

INGLES MARKETS INC  
Form 10-Q  
May 06, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 28, 2015

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

For the transition period from                      to

Commission file number 0-14706.

INGLES MARKETS, INCORPORATED

(Exact name of registrant as specified in its charter)

North Carolina (State or other jurisdiction of incorporation or organization)	56-0846267 (I.R.S. Employer Identification No.)
P.O. Box 6676, Asheville NC (Address of principal executive offices)	28816 (Zip Code)

(828) 669-2941

Registrant's telephone number, including area code

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

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

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

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Large accelerated filer

Accelerated filer

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

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

Yes No .

As of May 4, 2015 the Registrant had 13,760,976 shares of Class A Common Stock, \$0.05 par value per share, outstanding and 6,498,800 shares of Class B Common Stock, \$0.05 par value per share, outstanding.

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## Part I. FINANCIAL INFORMATION

## Item 1. FINANCIAL STATEMENTS

## INGLES MARKETS, INCORPORATED AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	March 28, 2015	September 27, 2014
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 8,684,175	\$ 8,613,628
Receivables - net	64,368,373	60,991,062
Inventories	337,056,383	329,523,604
Other current assets	15,286,536	14,789,004
Total Current Assets	425,395,467	413,917,298
Property and Equipment – Net	1,208,453,632	1,218,607,029
Other Assets	24,391,182	24,427,237
Total Assets	\$ 1,658,240,281	\$ 1,656,951,564
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities:		
Current portion of long-term debt	\$ 13,939,858	\$ 12,488,400
Accounts payable - trade	157,556,951	167,314,891
Accrued expenses and current portion of other long-term liabilities	60,464,274	70,944,728
Total Current Liabilities	231,961,083	250,748,019
Deferred Income Taxes	73,865,000	70,040,000
Long-Term Debt	914,597,118	924,771,343
Other Long-Term Liabilities	32,359,706	28,790,035
Total Liabilities	1,252,782,907	1,274,349,397
Stockholders' Equity		
Preferred stock, \$0.05 par value; 10,000,000 shares authorized; no shares issued	—	—
Common stocks:		
Class A, \$0.05 par value; 150,000,000 shares authorized; 13,760,083 shares issued and outstanding March 28, 2015; 13,540,333 shares issued and outstanding at September 27, 2014	688,004	677,017
Class B, convertible to Class A, \$0.05 par value; 100,000,000 shares authorized; 6,499,693 shares issued and outstanding March 28, 2015; 6,719,443 shares	324,985	335,972

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issued and outstanding at September 27, 2014

Paid-in capital in excess of par value	12,311,249	12,311,249
Retained earnings	392,133,136	369,277,929
Total Stockholders' Equity	405,457,374	382,602,167
Total Liabilities and Stockholders' Equity	\$ 1,658,240,281	\$ 1,656,951,564

See notes to unaudited condensed consolidated financial statements.

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## INGLES MARKETS, INCORPORATED AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Three Months Ended	
	March 28, 2015	March 29, 2014
Net sales	\$ 915,334,689	\$ 947,760,587
Cost of goods sold	696,643,697	741,636,640
Gross profit	218,690,992	206,123,947
Operating and administrative expenses	185,578,000	178,402,604
Gain from sale or disposal of assets	521,222	83,283
Income from operations	33,634,214	27,804,626
Other income, net	563,966	737,862
Interest expense	11,577,970	11,698,560
Income before income taxes	22,620,210	16,843,928
Income tax expense	8,318,000	6,389,000
Net income	\$ 14,302,210	\$ 10,454,928
Per share amounts:		
Class A Common Stock		
Basic earnings per common share	\$ 0.72	\$ 0.47
Diluted earnings per common share	\$ 0.71	\$ 0.46
Class B Common Stock		
Basic earnings per common share	\$ 0.66	\$ 0.43
Diluted earnings per common share	\$ 0.66	\$ 0.43
Cash dividends per common share		
Class A Common Stock	\$ 0.165	\$ 0.165
Class B Common Stock	\$ 0.150	\$ 0.150

See notes to unaudited condensed consolidated financial statements.



