TASTY BAKING CO
Form 10-Q
November 01, 2010

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

FORM 10-Q

(Mark One)

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

For the thirteen weeks ended September 25, 2010

o 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 1-5084

TASTY BAKING COMPANY
(Exact name of Company as specified in its charter)

Pennsylvania (State of Incorporation)	23-1145880 (IRS Employer Identification Number)

Navy Yard Corporate Center, Three Crescent Drive, Suite 200, Philadelphia, Pennsylvania 19112
(Address of principal executive offices including Zip Code)

215-221-8500
(Company'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 o

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 o NO o

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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	o	Accelerated filer	o
Non-accelerated filer	o	Smaller reporting company	x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
YES o NO x

There were 8,582,286 shares of Common Stock outstanding as of November 1, 2010.

TASTY BAKING COMPANY AND SUBSIDIARIES

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Part I. FINANCIAL INFORMATION
Item 1. Financial Statements

TASTY BAKING COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(000's, except per share amounts)

	For the Thirteen Weeks Ended		For the Thirty-nine Weeks Ended	
	September 25, 2010	September 26, 2009	September 25, 2010	September 26, 2009
Gross sales	$ 68,234	$ 74,056	$ 214,379	$ 229,517
Less discounts and allowances	(27,864)	(30,472)	(87,347)	(92,813)
Net sales	40,370	43,584	127,032	136,704
Costs and expenses:				
Cost of sales, exclusive of depreciation shown below	29,883	28,670	92,178	86,042
Depreciation	2,656	3,486	11,238	10,045
Selling, general and administrative	13,140	12,489	38,069	37,560
Interest expense	1,823	720	4,721	1,870
Other (income) expense, net	1,165	(873)	1,094	(1,256)
	48,667	44,492	147,300	134,261
Income (loss) before provision for income taxes	(8,297)	(908)	(20,268)	2,443
Provision for income taxes	3,357	377	8,074	(700)
Net income (loss)	$ (4,940)	$ (531)	$ (12,194)	$ 1,743
Average common shares outstanding:				
Basic	8,151	8,064	8,144	8,061
Diluted	8,151	8,064	8,144	8,061
Per share of common stock:				
Net income (loss):				
Basic	$ (0.61)	$ (0.07)	$ (1.50)	$ 0.21
Diluted	$ (0.61)	$ (0.07)	$ (1.50)	$ 0.21

Cash dividend	$ 0.05	$ 0.05	$ 0.15	$ 0.15

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

TASTY BAKING COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(000's)

	For the Thirty-nine Weeks Ended	
	September 25, 2010	September 26, 2009
Cash flows from (used for) operating activities		
Net income (loss)	$ (12,194)	$ 1,743
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	11,238	10,045
Amortization	408	276
Accretion of asset retirement obligation	206	294
Gain on sale of property, plant and equipment	(645)	(9)
(Gain) loss on sale of route	(21)	1
Defined benefit pension expense	238	934
Pension contributions	(2,314)	(1,792)
(Increase) decrease in deferred taxes	(8,295)	1,038
(Increase) decrease in prepaid rent	4,385	(6,034)
Decrease in reserve for restructure	(264)	(715)
Share-based compensation	1,300	992
Postretirement benefit income	-	(4,107)
Other	(95)	1,486
Changes in assets and liabilities:		
(Increase) decrease in receivables	(471)	96
Increase in inventories	(3,302)	(475)
(Increase) decrease in prepayments, deferred taxes and other	(1,380)	714
(Increase) decrease in accrued taxes	174	(729)
Increase (decrease) in accounts payable, accrued payroll and other current liabilities	3,476	(26)
Net cash from (used for) operating activities	$ (7,556)	$ 3,732
Cash flows from (used for) investing activities		
Independent sales distributor loan repayments	2,037	2,401
Proceeds from sale of property, plant and equipment	6,032	24
Purchase of property, plant and equipment	(12,019)	(34,080)
Loans to independent sales distributors	(1,615)	(2,068)
Other	120	(202)
Net cash used for investing activities	$ (5,445)	$ (33,925)
Cash flows from (used for) financing activities		

Dividends paid		(1,288)		(1,278)
Repurchase of treasury shares		(108)		-
Payment on long-term debt		(4,415)		(10,363)
Increase in long-term debt		16,680		41,717
Net increase in cash overdraft		2,132		149
Net cash from financing activities	$	13,001	$	30,225
Net increase in cash and cash equivalents		-		32
Cash and cash equivalents, beginning of year		5		58
Cash and cash equivalents, end of period	$	5	$	90

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

TASTY BAKING COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)
(000's)

