

SPARTAN STORES INC
Form 10-Q
October 16, 2008

**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 September 13, 2008.

OR

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller Reporting Company

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

Yes No

As of October 10, 2008 the registrant had 22,086,869 outstanding shares of common stock, no par value.

FORWARD-LOOKING STATEMENTS

The matters discussed in this Quarterly Report on Form 10-Q, in our press releases and in our publicly accessible conference calls 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," "plans," "believes," "estimates," that a particular occurrence "may," "could," or "will likely" result or that a particular event "will," "may," "could," "should" or "will likely" occur or "continue" in the future, that the "outlook," "strategy," 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 the Quarterly Report, release or statement.

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 29, 2008 (in particular, you should refer to the discussion of "Risk Factors" in Item 1A of our Annual Report on Form 10-K) 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 maintain and strengthen our retail-store performance; assimilate acquired stores; maintain or grow sales; respond successfully to competitors; maintain or increase gross margin; anticipate and successfully respond to openings of competitors; maintain and improve customer and supplier relationships; realize expected benefits of new relationships; realize growth opportunities; expand our customer base; reduce operating costs; sell on favorable terms assets classified as held for sale; generate cash; continue to meet the terms of our debt covenants; continue to pay dividends; and, implement the other programs, plans, priorities, 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 Distribution and Retail businesses compete with many distributors, 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, our ability to implement effective new marketing and merchandising programs and unseasonable weather conditions. 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, and as a result, our net earnings and cash flows, may be adversely affected by changes in 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 future income tax expense, and as a result, our net earnings and cash flows, could be adversely affected by changes in tax laws. Our accounting estimates could change due to changes in facts, assumptions, or acceptable methods, and actual results may vary materially from our estimates. Our operating and administrative expenses, net earnings and cash flow could also be adversely affected by changes in our sales mix.

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Our ongoing cost reduction initiatives and changes in our marketing and merchandising programs may not be as successful as anticipated. Acts of terrorism, war, natural disaster, fire, accident, general economic conditions or other circumstances beyond our control could have adverse effects on the availability of and our ability to operate our warehouses and other facilities, consumer buying behavior, fuel costs, shipping and transportation, product imports, product cost inflation and its impact on LIFO expense 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 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; changes in accounting pronouncements; 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 and financial stability of the banking community.

Our dividend policy 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.

This section is intended to provide meaningful cautionary statements. 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)

| <u>Assets</u> | <u>September 13, 2008</u> | <u>March 29, 2008</u> |
|--|-------------------------------|---------------------------|
| Current assets | | |
| Cash and cash equivalents | \$ 28,477 | \$ 19,867 |
| Accounts receivable, net | 54,479 | 59,885 |
| Inventories, net | 131,301 | 113,078 |
| Prepaid expenses and other current assets | 8,286 | 9,252 |
| Deferred taxes on income | 6,470 | 7,792 |
| Property and equipment held for sale | - | 2,404 |
| Total current assets | 229,013 | 212,278 |
| Other assets | | |
| Goodwill | 186,265 | 186,531 |
| Other, net | 27,713 | 28,143 |
| Total other assets | 213,978 | 214,674 |
| Property and equipment, net | 190,819 | 183,185 |
| Total assets | \$ 633,810 | \$ 610,137 |
| <u>Liabilities and Shareholders' Equity</u> | | |
| Current liabilities | | |
| Accounts payable | \$ 121,217 | \$ 112,899 |
| Accrued payroll and benefits | 26,434 | 35,723 |
| Other accrued expenses | 24,497 | 23,003 |
| Current portion of exit costs | 10,154 | 9,280 |
| Current maturities of long-term debt and capital lease obligations | 7,976 | 10,874 |
| Total current liabilities | 190,278 | 191,779 |
| Long-term liabilities | | |
| Deferred income taxes | 22,527 | 17,730 |
| Postretirement benefits | 8,592 | 8,127 |
| Other long-term liabilities | 13,979 | 15,434 |

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| Exit costs | 28,442 | 26,847 |
| Long-term debt and capital lease obligations | 141,957 | 143,574 |
| | <hr/> | <hr/> |
| Total long-term liabilities | 215,497 | 211,712 |
| Commitments and contingencies (Note 5) | | |
| Shareholders' equity | | |
| Common stock, voting, no par value; 50,000 shares authorized; 22,086 and 21,909 shares outstanding | 133,571 | 130,718 |
| Preferred stock, no par value, 10,000 shares authorized; no shares outstanding | - | - |
| Accumulated other comprehensive loss | (1,189) | (1,142) |
| Retained earnings | 95,653 | 77,070 |
| | <hr/> | <hr/> |
| Total shareholders' equity | 228,035 | 206,646 |
| | <hr/> | <hr/> |
| Total liabilities and shareholders' equity | \$ 633,810 | \$ 610,137 |
| | <hr/> | <hr/> |

See accompanying notes to condensed consolidated financial statements.

