INGLES MARKETS INC
Form 10-Q
August 07, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 28, 2014

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 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
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 .

As of August 6, 2014, the Registrant had 13,519,633 shares of Class A Common Stock, $0.05 par value per share, outstanding and 9,240,143 shares of Class B Common Stock, $0.05 par value per share, outstanding.

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INGLES MARKETS, INCORPORATED

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Part I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

INGLES MARKETS, INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	June 28, 2014	September 28, 2013
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 4,025,031	$ 16,844,007
Receivables - net	65,261,620	59,929,491
Inventories	337,083,967	329,691,256
Other current assets	15,206,673	28,075,314
Total Current Assets	421,577,291	434,540,068
Property and Equipment – Net	1,206,295,174	1,212,132,055
Other Assets	26,433,139	22,655,614
Total Assets	$ 1,654,305,604	$ 1,669,327,737
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current Liabilities:		
Current portion of long-term debt	$ 13,783,183	$ 18,956,761
Accounts payable - trade	153,397,178	160,314,263
Accrued expenses and current portion of other long-term liabilities	58,356,008	72,002,983
Total Current Liabilities	225,536,369	251,274,007
Deferred Income Taxes	71,261,000	86,082,000
Long-Term Debt	895,518,575	893,514,238
Other Long-Term Liabilities	28,375,898	27,818,217
Total Liabilities	1,220,691,842	1,258,688,462
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; 13,519,633 shares issued and outstanding June 28, 2014; 13,437,975 shares issued and outstanding at September 28, 2013	675,982	671,899
Class B, convertible to Class A, $0.05 par value; 100,000,000 shares authorized; 9,240,143 shares issued and outstanding June 28, 2014; 9,321,801 shares issued	462,007	466,090

and outstanding at September 28, 2013		
Paid-in capital in excess of par value	77,186,249	77,186,249
Retained earnings	355,289,524	332,315,037
Total Stockholders' Equity	433,613,762	410,639,275
Total Liabilities and Stockholders' Equity	$ 1,654,305,604	$ 1,669,327,737

See notes to unaudited condensed consolidated financial statements.

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INGLES MARKETS, INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Three Months Ended	
	June 28, 2014	June 29, 2013
Net sales	$ 978,261,998	$ 934,015,475
Cost of goods sold	763,110,952	723,362,566
Gross profit	215,151,046	210,652,909
Operating and administrative expenses	182,718,535	177,812,124
Gain from sale or disposal of assets	927,851	62,172
Income from operations	33,360,362	32,902,957
Other income, net	671,320	778,323
Interest expense	11,568,452	16,001,255
Loss on early extinguishment of debt	—	43,089,248
Income (loss) before income taxes	22,463,230	(25,409,223)
Income tax expense (benefit)	8,629,000	(10,985,000)
Net income (loss)	$ 13,834,230	$ (14,424,223)
Per share amounts:		
Class A Common Stock		
Basic earnings (loss) per common share	$ 0.63	$ (0.62)
Diluted earnings (loss) per common share	$ 0.61	$ (0.62)
Class B Common Stock		
Basic earnings (loss) per common share	$ 0.57	$ (0.56)
Diluted earnings (loss) per common share	$ 0.57	$ (0.56)
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 condensed consolidated financial statements.

INGLES MARKETS, INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Nine Months Ended	
	June 28, 2014	June 29, 2013
Net sales	$ 2,871,147,455	$ 2,789,687,266
Cost of goods sold	2,246,366,795	2,172,183,545
Gross profit	624,780,660	617,503,721
Operating and administrative expenses	538,551,319	527,635,772
Gain from sale or disposal of assets	1,136,008	4,237,814
Income from operations	87,365,349	94,105,763
Other income, net	2,249,183	2,082,218
Interest expense	35,049,245	47,281,153
Loss on early extinguishment of debt	—	43,089,248
Income before income taxes	54,565,287	5,817,580
Income tax expense	20,743,000	584,000
Net income	$ 33,822,287	$ 5,233,580
Per share amounts:		
Class A Common Stock		
Basic earnings per common share	$ 1.54	$ 0.23
Diluted earnings per common share	$ 1.49	$ 0.21
Class B Common Stock		
Basic earnings per common share	$ 1.40	$ 0.21
Diluted earnings per common share	$ 1.40	$ 0.21
Cash dividends per common share		
Class A Common Stock	$ 0.495	$ 1.155
Class B Common Stock	$ 0.450	$ 1.050

See notes to unaudited condensed consolidated financial statements.