	September 25, 2010	December 26, 2009
Assets		
Current assets:		
Cash and cash equivalents	$ 5	$ 5
Receivables, less allowance of $3,145 and $3,063 respectively	19,941	19,480
Inventories	10,069	6,767
Deferred income taxes	3,389	3,389
Prepayments and other	3,043	2,158
Total current assets	36,447	31,799
Property, plant and equipment:		
Land	400	1,433
Buildings and improvements	22,784	66,724
Machinery and equipment	123,289	151,327
Construction in progress	6,109	43,367
	152,582	262,851
Less accumulated depreciation	(42,419)	(141,199)
	110,163	121,652
Other assets:		
Route territories	2,016	2,102
Long-term receivables from independent sales distributors	8,905	9,286
Long-term prepaid rent, net	3,017	7,452
Deferred income taxes	23,812	16,085
Miscellaneous	1,144	1,094
	38,894	36,019
Total assets	$ 185,504	$ 189,470
Liabilities		
Current liabilities:		
Accounts payable	$ 15,770	$ 8,824
Accrued payroll and employee benefits	4,768	6,457
Cash overdraft	8,056	5,924
Current obligations under capital leases	971	919
Notes payable, banks and current portion of long-term debt	4,861	1,128
Reserve for restructure	813	1,078
Other current liabilities	7,276	7,535
Total current liabilities	42,515	31,865
Accrued pensions	21,022	25,257
Asset retirement obligations	-	7,444
Long-term debt	96,738	88,147
	1,275	1,387

Long-term obligations under capital leases, less current portion				
Other non-current liabilities		8,193		7,586
Total liabilities	$	169,743	$	161,686
Shareholders' equity				
Accumulated other comprehensive loss	$	(5,421)	$	(6,348)
Capital in excess of par value of stock		27,355		28,016
Common stock, par value $0.50 per share and entitled to one vote per share: Authorized 30,000 shares, issued 9,116 shares, outstanding 8,582 shares		4,558		4,558
Retained earnings (accumulated deficit)		(1,922)		11,560
Treasury stock, at cost		(8,809)		(10,002)
Total shareholders' equity	$	15,761	$	27,784
Total liabilities and shareholders' equity	$	185,504	$	189,470

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Notes to Condensed Consolidated Financial Statements
All disclosures are pre-tax, unless otherwise noted.

1. Summary of Significant Accounting Policies

Nature of the Business
Tasty Baking Company (the "Company") is a leading producer of sweet baked goods and one of the nation's oldest and largest independent baking companies, in operation since 1914. It has two manufacturing facilities, one in Philadelphia, Pennsylvania and a second facility in Oxford, Pennsylvania.

Fiscal Year
The Company and its subsidiaries operate on a 52-53 week fiscal year, ending on the last Saturday of December. Fiscal year 2010 is a 52-week year. Fiscal year 2009 was a 52-week year.

Basis of Consolidation
The condensed consolidated financial statements include the accounts of the Company and its subsidiaries. All intercompany accounts and transactions have been eliminated.

The condensed consolidated financial statements included herein have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP") have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments, consisting of only normal recurring items, which are necessary for a fair statement of the results of operations for the periods shown. The results of operations for such periods are not necessarily indicative of the results expected for the full year or for any future period.

Use of Estimates
The preparation of condensed consolidated financial statements in conformity with GAAP requires management to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an ongoing basis, the Company evaluates its estimates, including those related to customer sales, discounts and allowances, long-lived asset impairment, indefinite-lived asset impairment, pension plan assumptions, workers' compensation expense and income taxes. Actual results may differ from these estimates.

Concentration of Credit
The Company encounters, in the normal course of business, exposure to concentrations of credit risk with respect to trade receivables. Ongoing credit evaluations of customers' financial conditions are performed and, generally, no collateral is required. The Company maintains reserves for potential credit losses and such losses have not exceeded management's expectations.

Revenue Recognition
Revenue is recognized when title and risk of loss pass, which is upon receipt of goods by the independent sales distributors, retailers or third party distributors. For route sales, the Company sells to independent sales distributors who, in turn, sell to retailers. Revenue for sales to independent sales distributors is recognized upon receipt of the product by the distributor. For sales made directly to a customer or a third party distributor, revenue is recognized upon receipt of the products by the retailer or third party distributor.

Sale of Routes

Sales distribution routes are primarily owned by independent sales distributors that purchase the exclusive right to sell and distribute Tastykake® products in defined geographic areas. When the Company sells routes to independent sales distributors, it recognizes a gain or loss on the sale. Routes sold by the Company are either existing routes that the Company has previously purchased from an independent sales distributor or newly established routes in new areas. Any gain or loss recorded by the Company is based on the difference between the sales price and the carrying value of the route. Any potential impairment of net carrying value is reserved as identified. The Company recognizes gains or losses on sales of routes when all material services or conditions related to the sale have been substantially performed or satisfied by the Company. In most cases, the Company will finance a portion of the purchase price with interest bearing notes, which are required to be repaid in full. Interest rates on the notes are based on Treasury or LIBOR yields plus a spread. The Company has no obligation to later repurchase a route but may choose to do so to facilitate a change in route ownership.