## INGLES MARKETS, INCORPORATED AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Six Months Ended	
	March 28, 2015	March 29, 2014
Net sales	\$ 1,879,831,524	\$ 1,892,885,457
Cost of goods sold	1,436,747,974	1,483,255,844
Gross profit	443,083,550	409,629,613
Operating and administrative expenses	372,556,852	355,832,785
Gain from sale or disposal of assets	639,004	208,156
Income from operations	71,165,702	54,004,984
Other income, net	1,126,726	1,577,865
Interest expense	23,600,880	23,480,791
Income before income taxes	48,691,548	32,102,058
Income tax expense	19,351,000	12,114,000
Net income	\$ 29,340,548	\$ 19,988,058
Per share amounts:		
Class A Common Stock		
Basic earnings per common share	\$ 1.49	\$ 0.91
Diluted earnings per common share	\$ 1.45	\$ 0.88
Class B Common Stock		
Basic earnings per common share	\$ 1.36	\$ 0.83
Diluted earnings per common share	\$ 1.36	\$ 0.83
Cash dividends per common share		
Class A Common Stock	\$ 0.33	\$ 0.33
Class B Common Stock	\$ 0.30	\$ 0.30

See notes to unaudited condensed consolidated financial statements.

## INGLES MARKETS, INCORPORATED AND SUBSIDIARIES

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

SIX MONTHS ENDED MARCH 28, 2015 AND MARCH 29, 2014

	Class A Common Stock		Class B Common Stock		Paid-in Capital in Excess of Par Value	Retained Earnings	Total
	Shares	Amount	Shares	Amount			
Balance, September 28, 2013	13,437,975	\$ 671,899	9,321,801	\$ 466,090	\$ 77,186,249	\$ 332,315,037	\$ 410,639,275
Net income	—	—	—	—	—	19,988,058	19,988,058
Cash dividends	—	—	—	—	—	(7,231,123)	(7,231,123)
Common stock conversions	30,562	1,528	(30,562)	(1,528)	—	—	—
Balance, March 29, 2014	13,468,537	\$ 673,427	9,291,239	\$ 464,562	\$ 77,186,249	\$ 345,071,972	\$ 423,396,210
Balance, September 27, 2014	13,540,333	\$ 677,017	6,719,443	\$ 335,972	\$ 12,311,249	\$ 369,277,929	\$ 382,602,167
Net income	—	—	—	—	—	29,340,548	29,340,548
Cash dividends	—	—	—	—	—	(6,485,341)	(6,485,341)
Common stock conversions	219,750	10,987	(219,750)	(10,987)	—	—	—
Balance, March 28, 2015	13,760,083	\$ 688,004	6,499,693	\$ 324,985	\$ 12,311,249	\$ 392,133,136	\$ 405,457,374

See notes to unaudited condensed consolidated financial statements.



## INGLES MARKETS, INCORPORATED AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Six Months Ended	
	March 28, 2015	March 29, 2014
Cash Flows from Operating Activities:		
Net income	\$ 29,340,548	\$ 19,988,058
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	50,898,628	48,113,901
Gain from sale or disposal of assets	(639,004)	(208,156)
Receipt of advance payments on purchases contracts	3,518,251	2,516,458
Recognition of advance payments on purchases contracts	(2,298,705)	(1,632,251)
Deferred income taxes	3,825,000	(3,271,000)
Changes in operating assets and liabilities:		
Receivables	(3,006,991)	(4,994,302)
Inventory	(7,532,779)	(3,732,015)
Other assets	(317,709)	2,064,706
Accounts payable and accrued expenses	(14,886,343)	(8,095,489)
Net Cash Provided by Operating Activities	58,900,896	50,749,910
Cash Flows from Investing Activities:		
Proceeds from sales of property and equipment	674,380	200,804
Capital expenditures	(44,296,622)	(51,838,307)
Net Cash Used by Investing Activities	(43,622,242)	(51,637,503)
Cash Flows from Financing Activities:		
Proceeds from short-term borrowings	398,870,522	297,451,513
Payments on short-term borrowings	(399,108,140)	(297,451,513)
Proceeds from other long-term borrowings	—	14,000,000
Principal payments on long-term borrowings	(8,485,148)	(15,337,958)
Dividends paid	(6,485,341)	(7,231,123)
Net Cash Used by Financing Activities	(15,208,107)	(8,569,081)
Net Increase (Decrease) in Cash and Cash Equivalents	70,547	(9,456,674)
Cash and cash equivalents at beginning of period	8,613,628	16,844,007
Cash and Cash Equivalents at End of Period	\$ 8,684,175	\$ 7,387,333

See notes to unaudited condensed consolidated financial statements.



INGLES MARKETS, INCORPORATED AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM FINANCIAL STATEMENTS

Six Months Ended March 28, 2015 and March 29, 2014

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 March 28, 2015, the results of operations for the three-month and six-month periods ended March 28, 2015 and March 29, 2014, and the changes in stockholders' equity and cash flows for the six-month periods ended March 28, 2015 and March 29, 2014. 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 27, 2014 filed by the Company under the Securities Exchange Act of 1934 on December 16, 2014.

The results of operations for the three-month and six-month periods ended March 28, 2015 are not necessarily indicative of the results to be expected for the full fiscal year.

