SPARTAN STORES INC
Form 10-Q
February 03, 2006

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 December 31, 2005.

OR

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

For the transition period from ______________ to ______________.

Commission File Number: 000-31127

SPARTAN STORES, INC.
(Exact Name of Registrant as Specified in Its Charter)

Michigan (State or Other Jurisdiction of Incorporation or Organization)	**38-0593940** (I.R.S. Employer Identification No.)
850 76th Street, S.W. **P.O. Box 8700** **Grand Rapids, Michigan** (Address of Principal Executive Offices)	**49518** (Zip Code)

(616) 878-2000
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No _

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act).

Yes X No _

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act)

Yes _ No X

As of January 27, 2006 the registrant had 20,814,894 outstanding shares of Common Stock, no par value.

FORWARD-LOOKING STATEMENTS

The matters discussed in this Quarterly Report on Form 10-Q include "forward-looking statements" about the plans, strategies, objectives, goals or expectations of Spartan Stores, Inc. (together with its subsidiaries, "Spartan Stores"). These forward-looking statements are identifiable by words or phrases indicating that Spartan Stores or management "expects," "anticipates," "projects," "plans," "believes," "estimates," "intends," is "optimistic" or "confident" that a particular occurrence "will," "may," "could," "should" or "will likely" result or that a particular event "will," "may," "could," "should" or "will likely" occur in the future, that the "outlook" or "trend" is toward a particular result or occurrence, or similarly stated expectations. Accounting estimates, such as those described under the heading "Critical Accounting Policies" in Item 2 of this Form 10-Q, are inherently forward-looking. You should not place undue reliance on these forward-looking statements, which speak only as of the date of this Quarterly Report.

In addition to other risks and uncertainties described in connection with the forward-looking statements contained in this Quarterly Report on Form 10-Q, Spartan Stores' Annual Report on Form 10-K for the year ended March 26, 2005 and other periodic reports filed with the Securities and Exchange Commission, there are many important factors that could cause actual results to differ materially. Our ability to strengthen our retail-store performance; maintain or grow sales; maintain or increase gross margin; maintain and improve customer and supplier relationships; reduce operating costs; sell on favorable terms assets classified as held for sale; generate cash; continue to meet the terms of our debt covenants; and implement the other programs, plans, strategies, objectives, goals or expectations described in this Quarterly Report, our press releases and our public comments will be affected by changes in economic conditions generally or in the markets and geographic areas that we serve, adverse effects of the changing food and distribution industries and other factors including, but not limited to, those discussed below.

Anticipated future sales are subject to competitive pressures from many sources. Our Grocery Distribution and Retail businesses compete with many supercenters, warehouse discount stores, supermarkets, pharmacies and product manufacturers. Future sales will be dependent on the number of retail stores that we own and operate, our ability to retain and add to the retail stores to whom we distribute, competitive pressures in the retail industry generally and our geographic markets specifically and our ability to implement effective new marketing and merchandising programs. Competitive pressures in these and other business segments may result in unexpected reductions in sales volumes, product prices or service fees.

Our operating and administrative expenses may be adversely affected by unexpected costs associated with, among other factors: difficulties in the operation of our business segments; future business acquisitions; adverse effects on business relationships with independent retail grocery store customers; difficulties in the retention or hiring of employees; labor shortages, stoppages or disputes; business and asset divestitures; increased transportation or fuel costs; current or future lawsuits and administrative proceedings; and losses of, or financial difficulties of, customers or suppliers. Our future costs for pension and postretirement benefit costs may be adversely affected by changes in actuarial assumptions and methods, investment return and the composition of the group of employees and retirees covered, changes in our business that result in a withdrawal liability under multi-employer plans, and the actions and contributions of other employers who participate in multi-employer plans to which we contribute. Our operating and administrative expenses, net earnings and cash flow could also be adversely affected by changes in our sales mix. Our ongoing cost reduction initiatives and changes in our marketing and merchandising programs may not be as successful as we anticipate. Acts of terrorism or war have in the past and may in the future result in considerable economic and political uncertainties that could have adverse effects on consumer buying behavior, fuel costs, shipping and transportation, product imports and other factors affecting our company and the grocery industry generally. Our asset impairment and exit cost provisions are estimates and actual costs may be more or less than these estimates.

Our ability to complete the proposed acquisition of certain of the assets of D&W Food Centers, Inc. ("D&W") depends on satisfaction of a variety of contractual conditions, not all of which are entirely within the control of us or D&W. Realization of increased sales and earnings, as a result of that transaction, depends on our ability to successfully complete the transaction, integrate the acquired assets, and implement our plans and business practices.