Sales distribution routes owned by the Company are considered to have an indefinite life and are reviewed for impairment at least annually or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Any potential impairment is recognized when the fair value of the route is less than the net carrying value. As of September 25, 2010 and December 26, 2009, the net carrying value of sales distribution routes owned by the Company was $2.0 million and $2.1 million, respectively.

Cash and Cash Equivalents

The Company considers investments with an original maturity of three months or less on its acquisition date to be cash equivalents. Cash overdrafts are recorded within current liabilities. Cash flows associated with cash overdrafts are classified as financing activities.

Inventory Valuation

Inventories, which include material, labor and manufacturing overhead, are stated at the lower of cost or market, cost being determined using the first-in, first-out ("FIFO") method. Inventory balances for raw materials, work in progress and finished goods are regularly analyzed and provisions for excess and obsolete inventory are recorded, as necessary, based on the forecast of product demand and production requirements.

Property and Depreciation

Property, plant and equipment are carried at cost. Depreciation is computed by the straight-line method over the following estimated useful lives of the assets.

Asset Category	Estimated Useful Life
Buildings and improvements	26-39 years
Machinery and equipment	7-15 years
Vehicles	5-10 years
Capitalized hardware and software	5 years
Construction in progress	Not applicable

Spare parts are capitalized as part of machinery and equipment and are expensed as utilized or capitalized as part of the relevant fixed asset. Spare parts are valued using a moving average method and are reviewed for potential obsolescence on a regular basis. Reserves are established for all spare parts that are no longer usable and have no fair market value. During the second quarter of 2010, the Company disposed of $1.3 million of excess and obsolete spare parts, for which the Company had previously provided a full reserve. During the third quarter of 2010, the Company recorded a charge of $0.6 million related to the disposal of spare parts that had previously been expected to be relocated to the Company's new bakery and distribution facility at the Navy Yard. As of September 25, 2010 and December 26, 2009, the Company had reserves for excess and obsolete spare parts of $0.1 million and $1.5 million, respectively.

Costs of major additions, replacements and betterments are capitalized, while maintenance and repairs, which do not improve or extend the life of the respective assets, are expensed as incurred. For significant projects, the Company capitalizes interest and labor costs associated with the construction and installation of plant and equipment and significant information technology development projects.

Long-lived assets are reviewed for impairment at least annually or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. In instances where the carrying amount may not be recoverable, the review for potential impairment utilizes estimates and assumptions of future cash flows directly related to the asset. For assets where there is no plan for future use, the review for impairment includes estimates and assumptions of the fair value of the asset, which is based on the best information available. These assets are recorded at the lower of their book value or fair value.

The Company settled its conditional asset retirement obligation related to the Hunting Park, Philadelphia manufacturing facility in connection with the sale of the property during the third quarter of 2010. Prior to the sale of the building the Company had recorded $0.2 million of interest associated with the asset retirement obligation during fiscal 2010. As of September 25, 2010 the Company does not have any conditional asset retirement obligations. As of December 26, 2009, the Company's conditional asset retirement obligation totaled $7.5 million.

Grants

The Company receives grants from various government agencies for employee training purposes. Expenses for the training are recognized in the condensed consolidated Statements of Operations at the time the training takes place. When the proper approvals are given and funds are received from the government agencies, the Company records an offset to the training expense already recognized.

In 2007, the Company received a $0.6 million grant from the Department of Community and Economic Development of the Commonwealth of Pennsylvania ("DCED"). The opportunity grant has certain spending, job retention and nondiscrimination conditions with which the Company must comply. The Company accounted for this grant under the deferred income approach and will amortize the deferred income over the same period as the useful life of the asset acquired with the grant. The assets acquired with the grant were placed into service in the first quarter of 2010, and likewise the amortization of the grant also commenced in the first quarter of 2010.

Additionally, in conjunction with The Reinvestment Funds, Allegheny West Foundation and the DCED, the Company participates in Project Fresh Start (the "Project"). The Project is an entrepreneurial development program that provides an opportunity for qualified minority entrepreneurs to purchase independent sales distribution routes. The source of grant monies for this program is the DCED. The grants are used by minority applicants to partially fund their purchase of an independent sales distribution route.

Because the Project's grant funds merely pass through the Company in its role as an intermediary, the Company records an offsetting asset and liability for the total amount of grants as they relate to the Project. There is no impact to the condensed consolidated Statements of Operations related to the establishment of, or subsequent change to, the asset and liability amounts.

