INGLES MARKETS INC
Form 10-Q
August 09, 2011

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 June 25, 2011

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

For the transition period from ______ to ______

Commission file number 0-14706.

INGLES MARKETS, INCORPORATED

(Exact name of registrant as specified in its charter)

North Carolina **(State or other jurisdiction of** **incorporation or organization)**	**56-0846267** **(I.R.S. Employer** **Identification No.)**
P.O. Box 6676, Asheville NC **(Address of principal executive offices)**	**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 þ No ¨.

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨.

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

Large accelerated filer	¨	Accelerated filer	þ
Non-accelerated filer	¨ (Do not check if a smaller reporting company.)	Smaller reporting company	¨

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

As of July 25, 2011, the Registrant had 12,939,533 shares of Class A Common Stock, $0.05 par value per share, outstanding and 11,503,726 shares of Class B Common Stock, $0.05 par value per share, outstanding.

INGLES MARKETS, INCORPORATED

INDEX

Part I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

INGLES MARKETS, INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	June 25, 2011	September 25, 2010
ASSETS		
Current Assets:		
Cash and cash equivalents	**$ 6,859,785**	$ 57,854,587
Certificates of deposit		6,000,000
Receivables net	**60,214,826**	53,080,901
Inventories	**305,382,753**	286,430,753
Other current assets	**16,835,114**	19,603,242
Total Current Assets	**389,292,478**	422,969,483
Property and Equipment Net	**1,085,279,940**	1,089,390,677
Restricted Investments	**95,736,465**	
Other Assets	**20,734,160**	19,997,950
Total Assets	**$ 1,591,043,043**	$ 1,532,358,110
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Current portion of long-term debt	**$ 74,319,186**	$ 92,184,965
Accounts payable trade	**155,189,052**	141,690,162
Accrued expenses and current portion of other long-term liabilities	**78,338,584**	85,098,765
Total Current Liabilities	**307,846,822**	318,973,892
Deferred Income Taxes	**67,714,000**	72,213,000
Long-Term Debt	**782,780,279**	725,314,038
Other Long-Term Liabilities	**7,649,599**	6,776,391
Total Liabilities	**1,165,990,700**	1,123,277,321
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; 12,939,533 shares issued and outstanding June 25, 2011; 12,889,433 shares issued and outstanding at September 25, 2010	**646,977**	644,472
Class B, convertible to Class A, $0.05 par value; 100,000,000 shares authorized; 11,503,726 shares issued and outstanding June 25, 2011; 11,582,826 shares issued and outstanding at September 25, 2010	**575,186**	579,141
Paid-in capital in excess of par value	**117,050,922**	117,592,932
Retained earnings	**306,779,258**	290,264,244
Total Stockholders Equity	**425,052,343**	409,080,789
Total Liabilities and Stockholders Equity	**$ 1,591,043,043**	$ 1,532,358,110

See notes to unaudited interim financial statements.

INGLES MARKETS, INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Three Months Ended	
	June 25, 2011	**June 26, 2010**
Net sales	**$ 910,978,159**	$ 856,128,148
Cost of goods sold	**709,638,537**	659,241,460
Gross profit	**201,339,622**	196,886,688
Operating and administrative expenses	**169,762,486**	164,842,080
Rental income, net	**575,418**	458,527
Gain from sale or disposal of assets	**2,655,912**	129,571
Income from operations	**34,808,466**	32,632,706
Other income, net	**945,421**	1,533,480
Interest expense	**15,344,197**	16,206,484
Income before income taxes	**20,409,690**	17,959,702
Income tax expense (benefit):		
Current	**10,091,000**	3,598,000
Deferred	**(2,406,000)**	2,916,750
	7,685,000	6,514,750
Net income	**$ 12,724,690**	$ 11,444,952
Per share amounts:		
Class A Common Stock		
Basic earnings per common share	**$ 0.54**	$ 0.49
Diluted earnings per common share	**$ 0.52**	$ 0.46
Class B Common Stock		
Basic earnings per common share	**$ 0.49**	$ 0.44
Diluted earnings per common share	**$ 0.49**	$ 0.44
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.

