

INGLES MARKETS INC  
Form 10-Q  
July 30, 2010  
Table of Contents

**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 26, 2010

.. **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)

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|  |  |
|--|--|
| <b>North Carolina</b><br>(State or other jurisdiction of<br>incorporation or organization) | <b>56-0846267</b><br>(I.R.S. Employer<br>Identification No.) |
| <b>P.O. Box 6676, Asheville NC</b><br>(Address of principal executive offices)             | <b>28816</b><br>(Zip Code)                                   |
| <b>(828) 669-2941</b>  |  |

**Registrant's telephone number, including area code**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No .

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

As of July 27, 2010, the Registrant had 12,889,358 shares of Class A Common Stock, \$0.05 par value per share, outstanding and 11,582,901 shares of Class B Common Stock, \$0.05 par value per share, outstanding.

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**Table of Contents**

INGLES MARKETS, INCORPORATED

INDEX

|   | <b>Page<br/>No.</b> |
|---|---------------------|
| Part I Financial Information  |                     |
| Item 1. Financial Statements (Unaudited)  |                     |
| <u>Condensed Consolidated Balance Sheets as of June 26, 2010 and September 26, 2009</u>   | 3                   |
| <u>Condensed Consolidated Statements of Income for the<br/>Three Months Ended June 26, 2010 and June 27, 2009</u>                     | 4                   |
| <u>Nine Months Ended June 26, 2010 and June 27, 2009</u>  | 5                   |
| <u>Condensed Consolidated Statements of Changes in Stockholders' Equity for the Nine Months Ended June 26, 2010 and June 27, 2009</u> | 6                   |
| <u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended June 26, 2010 and June 27, 2009</u>                      | 7                   |
| <u>Notes to Unaudited Interim Financial Statements</u>  | 8                   |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                                  | 12                  |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>   | 21                  |
| <u>Item 4. Controls and Procedures</u>  | 22                  |
| Part II Other Information   |                     |
| <u>Item 6. Exhibits</u>   | 22                  |
| <u>Signatures</u>   | 23                  |

**Table of Contents**

## Part I. FINANCIAL INFORMATION

**Item 1. FINANCIAL STATEMENTS**  
**INGLES MARKETS, INCORPORATED AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)**

|  | June 26,<br>2010        | September 26,<br>2009 |
|--|-------------------------|-----------------------|
| <b>ASSETS</b>  |                         |                       |
| Current Assets:  |                         |                       |
| Cash and Cash Equivalents  | \$ 53,174,228           | \$ 77,035,848         |
| Notes and Accounts Receivable, net   | 53,008,861              | 50,401,639            |
| Inventories  | 283,624,176             | 271,744,736           |
| Other Current Assets   | 13,600,408              | 24,537,514            |
| <b>Total Current Assets</b>  | <b>403,407,673</b>      | 423,719,737           |
| Property and Equipment net   | 1,080,981,729           | 1,072,937,349         |
| Other Assets   | 20,693,475              | 20,951,979            |
| <b>Total Assets</b>  | <b>\$ 1,505,082,877</b> | \$ 1,517,609,065      |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>   |                         |                       |
| Current Liabilities:   |                         |                       |
| Current portion of long-term debt  | \$ 91,373,127           | \$ 31,314,776         |
| Accounts payable - trade   | 132,392,530             | 118,378,264           |
| Accrued expenses and current portion of other long-term liabilities  | 62,611,676              | 78,868,836            |
| <b>Total Current Liabilities</b>   | <b>286,377,333</b>      | 228,561,876           |
| Deferred Income Taxes  | 68,664,000              | 67,223,000            |
| Long-Term Debt   | 734,203,360             | 817,999,569           |
| Other Long-Term Liabilities  | 6,591,480               | 5,660,664             |
| <b>Total Liabilities</b>   | <b>1,095,836,173</b>    | 1,119,445,109         |
| 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; 12,889,358 shares issued and outstanding June 26, 2010; 12,889,608 shares issued and outstanding at September 26, 2009                         | 644,468                 | 644,430               |
| Class B, convertible to Class A, \$0.05 par value; 100,000,000 shares authorized; 11,582,901 shares issued and outstanding June 26, 2010; 11,623,651 shares issued and outstanding at September 26, 2009 | 579,145                 | 581,183               |
| Paid-in capital in excess of par value   | 117,592,932             | 118,184,132           |
| Retained earnings  | 290,430,159             | 278,754,211           |
| <b>Total Stockholders Equity</b>   | <b>409,246,704</b>      | 398,163,956           |
| <b>Total Liabilities and Stockholders Equity</b>   | <b>\$ 1,505,082,877</b> | \$ 1,517,609,065      |

See notes to unaudited interim financial statements.

**Table of Contents****INGLES MARKETS, INCORPORATED AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)**

|   | <b>Three Months Ended</b> |                          |
|---|---------------------------|--------------------------|
|   | <b>June 26,<br/>2010</b>  | <b>June 27,<br/>2009</b> |
| Net sales                                   | <b>\$ 856,128,148</b>     | \$ 826,765,973           |
| Cost of goods sold                          | <b>659,241,460</b>        | 635,199,416              |
| Gross profit                                | <b>196,886,688</b>        | 191,566,557              |
| Operating and administrative expenses       | <b>164,462,526</b>        | 157,950,967              |
| Rental income, net                          | <b>458,527</b>            | 325,715                  |
| Gain (loss) from sale or disposal of assets | <b>129,571</b>            | (98,814)                 |
| Income from operations                      | <b>33,012,260</b>         | 33,842,491               |
| Other income, net                           | <b>1,533,480</b>          | 416,387                  |
| Interest expense                            | <b>16,206,484</b>         | 16,434,384               |
| Loss on early extinguishment of debt        |                           | 10,240,667               |
| Income before income taxes                  | <b>18,339,256</b>         | 7,583,827                |
| Income tax expense (benefit):               |                           |                          |
| Current                                     | <b>3,598,000</b>          | (3,120,000)              |
| Deferred                                    | <b>3,072,000</b>          | 5,967,000                |
|   | <b>6,670,000</b>          | 2,847,000                |
| Net income                                  | <b>\$ 11,669,256</b>      | \$ 4,736,827             |
| Per share amounts:                          |                           |                          |
| Class A Common Stock                        |                           |                          |
| Basic earnings per common share             | <b>\$ 0.50</b>            | \$ 0.20                  |
| Diluted earnings per common share           | <b>\$ 0.48</b>            | \$ 0.19                  |
| Class B Common Stock                        |                           |                          |
| Basic earnings per common share             | <b>\$ 0.45</b>            | \$ 0.18                  |
| Diluted earnings per common share           | <b>\$ 0.45</b>            | \$ 0.18                  |
| Cash dividends per common share:            |                           |                          |
| Class A Common Stock                        | <b>\$ 0.165</b>           | \$ 0.165                 |
| Class B Common Stock                        | <b>\$ 0.150</b>           | \$ 0.150                 |

See notes to unaudited interim financial statements.