B. NEW ACCOUNTING PRONOUNCEMENTS

There were no new accounting standards adopted in the six-month period ended March 28, 2015.

C. ALLOWANCE FOR DOUBTFUL ACCOUNTS

Receivables are presented net of an allowance for doubtful accounts of \$527,000 at March 28, 2015 and \$307,000 at September 27, 2014, respectively.

D. INCOME TAXES

The Company's effective tax rate differs from the federal statutory rate primarily as a result of state income taxes and tax credits.

The Company has unrecognized tax benefits and could also incur interest and penalties related to uncertain tax positions. The amounts are not material and are not expected to 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 federal and state income tax examinations by tax authorities for the years before 2011.

On September 13, 2013, the IRS released final tangible property regulations under Sections 162(a) and 263(a) of the Internal Revenue Code regarding the deduction and capitalization of expenditures related to tangible property as well as dispositions of tangible property. These regulations are effective for the Company's fiscal year ending September 26, 2015. The Company has determined that the regulations do not have a material impact on the Company's consolidated results of operations, cash flows or financial position.

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

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

	March 28, 2015	September 27, 2014
Property, payroll and other taxes payable	\$ 10,366,402	\$ 16,469,128
Salaries, wages and bonuses payable	22,156,139	25,514,842
Self-insurance liabilities	11,005,845	12,934,920
Interest payable	12,793,594	12,676,648
Other	4,142,294	3,349,190
	\$ 60,464,274	\$ 70,944,728





Self-insurance liabilities are established for general liability claims, workers' compensation and employee group medical and dental benefits based on claims filed and estimates of claims incurred but not reported. The Company is insured for covered costs in excess of \$750,000 per occurrence for workers' compensation, \$500,000 for general liability and \$325,000 per covered person for medical care benefits for a policy year. At March 28, 2015, the Company's self-insurance reserves totaled \$30.3 million. Of this amount, \$11.0 million is accounted for as a current liability and \$19.3 million as a long-term liability. Employee insurance expense, including workers' compensation and medical care benefits, net of employee contributions, totaled \$8.6 million and \$5.8 million for each of the three-month periods ended March 28, 2015 and March 29, 2014, respectively. For the six-month periods ended March 28, 2015 and March 29, 2014, employee insurance expense, net of employee contributions, totaled \$16.3 million and \$12.0 million, respectively.

#### F. LONG-TERM DEBT

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

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

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

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

In connection with the offering of the Notes, the Company extended the maturity date of its \$175.0 million line of credit from December 29, 2015 to June 12, 2018 and modified certain interest rate options and covenants. Outstanding borrowings under the line of credit totaled \$29.7 million at March 28, 2015 and \$29.9 million at September 27, 2014.

The line of credit provides the Company with various interest rate options based on the prime rate, the Federal Funds Rate, or the London Interbank Offering Rate. The line allows the Company to issue up to \$30.0 million in unused letters of credit, of which \$10.3 million of unused letters of credit were issued at March 28, 2015. The Company is not required to maintain compensating balances in connection with the line of credit.

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

The Bonds were issued by the Buncombe County Industrial Facilities and Pollution Control Financing Authority and were purchased by certain financial institutions. Under a Continuing Covenant and Collateral Agency Agreement (the "Covenant Agreement") between the financial institutions and the Company, the financial institutions would hold the Bonds until January 2, 2018, subject to certain events. Mandatory redemption of the Bonds by the Company in the annual amount of \$4.5 million began on January 1, 2014.

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

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

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

The Notes, the Bonds and the line of credit contain provisions that under certain circumstances would permit lending institutions to terminate or withdraw their respective extensions of credit to the Company. Included among the triggering factors permitting the

termination or withdrawal of the line of credit to the Company are certain events of default, including both monetary and non-monetary defaults, the initiation of bankruptcy or insolvency proceedings, and the failure of the Company to meet certain financial covenants designated in its respective loan documents. The Company was in compliance with all financial covenants related to its borrowings at March 28, 2015.

The Company's long-term debt agreements generally have cross-default provisions which could result in the acceleration of payments due under the Company's line of credit, Bond and Notes indenture in the event of default under any one instrument.

#### G. DIVIDENDS

The Company paid cash dividends of \$0.165 for each share of Class A Common Stock and \$0.15 for each share of Class B Common Stock on October 23, 2014 to stockholders of record on October 9, 2014.

The Company paid cash dividends of \$0.165 for each share of Class A Common Stock and \$0.15 for each share of Class B Common Stock on January 22, 2015 to stockholders of record on January 8, 2015.

For additional information regarding the dividend rights of the Class A Common Stock and Class B Common Stock, please see Note 8, "Stockholders' Equity" to the Consolidated Financial Statements of the Annual Report on Form 10-K filed by the Company under the Securities Exchange Act of 1934 on December 16, 2014.