INGLES MARKETS, INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Nine Months Ended	
	June 25, 2011	**June 26, 2010**
Net sales	**$ 2,654,102,227**	$ 2,534,086,573
Cost of goods sold	**2,064,645,838**	1,966,070,348
Gross profit	**589,456,389**	568,016,225
Operating and administrative expenses	**505,586,653**	488,047,319
Rental income, net	**1,443,413**	1,127,348
Gain (loss) from sale or disposal of assets	**2,676,674**	(63,145)
Income from operations	**87,989,823**	81,033,109
Other income, net	**3,146,470**	3,229,883
Interest expense	**46,912,397**	48,956,253
Income before income taxes	**44,223,896**	35,306,739
Income tax expense (benefit):		
Current	**22,070,000**	10,987,000
Deferred	**(5,945,000)**	1,711,250
	16,125,000	12,698,250
Net income	**$ 28,098,896**	$ 22,608,489
Per share amounts:		
Class A Common Stock		
Basic earnings per common share	**$ 1.20**	$ 0.97
Diluted earnings per common share	**$ 1.15**	$ 0.92
Class B Common Stock		
Basic earnings per common share	**$ 1.09**	$ 0.88
Diluted earnings per common share	**$ 1.09**	$ 0.88
Cash dividends per common share:		
Class A Common Stock	**$ 0.495**	$ 0.495
Class B Common Stock	**$ 0.450**	$ 0.450

See notes to unaudited interim financial statements.

INGLES MARKETS, INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY (UNAUDITED)

NINE MONTHS ENDED JUNE 25, 2011 AND JUNE 26, 2010

	Class A Common Stock		Class B Common Stock		Paid-in Capital in Excess of	Retained	
	Shares	Amount	Shares	Amount	Par Value	Earnings	Total
Balance, September 26, 2009	12,888,608	$ 644,430	11,623,651	$ 581,183	$ 118,184,132	$ 274,891,998	$ 394,301,743
Net income						22,608,489	22,608,489
Cash dividends						(11,605,452)	(11,605,452)
Common stock conversions	750	38	(750)	(38)			
Stock repurchases, at cost			(40,000)	(2,000)	(591,200)		(593,200)
Balance, June 26, 2010	**12,889,358**	**$ 644,468**	**11,582,901**	**$ 579,145**	**$ 117,592,932**	**$ 285,895,035**	**$ 404,711,580**
Balance, September 25, 2010	12,889,433	$ 644,472	11,582,826	$ 579,141	$ 117,592,932	$ 290,264,244	$ 409,080,789
Net income						28,098,896	28,098,896
Cash dividends						(11,583,882)	(11,583,882)
Common stock conversions	50,100	2,505	(50,100)	(2,505)			
Stock repurchases, at cost			(29,000)	(1,450)	(542,010)		(543,460)
Balance, June 25, 2011	**12,939,533**	**$ 646,977**	**11,503,726**	**$ 575,186**	**$ 117,050,922**	**$ 306,779,258**	**$ 425,052,343**

See notes to unaudited interim financial statements.