**Table of Contents****INGLES MARKETS, INCORPORATED AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)**

|   | Nine Months Ended |                  |
|---|-------------------|------------------|
|   | June 26,<br>2010  | June 27,<br>2009 |
| Net sales                                   | \$ 2,534,086,573  | \$ 2,420,805,779 |
| Cost of goods sold                          | 1,966,070,348     | 1,862,560,295    |
| Gross profit                                | 568,016,225       | 558,245,484      |
| Operating and administrative expenses       | 486,908,658       | 471,268,528      |
| Rental income, net                          | 1,127,348         | 1,871,660        |
| (Loss) gain from sale or disposal of assets | (63,145)          | 179,739          |
| Income from operations                      | 82,171,770        | 89,028,355       |
| Other income, net                           | 3,229,883         | 1,668,806        |
| Interest expense                            | 48,956,253        | 42,530,846       |
| Loss on early extinguishment of debt        |                   | 10,240,667       |
| Income before income taxes                  | 36,445,400        | 37,925,648       |
| Income tax expense:                         |                   |                  |
| Current                                     | 10,987,000        | 4,333,000        |
| Deferred                                    | 2,177,000         | 9,956,000        |
|   | 13,164,000        | 14,289,000       |
| Net income                                  | \$ 23,281,400     | \$ 23,636,648    |
| Per share amounts:                          |                   |                  |
| Class A Common Stock                        |                   |                  |
| Basic earnings per common share             | \$ 0.99           | \$ 1.01          |
| Diluted earnings per common share           | \$ 0.96           | \$ 0.95          |
| Class B Common Stock                        |                   |                  |
| Basic earnings per common share             | \$ 0.90           | \$ 0.92          |
| Diluted earnings per common share           | \$ 0.90           | \$ 0.92          |
| 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.

**Table of Contents****INGLES MARKETS, INCORPORATED AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY (UNAUDITED)**

NINE MONTHS ENDED JUNE 26, 2010 AND JUNE 27, 2009

|                               | Class A<br>Common Stock |                   | Class B<br>Common Stock |                   | Paid-in                              | Retained<br>Earnings  | Total                 |
|-------------------------------|-------------------------|-------------------|-------------------------|-------------------|--------------------------------------|-----------------------|-----------------------|
|                               | Shares                  | Amount            | Shares                  | Amount            | Capital in<br>Excess of<br>Par Value |                       |                       |
| Balance, September 27, 2008   | 12,818,608              | \$ 640,930        | 11,693,651              | \$ 584,683        | \$ 118,184,132                       | \$ 265,404,700        | \$ 384,814,445        |
| Net income                    |                         |                   |                         |                   |                                      | 23,636,648            | 23,636,648            |
| Cash dividends                |                         |                   |                         |                   |                                      | (11,608,893)          | (11,608,893)          |
| Common stock conversions      | 40,000                  | 2,000             | (40,000)                | (2,000)           |                                      |                       |                       |
| <b>Balance, June 27, 2009</b> | <b>12,858,608</b>       | <b>\$ 642,930</b> | <b>11,653,651</b>       | <b>\$ 582,683</b> | <b>\$ 118,184,132</b>                | <b>\$ 277,432,455</b> | <b>\$ 396,842,200</b> |
| Balance, September 26, 2009   | 12,888,608              | \$ 644,430        | 11,623,651              | \$ 581,183        | \$ 118,184,132                       | \$ 278,754,211        | \$ 398,163,956        |
| Net income                    |                         |                   |                         |                   |                                      | 23,281,400            | 23,281,400            |
| 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)             |
| <b>Balance, June 26, 2010</b> | <b>12,889,358</b>       | <b>\$ 644,468</b> | <b>11,582,901</b>       | <b>\$ 579,145</b> | <b>\$ 117,592,932</b>                | <b>\$ 290,430,159</b> | <b>\$ 409,246,704</b> |

See notes to unaudited interim financial statements.



**Table of Contents****INGLES MARKETS, INCORPORATED AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

|   | Nine Months Ended    |                      |
|---|----------------------|----------------------|
|   | June 26,<br>2010     | June 27,<br>2009     |
| <b>Cash Flows from Operating Activities:</b>                                      |                      |                      |
| Net income  | \$ 23,281,400        | \$ 23,636,648        |
| Adjustments to reconcile net income to net cash provided by operating activities: |                      |                      |
| Depreciation and amortization expense   | 64,011,316           | 58,974,477           |
| Loss on extinguishment of debt  |                      | 10,240,667           |
| Loss (gain) on disposals of property and equipment                                | 63,145               | (179,739)            |
| Receipt of advance payments on purchases contracts                                | 2,677,167            | 2,252,413            |
| Recognition of advance payments on purchases contracts                            | (2,536,045)          | (3,249,405)          |
| Deferred income taxes   | 2,177,000            | 9,956,000            |
| Changes in operating assets and liabilities:                                      |                      |                      |
| Receivables   | (2,607,222)          | (2,976,105)          |
| Inventory   | (11,879,441)         | (21,859,004)         |
| Other assets  | 7,132,296            | (11,650,181)         |
| Accounts payable and accrued expenses   | (6,404,545)          | (7,131,073)          |
| <b>Net Cash Provided by Operating Activities</b>                                  | <b>75,915,071</b>    | <b>58,014,698</b>    |
| <b>Cash Flows from Investing Activities:</b>                                      |                      |                      |
| Proceeds from sales of property and equipment                                     | 1,434,109            | 1,122,119            |
| Capital expenditures  | (65,274,290)         | (127,400,360)        |
| <b>Net Cash Used by Investing Activities</b>                                      | <b>(63,840,181)</b>  | <b>(126,278,241)</b> |
| <b>Cash Flows from Financing Activities:</b>                                      |                      |                      |
| Proceeds from short-term borrowings   |                      | 528,069,000          |
| Payments on short-term borrowings   |                      | (555,824,000)        |
| Proceeds from issuance of bonds   |                      | 555,151,000          |
| Bond issuance costs   |                      | (11,787,356)         |
| Proceeds from other long-term borrowings  |                      | 74,070,924           |
| Principal payments on long-term borrowings  | (23,737,858)         | (451,112,009)        |
| Prepayment penalties on debt extinguishment                                       |                      | (6,825,418)          |
| Common stock repurchases  | (593,200)            |                      |
| Dividends paid  | (11,605,452)         | (11,608,893)         |
| <b>Net Cash (Used) Provided by Financing Activities</b>                           | <b>(35,936,510)</b>  | <b>120,133,248</b>   |
| <b>Net (Decrease) Increase in Cash and Cash Equivalents</b>                       | <b>(23,861,620)</b>  | <b>51,869,705</b>    |
| Cash and cash equivalents at beginning of year                                    | 77,035,848           | 4,178,897            |
| <b>Cash and Cash Equivalents at End of Period</b>                                 | <b>\$ 53,174,228</b> | <b>\$ 56,048,602</b> |

See notes to unaudited interim financial statements.



