes this transaction data may reflect cost-conscious customers dining out less and changing purchasing habits towards lower priced items.

Changes in grocery segment sales for the six months ended March 29, 2008 are summarized as follows (in thousands):

| Total grocery sales for the six months ended March 31, 2007 | $\mathbf{\$ 1 , 3 1 0 , 4 3 3}$ |
| :--- | ---: |
| Comparable store sales increase (including gasoline) | $\mathbf{1 8 1 , 0 8 5}$ |
| Impact of stores opened in fiscal 2007 and 2008 | $\mathbf{6 , 5 6 8}$ |
| Impact of stores closed in fiscal 2007 and 2008 | $\mathbf{( 3 , 1 1 2 )}$ |
| Other | $\mathbf{2 2}$ |

Total grocery sales for the six months ended March 29, 2008
\$ 1,494,996
Net sales to outside parties for the Company s milk processing subsidiary increased $\$ 8.5$ million, or $15.0 \%$, in the six-month period ended March 29, 2008 compared to the six-month period ended March 31, 2007. The sales increase is primarily attributable to increased raw milk costs in the six-month period ended March 29, 2008 compared to the six-month period ended March 31, 2007. Raw milk cost increases are typically passed on to customers in the pricing of milk products.

The Company expects sales growth for the remainder of fiscal 2008 to approximate the rate of growth experienced in the first six months of this fiscal year. Sales growth for the remainder of fiscal year 2008 will be influenced to some extent by market fluctuations in the per gallon price of gasoline, and overall food cost inflation. The Company also expects that the maturation of new and expanded stores will contribute to sales growth.

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In addition to the factors discussed above, the Company expects to accelerate the completion of new, remodeled or replacement stores and add additional fuel centers during the last six months of fiscal 2008.

Gross Profit. Gross profit for the six months ended March 29, 2008 increased $\$ 33.7$ million, or $10.2 \%$, to $\$ 365.1$ million compared to $\$ 331.4$ million, for the six months ended March 31, 2007. As a percent of sales, gross profit decreased to $23.4 \%$ for the six months ended March 29, 2008 from $24.2 \%$ for the six months ended March 31, 2007.

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Gross profit dollars increased due to the higher sales volume in the grocery segment. The majority of grocery segment sales growth in dollars occurred in gasoline and non-perishable grocery. Gasoline generally earns a lower gross margin than the Company s other departments and non-perishable departments such as grocery generally earn lower gross margins than perishable departments. Excluding gasoline sales, grocery segment gross profit as a percentage of sales was $26.9 \%$ for the six months ended March 29,2008 compared to $26.6 \%$ for the same period of last fiscal year. During periods of rising prices, margins may temporarily increase due to the sale of goods purchased before cost increases.

Gross profit for the Company s milk processing subsidiary for the March 2008 six month period decreased $\$ 1.1$ million, or $9.8 \%$, to $\$ 10.5$ million, or $10.8 \%$ of sales, compared to $\$ 11.6$ million, or $14.1 \%$ of sales, for the March 2007 six month period. Rapidly rising raw milk prices decreased gross profit as a percentage of sales, as relatively stable per-gallon milk profit margins were applied to a higher sales price, and influenced a decrease in overall case volume sales.

Operating and Administrative Expenses. Operating and administrative expenses increased $\$ 27.4$ million, or $9.9 \%$, to $\$ 303.3$ million for the six months ended March 29, 2008, from $\$ 276.0$ million for the six months ended March 31, 2007. As a percentage of sales, operating and administrative expenses decreased to $19.5 \%$ for the six-month period ended March 29,2008 from $20.2 \%$ for the six-month period ended March 31, 2007. A variety of factors contributed to the dollar increase.

A breakdown of the major increases (decreases) in operating and administrative expenses is as follows:

|  | Increase <br> (decrease) <br> in millions | Increase <br> (decrease) <br> as a \% <br> of sales |  |
| :--- | :--- | ---: | ---: |
| Salaries and wages | $\$$ | 14.7 | $0.94 \%$ |
| Depreciation and amortization | $\$$ | 2.7 | $0.17 \%$ |
| Utilities and fuel | $\$$ | 2.2 | $0.14 \%$ |
| Insurance expenses | $\$$ | 2.1 | $0.13 \%$ |
| Store supplies | $\$$ | 2.0 | $0.13 \%$ |
| Bank charges | $\$$ | 1.9 | $0.12 \%$ |

Salaries and wages increased in dollars due to additional labor hours required for the increased sales volume, but decreased as a percentage of sales due to the allocation of management salaries over higher sales dollars and sales growth in less labor-intensive departments such as gasoline.