INGLES MARKETS, INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Nine Months Ended	
	June 25, 2011	**June 26, 2010**
Cash Flows from Operating Activities:		
Net income	**$ 28,098,896**	$ 22,608,489
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	**63,811,769**	64,011,316
(Gain) loss on disposals of property and equipment	**(2,676,674)**	63,145
Receipt of advance payments on purchases contracts	**2,714,583**	2,677,167
Recognition of advance payments on purchases contracts	**(2,090,196)**	(2,536,045)
Deferred income taxes	**(5,945,000)**	1,711,250
Changes in operating assets and liabilities:		
Receivables	**(4,132,727)**	(2,607,222)
Inventory	**(18,952,000)**	(11,879,441)
Other assets	**65,706**	9,632,296
Accounts payable and accrued expenses	**13,285,851**	(5,265,884)
Net Cash Provided by Operating Activities	**74,180,208**	78,415,071
Cash Flows from Investing Activities:		
Purchase of certificates for deposit		(3,000,000)
Proceeds from maturities of certificates of deposit	**6,000,000**	15,000,000
Purchases of restricted investments	**(95,736,465)**	
Proceeds from sales of property and equipment	**111,560**	1,434,109
Capital expenditures	**(63,023,224)**	(65,274,290)
Net Cash Used by Investing Activities	**(152,648,129)**	(51,840,181)
Cash Flows from Financing Activities:		
Proceeds from short-term borrowings	**172,829,090**	
Payments on short-term borrowings	**(172,829,090)**	
Proceeds from other long-term borrowings	**99,740,000**	
Principal payments on long-term borrowings	**(60,139,539)**	(23,737,858)
Common stock repurchases	**(543,460)**	(593,200)
Dividends paid	**(11,583,882)**	(11,605,452)
Net Cash Provided (Used) by Financing Activities	**27,473,119**	(35,936,510)
Net Decrease in Cash and Cash Equivalents	**(50,994,802)**	(9,361,620)
Cash and cash equivalents at beginning of year	**57,854,587**	59,535,848
Cash and Cash Equivalents at End of Period	**$ 6,859,785**	$ 50,174,228

See notes to unaudited interim financial statements.

INGLES MARKETS, INCORPORATED AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM FINANCIAL STATEMENTS

Nine Months Ended June 25, 2011 and June 26, 2010

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 June 25, 2011, the results of operations for the three-month and nine-month periods ended June 25, 2011 and June 26, 2010, and the changes in stockholders equity and cash flows for the nine-month periods ended June 25, 2011 and June 26, 2010. 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-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 25, 2010 filed by the Company under the Securities Exchange Act of 1934 on November 30, 2010.

The results of operations for the three-month and nine-month periods ended June 25, 2011 are not necessarily indicative of the results to be expected for the full fiscal year.

Certain amounts in the Condensed Consolidated Statements of Cash Flows for the nine months ended June 26, 2010 have been reclassified to conform to the current-year presentation of certificates of deposit.

B. RESTATEMENT OF PRIOR FINANCIAL STATEMENTS

While researching alternative methods to calculate retained claim liability for our self-insured workers compensation insurance program, we discovered errors in the application of actuarial methods used to estimate the obligation for future payments resulting from claims due to past events. These errors primarily related to the Company s selection of loss development factors and the application of such factors to the population of claims. The impact of these prior period misstatements to our consolidated financial statements resulted in the understatement of workers compensation expense with a corresponding understatement of workers compensation self insurance liabilities over multiple fiscal years through September 25, 2010.

In accordance with applicable accounting guidance, an adjustment to the financial statements for each individual prior period presented is required to reflect the correction of the period-specific effects of the change, if material. Based on our evaluation of relevant quantitative and qualitative factors, we determined the identified corrections are immaterial to the Company s individual prior period consolidated financial statements, however, the cumulative correction of the prior period errors would be material to our current year Condensed Consolidated Statements of Income. Consequently, we have restated the accompanying Condensed Consolidated Balance Sheet as of September 25, 2010 and the opening September 25, 2010 and September 26, 2009 balances presented in our Condensed Consolidated Statement of Changes in Stockholders Equity as of June 25, 2011, appearing herein, from amounts previously reported to correct the prior period adjustments by the understatement of workers compensation self insurance liabilities with a corresponding reduction to retained earnings.

The impact of these adjustments is not material to our 2010 and 2009 statement of cash flows as the impact to individual line items within operating activities is not material and there was no net impact to cash provided by operating activities, cash used in investing activities and cash used in financing activities. However, we will restate the 2010 and 2009 statement of cash flows as it appears in our 2011 Annual Report on Form 10-K to reflect changes to individual line items within operating activities.