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**Table of Contents**

**INGLES MARKETS, INCORPORATED AND SUBSIDIARIES**

**NOTES TO UNAUDITED INTERIM FINANCIAL STATEMENTS**

Nine Months Ended June 26, 2010 and June 27, 2009

**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 26, 2010, the results of operations for the three-month and nine-month periods ended June 26, 2010 and June 27, 2009, and the changes in stockholders' equity and cash flows for the nine-month periods ended June 26, 2010 and June 27, 2009. 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 26, 2009 filed by the Company under the Securities Exchange Act of 1934 on December 7, 2009.

The results of operations for the three-month and nine-month periods ended June 26, 2010 are not necessarily indicative of the results to be expected for the full fiscal year.

Certain amounts for the three and nine months ended June 27, 2009 have been reclassified to conform to the current year presentation in the accompanying financial statements. Beginning with the fiscal quarter ended September 26, 2009 the Company began including the costs of its distribution network in the line item Cost of goods sold on the Condensed Consolidated Statements of Income. These costs previously were included in the line item Operating and administrative expenses on the Condensed Consolidated Statements of Income. While this is an accounting policy election, management believes the new presentation is more closely aligned with industry practice. The amounts for the three and nine months ended June 27, 2009 have been reclassified to conform to the current year presentation in the accompanying consolidated financial statements.

**B. NEW ACCOUNTING PRONOUNCEMENTS**

In June 2009, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 168 The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Standard No. 162 (SFAS 168). SFAS 168 replaces the Generally Accepted Accounting Principles (GAAP) with two levels of GAAP: authoritative and non-authoritative. On July 1, 2009, the FASB Accounting Standards Codification (FASB ASC) became the single source of authoritative nongovernmental GAAP, except for rules and interpretive releases of the Securities and Exchange Commission. All other non-grandfathered accounting literature became non-authoritative. The adoption of SFAS 168 did not have a material impact on the Company's condensed consolidated financial statements. As a result of the adoption of SFAS 168, all references to GAAP now refer to the codified FASB ASC topic.

In September 2006, FASB ASC Topic 820 was issued which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. FASB ASC Topic 820 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. FASB ASC Topic 820 was effective for the Company as of the year ending September 26, 2009. The adoption of FASB ASC Topic 820 did not have a significant impact on the Company's condensed consolidated financial statements.

In April 2009, FASB ASC Topic 855 was issued which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or available to be issued. The Company adopted FASB ASC Topic 855 for the quarter ending June 27, 2009. The adoption did not have a material impact on the Company's condensed consolidated financial statements.

**C. ALLOWANCE FOR DOUBTFUL ACCOUNTS**

Receivables are presented net of an allowance for doubtful accounts of \$545,000 and \$639,000 at June 26, 2010 and September 26, 2009, respectively.

**D. INCOME TAXES**

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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 26, 2010, 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 26, 2010, the Company had gross unrecognized tax benefits of approximately \$140,000, all of which, if recognized, would

**Table of Contents**

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.

**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 26,<br>2010     | September 26,<br>2009 |
|--|----------------------|-----------------------|
| Property, payroll, and other taxes payable | \$ 12,693,789        | \$ 15,783,416         |
| Salaries, wages and bonuses payable        | 21,484,169           | 22,203,640            |
| Self-insurance liabilities                 | 14,140,187           | 14,156,543            |
| Income taxes payable                       | 2,529,079            |                       |
| Interest                                   | 6,836,685            | 20,414,995            |
| Other                                      | 4,927,767            | 6,310,242             |
|  | <b>\$ 62,611,676</b> | <b>\$ 78,868,836</b>  |

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 \$300,000 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 \$4.8 million and \$5.8 million for each of the three-month periods ended June 26, 2010 and June 27, 2009, respectively. For the nine-month periods ended June 26, 2010 and June 27, 2009, employee insurance expense, net of employee contributions, totaled \$20.7 million and \$18.5 million, respectively.

**F. 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, 2013 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 26, 2010, the Company had \$185.0 million of total commitments available under lines of credit, with no borrowings outstanding.

The lines of credit provide the Company with various interest rate options generally at rates less than prime. The lines allow the Company to issue up to \$30.0 million in unused letters of credit, of which \$8.4 million of unused letters of credit were issued at June 26, 2010. The Company is not required to maintain compensating balances in connection with these lines of credit.

The Notes and 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

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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 26, 2010.

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.

**Table of Contents****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 April 22, 2010, January 21, 2010 and October 22, 2009 to stockholders of record on April 8, 2010, January 7, 2010 and October 8, 2009, respectively.

**H. 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 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>June 26, 2010 |              | Nine Months Ended<br>June 26, 2010 |               |
|---|-------------------------------------|--------------|------------------------------------|---------------|
|   | Class A                             | Class B      | Class A                            | Class B       |
| <i>Numerator: Allocated net income</i>                  |                                     |              |                                    |               |
| Net income allocated, basic                             | \$ 6,422,210                        | \$ 5,247,046 | \$ 12,800,393                      | \$ 10,481,007 |
| Conversion of Class B to Class A shares                 | 5,247,046                           |              | 10,481,007                         |               |
| Net income allocated, diluted                           | \$ 11,669,256                       | \$ 5,247,046 | \$ 23,281,400                      | \$ 10,481,007 |
| <i>Denominator: Weighted average shares outstanding</i> |                                     |              |                                    |               |
| Weighted average shares outstanding, basic              | 12,888,707                          | 11,583,552   | 12,888,641                         | 11,607,794    |
| Conversion of Class B to Class A shares                 | 11,583,552                          |              | 11,607,794                         |               |
| Weighted average shares outstanding, diluted            | 24,472,259                          | 11,583,552   | 24,496,435                         | 11,607,794    |
| <b>Earnings per share</b>                               |                                     |              |                                    |               |
| Basic   | \$ 0.50                             | \$ 0.45      | \$ 0.99                            | \$ 0.90       |
| Diluted   | \$ 0.48                             | \$ 0.45      | \$ 0.96                            | \$ 0.90       |