Depreciation and amortization increased as a result of the Company s higher level of capital expenditures beginning in fiscal year 2006.
Utilities and fuel expense increased due to increases in market energy costs. These market increases affect store operating costs as well as distribution costs.

Insurance expense increased due to increased employee health insurance and workers compensation claims.

Store supplies expenses increased as a result of increases in petroleum costs, which affect the cost of plastic used in many of the Company s wraps, bags, and packaging. Overall sales increases also resulted in increased supply expenses, including higher proportionate sales increases in the deli and bakery departments, which require more wrapping and packaging.

Bank charges rose primarily due to increased fees for processing debit and credit cards. The increase is a result of both increased usage of cards and increased transaction fees related to the usage.

Rental Income, Net. Rental income, net decreased $\$ 0.2$ million to $\$ 2.1$ million for the six-month period ended March 29, 2008 from $\$ 2.3$ million in the March 2007 comparable period. The Company s expansion and relocation activities have resulted in less tenant space available for lease.

Gain (Loss) From Sale or Disposal of Assets. Losses from the sale or disposal of assets totaled $\$ 0.6$ million and $\$ 0.5$ million for the six months ended March 29, 2008 and March 31, 2007, respectively. There were no significant asset sale or disposal transactions in either fiscal quarter.

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Other Income, Net. Other income, net totaled $\$ 1.5$ million and $\$ 1.3$ million for the six-month periods ended March 29, 2008 and March 31, 2007, respectively. Increased sales of waste paper and packaging was partially offset by reduced interest income for the comparable six month periods.

Interest Expense. Interest expense decreased $\$ 0.8$ million to $\$ 23.1$ million for the six months ended March 29, 2008 from $\$ 23.9$ million for the six months ended March 31, 2007 . Interest expense decreased as new borrowings were at lower interest rates, reflecting decreases in market interest rates and the addition of borrowing collateralized by certain store properties and equipment.

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Interest capitalized as construction costs increased due to the greater number of new store, remodel and relocation projects undertaken by the Company in recent months.

Income Taxes. Income tax expense as a percentage of pre-tax income increased to $38.4 \%$ for the six-month period ended March 29,2008 compared to $28.9 \%$ for the six-month period ended March 31, 2007 due to the settlement of a tax position under an initiative offered by one of the states in which the Company conducts its operations. As a result of this settlement the Company reduced its reserve for uncertain tax positions by $\$ 3.2$ million and reduced income tax expense by the same amount during the six months ended March 31, 2007. Without this reduction, the effective tax rate would have been $38.1 \%$ for the six months ended March 31, 2007.

Net Income. Net income increased $\$ 1.0$ million, or $4.1 \%$, for the six-month period ended March 29, 2008 to $\$ 25.7$ million compared to $\$ 24.7$ million for the six-month period ended March 31, 2007. Net income, as a percentage of sales, was $1.7 \%$ for the six-month period ended March 2008 and $1.8 \%$ for the March 2007 comparable period. Basic and diluted earnings per share for Class A Common Stock were $\$ 1.10$ and $\$ 1.05$ for the six-month period ended March 29,2008 compared to $\$ 1.06$ and $\$ 1.01$, respectively, for the March 2007 comparable period. Basic and diluted earnings per share for Class B Common Stock were each $\$ 1.00$ for the fiscal period ended March 29, 2008 compared to $\$ 0.96$ of basic and diluted earnings per share for the March 2007 comparable period.

## Liquidity and Capital Resources

## Capital Expenditures

The Company believes that a key to its ability to continue to develop a loyal customer base is providing conveniently located, clean and modern stores which provide customers with good service and a broad selection of competitively priced products. Therefore, the Company has invested and will continue to invest significant amounts of capital toward the modernization of its store base. The Company s modernization program includes the opening of new stores, the completion of major remodels and expansion of selected existing stores, the relocation of selected existing stores to larger, more convenient locations and the completion of minor remodeling of its remaining existing stores. The Company will also add fuel centers and other products complementary to grocery sales where market conditions and real estate considerations warrant.

Capital expenditures totaled $\$ 114.1$ million for the six-month period ended March 31, 2007, including the completion of four replacement stores, one remodeled store, and the purchase of nine land parcels. The Company also purchased two shopping centers where it operated leased stores and added five fuel centers. Capital expenditures also included the costs of upgrading and replacing store equipment, technology investments, capital expenditures related to the Company s distribution operation and its milk processing plant, and expenditures for stores to open later in fiscal 2008 and in fiscal 2007.