Our adoption of a dividend policy on December 13, 2005 does not commit the Board of Directors to declare future dividends. Each future dividend will be considered and declared by the Board of Directors in its discretion. The ability of the Board of Directors to continue to declare dividends will depend on a number of factors, including our future financial condition and profitability and compliance with the terms of our credit facilities.

Our future interest expense and income also may differ from current expectations, depending upon, among other factors: the amount of additional borrowings; changes in our borrowing agreements; changes in the interest rate environment; and changes in the amount of fees received or paid. The availability of our secured loan agreement depends on compliance with the terms of the loan agreement.

This section is intended to provide meaningful cautionary statements for purposes of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. This should not be construed as a complete list of all economic, competitive, governmental, technological and other factors that could adversely affect our expected consolidated financial position, results of operations or liquidity. We undertake no obligation to update or revise our forward-looking statements to reflect developments that occur or information obtained after the date of this Quarterly Report.

PART I
FINANCIAL INFORMATION

ITEM 1. **Financial Statements**

SPARTAN STORES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)
(Unaudited)

Assets	December 31, 2005	March 26, 2005
Current assets		
Cash and cash equivalents	$ 11,782	$ 14,880
Accounts receivable, net	41,075	43,445
Inventories, net	104,004	95,988
Prepaid expenses and other current assets	5,424	7,884
Deferred taxes on income	5,604	5,396
Property and equipment held for sale	4,668	3,855
Total current assets	172,557	171,448
Other assets		
Goodwill	72,465	72,315
Deferred taxes on income	12,087	18,680
Other, net	13,369	13,135
Total other assets	97,921	104,130
Property and equipment, net	108,394	108,879
Total assets	$ 378,872	$ 384,457

Liabilities and Shareholders' Equity	December 31, 2005	March 26, 2005
Current liabilities		
Accounts payable	$ 88,751	$ 82,391
Accrued payroll and benefits	25,420	30,775
Other accrued expenses	27,340	25,176
Current maturities of long-term debt	1,654	2,848
Total current liabilities	143,165	141,190
Other long-term liabilities	11,596	16,814
Postretirement benefits	10,054	9,097
Long-term debt	74,867	91,946

Shareholders' equity		
Common stock, voting, no par value; 50,000 shares authorized; 20,812 and 20,524 shares outstanding	121,513	118,144
Preferred stock, no par value, 10,000 shares authorized; no shares outstanding	-	-
Deferred stock-based compensation	(3,170)	(719)
Accumulated other comprehensive loss	(203)	(203)
Retained earnings	21,050	8,188
Total shareholders' equity	139,190	125,410
Total liabilities and shareholders' equity	$ 378,872	$ 384,457

See accompanying notes to condensed consolidated financial statements.

SPARTAN STORES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS
(In thousands, except per share data)
(Unaudited)

	16 Weeks Ended		40 Weeks Ended	
	December 31, 2005	**January 1, 2005**	**December 31, 2005**	**January 1, 2005**
Net sales	$ 642,274	$ 624,517	$ 1,587,135	$ 1,585,543
Cost of sales	526,530	507,165	1,292,038	1,287,200
Gross margin	115,744	117,352	295,097	298,343
Operating expenses				
Selling, general and administrative expenses	106,592	105,912	267,434	268,780
Provision for asset impairments and exit costs	787	-	1,057	-
Total operating expenses	107,379	105,912	268,491	268,780
Operating earnings	8,365	11,440	26,606	29,563
Other income and expenses				
Interest expense	2,538	2,897	6,070	7,466
Debt extinguishment	-	561	-	561
Other, net	(1,294)	(939)	(1,349)	(910)
Total other income and expenses	1,244	2,519	4,721	7,117
Earnings before income taxes and discontinued operations	7,121	8,921	21,885	22,446
Income taxes	2,351	3,123	7,232	7,855
Earnings from continuing operations	4,770	5,798	14,653	14,591
Loss from discontinued operations, net of taxes	(1,413)	(1,273)	(1,791)	(1,562)
Net earnings	$ 3,357	$ 4,525	$ 12,862	$ 13,029
Basic earnings per share:				
Earnings from continuing operations	$ 0.23	$ 0.28	$ 0.71	$ 0.72
Loss from discontinued operations	(0.07)	(0.06)	(0.09)	(0.08)
Net earnings	$ 0.16	$ 0.22	$ 0.62	$ 0.64

Diluted earnings per share:				
Earnings from continuing operations	$ 0.22	$ 0.28	$ 0.69	$ 0.71
Loss from discontinued operations	(0.06)	(0.06)	(0.09)	(0.08)
Net earnings	$ 0.16	$ 0.22	$ 0.60	$ 0.63
Weighted average shares outstanding:				
Basic	20,812	20,498	20,758	20,416
Diluted	21,321	20,795	21,330	20,658

See accompanying notes to condensed consolidated financial statements.