**Table of Contents**

The per share amounts for the third quarter of fiscal 2009 and the nine months ended June 27, 2009 are based on the following amounts:

|   | Three Months Ended<br>June 27, 2009 |              | Nine Months Ended<br>June 27, 2009 |               |
|---|-------------------------------------|--------------|------------------------------------|---------------|
|   | Class A                             | Class B      | Class A                            | Class B       |
| <i>Numerator: Allocated net income</i>                  |                                     |              |                                    |               |
| Net income allocated, basic                             | \$ 2,596,736                        | \$ 2,140,091 | \$ 12,936,804                      | \$ 10,699,844 |
| Conversion of Class B to Class A shares                 | 2,140,091                           |              | 10,699,844                         |               |
| Net income allocated, diluted                           | \$ 4,736,827                        | \$ 2,140,091 | \$ 23,636,648                      | \$ 10,699,844 |
| <i>Denominator: Weighted average shares outstanding</i> |                                     |              |                                    |               |
| Weighted average shares outstanding, basic              | 12,858,608                          | 11,653,651   | 12,837,509                         | 11,674,750    |
| Conversion of Class B to Class A shares                 | 11,653,651                          |              | 11,674,750                         |               |
| Weighted average shares outstanding, diluted            | 24,512,259                          | 11,653,651   | 24,512,259                         | 11,674,750    |
| <b>Earnings per share</b>                               |                                     |              |                                    |               |
| Basic   | \$ 0.20                             | \$ 0.18      | \$ 1.01                            | \$ 0.92       |
| Diluted   | \$ 0.19                             | \$ 0.18      | \$ 0.95                            | \$ 0.92       |

## I. 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 |                       | Nine Months Ended |                  |
|--|--------------------|-----------------------|-------------------|------------------|
|  | June 26,<br>2010   | June 27,<br>2009      | June 26,<br>2010  | June 27,<br>2009 |
| <b>Revenues from unaffiliated customers:</b> |                    |                       |                   |                  |
| Grocery sales                                | \$ 826,969         | \$ 801,372            | \$ 2,448,692      | \$ 2,338,933     |
| Shopping center rentals                      | 2,288              | 2,459                 | 6,893             | 8,114            |
| Fluid dairy                                  | 29,160             | 25,393                | 85,395            | 81,872           |
| Total revenues from unaffiliated customers   | \$ 858,417         | \$ 829,224            | \$ 2,540,980      | \$ 2,428,919     |
| <b>Income from operations:</b>               |                    |                       |                   |                  |
| Grocery sales                                | \$ 29,931          | \$ 30,120             | \$ 72,425         | \$ 77,176        |
| Shopping center rentals                      | 458                | 326                   | 1,127             | 1,872            |
| Fluid dairy                                  | 2,623              | 3,396                 | 8,620             | 9,980            |
| Total income from operations                 | \$ 33,012          | \$ 33,842             | \$ 82,172         | \$ 89,028        |
|  | June 26,<br>2010   | September 26,<br>2009 |                   |                  |



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|  |                  |                  |
|--|------------------|------------------|
| Assets:                                |                  |                  |
| Grocery sales                          | \$ 1,352,126     | \$ 1,366,248     |
| Shopping center rentals                | 126,339          | 126,853          |
| Fluid dairy                            | 28,807           | 26,450           |
| Elimination of intercompany receivable | (2,189)          | (1,942)          |
| <br>Total assets                       | <br>\$ 1,505,083 | <br>\$ 1,517,609 |

**Table of Contents**

Sales by product category (amounts in thousands) are as follows:

|                              | Three Months Ended |                   | Nine Months Ended   |                     |
|------------------------------|--------------------|-------------------|---------------------|---------------------|
|                              | June 26,<br>2010   | June 27,<br>2009  | June 26,<br>2010    | June 27,<br>2009    |
| Grocery                      | \$ 332,347         | \$ 336,332        | \$ 1,025,527        | \$ 1,021,869        |
| Non-foods                    | 175,491            | 171,952           | 511,361             | 493,407             |
| Perishables                  | 204,781            | 197,215           | 585,464             | 574,371             |
| Gasoline                     | 114,350            | 95,873            | 326,340             | 249,286             |
| <b>Total grocery segment</b> | <b>\$ 826,969</b>  | <b>\$ 801,372</b> | <b>\$ 2,448,692</b> | <b>\$ 2,338,933</b> |

The grocery category includes grocery, dairy, and frozen foods.

The non-foods include alcoholic beverages, tobacco, pharmacy, health and video.

The perishables category includes meat, produce, deli and bakery.

Revenue from shopping center rentals is reported on the rental income, net line of the income statements. Grocery and fluid dairy revenues are included in the caption "Net sales" in the Condensed Consolidated Statements of Income.

For the three-month periods ended June 26, 2010 and June 27, 2009, respectively, the fluid dairy segment had \$13.4 million and \$12.7 million in sales to the grocery sales segment. The fluid dairy segment had \$41.7 million in sales to the grocery sales segment for each of the nine-month periods ended June 26, 2010 and June 27, 2009. These sales have been eliminated in consolidation and are excluded from the amounts in the table above.

**J. FAIR VALUES OF FINANCIAL INSTRUMENTS**

The carrying amounts for cash and cash equivalents, accounts receivable, and accounts payable approximate fair value due to the short-term maturity of these instruments. At June 26, 2010 and September 26, 2009, the fair value of the Company's debt was estimated at \$854.3 million and \$884.2 million, respectively, primarily using market yields and taking into consideration the underlying terms of the debt. Such fair value was more than the carrying value of debt at June 26, 2010 by \$28.8 million and less than the carrying value of debt at September 26, 2009 by \$34.9 million.

**K. SUBSEQUENT EVENTS**

We have evaluated subsequent events and transactions for potential recognition or disclosure in the financial statements through the day the financial statements were issued.

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

Ingles, a leading supermarket chain in the Southeast, operates 202 supermarkets in Georgia (73), North Carolina (69), South Carolina (36), Tennessee (21), 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. As of June 26, 2010, the Company operated 70 in-store pharmacies and 69 fuel centers.

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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's operations, providing both operational and economic benefits.

### *Critical Accounting Policies*

Critical accounting policies are those accounting policies that management believes are important to the portrayal of the Company's 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. Estimates are based on historical experience and other factors believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Management estimates,

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**Table of Contents**

by their nature, involve judgments regarding future uncertainties, and actual results may therefore differ materially from these estimates.

*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 coverage of \$750,000 per occurrence for workers' compensation and \$300,000 per covered person for medical care benefits for a policy year. 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. At June 26, 2010, the Company's self insurance reserves totaled \$14.1 million for employee group insurance, workers' compensation insurance and general liability insurance.

*Asset Impairments*

The Company accounts for the impairment of long-lived assets in accordance with FASB ASC Topic 360. 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 closed properties under long-term lease agreements, a 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, in accordance with FASB ASC Topic 420. The Company's estimates of market rates are based on its experience, knowledge and 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 Unaudited Condensed Consolidated Balance Sheets.