Ingles capital expenditure plans for all of fiscal 2008 include investments of approximately $\$ 200$ million. For the balance of fiscal 2008, the Company plans to open two new stores, three remodeled stores, three replacement stores, and add a total of eight new fuel stations at new or existing stores. Expenditure plans will also include investments in stores expected to open in fiscal 2009, as well as technology improvements, upgrading and replacing existing store equipment, warehouse and transportation equipment, and improvements to the Company s milk processing plant.

The Company expects that its net annual capital expenditures will be in the range of approximately $\$ 150$ to $\$ 175$ million going forward in order to maintain a modern store base. In general, the Company is increasing the average size of stores being built, which could affect both the number of projects pursued at any given time and the cost of these projects. The number of projects may also fluctuate due to the varying costs of the types of projects pursued including new stores, major remodel/expansions or minor remodels. The Company makes decisions on the allocation of capital expenditure dollars based on many factors, including the competitive environment, other Company capital initiatives and its financial condition.

The Company does not generally enter into commitments for capital expenditures other than on a store-by-store basis at the time it begins construction on a new store or begins a major or minor remodeling project. The Company generally engages in major remodeling and new store development in no more than three or four locations at a time. Construction commitments at March 29, 2008 totaled $\$ 37.8$ million.

## Liquidity

The Company generated net cash from operations of $\$ 34.7$ million for the six months ended March 29, 2008 compared to $\$ 52.8$ million for the comparable 2007 period. In addition to the $\$ 1.0$ million increase in net income over the comparative six-month periods, inventory increased $\$ 13.5$ million during the six months ended March 29, 2008 to support increased growth and reflecting food cost inflation. Accounts payable and accrued expenses decreased $\$ 6.3$ million, primarily from the timing of invoice payments.

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Cash used by investing activities for the six-month period ended March 29, 2008 totaled $\$ 113.7$ million, comprised primarily of $\$ 114.1$ million of capital expenditures during the period, partially offset by $\$ 0.4$ million of proceeds from the sale of assets.

Cash provided by financing activities during the six-month period ended March 29, 2008 totaled $\$ 75.1$ million. During this period, the Company reduced its line of credit borrowings and funded capital expenditures with $\$ 87.1$ million of new borrowings secured by

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certain of the Company s store properties and equipment. These loans generally may be repaid in three years or less without penalty and have a current weighted average fixed interest rate of approximately $6.05 \%$. Cash used by financing activities during this period included principal payments on long-term debt of $\$ 5.1$ million and dividend payments of $\$ 7.7$ million.

At March 29, 2008, the Company had lines of credit with five banks totaling $\$ 185.0$ million, of which $\$ 13.5$ million was outstanding at March 29, 2008. The lines of credit mature between October 2008 and November 2010. The lines provide the Company with various interest rate options generally at rates less than the prime rate. The Company also has a facility with a bank to issue up to $\$ 30.0$ million of unused letters of credit, of which $\$ 20.7$ million of unused letters of credit were issued at March 29, 2008. This facility matures in October 2009. The Company is not required to maintain compensating balances in connection with these lines of credit. The lines of credit contain provisions that under certain circumstances would permit lending institutions to terminate or withdraw their respective extensions of credit to the Company. Included among the triggering factors permitting the termination or withdrawal of lines of credit to the Company are certain events of default, including both monetary and non-monetary defaults, the initiation of bankruptcy or insolvency proceedings, and the failure of the Company to meet certain financial covenants designated in its respective loan documentation. The Company was in compliance with all financial covenants related to these lines of credit at March 29, 2008.

At March 29, 2008, the Company had $\$ 349.8$ million principal amount of senior subordinated notes (the Notes ) outstanding to mature in December 2011. The indenture governing the Notes contains certain restrictive covenants relating to, among other things, the issuance of indebtedness and the payment of dividends. The Notes are currently redeemable by the Company at a premium rate of $102.903 \%$. The redemption premium decreases to $101.369 \%$ on December 1, 2008. Beginning December 1, 2009 the Notes can be redeemed at par. The Company was in compliance with all financial covenants related to the Notes at March 29, 2008.

The Company s long term debt agreements generally have cross-default provisions which could result in the acceleration of payments due under the Company s lines of credit and the Notes in the event of default under any one instrument.