SPARTAN STORES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS

(In thousands, except per share data)

(Unaudited)

| | 12 Weeks Ended | | 24 Weeks Ended | |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 13, 2008 | September 15, 2007 | September 13, 2008 | September 15, 2007 |
| Net sales | \$ 626,830 | \$ 598,053 | \$ 1,213,535 | \$ 1,118,256 |
| Cost of sales | 499,312 | 475,638 | 970,487 | 896,571 |
| Gross margin | 127,518 | 122,415 | 243,048 | 221,685 |
| Operating expenses | 104,971 | 103,126 | 205,491 | 190,518 |
| Operating earnings | 22,547 | 19,289 | 37,557 | 31,167 |
| Other income and expenses | | | | |
| Interest expense | 2,408 | 2,446 | 4,860 | 4,875 |
| Other, net | (140) | (100) | (209) | (178) |
| Total other income and expenses | 2,268 | 2,346 | 4,651 | 4,697 |
| Earnings before income taxes and discontinued operations | 20,279 | 16,943 | 32,906 | 26,470 |
| Income taxes: | | | | |
| Net impact of enactment of Michigan Business Tax (Note 7) | - | 2,748 | - | 2,748 |
| Income taxes | 8,244 | 5,929 | 13,294 | 9,264 |
| Total income taxes | 8,244 | 8,677 | 13,294 | 12,012 |
| Earnings from continuing operations | 12,035 | 8,266 | 19,612 | 14,458 |
| (Loss) earnings from discontinued operations, net of taxes | (963) | 836 | 1,379 | 1,160 |
| Net earnings | \$ 11,072 | \$ 9,102 | \$ 20,991 | \$ 15,618 |
| Basic earnings per share: | | | | |
| Earnings from continuing operations | \$ 0.56 | \$ 0.39 | \$ 0.92 | \$ 0.68 |
| | (0.04) | 0.04 | 0.06 | 0.06 |

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|--|---------|---------|---------|---------|
| (Loss) earnings from discontinued operations | | | | |
| Net earnings | \$ 0.52 | \$ 0.43 | \$ 0.98 | \$ 0.74 |

Diluted earnings per share:

| | | | | |
|--|---------|---------|---------|---------|
| Earnings from continuing operations | \$ 0.55 | \$ 0.38 | \$ 0.90 | \$ 0.67 |
| (Loss) earnings from discontinued operations | (0.04) | 0.04 | 0.06 | 0.05 |
| Net earnings | \$ 0.51 | \$ 0.42 | \$ 0.96 | \$ 0.72 |

Weighted average shares outstanding:

| | | | | |
|---------|--------|--------|--------|--------|
| Basic | 21,478 | 21,260 | 21,445 | 21,221 |
| Diluted | 21,778 | 21,695 | 21,754 | 21,673 |

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 | Accumulated Other Comprehensive Loss | Retained Earnings | Total |
|--|-----------------------|-----------------|---|----------------------|------------|
| Balance - March 30, 2008 | 21,909 | \$ 130,718 | \$ (1,142) | \$ 77,070 | \$ 206,646 |
| Effects of changing the pension plans' measurement date pursuant to SFAS No. 158, net of taxes | - | - | (47) | (199) | (246) |
| Comprehensive earnings: | | | | | |
| Net earnings | - | - | - | 20,991 | 20,991 |
| Dividends - \$.10 per share | - | - | - | (2,209) | (2,209) |
| Stock-based employee compensation | - | 2,622 | - | - | 2,622 |
| Issuances of common stock and related tax benefits on stock option exercises | 41 | 578 | - | - | 578 |
| Issuances of restricted stock and related income tax benefits | 221 | 674 | - | - | 674 |
| Cancellations of restricted stock | (85) | (1,021) | - | - | (1,021) |
| Balance - September 13, 2008 | 22,086 | \$ 133,571 | \$ (1,189) | \$ 95,653 | \$ 228,035 |

See accompanying notes to condensed consolidated financial statements.