SPARTAN STORES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
(In thousands)
(Unaudited)

	Shares Outstanding	Common Stock	Deferred Stock-Based Compensation	Accumulated Other Comprehensive Loss	Retained Earnings	Total
Balance - March 27, 2005	20,524	$ 118,144	$ (719)	$ (203)	$ 8,188	$ 125,410
Comprehensive income, net of tax:						
Net earnings for fiscal 2006	-	-	-	-	12,862	12,862
Issuances of common stock	43	317	-	-	-	317
Issuances of restricted stock	252	3,060	(3,060)	-	-	-
Cancellations of restricted stock	(7)	(8)	8	-	-	-
Amortization of restricted stock	-	-	601	-	-	601
Balance - December 31, 2005	20,812	$ 121,513	$ (3,170)	$ (203)	$ 21,050	$ 139,190

See accompanying notes to condensed consolidated financial statements.

SPARTAN STORES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	40 Weeks Ended	
	December 31, 2005	**January 1, 2005**
Cash flows from operating activities		
Net earnings	$ 12,862	$ 13,029
Loss from discontinued operations	1,791	1,562
Earnings from continuing operations	14,653	14,591
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Debt extinguishment	-	561
Provision for asset impairments and exit costs	1,057	-
Depreciation and amortization	16,089	17,627
Postretirement benefits	957	912
Deferred taxes on income	6,665	6,896
Restricted stock amortization	601	141
Gain/loss on sale of assets	(1,218)	(770)
Other, net	368	(41)
Changes in operating assets and liabilities:		
Accounts receivable	2,332	(2,535)
Inventories	(8,016)	1,121
Prepaid expenses and other assets	916	3,561
Accounts payable	4,826	4,960
Accrued payroll and benefits	(5,234)	1,477
Other accrued expenses and other liabilities	(822)	(1,096)
Net cash provided by operating activities	33,174	47,405
Cash flows from investing activities		
Purchases of property and equipment	(16,975)	(17,771)
Net proceeds from the sale of assets	2,324	2,832
Other	(114)	(205)
Net cash used in investing activities	(14,765)	(15,144)
Cash flows from financing activities		
Net payments on revolver	(15,975)	(8,602)
Repayment of long-term debt	(1,882)	(18,438)
Financing fees paid	-	(492)
Proceeds from sale of common stock	317	636
Net cash used in financing activities	(17,540)	(26,896)

Discontinued operations				
Net cash used in discontinued operations		(3,967)		(4,041)
Net (decrease) increase in cash and cash equivalents		(3,098)		1,324
Cash and cash equivalents at beginning of period		14,880		13,252
Cash and cash equivalents at end of period	$	11,782	$	14,576

See accompanying notes to condensed consolidated financial statements.

SPARTAN STORES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1
Basis of Presentation and Significant Accounting Policies

The Condensed Consolidated Financial Statements include the accounts of Spartan Stores, Inc. and its subsidiaries ("Spartan Stores"). All significant intercompany accounts and transactions have been eliminated.

In the opinion of management, the accompanying condensed consolidated financial statements, taken as a whole, contain all adjustments, which are of a normal recurring nature, necessary to present fairly the financial position of Spartan Stores as of December 31, 2005 and the results of its operations and cash flows for the interim periods presented. Interim results are not necessarily indicative of results for a full year.