We have also adjusted the Condensed Consolidated Statements of Income for the three and nine months ended June 26, 2010 by approximately $380,000 ($224,000 net of tax) and approximately $1.1 million ($672,000 net of tax), respectively, to reflect the additional workers compensation expense. We have also adjusted the Condensed Consolidated Statement of Cash Flows for the nine months ended June 26, 2010 to reflect changes to the individual line items within operating activities. The current year effect of the adjustment is not material to the condensed consolidated financial statements.

The tables below summarize the effect of the restatement of previously reported consolidated financial statements for the periods that will be presented in our 2011 Annual report on Form 10-K (in thousands, except per share data):

	As of September 25, 2010		
	As Previously Reported	Adjustment	As Restated
Consolidated Balance Sheet			
Deferred income taxes (current)	$ 6,070	$ 3,058	$ 9,128
Other current assets	16,545	3,058	19,603
Total assets	1,529,300	3,058	1,532,358
Self-insurance liabilities	14,523	7,817	22,340
Accrued expenses and current portion of other long-term liabilities	77,282	7,817	85,099
Retained earnings	295,023	(4,759)	290,264
Total stockholders equity	413,840	(4,759)	409,081
Total liabilities and stockholders equity	1,529,300	3,058	1,532,358

	Year Ended September 25, 2010			Year Ended September 26, 2009		
	As Previously Reported	Adjustment	As Restated	As Previously Reported	Adjustment	As Restated
Consolidated Statement of Income						
Operating and administrative expenses	$ 653,674	$ 1,518	$ 655,192	$ 632,410	$ 1,521	$ 633,931
Income from operations	110,965	(1,518)	109,447	113,223	(1,521)	111,702
Income before income taxes	50,335	(1,518)	48,817	46,234	(1,521)	44,713
Income tax expense (benefit):						
Deferred	5,745	(621)	5,124	16,803	(626)	16,177
Net income	31,739	(897)	30,842	28,828	(895)	27,933
Earnings per share:						
Class A Common Stock						
Basic	1.35	(0.03)	1.32	1.23	(0.04)	1.19
Diluted	1.30	(0.04)	1.26	1.18	(0.04)	1.14
Class B Common Stock						
Class A	1.23	(0.03)	1.20	1.12	(0.04)	1.08
Class B	1.23	(0.03)	1.20	1.12	(0.04)	1.08

C. NEW ACCOUNTING PRONOUNCEMENTS

There were no accounting standards adopted in the nine-month period ended June 25, 2011.

D. ALLOWANCE FOR DOUBTFUL ACCOUNTS

Receivables are presented net of an allowance for doubtful accounts of $454,000 and $596,000 at June 25, 2011 and September 25, 2010, respectively.

E. INCOME TAXES

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 June 25, 2011, the Company had approximately $53,000 accrued for interest and penalties.

The Company s effective tax rate differs from the federal statutory rate primarily as a result of state income taxes and tax credits. As of June 25, 2011, the Company had gross unrecognized tax benefits of approximately $140,000, 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 2005. Additionally, the Internal Revenue Service has completed its examination of the Company s U.S. Federal income tax returns filed through fiscal 2008. As of June 25, 2011 certain of the Company s tax returns for fiscal 2006-2009 are under examination by certain state tax authorities.

The Company had approximately $2.9 million and $6.0 million of refundable income taxes included in the caption Other current assets in the Condensed Consolidated Balance Sheets at June 25, 2011 and September 25, 2010, respectively.

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

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

	June 25, 2011	September 25, 2010
Property, payroll and other taxes payable	**$ 13,742,788**	$ 15,829,531
Salaries, wages and bonuses payable	**22,468,824**	23,291,110
Self-insurance liabilities	**23,657,944**	22,340,050
Income taxes payable	**6,714,757**	
Interest	**7,036,131**	19,531,257
Other	**4,718,140**	4,106,817
	$ 78,338,584	$ 85,098,765

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 $325,000 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 $8.0 million and $5.2 million for each of the three-month periods ended June 25, 2011 and June 26, 2010, respectively. For the nine-month periods ended June 25, 2011 and June 26, 2010, employee insurance expense, net of employee contributions, totaled $24.9 million and $21.8 million, respectively.