SPARTAN STORES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

| | 24 Weeks Ended | |
|---|-----------------------|-----------------------|
| | September 13, 2008 | September 15, 2007 |
| Cash flows from operating activities | | |
| Net earnings | \$ 20,991 | \$ 15,618 |
| Earnings from discontinued operations | (1,379) | (1,160) |
| Earnings from continuing operations | 19,612 | 14,458 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Depreciation and amortization | 12,519 | 10,512 |
| Postretirement benefits expense | 721 | 1,171 |
| Deferred taxes on income related to enactment of the Michigan Business Tax (Note 7) | - | 2,748 |
| Deferred taxes on income | 7,154 | 9,726 |
| Stock-based compensation expense | 2,622 | 1,310 |
| Excess tax benefit on stock compensation | (1,471) | - |
| Other | (28) | (2) |
| Change in operating assets and liabilities: | | |
| Accounts receivable | 310 | (12,713) |
| Inventories | (29,182) | (26,929) |
| Prepaid expenses and other assets | (523) | (4,100) |
| Accounts payable | 22,732 | 19,255 |
| Accrued payroll and benefits | (8,624) | (6,680) |
| Postretirement benefits payments | (26) | (1,219) |
| Other accrued expenses and other liabilities | (2,482) | (3,282) |
| Net cash provided by operating activities | 23,334 | 4,255 |
| Cash flows from investing activities | | |
| Purchases of property and equipment | (24,877) | (15,923) |
| Net proceeds from the sale of assets | 392 | 18 |
| Acquisitions, net of cash acquired | - | (46,447) |
| Other | 17 | (10) |
| Net cash used in investing activities | (24,468) | (62,362) |
| Cash flows from financing activities | | |
| Net payments on revolving credit facility | - | (46,512) |
| Proceeds from long-term borrowings | - | 110,000 |
| Repayment of long-term borrowings | (4,711) | (1,335) |
| Financing fees paid | - | (3,496) |
| Excess tax benefit on stock compensation | 1,471 | - |

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| | | |
|--|------------------|------------------|
| Proceeds from exercise of stock options | 348 | 575 |
| Dividends paid | (1,105) | (2,181) |
| | <hr/> | |
| Net cash (used in) provided by financing activities | (3,997) | 57,051 |
| Cash flows from discontinued operations | | |
| Net cash used in operating activities | (44) | (1,150) |
| Net cash provided by investing activities | 13,785 | 2,451 |
| | <hr/> | |
| Net cash provided by discontinued operations | 13,741 | 1,301 |
| | <hr/> | |
| Net increase in cash and cash equivalents | 8,610 | 245 |
| Cash and cash equivalents at beginning of period | 19,867 | 12,063 |
| | <hr/> | |
| Cash and cash equivalents at end of period | \$ 28,477 | \$ 12,308 |
| | <hr/> | |

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 accompanying unaudited 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 September 13, 2008 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.

Note 2

New Accounting Standards

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, "Fair Value Measurements" (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles, and expands disclosures about fair value measurements. This statement does not require any new fair value measurements, but applies under other accounting pronouncements that require or permit fair value measurements. In February 2007, the FASB delayed the effective date of SFAS 157 to fiscal years beginning after November 15, 2008 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Effective March 30, 2008, the first day of fiscal year 2009, Spartan Stores adopted the provisions of SFAS 157 related to financial assets and liabilities recognized or disclosed on a recurring basis. Adoption of these provisions had no impact on the consolidated financial statements. Spartan Stores is currently evaluating the impact, if any, that SFAS 157 provisions related to nonfinancial assets and nonfinancial liabilities will have on the consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements Nos. 87, 88, 106 and 132(R)" (SFAS 158). SFAS 158 requires that employers measure plan assets and obligations as of the date of their year-end financial statements beginning with Spartan Stores' fiscal year ending March 28, 2009. Spartan Stores adopted the measurement date provisions of SFAS 158 on March 30, 2008, the first day of fiscal year 2009, and recorded the cumulative effect of adopting these provisions by decreasing shareholders' equity by \$0.2 million.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), "Business Combinations" (SFAS 141R), which revises SFAS No. 141. SFAS 141R establishes principles and requirements for the reporting entity in a business combination, including recognition and measurement in the financial statements of the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. The statement also establishes disclosure requirements to enable financial statement users to evaluate the nature and financial effects of the business combination. SFAS 141R will become effective for Spartan Stores at the beginning of fiscal year 2010, and must be applied prospectively to business combinations for which the acquisition date is on or after the beginning of fiscal year 2010. Spartan Stores is currently evaluating the impact that SFAS 141R will have on future consolidated financial statements.

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In May 2008, the FASB issued FSP No. APB 14-1, "Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)" (FSP APB 14-1), that changes the accounting treatment for convertible debt instruments that allow for either mandatory or optional cash settlements. FSP APB 14-1 will require Spartan Stores to recognize non-cash interest expense on its \$110 million convertible senior notes based on the market rate for similar debt instruments without the conversion feature as of the date of debt issuance. FSP APB 14-1 will be effective at the beginning of fiscal year 2010 and must be applied on a retrospective basis.