INGLES MARKETS, INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (UNAUDITED)

NINE MONTHS ENDED JUNE 28, 2014 AND JUNE 29, 2013

	Class A Common Stock Shares	Class A Common Stock Amount	Class B Common Stock Shares	Class B Common Stock Amount	Paid-in Capital in Excess of Par Value	Retained Earnings	Total
Balance, September 29, 2012	12,953,635	$ 647,682	11,306,141	$ 565,307	$ 114,236,249	$ 341,964,231	$ 457,413,469
Net income	—	—	—	—	—	5,233,580	5,233,580
Cash dividends	—	—	—	—	—	(26,833,458)	(26,833,458)
Common stock conversions	53,590	2,680	(53,590)	(2,680)	—	—	—
Stock repurchases, at cost	—	—	(1,500,000)	(75,000)	(37,050,000)	—	(37,125,000)
Balance, June 29, 2013	13,007,225	$ 650,362	9,752,551	$ 487,627	$ 77,186,249	$ 320,364,353	$ 398,688,591
Balance, September 28, 2013	13,437,975	$ 671,899	9,321,801	$ 466,090	$ 77,186,249	$ 332,315,037	$ 410,639,275
Net income	—	—	—	—	—	33,822,287	33,822,287
Cash dividends	—	—	—	—	—	(10,847,800)	(10,847,800)
Common stock conversions	81,658	4,083	(81,658)	(4,083)	—	—	—
Balance, June 28, 2014	13,519,633	$ 675,982	9,240,143	$ 462,007	$ 77,186,249	$ 355,289,524	$ 433,613,762

See notes to unaudited condensed consolidated financial statements.

INGLES MARKETS, INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Nine Months Ended	
	June 28, 2014	June 29, 2013
Cash Flows from Operating Activities:		
Net income	$ 33,822,287	$ 5,233,580
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	72,845,281	71,082,750
Loss on early extinguishment of debt	—	43,089,248
Gain on disposals of property and equipment	(1,136,008)	(4,237,814)
Receipt of advance payments on purchases contracts	2,518,662	3,215,720
Recognition of advance payments on purchases contracts	(2,455,180)	(2,632,535)
Deferred income taxes	(15,362,000)	479,000
Changes in operating assets and liabilities:		
Receivables	(5,332,129)	1,555,201
Inventory	(7,392,711)	(4,929,613)
Other assets	10,950,772	(10,915,150)
Accounts payable and accrued expenses	(14,443,183)	(19,884,732)
Net Cash Provided by Operating Activities	74,015,791	82,055,655
Cash Flows from Investing Activities:		
Proceeds from sales of property and equipment	278,166	7,732,616
Capital expenditures	(73,095,891)	(76,776,219)
Net Cash Used by Investing Activities	(72,817,725)	(69,043,603)
Cash Flows from Financing Activities:		
Proceeds from short-term borrowings	327,226,731	566,231,646
Payments on short-term borrowings	(327,226,731)	(602,877,000)
Proceeds from issuance of bonds	—	700,000,000
Bond issuance costs	—	(9,318,363)
Proceeds from other long-term borrowings	14,000,000	8,000,000
Principal payments on long-term borrowings	(17,169,242)	(583,461,082)
Prepayment penalties on debt extinguishment	—	(27,759,630)
Stock repurchases	—	(37,125,000)
Dividends paid	(10,847,800)	(26,833,458)
Net Cash Used by Financing Activities	(14,017,042)	(13,142,887)
Net Decrease in Cash and Cash Equivalents	(12,818,976)	(130,835)
Cash and cash equivalents at beginning of period	16,844,007	4,683,410
Cash and Cash Equivalents at End of Period	$ 4,025,031	$ 4,552,575

See notes to unaudited condensed consolidated financial statements.