G. LONG-TERM DEBT

In May 2009, the Company issued $575.0 million aggregate principal amount of senior notes due in 2017 (the Notes) in a private placement. The Notes bear an interest rate of 8.875% per annum and were issued at a discount to yield 9.5% per annum.

The Company may redeem all or a portion of the Notes at any time on or after May 15, 2014 at the following redemption prices (expressed as percentages of the principal amount), if redeemed during the 12-month period beginning May 15 of the years indicated below:

Year	
2013	104.438%
2014	102.219%
2015 and thereafter	100.000%

In connection with the offering of the Notes, the Company entered into a new three-year $175.0 million line of credit and terminated three other lines of credit. At June 25, 2011, the Company had $175.0 million of total commitments available under the line of credit, with no borrowings outstanding.

The line of credit provides the Company with various interest rate options generally at rates less than prime. The line allows the Company to issue up to $30.0 million in unused letters of credit, of which $8.7 million of unused letters of credit were issued at June 25, 2011. The Company is not required to maintain compensating balances in connection with the line of credit.

On December 29, 2010, the Company completed the funding of $99.7 million of Recovery Zone Facility Bonds (the Bonds) for: (A) acquisition, construction and equipping of an approximately 830,000 square foot new warehouse and distribution center and a new grocery store to be located in Buncombe County, North Carolina (the Project), and (B) the payment of certain expenses incurred in connection with the issuance of the Bonds. The final maturity date of the Bonds is January 1, 2036.

Bond proceeds were invested in a trust account with the Bond trustee. The Company receives disbursements from the account as it submits requisitions to the trustee for incurred Project costs. The account with the Bond trustee is listed in the line item Restricted investments on the Condensed Consolidated Balance Sheets and consists of money market deposits and United States Treasury securities which mature no later than September 2012. These investments are classified as available-for-sale and are stated at market value.

The Bonds were issued by the Buncombe County Industrial Facilities and Pollution Control Financing Authority and were purchased by certain financial institutions. Under a Continuing Covenant and Collateral Agency Agreement (the Covenant Agreement) between the financial institutions and the Company, the financial institutions will hold the Bonds until January 1, 2017, subject to certain events. Mandatory redemption of the Bonds by the Company in the annual amount of $4,530,000 begins on January 1, 2014. The Company may redeem the Bonds without penalty or premium at any time prior to January 1, 2017.

Interest earned by bondholders on the Bonds is exempt from Federal and North Carolina income taxation. Initially, the interest rate on the Bonds is equal to one month LIBOR (adjusted monthly) plus a credit spread, adjusted to reflect the income tax exemption.

The Company s obligation to repay the Bonds is collateralized by the Project. Additional collateral may be required in order to meet certain loan to value criteria in the Covenant Agreement. The Covenant Agreement incorporates substantially all financial covenants included in the line of credit.

Also on December 29, 2010, the Company executed an amendment to extend the maturity of the line of credit from May 12, 2012 to December 29, 2015. All other terms of the Line Agreement remain in place.

The Notes, the Bonds and the line 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 June 25, 2011.

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 Notes indenture in the event of default under any one instrument.

H. 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 April 21, 2011, January 20, 2011 and October 21, 2010 to stockholders of record on April 7, 2011, January 6, 2011 and October 7, 2010, respectively.

I. 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.

The Company calculates earnings per share for its Class A Common Stock and Class B Common Stock in accordance with FASB ASC Topic 260.

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 dividend rights of each class of stock. Diluted earnings per share is calculated assuming 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 and prior periods.

	Three Months Ended June 25, 2011		**Nine Months Ended June 25, 2011**	
	Class A	**Class B**	**Class A**	**Class B**
Numerator: Allocated net income				