Upon adoption on March 29, 2009, Spartan Stores expects to retroactively record additional non-cash interest expense of approximately \$2.7 million and \$3.2 million, pre-tax, for fiscal years 2008 and 2009, respectively. Spartan Stores also expects to record an increase in shareholders' equity of \$27.6 million and a decrease in long-term debt of \$27.6 million.

In June 2008, the FASB issued FSP No. EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities" (FSP EITF 03-6-1). FSP EITF 03-6-1 clarifies that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents are participating securities and must be included in the computation of earnings per share pursuant to the two-class method described in FASB Statement No. 128, "Earnings Per Share." FSP EITF 03-6-1 will be effective at the beginning of fiscal year 2010 and must be applied on a retrospective basis. Spartan Stores is currently evaluating the impact that FSP EITF 03-6-1 will have on the consolidated financial statements.

Note 3

Discontinued Operations

During the fourth quarter of fiscal year 2008, Spartan Stores approved a plan to close the remaining 14 *The Pharm* stores and sell the prescription files. In the first quarter of fiscal 2009, Spartan Stores completed the closure and disposition of the prescription files of 13 of the 14 remaining *The Pharm* stores, allowing Spartan Stores to concentrate efforts and resources on business opportunities with the best long-term growth potential and focus more on core distribution and conventional supermarket operations. In the second quarter of fiscal 2009, the closure and disposition of the prescription file of the last remaining store was completed. Total net cash proceeds of \$13.8 million were received during the current fiscal year. Asset impairment charges and exit costs of \$6.4 million were also recognized (Note 4). The results of operations of these stores have been classified as discontinued operations in the consolidated financial statements for all periods presented.

Results of the discontinued operations are excluded from the accompanying notes to the consolidated financial statements for all periods presented, unless otherwise noted.

The following table details the results of discontinued operations reported on the Consolidated Statements of Earnings:

(In thousands)

| | 12 Weeks Ended | |
|---|-----------------------|-----------------------|
| | September 13, 2008 | September 15, 2007 |
| Loss from discontinued operations (net of taxes of (\$915) and (\$408)) | \$ (1,435) | \$ (754) |
| Gain on disposal of discontinued operations (net of taxes of \$301 and \$860) | 472 | 1,590 |
| Total (loss) earnings from discontinued operations | \$ (963) | \$ 836 |

(In thousands)

| | 24 Weeks Ended | |
|--|-----------------------|-----------------------|
| | September 13, 2008 | September 15, 2007 |

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| | | |
|---|------------|----------|
| Loss from discontinued operations (net of taxes of (\$4,688) and (\$233)) | \$ (6,420) | \$ (430) |
| Gain on disposal of discontinued operations (net of taxes of \$5,695 and \$858) | 7,799 | 1,590 |
| | <hr/> | <hr/> |
| Total earnings from discontinued operations | \$ 1,379 | \$ 1,160 |
| | <hr/> | <hr/> |

Sales in discontinued operations for the quarters ended September 13, 2008 and September 15, 2007 were \$1.4 million and \$35.8 million, respectively. Sales for the year-to-date periods ended September 13, 2008 and September 15, 2007 were \$22.3 million and \$72.2 million, respectively. Significant assets and liabilities of discontinued operations are as follows:

| (In thousands) | September 13, 2008 | March 29, 2008 |
|------------------------|-----------------------|-------------------|
| Current assets | \$ 393 | \$ 18,523* |
| Property, net | 4,737 | 6,607 |
| Other long-term assets | 54 | 381 |
| Current liabilities | 5,217 | 14,173 |
| Long-term liabilities | 4,668 | 1,569 |

* Includes property and equipment held for sale

Note 4 **Asset Impairments and Exit Costs**

The following table provides the activity of exit costs for our Retail segment for the 24 weeks ended September 13, 2008. Exit costs recorded in the Consolidated Balance Sheets are included in "Current portion of exit costs" in Current liabilities and "Exit costs" in Long-term liabilities based on when the obligations are expected to be paid.

| (In thousands) | |
|--|-----------|
| Balance at March 30, 2008 | \$ 36,127 |
| Exit costs related to disposition of <i>The Pharm</i> stores | 5,362 |
| Payments, net of interest accretion | (2,893) |
| | 38,596 |
| Balance at September 13, 2008 | \$ 38,596 |

Exit costs of \$5.4 million were recorded related to the disposition of *The Pharm* stores (Note 3) for store lease obligations not assumed by the purchaser of \$2.7 million, an estimated partial withdrawal liability from a multi-employer pension plan of \$2.3 million and severance of \$0.4 million. The store lease obligations include the present value of future minimum lease payments, calculated using a risk-free interest rate, and related ancillary costs from the date of closure to the end of the remaining lease term, net of estimated sublease income. In addition, asset impairment charges of \$1.0 million were recorded for unsold assets.