Stock-Based Compensation
Spartan Stores has a stock incentive plan, which is more fully described in Note 10 of the 2005 Annual Report on Form 10-K. Spartan Stores accounts for the plan under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations. No stock-based compensation cost for stock options is reflected in the Consolidated Statements of Earnings, as all options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net earnings and earnings per share as if Spartan Stores had applied the fair value recognition principles of Statement of Financial Accounting Standards Statement No. 123, "Accounting for Stock-Based Compensation," to stock options granted to employees:

(In thousands, except per share data)

	16 Weeks Ended	
	December 31, 2005	**January 1, 2005**
Net earnings, as reported	$ 3,357	$ 4,525
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(116)	(91)
Pro forma net earnings	$ 3,241	$ 4,434
Basic earnings per share - as reported	$ 0.16	$ 0.22
Basic earnings per share - pro forma	0.16	0.22
Diluted earnings per share - as reported	$ 0.16	$ 0.22
Diluted earnings per share - pro forma	0.15	0.21

(In thousands, except per share data)

	40 Weeks Ended	
	December 31, 2005	January 1, 2005
Net earnings, as reported	$ 12,862	$ 13,029
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(285)	(253)
Pro forma net earnings	$ 12,577	$ 12,776
Basic earnings per share - as reported	$ 0.62	$ 0.64
Basic earnings per share - pro forma	$ 0.61	$ 0.63
Diluted earnings per share - as reported	$ 0.60	$ 0.63
Diluted earnings per share - pro forma	$ 0.59	$ 0.62

Reclassifications

Certain reclassifications have been made to the fiscal 2005 condensed consolidated financial statements to conform to the fiscal 2006 presentation.

Note 2
New Accounting Standards

In December 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 123(R), "Share-Based Payment" that will require compensation costs related to share-based payment transactions to be recognized in the consolidated financial statements. With limited exceptions, the amount of compensation cost will be measured based on the grant date fair value of the equity or liability instruments issued. In addition, liability awards will be remeasured each reporting period. Compensation cost will be recognized over the period that an employee provides services in exchange for the award. SFAS No. 123(R) replaces SFAS No. 123, and supercedes APB Opinion No. 25. This Statement becomes effective for Spartan Stores at the beginning of fiscal 2007.

Spartan Stores intends to adopt SFAS No. 123(R) using the "modified prospective" transition method beginning with the first quarter of fiscal 2007. Under this method, awards that are modified, granted, or settled on or after March 26, 2006 will be measured and accounted for in accordance with SFAS No. 123(R). In addition, in Spartan Stores' first quarter of fiscal 2007, expense must be recognized for unvested awards that were granted prior to Spartan Stores' adoption of SFAS No. 123(R), and the expense will be based on the fair value determined at the grant date under SFAS No. 123, "Accounting for Stock-Based Compensation." As permitted by SFAS No. 123, Spartan Stores currently accounts for share-based payments to employees using APB Opinion No. 25's intrinsic value method and, as such, recognizes no compensation cost for employee stock options. The impact of adoption of SFAS No. 123(R) cannot be predicted at this time because it will depend on levels of share-based payments granted in the future. Had Spartan Stores adopted SFAS No. 123(R) in prior periods, the impact of that standard would have approximated the impact of SFAS No. 123 as described in the disclosure of pro forma net income and earnings per share in Note 1 to our consolidated financial statements. However, the calculation of compensation cost for share-based payment transactions after the effective date of SFAS No. 123(R) may be different from the calculation of compensation cost under SFAS No. 123, and such differences have not yet been quantified.

In June 2005, the Emerging Issues Task Force ("EITF") reached a consensus on EITF Issue No. 05-6, "Determining the Amortization Period for Leasehold Improvements Purchased after Lease Inception or Acquired in a Business Combination" ("EITF 05-6"). EITF 05-6 requires that leasehold improvements acquired in a business combination be amortized over the shorter of the useful life of the assets or a term that includes required lease periods and renewals that are deemed to be reasonably assured at the date of acquisition. EITF 05-6 also requires that leasehold improvements that are placed in service significantly after and not contemplated at or near the beginning of the lease term be amortized over the shorter of the useful life of the assets or a term that includes required lease periods and renewals that are deemed to be reasonably assured at the date the leasehold improvements are purchased. EITF 05-6 became effective for Spartan Stores' fiscal quarter beginning September 11, 2005. The adoption of EITF 05-6 did not have a material effect on Spartan Stores' consolidated financial statements.

In October 2005, the FASB issued FASB Staff Position FAS 13-1, "Accounting for Rental Costs Incurred During a Construction Period" ("FSP FAS 13-1"). FSP FAS 13-1 requires rental costs associated with building or ground leases incurred during a construction period to be recognized as rental expense. FSP FAS 13-1 is effective for the first reporting period beginning after December 15, 2005; however, a lessee is required to cease capitalizing rental costs as of December 15, 2005 for operating lease arrangements entered into prior to December 15, 2005. Early adoption is permitted for annual or interim financial statements that have not yet been issued. Spartan Stores will adopt FSP FAS 13-1 beginning with the fiscal fourth quarter beginning January 1, 2006. The impact of FSP FAS 13-1 is not expected to have a material effect on Spartan Stores' consolidated financial statements.