*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 \$26.4 million and \$26.0 million for the fiscal quarters ended June 26, 2010 and June 27, 2009, respectively. For the nine-month periods ended June 26, 2010 and June 27, 2009, vendor allowances applied as a reduction of merchandise costs totaled \$79.3 million and \$75.1 million, respectively. Vendor advertising allowances that represent a reimbursement of specific identifiable incremental costs of advertising the vendor's specific products are recorded as a reduction to the related expense in the period in which the related expense is incurred. Vendor advertising allowances recorded as a reduction of advertising expense totaled \$3.2 million for the fiscal quarter ended June 26, 2010 and \$3.7 million for the fiscal quarter ended June 27, 2009. For the nine-month periods ended June 26, 2010 and June 27, 2009, vendor advertising allowances recorded as a reduction of advertising expense totaled \$10.0 million and \$10.2 million, respectively.

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 the Company's product advertising, which could increase or decrease the Company's expenditures.

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Similarly, the Company is not able to assess the impact of vendor advertising allowances on creating additional revenue, as such allowances do not directly generate revenue for the Company's stores.

**Table of Contents***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's positions 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 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.

*Results of Operations*

Ingles operates on a 52 or 53-week fiscal year ending on the last Saturday in September. There are 13 and 39 weeks of operations included in the unaudited condensed consolidated statements of income for the three and nine-month periods ended June 26, 2010 and June 27, 2009. 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 nine-month periods ended June 26, 2010 and June 27, 2009, comparable store sales include 196 and 195 stores, respectively.

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 I Lines of Business to the Unaudited Condensed Consolidated Financial Statements.

|                                       | Three Months Ended |                  | Nine Months Ended |                  |
|---------------------------------------|--------------------|------------------|-------------------|------------------|
|                                       | June 26,<br>2010   | June 27,<br>2009 | June 26,<br>2010  | June 27,<br>2009 |
| Net sales                             | 100.0%             | 100.0%           | 100.0%            | 100.0%           |
| Gross profit                          | 23.0%              | 23.2%            | 22.4%             | 23.1%            |
| Operating and administrative expenses | 19.2%              | 19.1%            | 19.2%             | 19.5%            |
| Rental income, net                    | 0.1 %              | %                | %                 | 0.1%             |
| Income from operations                | 3.9%               | 4.1%             | 3.2%              | 3.7%             |
| Other income, net                     | 0.2%               | %                | 0.1%              | 0.1%             |
| Interest expense                      | 1.9%               | 2.0%             | 1.9%              | 1.8%             |
| Loss on early extinguishment of debt  | %                  | 1.2%             | %                 | 0.4%             |
| Income taxes                          | 0.8%               | 0.3%             | 0.5%              | 0.6%             |
| Net income                            | 1.4%               | 0.6%             | 0.9%              | 1.0%             |

**Three Months Ended June 26, 2010 Compared to the Three Months Ended June 27, 2009**

Net income for the third quarter of fiscal 2010 totaled \$11.7 million, compared with net income of \$4.7 million earned for the third quarter of fiscal 2009. During the third quarter of fiscal 2009, the Company issued \$575 million aggregate principal amount of senior notes in a private placement and used a portion of the proceeds to repay existing debt that carried call premiums or prepayment penalties. As a result, the Company incurred debt extinguishment expenses totaling \$10.2 million during the third quarter of 2009. Excluding this amount, income before income taxes increased to \$18.3 million for the three months ended June 26, 2010 from \$17.8 million for the three months ended June 27, 2009.

*Net Sales.* Net sales increased 3.6% to \$856.1 million for the three months ended June 26, 2010 from \$826.8 million for the three months ended June 27, 2009. Excluding gasoline, net sales increased 1.5%. Ingles operated 202 stores at June 26, 2010, compared to 201 stores at June 27, 2009. Retail square footage was approximately 10.8 million at June 26, 2010 and approximately 10.7 million at June 27, 2009.

Grocery segment comparable store sales grew \$22.7 million, or 2.9% in the third quarter of fiscal 2010 compared to the third quarter of fiscal 2009. Excluding gasoline, comparable store sales increased 0.8%. Comparable store sales growth excluding gasoline continues to be affected by price deflation and the effect of the economic recession on consumer spending. The number of customer transactions (excluding gasoline) increased 7.9%, while the average transaction size (excluding gasoline) decreased by 7.0%.



**Table of Contents**

In contrast to many of the Company's other products, the retail price of gasoline was approximately 24% higher during the third quarter of fiscal 2010 compared with the third quarter of fiscal 2009. Total gallons sold decreased 3.8% over the comparable fiscal quarters due to an overall decrease in demand.

Sales by product category (amounts in thousands) are as follows:

|                              | Three Months Ended |                   |
|------------------------------|--------------------|-------------------|
|                              | June 26,<br>2010   | June 27,<br>2009  |
| Grocery                      | \$ 332,347         | \$ 336,332        |
| Non-foods                    | 175,491            | 171,952           |
| Perishables                  | 204,781            | 197,215           |
| Gasoline                     | 114,350            | 95,873            |
| <b>Total grocery segment</b> | <b>\$ 826,969</b>  | <b>\$ 801,372</b> |

The grocery category includes grocery, dairy, and frozen foods.

The non-foods include alcoholic beverages, tobacco, pharmacy, health and video.

The perishable category includes meat, produce, deli and bakery.

Changes in grocery segment sales for the quarter ended June 26, 2010 are summarized as follows (dollars in thousands):

|   |                   |
|---|-------------------|
| Total grocery sales for the three months ended June 27, 2009        | \$ 801,372        |
| Comparable store sales decrease (including gasoline)                | 22,680            |
| Impact of stores opened in fiscal 2009 and 2010                     | 3,874             |
| Impact of stores closed in fiscal 2009 and 2010                     | (943)             |
| Other   | (14)              |
| <b>Total grocery sales for the three months ended June 26, 2010</b> | <b>\$ 826,969</b> |

Net sales to outside parties for the Company's milk processing subsidiary increased \$3.8 million, or 14.8%, in the June 2010 quarter compared to the June 2009 quarter. The sales increase is attributable to an increase in raw milk costs, which are generally passed on to customers in the pricing of milk products. The volume of gallons sold was level across the comparative fiscal quarters.

*Gross Profit.* Gross profit for the three-month period ended June 26, 2010 increased \$5.3 million, or 2.8%, to \$196.9 million, or 23.0% of sales, compared to \$191.6 million, or 23.2% of sales, for the three-month period ended June 27, 2009.

Grocery segment gross profit as a percentage of total sales was influenced by gasoline margins (which are typically much lower than margins earned on other grocery segment products), competitive factors and the effect of price deflation on certain of the Company's products. The Company's emphasis on sales growth, market share and customer satisfaction has affected its prices and margins. Excluding gasoline sales, grocery segment gross profit as a percentage of sales was relatively constant at 26.0% for the three months ended June 26, 2010 compared with 25.9% for the three months ended June 27, 2009.

Gross profit for the Company's milk processing subsidiary for the June 2010 quarter decreased \$0.6 million, or 10.6%, to \$5.0 million, or 11.9% of sales, compared to \$5.6 million, or 14.8% of sales for the June 2009 quarter. Raw milk prices were higher during the June 2010 quarter, which decreased gross profit as a percentage of sales, as relatively stable per-gallon milk profit margins were applied to the higher sales price. Competitive issues also served to keep gross margins lower.