Note 5 **Commitments and Contingencies**

Various lawsuits and claims, arising in the ordinary course of business, are pending or have been asserted against Spartan Stores. While the ultimate effect of such actions cannot be predicted with certainty, management believes that their outcome will not result in a material adverse effect on the consolidated financial position, operating results or liquidity of Spartan Stores.

Note 6
Associate Retirement Plans

The following table provides the components of net periodic pension and postretirement benefit costs for the second quarter and year-to-date periods ended September 13, 2008 and September 15, 2007:

(In thousands)

| 12 Weeks Ended | Pension Benefits | | SERP Benefits | | Postretirement Benefits | |
|------------------------------------|-------------------|-------------------|-------------------|-------------------|-------------------------|-------------------|
| | Sept. 13, 2008 | Sept. 15, 2007 | Sept. 13, 2008 | Sept. 15, 2007 | Sept. 13, 2008 | Sept. 15, 2007 |
| Service cost | \$ 665 | \$ 883 | \$ 13 | \$ 13 | \$ 42 | \$ 53 |
| Interest cost | 797 | 683 | 11 | 9 | 92 | 100 |
| Expected return on plan assets | (1,082) | (933) | - | - | - | - |
| Amortization of prior service cost | (173) | (173) | - | - | (13) | (16) |
| Recognized actuarial net loss | 87 | 73 | 9 | 7 | - | 10 |
| Net periodic benefit cost | \$ 294 | \$ 533 | \$ 33 | \$ 29 | \$ 121 | \$ 147 |

(In thousands)

| 24 Weeks Ended | Pension Benefits | | SERP Benefits | | Postretirement Benefits | |
|------------------------------------|-------------------|-------------------|-------------------|-------------------|-------------------------|-------------------|
| | Sept. 13, 2008 | Sept. 15, 2007 | Sept. 13, 2008 | Sept. 15, 2007 | Sept. 13, 2008 | Sept. 15, 2007 |
| Service cost | \$ 1,330 | \$ 1,766 | \$ 26 | \$ 26 | \$ 84 | \$ 106 |
| Interest cost | 1,595 | 1,366 | 22 | 18 | 185 | 200 |
| Expected return on plan assets | (2,165) | (1,866) | - | - | - | - |
| Amortization of prior service cost | (345) | (346) | - | - | (27) | (32) |
| Recognized actuarial net loss | 173 | 146 | 17 | 14 | - | 20 |
| Net periodic benefit cost | \$ 588 | \$ 1,066 | \$ 65 | \$ 58 | \$ 242 | \$ 294 |

No payments are required to be made in fiscal 2009 to meet the minimum funding requirements; however, Spartan Stores may elect to make a voluntary contribution.

Note 7
Taxes on Income

As of September 13, 2008, there have been no material changes to the amount of unrecognized tax benefits. Spartan Stores does not anticipate that total unrecognized tax benefits will significantly change prior to September 12, 2009.

The effective income tax rate is higher than the statutory Federal income tax rate due to state income taxes.

During the prior year second quarter, the Michigan legislature enacted a new business income tax effective January 1, 2008, which replaced the former Michigan Single Business Tax that was in effect through December 31, 2007. The

new income tax law was subsequently revised on September 30, 2007, two weeks after the end of Spartan Stores' prior year second quarter, to correct a deficiency in the tax code that would have significantly penalized Michigan-based companies. Because the legislative revision was not enacted until Spartan Stores' fiscal 2008 third quarter, generally accepted accounting principles required recognition of the negative impact of the originally enacted law in Spartan Stores' prior year second quarter results, and a credit of this same charge in the third quarter of fiscal 2008 when the revision was enacted. As a result, Spartan Stores recorded a one-time, non-cash charge of \$2.7 million in Income taxes in the prior year second quarter and a corresponding change in deferred taxes on income, and credited the same amount in the third quarter as a reduction to Income taxes of \$2.7 million. As a result of this charge in the prior year second quarter, the effective income tax rate was 51.2% and 45.4% for the second quarter and year-to-date periods ended September 15, 2007, versus the Federal statutory income tax rate of 35%.

Note 8**Stock-Based Compensation**

Spartan Stores has two shareholder-approved stock incentive plans that provide for the granting of incentive stock options, non-qualified stock options, stock appreciation rights, restricted stock, restricted stock units, stock awards, and other stock-based awards to directors, officers and other key associates.