The Company s principal sources of liquidity are expected to be cash flow from operations, borrowings under its lines of credit and long-term financing. As of March 29, 2008, the Company had unencumbered real property and equipment with a net book value of approximately $\$ 561.9$ million. The Company believes, based on its current results of operations and financial condition, that its financial resources, including existing bank lines of credit, short- and long-term financing expected to be available to it and internally generated funds, will be sufficient to meet planned capital expenditures and working capital requirements for the foreseeable future, including any debt service requirements of additional borrowings. However, there can be no assurance that any such sources of financing will be available to the Company on acceptable terms, or at all.

It is possible that, in the future, the Company s results of operations and financial condition will be different from that described in this report based on a number of factors. These factors may include, among others, increased food and gasoline costs, increased competition, changing regional and national economic conditions, adverse climatic conditions affecting food production and delivery and changing demographics as well as the additional factors discussed below under Forward Looking Statements. It is also possible, for such reasons, that the results of operations from the new, expanded, remodeled and/or replacement stores will not meet or exceed the results of operations from existing stores that are described in this report.

## Contractual Obligations and Commercial Commitments

There have been no material changes in contractual obligations and commercial commitments subsequent to September 29, 2007.

## Off Balance Sheet Arrangements

The Company is not a party to any off-balance sheet arrangements that have, or are reasonably likely to have, a current or future material effect on the Company s financial condition, revenues, expenses, results of operations, liquidity, capital expenditures or capital resources.

## Quarterly Cash Dividends

Since December 27, 1993, the Company has paid regular quarterly cash dividends of $\$ 0.165$ (sixteen and one-half cents) per share on its Class A Common Stock and $\$ 0.15$ (fifteen cents) per share on its Class B Common Stock for an annual rate of $\$ 0.66$ and $\$ 0.60$ per share, respectively.

The Company expects to continue paying regular cash dividends on a quarterly basis. However, the Board of Directors periodically reconsiders the declaration of dividends. The Company pays these dividends at the discretion of the Board of Directors, and the continuation of these payments, the amount of such dividends, and the form in which the dividends are paid (cash or stock) depends upon the results of operations, the

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financial condition of the Company and other factors which the Board of Directors deems relevant. In addition, certain loan agreements containing provisions outlining minimum tangible net worth requirements restrict the ability of the Company to pay additional dividends to approximately $\$ 159.1$ million based on tangible net worth at March 29, 2008. Further, the Company is prevented from declaring dividends at any time that it is in default under the indenture governing the Company s senior subordinated debt. In addition, the terms of the indenture may restrict the ability of the Company to pay additional dividends based on certain financial parameters.

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Seasonality
Sales in the grocery segment of the Company s business are subject to a slight seasonal variance due to holiday related sales and due to sales in areas where seasonal homes are located. Sales are traditionally higher in the Company sfirst fiscal quarter due to the inclusion of sales related to Thanksgiving and Christmas. The Company s second fiscal quarter traditionally has the lowest sales of the year, unless Easter occurs in that quarter as it did in fiscal year 2008. In the third and fourth quarter, sales are affected by the return of customers to seasonal homes in our market area. The fluid dairy segment of the Company $s$ business has slight seasonal variation to the extent of its sales into the grocery industry. The Company s real estate segment is not subject to seasonal variations.

## Impact of Inflation

The following table from the United States Bureau of Labor Statistics lists changes in the Consumer Price Index that could have an effect on the Company s operations. One of the Company s significant costs is labor, which increases with general inflation. Inflation in energy costs affects both the Company s gasoline sales and distribution expenses.

|  | Three Months Ended |  | Twelve Months Ended |  |
| :---: | :---: | :---: | :---: | :---: |
|  | $\begin{gathered} \text { MARCH } 29, \end{gathered}$ | $\begin{gathered} \text { MARCH 31, } \\ 2007 \end{gathered}$ | $\underset{2008}{\text { MARCH }} \mathbf{2 9}$, | $\begin{gathered} \text { MARCH 31, } \\ 2007 \end{gathered}$ |
| All items | 3.1 \% | 4.7\% | 4.0 \% | 2.8\% |
| Food and beverages | 5.1 \% | 7.4\% | 4.4 \% | 3.3\% |
| Energy | 8.6 \% | 22.9\% | 17.0 \% | 4.4\% |