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In addition to the direct product cost, the cost of goods sold line item for the grocery segment includes inbound freight charges and the costs related to the Company's distribution network. Distribution network costs for the grocery segment were previously included in operating and administrative expenses and totaled \$10.5 million and \$11.8 million for the quarters ended June 2010 and June 2009, respectively. The milk processing segment is a manufacturing process; therefore, the costs mentioned above 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 in the grocery segment.

*Operating and Administrative Expenses.* Operating and administrative expenses increased \$6.5 million, or 4.1%, to \$164.5 million for the three months ended June 26, 2010, from \$158.0 million for the three months ended June 27, 2009. As a percentage of sales, operating and administrative expenses were 19.2% for the three months ended June 26, 2010 compared to 19.1% for the three months ended June 27, 2009. Excluding gasoline sales and associated gasoline operating expenses (primarily payroll), operating expenses

**Table of Contents**

were 22.0% of sales for the third fiscal 2010 quarter compared to 21.5% for the third fiscal quarter of 2009. The increased number of new and remodeled stores opened by the Company during fiscal years 2008 and 2009 contributed to higher expenses, while the economic recession has resulted in a longer sales growth time period to cover such expenses.

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

|  | <b>Increase<br/>in<br/>millions</b> | <b>Increase<br/>as a %<br/>of<br/>sales</b> |
|--|-------------------------------------|---|
| Salaries and wages                       | \$ 2.6                              | 0.31%                                       |
| Bank charges                             | \$ 1.0                              | 0.12%                                       |
| Insurance expenses                       | \$ 1.0                              | 0.12%                                       |
| Depreciation and amortization            | \$ 0.9                              | 0.10%                                       |
| Legal and professional fees and expenses | \$ 0.8                              | 0.10%                                       |

Salaries and wages increased in dollars due to additional labor hours required for the increased sales volume and the accelerated number of new and remodeled stores.

Bank charges increased due to an increase in the number of customer transactions and increases in per transaction interchange fees.

Insurance expense increased due to an increased number of employees and due to higher claims under the Company's self insurance programs.

Depreciation and amortization increased as a result of the Company's higher level of capital expenditures.

Legal and professional fees and expenses increased due to litigation costs related to store properties.

*Rental Income, Net.* Rental income, net totaled \$0.5 million for the June 2010 quarter compared with \$0.3 million for the June 2009 quarter. This increase is primarily related to the timing of tenant collections.

*Other Income, Net.* Other income, net totaled \$1.5 million and \$0.4 million for the three-month periods ended June 26, 2010 and June 27, 2009, respectively. The increase consists primarily of higher unit sales prices for waste paper and packaging, and an increase in the volume sold of these items.

*Interest Expense.* Interest expense decreased \$0.2 million for the three-month period ended June 26, 2010 to \$16.2 million from \$16.4 million for the three-month period ended June 27, 2009. Total debt at June 2010 was \$825.6 million compared to \$855.7 million at June 2009.

*Loss on early extinguishment of debt.* In May 2009, the Company issued \$575.0 million aggregate principal amount of senior notes due in 2017 (the "Notes"). Note proceeds were used to pay off \$349.8 million aggregate principal amount of senior subordinated debt maturing in 2011, pay off \$45.3 million of indebtedness outstanding under the Company's committed lines of credit, and pay off \$77.7 million of secured indebtedness. In conjunction with these transactions, the Company incurred call premiums and prepayment penalties totaling \$6.8 million and wrote off \$3.4 million of unamortized capitalized loan issuance costs associated with the paid off debt.

*Income Taxes.* Income tax expense as a percentage of pre-tax income decreased to 36.4% in the June 2010 quarter compared to 37.5% in the June 2009 quarter. The filing of the Company's fiscal year 2009 income tax return resulted in adjustments to provisions for state taxes and for deferred income taxes that were recorded in the current fiscal quarter.

*Net Income.* Net income totaled \$11.7 million, 1.4% of sales, for the three-month period ended June 26, 2010. Basic and diluted earnings per share for Class A Common Stock were \$0.50 and \$0.48, respectively, for the June 2010 quarter. Basic and diluted earnings per share for Class B Common Stock were each \$0.45 for the June 2010 quarter. Net income totaled \$4.7 million, 0.6% of sales, for the three-month period ended June 27, 2009. Basic and diluted earnings per share for Class A Common Stock were \$0.20 and \$0.19, respectively, for the June 2009 quarter. Basic and diluted earnings per share for Class B Common Stock were each \$0.18 for the June 2009 quarter.

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### **Nine Months Ended June 26, 2010 Compared to the Nine Months Ended June 27, 2009**

Net income for the first nine months of fiscal 2010 totaled \$23.3 million, compared with net income of \$23.6 million earned for the first nine months of fiscal 2009. During the third quarter of fiscal 2009, the Company issued \$575 million principal amount of senior notes and used a portion of the proceeds to repay existing debt that carried call premiums or prepayment penalties. As a result, the Company incurred debt extinguishment expenses totaling \$10.2 million during the third quarter of 2009. General economic

**Table of Contents**

conditions and higher expenses resulting from the Company's 2008 and 2009 store development activities also contributed to lower net income during the first nine months of fiscal year 2010.

*Net Sales.* Net sales for the nine months ended June 26, 2010 increased 4.7% to \$2.53 billion, compared to \$2.42 billion for the nine months ended June 27, 2009. Excluding gasoline, net sales increased 1.7%. The average per gallon retail price of gasoline was approximately 28% higher comparing the nine months of fiscal 2010 with the previous year.

Grocery segment comparable store sales excluding gasoline for the nine-month period grew \$19.1 million, or 0.9%. The number of customer transactions (excluding gasoline) increased 10.0%, while the average transaction size (excluding gasoline) decreased by approximately 7.7%. The Company believes this transaction data may reflect cost-conscious customers dining out less and changing purchasing habits towards lower priced items.

Sales by product category (amounts in thousands) are as follows:

|                              | Nine Months Ended   |                     |
|------------------------------|---------------------|---------------------|
|                              | June 26,<br>2010    | June 27,<br>2009    |
| Grocery                      | \$ 1,025,527        | \$ 1,021,869        |
| Non-foods                    | 511,361             | 493,407             |
| Perishables                  | 585,464             | 574,371             |
| Gasoline                     | 326,340             | 249,286             |
| <b>Total grocery segment</b> | <b>\$ 2,448,692</b> | <b>\$ 2,338,933</b> |

The grocery category includes grocery, dairy, and frozen foods.

The non-foods include alcoholic beverages, tobacco, pharmacy, health and video.

The perishable category includes meat, produce, deli and bakery.