Marketing Costs

The Company expenses marketing costs, which include advertising and consumer promotions, as incurred or over the period in which future benefits are expected to be received. Marketing costs are included as a part of selling, general and administrative expense. Total marketing costs, including direct marketing and marketing overhead costs, totaled $0.9 million and $2.7 million, for the thirteen and thirty-nine weeks ended September 25, 2010, respectively. Total marketing costs, including direct marketing and marketing overhead costs, totaled $0.9 million and $2.8 million, for the thirteen and thirty-nine weeks ended September 26, 2009, respectively.

Computer Software Costs

The Company capitalizes certain costs, such as software coding, installation and testing that are incurred to purchase or create and implement internal use computer software. The majority of the Company's capitalized software relates to the implementation of enterprise resource planning and handheld computer systems. The Company's unamortized capitalized computer software costs totaled $4.4 million and $5.0 million as of September 25, 2010 and December 26, 2009, respectively. The Company recognized $0.6 million and $1.5 million of amortization expense related to its capitalized computer software costs for the thirteen and thirty-nine weeks ended September 25, 2010, respectively. The Company recognized $0.7 million and $1.9 million of amortization expense related to its capitalized computer software costs for the thirteen and thirty-nine weeks ended September 26, 2009, respectively.

Freight, Shipping and Handling Costs

Outbound freight, shipping and handling costs are included as a part of selling, general and administrative expense. Total outbound freight, shipping and handling costs totaled $2.8 million and $8.6 million, for the thirteen and thirty-nine weeks ended September 25, 2010 and $2.6 million and $8.2 million, for the thirteen and thirty-nine weeks ended September 26, 2009, respectively. Inbound freight, shipping and handling costs are capitalized with inventory and expensed with cost of sales.

Pension Plan

The Company's funding policy for the pension plan is to contribute amounts deductible for federal income tax purposes plus such additional amounts, if any, as the Company's actuarial consultants advise to be appropriate. In 1987 the Company elected to immediately recognize all gains and losses in excess of the pension corridor, which is equal to the greater of ten percent of the projected pension benefit obligation or ten percent of the market-related value of plan assets. The Company accrues normal periodic pension expense or income during the year based upon certain assumptions and estimates. These estimates and assumptions include discount rate, rate of return on plan assets, compensation increases, mortality and employee turnover. In addition, the rate of return on plan assets is directly related to changes in the equity and credit markets, which can be very volatile. The use of the above estimates and assumptions, market volatility and the Company's election to immediately recognize all gains and losses in excess of its pension corridor in the current year may cause the Company to experience significant changes in its pension expense or income from year to year. Expense or income that falls outside the corridor is recognized only in the fourth quarter of each year.

Accounting for Derivative Instruments

The Company has entered into variable-to-fixed interest rate swap contracts to fix the interest rates on a portion of its variable interest rate debt. These contracts are accounted for as cash flow hedges. Accordingly, these derivatives are marked to market and the resulting gains or losses are recorded in other comprehensive income as an offset to the related hedged asset or liability. The actual interest expense incurred, inclusive of the effect of the hedge in the current period, is recorded in the condensed consolidated Statements of Operations.

Treasury Stock

Treasury stock is stated at cost. Cost is determined by the FIFO method.

Accounting for Income Taxes

The Company accounts for income taxes under the asset and liability method. Deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates in effect when the differences are expected to be recovered or settled.

Net Income (Loss) Per Common Share

Net income (loss) per common share is presented as basic and diluted earnings per share. Net income (loss) per common share – basic represents the earnings for the period available to each share of common stock outstanding during the reporting period. Net income (loss) per common share – diluted represents the amount of earnings for the period available to each share of common stock outstanding during the reporting period and to each share that would have been outstanding assuming the issuance of common shares for all dilutive potential common shares outstanding during the reporting period. For the thirteen and thirty-nine weeks ended September 25, 2010 options to purchase common stock totaling 302,225 and 307,492 shares, respectively, were not included in the calculation of net income (loss) per common share – diluted since the exercise price per share exceeded the actual price per share during the periods presented. For the thirteen and thirty-nine weeks ended September 26, 2009 options to purchase common stock totaling 316,725 and 317,042 shares, respectively, were not included in the calculation of net income (loss) per common share – diluted since the exercise price per share exceeded the actual price per share during the periods presented.

	Thirteen Weeks Ended				Thirty-nine Weeks Ended			
	September 25, 2010		September 26, 2009		September 25, 2010		September 26, 2009	
	Income (Loss)	Shares	Income (Loss)	Shares	Income (Loss)	Shares	Income (Loss)	Shares
Net income (loss)	$ (4,940)		$ (531)		$ (12,194)		$ 1,743	
Less:								
Income attributable to participating securities	(19)		(19)		(55)		(83)	
Net income (loss) available for common shareholders	$ (4,959)		$ (550)		$ (12,249)		$ 1,660	
Net income (loss) per common share - basic	(0.61)	8,151	(0.07)	8,064	(1.50)	8,144	0.21	8,061