Forward Looking Statements
This Quarterly Report contains certain forward-looking statements within the meaning of Section 21E of the Exchange Act. The words expect, anticipate, intend, plan, believe, seek and similar expressions are intended to identify forward-looking statements. While these forward-look statements and the related assumptions are made in good faith and reflect the Company s current judgment regarding the direction of the Company s business, actual results will almost always vary, sometimes materially, from any estimates, predictions, projections, assumptions or other future performance suggested herein. Such statements are based upon a number of assumptions and estimates which are inherently subject to significant risks and uncertainties many of which are beyond the Company s control. Some of these assumptions inevitably will not materialize, and unanticipated events will occur which will affect the Company s results. Some important factors (but not necessarily all factors) that affect the Company s revenues, growth strategies, future profitability and operating results, or that otherwise could cause actual results to differ materially from those expressed in or implied by any forward-looking statement, include business and economic conditions generally in the Company s operating area; the Company s ability to successfully implement its expansion and operating strategies and to manage rapid expansion; pricing pressures and other competitive factors; reduction in per gallon retail gasoline prices; the maturation of new and expanded stores; the Company s ability to reduce costs and achieve improvements in operating results; the availability and terms of financing; increases in labor and utility costs; success or failure in the ownership and development of real estate; changes in the laws and government regulations applicable to the Company; and changes in accounting policies, standards, guidelines or principles as may be adopted by regulatory agencies as well as the Financial Accounting Standards Board.

Consequently, actual events affecting the Company and the impact of such events on the Company s operations may vary significantly from those described in this report or contemplated or implied by statements in this report.

## Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The one-month London Interbank Offered Rate (LIBOR) is used as the basis for the interest rate on the Company s lines of credit as well as on certain other borrowings. This rate, as tracked by the Wall Street Journal, has decreased from approximately $5.3 \%$ at the end of September 2007 to approximately $2.7 \%$ at the end of March 2008.

## Item 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

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The Company maintains disclosure controls and procedures designed to provide reasonable assurance of achieving the objective that information in its Exchange Act reports is recorded, processed, summarized and reported within the time periods specified and pursuant to the regulations of the Securities and Exchange Commission. Disclosure controls and procedures, as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act, include controls and procedures designed to ensure the information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is accumulated and communicated to the Company s management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. It should be noted that the Company s system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met.

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As required by SEC Rule 13a-15(b), the Company carried out an evaluation, under the supervision and with participation of its management including its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of its disclosure controls and procedures as of March 29, 2008, the end of the period covered by this report. In making this evaluation, it considered matters previously identified and disclosed in connection with the filing of its Form 10-K for fiscal 2007. After consideration of the matters discussed above, the Company has concluded that its controls and procedures were effective as of March 29, 2008.
(b) Changes in Internal Control over Financial Reporting

No other change in internal control over financial reporting occurred during the Company s last fiscal quarter that materially affected, or is reasonably likely to materially affect, the company s internal control over financial reporting.

Part II. Other Information

## Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The Annual Meeting of Stockholders of Ingles Markets, Incorporated was held Tuesday, February 12, 2008. At this meeting, the Company s stockholders voted on the following proposals:

1. Elect nine members of the Board of Directors by holders of Class A Common Stock and Class B Common Stock to serve until the 2009 Annual Meeting of Stockholders:

| Name | Common Stock | Votes For | Votes <br> Withheld |
| :--- | :---: | ---: | ---: |
| Fred D. Ayers | Class A | $11,146,155$ | 279,982 |
| John O. Pollard | Class A | $10,754,395$ | 671,742 |
| Ronald B. Freeman | Class B | $10,959,541$ | 0 |
| Charles L. Gaither, Jr. | Class B | $10,959,541$ | 0 |
| Robert P. Ingle | Class B | $10,959,541$ | 0 |
| Robert P. Ingle, II | Class B | $10,959,541$ | 0 |
| James W. Lanning | Class B | $10,959,541$ | 0 |
| Charles E. Russell | Class B | $10,959,541$ | 0 |
| Laura Ingle Sharp | Class B | $10,959,541$ | 0 |

## Item 6. EXHIBITS

(a) Exhibits.

1) Exhibit 31.1 Rule 13a-14(a) Certificate
2) Exhibit 31.2 Rule 13a-14(a) Certificate
3) Exhibit 32.1 Certification Pursuant to 18 U.S.C. Section 1350
4) Exhibit 32.2 Certification Pursuant to 18 U.S.C. Section 1350

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## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Form 10-Q to be signed on its behalf by the undersigned thereunto duly authorized.

INGLES MARKETS, INCORPORATED

Date: May 5, 2008

Date: May 5, 2008
/s/ Robert P. Ingle
Robert P. Ingle
Chief Executive Officer
/s/ Ronald B. Freeman
Ronald B. Freeman
Vice President-Finance and Chief Financial Officer


[^0]:    See notes to unaudited interim financial statements.