Changes in grocery segment sales for the nine months ended June 26, 2010 can be summarized as follows (dollars in thousands):

|  |                     |
|--|---------------------|
| Total grocery sales for the nine months ended June 27, 2009        | \$ 2,338,933        |
| Comparable store sales decrease (including gasoline)               | 88,425              |
| Impact of stores opened in fiscal 2009 and 2010                    | 24,228              |
| Impact of stores closed in fiscal 2009 and 2010                    | (2,880)             |
| Other  | (14)                |
| <b>Total grocery sales for the nine months ended June 26, 2010</b> | <b>\$ 2,448,692</b> |

Net sales to outside parties for the Company's milk processing subsidiary increased \$3.5 million, or 4.3%, in the June 2010 nine-month period compared to the June 2009 nine-month period. The total volume of gallons sold during the comparative nine-month periods has been stable. Raw milk costs have fluctuated during the nine months ended June 26, 2010, decreasing during the Company's first fiscal quarter, then increasing during the second and third fiscal quarters.

The Company expects sales growth for the remainder of fiscal 2010 to approximate the rate of growth experienced in the first nine months of this fiscal year. Sales growth for the remainder of fiscal year 2010 will be influenced to some extent by market fluctuations in the per gallon price of gasoline and milk, changes in commodity prices and general economic conditions. The Company also expects that the maturation of new and expanded stores will contribute to sales growth.

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*Gross Profit.* Gross profit for the nine months ended June 26, 2010 increased \$9.8 million, or 1.8%, to \$568.0 million compared to \$558.2 million, for the nine months ended June 27, 2009. As a percentage of sales, gross profit totaled 22.4% for the nine months ended June 26, 2010 and 23.1% for the nine months ended June 27, 2009.

Grocery segment gross profit as a percentage of total sales (excluding gasoline) was 25.5% for the June 2010 nine-month period compared with 25.4% for the comparable fiscal 2009 period. The Company has responded to the current competitive environment by keeping prices as low as possible in order to grow sales and market share.

Gross profit for the Company's milk processing subsidiary for the June 2010 nine-month period decreased \$1.3 million, or 0.6%, to \$15.5 million, or 12.2% of sales, compared to \$16.8 million, or 13.6% of sales for the June 2009 nine-month period. Fluctuations in raw milk prices and competitive issues have served to keep gross margins lower during the current fiscal year.

**Table of Contents**

*Operating and Administrative Expenses.* Operating and administrative expenses increased \$15.6 million, or 3.3%, to \$486.9 million for the nine months ended June 26, 2010, from \$471.3 million for the nine months ended June 27, 2009. As a percentage of sales, operating and administrative expenses were 19.2% for the June 2010 nine-month period compared with 19.5% for the same period last year. Excluding gasoline sales and associated gasoline operating expenses (primarily payroll), operating expenses were 21.9% of sales for the nine-month fiscal 2010 period compared to 21.6% for the same period of fiscal 2009. In general, the Company's increased store development activities during fiscal years 2008 and 2009 have resulted in higher personnel, depreciation and occupancy costs. Current unfavorable economic conditions have extended the time needed for new and redeveloped stores to reach targeted levels of sales and profitability.

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

|                                   | <b>Increase<br/>in<br/>millions</b> | <b>Increase<br/>as a %<br/>of<br/>sales</b> |
|-----------------------------------|-------------------------------------|---|
| Salaries and wages                | \$ 6.5                              | 0.26%                                       |
| Depreciation and amortization     | \$ 4.0                              | 0.16%                                       |
| Insurance expenses                | \$ 3.7                              | 0.15%                                       |
| Advertising and promotion expense | \$ (2.0)                            | (0.08)%                                     |
| Bank charges                      | \$ 2.0                              | 0.08%                                       |

Salaries and wages increased in dollars due to additional labor hours required for the increased sales volume and the accelerated number of new and remodeled stores.

Depreciation and amortization increased as a result of the Company's higher level of capital expenditures.

Insurance expense increased due to an increased number of employees and due to higher claims under the Company's self insurance programs.

Bank charges increased due to an increase in the number of customer transactions and increases in per transaction interchange fees.

Advertising and promotion expenses decreased due to more targeted programs and due to lower print and media costs.

*Rental Income, Net.* Rental income, net decreased \$0.8 million to \$1.1 million in the June 2010 nine-month period from \$1.9 million in the June 2009 comparable period. The Company's expansion and relocation activities have resulted in less tenant space available for lease. In addition, current economic conditions have reduced occupancy rates and rent collections.

*Other Income, Net.* Other income, net totaled \$3.2 million and \$1.7 million for the nine-month periods ended June 26, 2010, and June 27, 2009, respectively. Other income consists primarily of sales of waste paper and packaging. The income increase results from higher unit sales prices and an increase in the volume sold of these items.

*Interest Expense.* Interest expense increased \$6.4 million to \$48.9 million for the nine months ended June 26, 2010 from \$42.5 million for the nine months ended June 27, 2009. The increase is primarily attributable to the issuance in May 2009 of \$575.0 million aggregate principal amount of senior notes and related transactions.

*Loss on Early Extinguishment of Debt.* In conjunction with the May 2009 payoff of the Company's \$349.8 million aggregate principal amount of senior subordinated debt and \$77.7 million of secured indebtedness, the Company incurred call premiums and prepayment penalties totaling \$6.8 million and wrote off \$3.4 million of unamortized capitalized loan issuance costs associated with the paid off debt.

*Income Taxes.* Income tax expense as a percentage of pre-tax income was 36.1% in the June 2010 nine-month period compared to 37.7% in the June 2009 nine-month period due to lower state taxes and deferred income taxes.

*Net Income.* Net income totaled \$23.3 million, 0.9% of sales, for the nine-month period ended June 26, 2010. Basic and diluted earnings per share for Class A Common Stock were \$0.99 and \$0.96, respectively, for the June 2010 nine-month period. Basic and diluted earnings per share for Class B Common Stock were each \$0.90 for the June 2010 nine-month period. Net income totaled \$23.6 million, 1.0% of sales, for the nine-month period ended June 27, 2009. Basic and diluted earnings per share for Class A Common Stock were \$1.01 and \$0.95, respectively, for

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the June 2009 nine-month period. Basic and diluted earnings per share for Class B Common Stock were each \$0.92 for the June 2009 nine-month period.

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## **Table of Contents**

### ***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. As such, 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 \$65.3 million for the nine-month period ended June 26, 2010, including the completion of two new stores and one remodeled store. 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 2010 and in fiscal 2011. Capital expenditures totaled \$127.4 million for the nine months ended June 27, 2009.

Ingles' capital expenditure plans for all of fiscal 2010 include investments of approximately \$90 million. The Company expects to complete three remodeling projects during the fourth quarter of fiscal 2010. Further expenditures include investments in stores expected to open in fiscal 2011 as well as technology improvements, upgrading and replacing existing store equipment and warehouse and transportation equipment, and improvements to the Company's milk processing plant.