INGLES MARKETS, INCORPORATED AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM FINANCIAL STATEMENTS

Nine Months Ended June 28, 2014 and June 29, 2013

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 28, 2014, the results of operations for the three-month and nine-month periods ended June 28, 2014 and June 29, 2013, and the changes in stockholders' equity and cash flows for the nine-month periods ended June 28, 2014 and June 29, 2013. 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 28, 2013 filed by the Company under the Securities Exchange Act of 1934 on December 12, 2013.

The results of operations for the three-month and nine-month periods ended June 28, 2014 are not necessarily indicative of the results to be expected for the full fiscal year.

B. NEW ACCOUNTING PRONOUNCEMENTS

In April 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2014-08 "Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity" (ASU 2014-08). ASU 2014-08 is aimed at reducing the frequency of disposals reported as discontinued operations by focusing on strategic shifts that have or are expected to have a major impact on an entity's operations and financial results. Such a shift could include the disposal of a major line of business, a major geographical area, a major equity method of investment or other major parts of the entity. ASU 2014-08 also permits companies to have continuing cash flows and significant continuing involvement with the disposed component. ASU 2014-08 requires expanded disclosures for discontinued operations and new disclosures for individually material disposals that do not meet the definition of a discontinued operation. The Company has early adopted ASU effective June 28, 2014. ASU 2014-08 did not have a material impact on the Company's financial position or results of operations.

C. ALLOWANCE FOR DOUBTFUL ACCOUNTS

Receivables are presented net of an allowance for doubtful accounts of $763,000 at June 28, 2014 and $773,000 at September 28, 2013.

D. 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 28, 2014, the Company had approximately $52,000 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 28, 2014, 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 2010. Additionally, the Internal Revenue Service has completed its examination of the Company's U.S. Federal income tax returns filed through fiscal 2011.

The Company had approximately $13.8 million of refundable income taxes included in the caption "Other current assets" in the Condensed Consolidated Balance Sheets at September 28, 2013.

On September 13, 2013, the IRS released final tangible property regulations under Sections 162(a) and 263(a) of the Internal Revenue Code regarding the deduction and capitalization of expenditures related to tangible property as well as dispositions of tangible property. These regulations will be effective for the Company's fiscal year ending September 26, 2015. Taxpayers may elect to apply them to tax years beginning on or after January 1, 2012. The Company does not anticipate that the regulations will have a material impact on the Company's consolidated results of operations, cash flows or financial position.

E. 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 28, 2014	September 28, 2013
Property, payroll and other taxes payable	$ 13,575,109	$ 16,771,941
Salaries, wages and bonuses payable	23,804,445	25,129,025
Self-insurance liabilities	13,423,165	12,844,143
Interest payable	2,595,268	12,993,252
Other	4,958,021	4,264,622
	$ 58,356,008	$ 72,002,983

Self-insurance liabilities are established for general liability claims, 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, $500,000 for general liability and $325,000 per covered person for medical care benefits for a policy year. At June 28, 2014 the Company's self-insurance reserves totaled $29.8 million. Of this amount, $13.4 million is accounted for as a current liability and $16.4 million as a long-term liability. Employee insurance expense, including workers' compensation and medical care benefits, net of employee contributions, totaled $8.0 million and $6.7 million for each of the three-month periods ended June 28, 2014 and June 29, 2013, respectively. For the nine-month periods ended June 28, 2014 and June 29, 2013, employee insurance expense, net of employee contributions, totaled $20.0 million and $24.5 million, respectively.

F. LONG-TERM DEBT

In June 2013, the Company issued $700.0 million aggregate principal amount of senior notes due in 2023 (the "Notes") in a private placement. The Notes bear an interest rate of 5.750% per annum and were issued at par. Note proceeds were used to repay $575.0 million aggregate principal amount of senior notes maturing in 2017, $52.0 million of indebtedness outstanding under the Company's line of credit, and to pay costs related to the offering of the Notes. Remaining Note proceeds will be used for general corporate purposes, including future capital expenditures.

The Company filed a registration statement with the Securities and Exchange Commission to exchange the private placement notes with registered notes. The exchange has been completed.