Spartan Stores accounts for stock-based compensation awards in accordance with the provisions of SFAS No. 123(R), "Share-Based Payment", which requires that share-based payment transactions be accounted for using a fair value method and the related compensation cost recognized in the consolidated financial statements over the period that an employee is required to provide services in exchange for the award. Spartan Stores recognized stock-based compensation expense (net of tax) of \$0.9 million (\$0.04 per diluted share) and \$0.5 million (\$0.02 per diluted share) in the second quarter of fiscal 2009 and 2008, respectively, as a component of Selling, general and administrative expenses in the Consolidated Statements of Earnings. Stock-based compensation expense (net of tax) was \$1.6 million (\$0.07 per diluted share) and \$0.9 million (\$0.04 per diluted share) for the year-to-date period ended September 13, 2008 and September 15, 2007, respectively.

The following table summarizes activity in our share-based compensation plans for the year-to-date period ended September 13, 2008:

| | Shares Under Options | Weighted Average Exercise Price | Restricted Stock Awards | Weighted Average Grant-Date Fair Value |
|--|----------------------------|---------------------------------------|-------------------------------|---|
| Outstanding at March 30, 2008 | 580,632 | \$ 13.16 | 580,090 | \$ 16.04 |
| Granted | 268,600 | 22.69 | 205,710 | 23.03 |
| Exercised/Vested | (41,113) | 8.48 | (173,520) | 13.56 |
| Cancelled/Forfeited | (7,491) | 17.79 | (30,118) | 20.01 |
| Outstanding at September 13, 2008 | 800,628 | \$ 16.56 | 582,162 | \$ 19.04 |
| Vested and expected to vest in the future at September 13, 2008 | 768,945 | \$ 16.32 | | |
| Exercisable at September 13, 2008 | 358,013 | \$ 10.53 | | |

The weighted average grant-date fair value of stock options granted during the second quarter ended September 15, 2007 was \$9.51. No stock options were granted during the second quarter ended September 13, 2008. The weighted average grant-date fair value of stock options granted during the year-to-date period ended September 13, 2008 and September 15, 2007 was \$8.80 and \$10.99, respectively. The fair value of each stock option grant is estimated on the date of grant using the Black-Scholes option-pricing model. The following weighted average assumptions were used to estimate the fair value of stock options at the date of grant using the Black-Scholes option-pricing model:

24 Weeks Ended

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| | <u>Sept. 13, 2008</u> | <u>Sept. 15, 2007</u> |
|-------------------------|-----------------------|-----------------------|
| Dividend yield | 0.88% | 0.70%-0.79% |
| Expected volatility | 37.55% | 32.84%-32.92% |
| Risk-free interest rate | 3.28% | 4.43%-4.76% |
| Expected life of option | 6.25 years | 6.25 years |

-12-

Due to certain events that are considered unusual and/or infrequent in nature, and that resulted in significant business changes during the limited historical exercise period, management does not believe that Spartan Stores' historical exercise data will provide a reasonable basis upon which to estimate the expected term of stock options. Therefore, the expected term of stock options granted is determined using the "simplified" method as described in SEC Staff Accounting Bulletins that uses the following formula: $((\text{vesting term} + \text{original contract term})/2)$.

As of September 13, 2008, total unrecognized compensation cost related to nonvested share-based awards granted under our stock incentive plans was \$2.3 million for stock options and \$9.4 million for restricted stock. The remaining compensation costs not yet recognized are expected to be recognized over a weighted average period of 2.7 years for stock options and 3.6 years for restricted stock.

Note 9 Supplemental Cash Flow Information

Non-cash financing activities include the issuance of restricted stock to employees and directors of \$4.7 million and \$4.6 million for the year-to-date periods ended September 13, 2008 and September 15, 2007, respectively. Non-cash investing activities include capital expenditures included in other accrued expenses of \$2.2 million and \$1.1 million for the year-to-date periods ended September 13, 2008 and September 15, 2007, respectively.