#### H. EARNINGS PER COMMON SHARE

The Company has two classes of common stock: Class A which is publicly traded, and Class B, which has no public market. The Class B Common Stock has restrictions on transfer; however, each share is convertible into one share of Class A Common Stock at any time. Each share of Class A Common Stock has one vote per share and each share of Class B Common Stock has ten votes per share. Each share of Class A Common Stock is entitled to receive cash dividends equal to 110% of any cash dividend paid on Class B Common Stock.

The Company calculates earnings per share using the two-class method in accordance with FASB ASC Topic 260.

The two-class method of computing basic earnings per share for each period reflects the cash dividends paid per share for each class of stock, plus the amount of allocated undistributed earnings per share computed using the participation

percentage which reflects the dividend rights of each class of stock. Diluted earnings per share is calculated assuming conversion of all shares of Class B Common Stock to shares of Class A Common Stock on a share-for-share basis. The tables below reconcile the numerators and denominators of basic and diluted earnings per share for current and prior periods.

	Three Months Ended March 28, 2015		Six Months Ended March 28, 2015	
	Class A	Class B	Class A	Class B
Numerator: Allocated net income				
Net income allocated, basic	\$ 9,917,366	\$ 4,384,844	\$ 20,283,204	\$ 9,057,344
Conversion of Class B to Class A shares	4,384,844	—	9,057,344	—
Net income allocated, diluted	\$ 14,302,210	\$ 4,384,844	\$ 29,340,548	\$ 9,057,344
Denominator: Weighted average shares outstanding				
Weighted average shares outstanding, basic	13,653,154	6,606,622	13,598,039	6,661,737
Conversion of Class B to Class A shares	6,606,622	—	6,661,737	—
Weighted average shares outstanding, diluted	20,259,776	6,606,622	20,259,776	6,661,737
Earnings per share				
Basic	\$ 0.72	\$ 0.66	\$ 1.49	\$ 1.36
Diluted	\$ 0.71	\$ 0.66	\$ 1.45	\$ 1.36

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The per share amounts for the second quarter of fiscal 2014 and the six months ended March 29, 2014 are based on the following amounts:

	Three Months Ended March 29, 2014		Six Months Ended March 29, 2014	
	Class A	Class B	Class A	Class B
Numerator: Allocated net income				
Net income allocated, basic	\$ 6,417,400	\$ 4,037,528	\$ 12,263,861	\$ 7,724,197
Conversion of Class B to Class A shares	4,037,528	—	7,724,197	—
Net income allocated, diluted	\$ 10,454,928	\$ 4,037,528	\$ 19,988,058	\$ 7,724,197
Denominator: Weighted average shares outstanding				
Weighted average shares outstanding, basic	13,456,262	9,303,514	13,447,893	9,311,883
Conversion of Class B to Class A shares	9,303,514	—	9,311,883	—
Weighted average shares outstanding, diluted	22,759,776	9,303,514	22,759,776	9,311,883
Earnings per share				
Basic	\$ 0.47	\$ 0.43	\$ 0.91	\$ 0.83
Diluted	\$ 0.46	\$ 0.43	\$ 0.88	\$ 0.83

## I. SEGMENT INFORMATION

The Company operates one primary business segment, retail grocery sales. The “Other” activities include fluid dairy and shopping center rentals. Information about the Company’s operations by lines of business (amounts in thousands) is as follows:

	Three Months Ended		Six Months Ended	
	March 28, 2015	March 29, 2014	March 28, 2015	March 29, 2014
Revenues from unaffiliated customers:				
Grocery sales	\$ 879,838	\$ 908,448	\$ 1,805,840	\$ 1,818,534
Other	35,496	39,313	73,992	74,351

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Total revenues from unaffiliated customers	\$ 915,335	\$ 947,761	\$ 1,879,832	\$ 1,892,885
Income from operations:				
Grocery sales	\$ 29,598	\$ 24,284	\$ 64,575	\$ 48,449
Other	4,036	3,521	6,591	5,556
Total income from operations	\$ 33,634	\$ 27,805	\$ 71,166	\$ 54,005

	March 28, 2015	September 27, 2014
Assets:		
Grocery sales	\$ 1,515,901	\$ 1,515,055
Other	144,008	144,667
Elimination of intercompany receivable	(1,669)	(2,770)
Total assets	\$ 1,658,240	\$ 1,656,952

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

	Three Months Ended		Six Months Ended	
	March 28, 2015	March 29, 2014	March 28, 2015	March 29, 2014
Grocery	\$ 348,269	\$ 355,658	\$ 706,585	\$ 714,557
Non-foods	185,428			