The Company may redeem all or a portion of the Notes at any time on or after June 15, 2018 at the following redemption prices (expressed as percentages of the principal amount), if redeemed during the 12-month period beginning June 15 of the years indicated below:

Year	
2018	102.875%
2019	101.917%
2020	100.958%
2021 and thereafter	100.000%

In connection with the offering of the Notes, the Company extended the maturity date of its $175.0 million line of credit from December 29, 2015 to June 12, 2018 and modified certain interest rate options and covenants. At June 28, 2014, the Company had no borrowings outstanding under the line of credit.

The line of credit provides the Company with various interest rate options based on the prime rate, the Federal Funds Rate, or the London Interbank Offering Rate. The line allows the Company to issue up to $30.0 million in unused letters of credit, of which $10.9 million of unused letters of credit were issued at June 28, 2014. 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 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.

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 would hold the Bonds until January 2, 2018, subject to certain events. Mandatory redemption of the Bonds by the Company in the annual amount of $4,530,000 began on January 1, 2014.

In connection with the offering of the Notes, the Company extended the maturity date of the Covenant Agreement from January 2, 2018 to June 30, 2021 and modified certain interest rate options and covenants. The Company may redeem the Bonds without penalty or premium at any time prior to June 30, 2021.

Interest earned by bondholders on the Bonds is exempt from Federal and North Carolina income taxation. 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 was 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.

On June 23, 2014 the Company amended the Line and the Covenant Agreement to a) reduce the Consolidated Net Worth requirement and b) increase the maximum allowed Restricted Payments in both the Line and the Covenant Agreement.

The amendments provide additional flexibility for the Company to consider stock repurchases under a plan approved by the Company's Board of Directors during the year ended September 28, 2013. Under the plan up to four million shares of the Company's Class A and Class B Common stock may be repurchased through open market purchases, block trades, purchases from the Company's Investment/Profit Sharing Plan and in negotiated private transactions. To date, 1.5 million shares have been repurchased under the plan, leaving 2.5 million shares available for repurchase.

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 the line 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 the line of credit at June 28, 2014.

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 line of credit, Bond and Notes indenture in the event of default under any one instrument.

G. 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 October 24, 2013 to stockholders of record on October 10, 2013.

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 23, 2014 to stockholders of record on January 9, 2014.

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 24, 2014 to stockholders of record on April 10, 2014.

On December 7, 2012, the Company declared a special dividend of $0.66 per share of Class A Common Stock and $0.60 per share of Class B Common Stock payable on December 31, 2012 to shareholders of record on December 21, 2012. 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 December 31, 2012 to stockholders of record on December 21, 2012.

For additional information regarding the dividend rights of the Class A Common Stock and Class B Common Stock, please see Note 8, “Stockholders’ Equity” to the Consolidated Financial Statements of the Annual Report on Form 10-K filed by the Company under the Securities Exchange Act of 1934 on December 12, 2013.

H. 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 using the two-class method 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 unless the conversion is anti-dilutive. For the three months ended June 29, 2013, 11,227,553 shares of convertible Class B Common Stock were not included in the diluted earnings per share calculation. The tables below reconcile the numerators and denominators of basic and diluted earnings per share for current and prior periods.

	Three Months Ended June 28, 2014		Nine Months Ended June 28, 2014	
	Class A	Class B	Class A	Class B
Numerator: Allocated net income				
Net income allocated, basic	$ 8,527,374	$ 5,306,856	$ 20,784,430	$ 13,037,857
Conversion of Class B to Class A shares	5,306,856	—	13,037,857	—
Net income allocated, diluted	$ 13,834,230	$ 5,306,856	$ 33,822,287	$ 13,037,857
Denominator: Weighted average shares outstanding				
Weighted average shares outstanding, basic	13,509,637	9,250,139	13,468,474	9,291,302
Conversion of Class B to Class A shares	9,250,139	—	9,291,302	—
Weighted average shares outstanding, diluted	22,759,776	9,250,139	22,759,776	9,291,302
Earnings per share				
Basic	$ 0.63	$ 0.57	$ 1.54	$ 1.40
Diluted	$ 0.61	$ 0.57	$ 1.49	$ 1.40

The per share amounts for the third quarter of fiscal 2013 and the nine months ended June 29, 2013 are based on the following amounts:

	Three Months Ended June 29, 2013		Nine Months Ended June 29, 2013	
	Class A	Class B	Class A	Class B
Numerator: Allocated net income				
Net income (loss) allocated, basic				