Note 10 Operating Segment Information

The following tables set forth information about Spartan Stores by operating segment:

(In thousands)

| | Distribution | Retail | Total |
|--|--------------|------------|--------------|
| | <hr/> | <hr/> | <hr/> |
| 12 Weeks Ended September 13, 2008 | | | |
| Net sales | \$ 303,302 | \$ 323,528 | \$ 626,830 |
| Depreciation and amortization | 1,856 | 4,487 | 6,343 |
| Operating earnings | 9,999 | 12,548 | 22,547 |
| Capital expenditures | 3,707 | 6,876 | 10,583 |
| 12 Weeks Ended September 15, 2007 | | | |
| Net sales | \$ 293,820 | 304,233 | 598,053 |
| Depreciation and amortization | 1,717 | 3,687 | 5,404 |
| Operating earnings | 7,647 | 11,642 | 19,289 |
| Capital expenditures | 1,874 | 5,880 | 7,754 |
| 24 Weeks Ended September 13, 2008 | | | |
| Net sales | \$ 601,446 | \$ 612,089 | \$ 1,213,535 |
| Depreciation and amortization | 3,622 | 8,463 | 12,085 |
| Operating earnings | 17,485 | 20,072 | 37,557 |
| Capital expenditures | 5,047 | 19,830 | 24,877 |
| 24 Weeks Ended September 15, 2007 | | | |
| Net sales | \$ 576,235 | 542,021 | 1,118,256 |
| Depreciation and amortization | 3,466 | 6,864 | 10,330 |
| Operating earnings | 12,856 | 18,311 | 31,167 |

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| | | | |
|----------------------|-------|--------|--------|
| Capital expenditures | 3,756 | 12,167 | 15,923 |
|----------------------|-------|--------|--------|

| | September 13, 2008 | March 29, 2008 |
|-------------------------|-----------------------|-------------------|
| | <hr/> | <hr/> |
| Total assets | | |
| Distribution | \$ 245,019 | \$ 219,962 |
| Retail | 383,607 | 364,664 |
| Discontinued operations | 5,184 | 25,511 |
| | <hr/> | <hr/> |
| Total | \$ 633,810 | \$ 610,137 |
| | <hr/> | <hr/> |

Note 11
Subsequent Event

On October 13, 2008, Spartan Stores entered into an Asset Purchase Agreement (the "Purchase Agreement") with VG's Food Center, Inc. and VG's Pharmacy, Inc. (collectively, "VG's"), to acquire certain operating assets of VG's, a privately held retail grocery operator, and a current customer of the Distribution segment, with 17 retail stores located in southeastern Michigan. Under the terms of the Purchase Agreement, Spartan Stores would acquire and assume store leases, leasehold improvements and certain operating assets associated with those stores, VG's trademarks, trade names and intangibles, and certain other property for a purchase price of \$85.0 million in cash. Spartan Stores would also purchase inventories.

Spartan Stores intends to finance this acquisition with available cash and borrowings on its senior secured revolving credit facility and expects the transaction to be completed late in its fiscal 2009 third quarter. The closing of the transaction is subject to a number of conditions stated in the Purchase Agreement. These conditions include, among others, that Spartan Stores be satisfied with its due diligence investigation; that certain consents and certificates be obtained from landlords and a variety of other third parties affected by the transaction; and that required regulatory approvals be obtained. The Purchase Agreement also contains representations and warranties of both parties, indemnification agreements, termination rights, and a variety of covenants and agreements.

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
Executive Overview

Spartan Stores is a leading regional grocery distributor and grocery retailer, operating principally in Michigan and Indiana.

We currently operate two reportable business segments: Distribution and Retail. Our Distribution segment provides a full line of grocery, general merchandise, health and beauty care, frozen and perishable items to nearly 400 independently owned grocery stores and our 84 corporate owned stores. Our Retail segment operates 84 retail supermarkets in Michigan under the banners *Family Fare Supermarkets*, *Glen's Markets*, *D&W Fresh Markets* and *Felpausch Food Centers* and 18 fuel centers / convenience stores under the banners *Family Fare Quick Stop*, *Glen's Quick Stop*, *D&W Fresh Markets Quick Stop* and *Felpausch Quick Stop* which are typically located adjacent to one of our supermarkets. Our retail supermarkets have a "neighborhood market" focus to distinguish them from supercenters and limited assortment stores.

Our sales and operating performance vary with seasonality. Our first and fourth quarters are typically our lowest sales quarters and therefore operating results are generally lower during these two quarters. Additionally, these two quarters can be affected by the timing of the Easter holiday, which results in a strong sales week. Many northern Michigan stores are dependent on tourism, and therefore, are most affected by seasons and weather patterns, including, but not limited to, the amount and timing of snowfall during the winter months and the range of temperature during the summer months. All quarters are 12 weeks, except for our third quarter, which is 16 weeks and includes the Thanksgiving and Christmas holidays.

We also operated 14 deep-discount food and drug stores under the banner *The Pharm*. In fiscal 2009, we completed the closure and sale of prescription files of all *The Pharm* stores, allowing us to concentrate efforts and resources on business opportunities with the best long-term growth potential and focus more on core distribution and conventional supermarket operations. The financial results of *The Pharm* stores have been included in discontinued operations in the accompanying consolidated financial statements for all periods presented.