Because of uncertain economic conditions, the Company's capital expenditures in fiscal 2010 are lower than previous years. The Company expects that its net annual capital expenditures will remain in the range of approximately \$120 to \$170 million going forward in order to maintain a modern store base. Planned expenditures for any given future fiscal year will be influenced by Company financial performance, overall economic conditions and the availability of financing. 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 and the availability of suitable financing. 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. Construction commitments at June 26, 2010 totaled \$15.8 million.

#### ***Liquidity***

The Company had cash on hand of \$53.1 million at June 26, 2010. This cash balance resulted primarily from financings accomplished during fiscal 2009 and a lower level of capital expenditures. The Company is being cautious with its liquidity until economic conditions improve and stores developed in fiscal years 2008 and 2009 have an opportunity to mature in a more typical operating environment. Interest earned on this cash balance is much lower than the Company's average borrowing rate, resulting in a short-term decrease in earnings until the cash can be profitably deployed.

The Company generated net cash from operations of \$75.9 million in the June 2010 nine-month period compared to \$58.0 million for the comparable 2009 period. Most of the change is attributable to increased non-cash depreciation and lower inventory growth.

Cash used by investing activities for the June 2010 nine-month period totaled \$63.8 million comprised primarily of \$65.3 million of capital expenditures during the period, partially offset by \$1.4 million of proceeds from the sale of assets. This compares with capital expenditures totaling \$127.4 million partially offset by \$1.1 million of proceeds from the sale of assets during the nine months ended June 27, 2009.

Cash used by financing activities during the nine-month period ended June 26, 2010 totaled \$35.9 million. Cash used by financing activities during this period included principal payments on long-term debt of \$23.7 million and dividend payments of \$11.6 million. The Company also used cash of \$0.6 million to repurchase 40,000 shares of Class B Common Stock from the Company's Investment/Profit Sharing Plan (the Plan). The Plan used the proceeds to fund retirement distributions. The shares were repurchased by the Company under a program announced in March 2010 that would allow the Company to repurchase up to one million shares of either Class A or Class B Common Stock.

Cash provided by financing activities during the nine-month period ended June 27, 2009 totaled \$120.1 million. 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



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of 8.875% per annum and were issued at a discount to yield 9.5% per annum. Note proceeds were used to pay off \$349.8 million aggregate principal amount of senior subordinated debt maturing in 2011, pay off \$45.3 million outstanding

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## **Table of Contents**

indebtedness under the Company's committed lines of credit, pay off \$77.7 million of secured indebtedness, and pay costs related to the offering of the Notes. Remaining Note proceeds are being used for general corporate purposes, including future capital expenditures and scheduled principal debt payments.

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. After giving effect to these transactions, the Company has \$185.0 million of total commitments under lines of credit.

The lines provide the Company with various interest rate options generally at rates less than prime. The lines allow the Company to issue up to \$30.0 million in unused letters of credit, of which \$8.4 million of unused letters of credit were issued at June 26, 2010. The Company is not required to maintain compensating balances in connection with these lines of credit.

The Notes and 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 June 26, 2010.

Long-term debt and lines of credit agreements contain various restrictive covenants requiring, among other things, certain levels of fixed charge coverage, leverage and net worth. These covenants have the effect of restricting certain types of transactions, including additional borrowings and the payment of cash dividends in excess of current quarterly per share amounts. As of June 26, 2010, the Company was in compliance with these covenants by a significant margin. Under the most restrictive of these covenants, the Company would be able to incur approximately \$367 million of additional borrowings (including borrowings under committed lines of credit) at June 26, 2010.

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 June 26, 2010, the Company had unencumbered real property and equipment with a net book value of approximately \$725 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, such sources of financing may not 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 intangible factors. These factors may include, among others, 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 26, 2009.

### *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.

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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 financial condition of the Company and other factors which the Board of Directors deems relevant.

**Table of Contents**

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. These covenants have the effect of restricting certain types of transactions, including the payment of cash dividends generally and in excess of current quarterly per share amounts. Further, the Company is prevented from declaring dividends at any time that it is in default under the indenture governing the Notes.

*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's first 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. 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 annualized 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 the Company's gasoline sales, distribution expenses, utility expenses and plastic supply costs.

|                    | Three Months Ended |                  | Twelve Months Ended |                  |
|--------------------|--------------------|------------------|---------------------|------------------|
|                    | June 26,<br>2010   | June 27,<br>2009 | June 26,<br>2010    | June 27,<br>2009 |
| All items          | 1.3%               | 3.3%             | 1.1%                | (1.4)%           |
| Food and beverages | 0.7%               | (1.3)%           | 0.7%                | 2.2%             |
| Energy             | 2.4%               | 22.1%            | 3.0%                | (25.5)           |

*Forward Looking Statements*

This Quarterly Report contains certain forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. The words expect, anticipate, intend, plan, likely, goal, believe, seek and similar expressions are intended to identify forward-looking statements. While these forward-looking 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. The Company does not undertake and specifically denies any obligation to update any such statements or to publicly announce the results of any revisions to any such statements to reflect future events or developments.

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

The Company does not typically utilize financial instruments for trading or other speculative purposes, nor does it typically utilize leveraged financial instruments. There have been no material changes in the market risk factors from those disclosed in the Company's Annual Report on Form 10-K for the year ended September 26, 2009.



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**Table of Contents**

**Item 4. CONTROLS AND PROCEDURES**

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.

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 June 26, 2010, 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 2009. After consideration of the matters discussed above, the Company has concluded that its controls and procedures were effective as of June 26, 2010.

(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 6. EXHIBITS**

(a) Exhibits.

- 1) Exhibit 10.1 Exhibits and Schedules to Credit Agreement dated May 12, 2009, among the Company and the lenders party thereto, Bank of America, as administrative agent, swing line lender and l/c issuer, Branch Banking and Trust Company, as syndication agent, Wachovia Bank, National Association, as documentation agent, and Banc of America Securities LLC, Branch Banking and Trust Company and Wachovia Capital Markets, LLC, as joint lead arrangers and joint book managers (included as Exhibit 10.1 to Ingles Markets, Incorporated's Current Report on Form 8-K, File No. 0-14706, previously filed with the Commission on May 15, 2009 and incorporated herein by this reference).
- 2) Exhibit 31.1 Rule 13a-14(a) Certificate
- 3) Exhibit 31.2 Rule 13a-14(a) Certificate
- 4) Exhibit 32.1 Certification Pursuant to 18 U.S.C. Section 1350
- 5) Exhibit 32.2 Certification Pursuant to 18 U.S.C. Section 1350

**Table of Contents**

**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: July 30, 2010

/s/ Robert P. Ingle  
Robert P. Ingle  
Chief Executive Officer

Date: July 30, 2010

/s/ Ronald B. Freeman  
Ronald B. Freeman  
Vice President-Finance and Chief Financial Officer