Note 3
Long-Term Debt

Effective December 9, 2005, Spartan Stores amended its existing senior secured revolving credit facility. The amendment increased the senior secured revolving credit facility ("credit facility") to $225.0 million from its original $215.0 million and now matures in December 2010 rather than December 2008. In addition, a $15.0 million Term B loan is included as part of the total $225.0 million credit facility, which may be drawn upon at Spartan Stores' option through June 1, 2006. The amended agreement provides increased flexibility for engaging in acquisitions and paying cash dividends. In addition, the amended agreement increases availability of credit on fixed assets, and increases the advance rates on certain categories of assets, resulting in additional availability. Interest rates under the amended agreement may be up to 50 basis points lower for LIBOR borrowings depending on levels of excess availability under the agreement.

Available borrowings under the credit facility are based on stipulated advance rates on eligible assets, as defined in the credit agreement. The credit facility contains covenants that include the maintenance of minimum EBITDA and maximum capital expenditures, as defined in the credit agreement. These covenants will not be effective as long as Spartan Stores maintains a minimum excess availability level, as defined in the credit agreement. Spartan Stores had available borrowings of $107.8 million at December 31, 2005 and maximum availability of $117.8 million, which exceeds the minimum excess availability levels. The credit facility provides for the issuance of letters of credit of which $10.5 million were outstanding and unused as of December 31, 2005. The credit facility bears interest at the London InterBank Offered Rate ("LIBOR") plus 1.50% or the prime rate (weighted average interest rate of 6.05% at December 31, 2005).

Spartan Stores' long-term debt consists of the following:

(In thousands)	December 31, 2005	March 26, 2005
Senior secured revolving credit facility, due December 2010	$ 66,061	$ 82,036
Notes payable, due June 2007, monthly principal payments of variable amounts	3,880	4,223
Other	6,580	8,535
	76,521	94,794
Less current portion	1,654	2,848

Total long-term debt	$ 74,867	$ 91,946

At December 31, 2005 long-term debt was due as follows:

(In thousands)

Fiscal Year		
2006	$	450
2007		2,135
2008		4,135
2009		591
2010		66,707
Thereafter		2,503
	$	76,521

Note 4
Sale of Joint Venture

Effective December 2004, Spartan Stores sold its 65 percent ownership interest in a retail store to its former joint venture partner. Total consideration of $4.5 million from the transaction was used to reduce outstanding debt. As a result of this sale, Spartan Stores recorded a pre-tax gain of $0.8 million in the third quarter of fiscal 2005 that is included in Other, net on the Consolidated Statements of Earnings. Spartan Stores' annualized retail sales and after-tax net earnings from the joint venture approximated $20.0 million and $0.3 million, respectively. Spartan Stores entered into a 10-year distribution supply agreement with the acquirer.

Note 5
Discontinued Operations

Spartan Stores' former convenience distribution operations, insurance operations and certain of its retail, grocery distribution and real estate operations have been recorded as discontinued operations. Results of the discontinued operations are excluded from the accompanying notes to the consolidated financial statements for all periods presented, unless otherwise noted.

Discontinued operations had no sales during the third quarter and year-to-date periods ended December 31, 2005 and January 1, 2005. The operating losses in discontinued operations for the third quarters ended December 31, 2005 and January 1, 2005 of $2.1 million and $2.0 million were partially offset by income tax benefits of $0.7 million and $0.7 million for the third quarters ended December 31, 2005 and January 1, 2005, respectively. The operating losses in discontinued operations for the year-to-date periods ended December 31, 2005 and January 1, 2005 of $2.7 million and $2.4 million were partially offset by income tax benefits of $0.9 million and $0.8 million for the year-to-date periods ended December 31, 2005 and January 1, 2005, respectively.

Total assets of discontinued operations totaled $6.1 million at March 26, 2005 and $6.2 million at December 31, 2005. Total liabilities of discontinued operations decreased from $14.4 million at March 26, 2005 to $12.5 million at December 31, 2005.

Spartan Stores anticipates that it will be subject to a partial withdrawal liability from a multi-employer pension plan related to the 2003 closures of certain of its discontinued *Food Town* stores when a final determination is made after June 30, 2006. Recent estimates provided by the trustees of the multi-employer pension plan indicate that there will be an underfunded liability which we believe to have resulted from a change in actuarial assu