On October 13, 2008, we entered into an Asset Purchase Agreement (the "Purchase Agreement") with VG's Food Center, Inc. and VG's Pharmacy, Inc. (collectively "VG's"), to acquire certain operating assets of VG's, a privately held retail grocery operator, and a current customer of our Distribution segment, with 17 retail stores located in southeastern Michigan. Under the terms of the Purchase Agreement, we would acquire and assume store leases, leasehold improvements and certain operating assets associated with those stores, VG's trademarks, trade names and intangibles, and certain other property for a purchase price of \$85.0 million in cash. We would also purchase inventories.

We intend to finance this acquisition with available cash and borrowings on our senior secured revolving credit facility and expect the transaction to be completed late in our fiscal 2009 third quarter. The closing of the transaction is subject to a number of conditions stated in the Purchase Agreement. These conditions include, among others, that we be satisfied with our due diligence investigation; that certain consents and certificates be obtained from landlords and a variety of other third parties affected by the transaction; and that required regulatory approvals be obtained. The Purchase Agreement also contains representations and warranties of both parties, indemnification agreements, termination rights, and a variety of covenants and agreements.

Results of Operations

The following table sets forth items from our Consolidated Statements of Earnings as a percentage of net sales and the year-to-year percentage change in dollar amounts:

(Unaudited)

| | Percentage of Net Sales | | | | Percentage Change | |
|---|-------------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| | 12 Weeks Ended | | 24 Weeks Ended | | 12 Weeks Ended | 24 Weeks Ended |
| | Sept. 13, 2008 | Sept. 15, 2007 | Sept. 13, 2008 | Sept. 15, 2007 | Sept. 13, 2008 | Sept. 13, 2008 |
| Net sales | 100.0 | 100.0 | 100.0 | 100.0 | 4.8 | 8.5 |
| Gross margin | 20.3 | 20.5 | 20.0 | 19.8 | 4.2 | 9.6 |
| Operating expenses | 16.7 | 17.3 | 16.9 | 17.0 | 1.8 | 7.9 |
| Operating earnings | 3.6 | 3.2 | 3.1 | 2.8 | 16.9 | 20.5 |
| Other income and expenses | 0.4 | 0.4 | 0.4 | 0.4 | (3.3) | (1.0) |
| Earnings before income taxes and discontinued operations | 3.2 | 2.8 | 2.7 | 2.4 | 19.7 | 24.3 |
| Income taxes: | | | | | | |
| Net impact of enactment of Michigan Business Tax | - | 0.4 | - | 0.3 | * | * |
| Income taxes | 1.3 | 1.0 | 1.1 | 0.8 | 39.0 | 43.5 |
| Total income taxes | 1.3 | 1.4 | 1.1 | 1.1 | (5.0) | 10.7 |
| Earnings from continuing operations | 1.9 | 1.4 | 1.6 | 1.3 | 45.6 | 35.6 |
| (Loss) earnings from discontinued operations, net of taxes | (0.1) | 0.1 | 0.1 | 0.1 | * | 18.9 |
| Net earnings | 1.8 | 1.5 | 1.7 | 1.4 | 21.6 | 34.4 |

* Percentage change is not meaningful

Net Sales - Net sales for the quarter ended September 13, 2008 ("second quarter") increased \$28.8 million, or 4.8 percent, from \$598.1 million in the quarter ended September 15, 2007 ("prior year second quarter") to \$626.8 million. Net sales for the year-to-date period ended September 13, 2008 ("current year-to-date") increased \$95.3 million, or 8.5 percent, from \$1,118.3 million in the prior year-to-date period ended September 15, 2007 ("prior year-to-date") to \$1,213.5 million.

Net sales for the second quarter in our Distribution segment increased \$9.5 million, or 3.2 percent, from \$293.8 million in the prior year second quarter to \$303.3 million. Net sales for the current year-to-date period increased \$25.2 million, or 4.4 percent, from \$576.2 million in the prior year-to-date period to \$601.4 million. The second quarter increase was due to the addition of new distribution customers of \$7.3 million and an increase in sales to existing customers of \$2.2 million. The year-to-date increase was due to the addition of new distribution customers of \$44.3

million and an increase in sales to existing customers of \$1.5 million, partially offset by the elimination of sales to *Felpausch* stores of \$20.6 million (due to our acquisition of the stores).

Net sales for the second quarter in our Retail segment increased \$19.3 million, or 6.3 percent, from \$304.2 million in the prior year second quarter to \$323.5 million. Net sales for the year-to-date period increased \$70.1 million, or 12.9 percent, from \$542.0 million in the prior year-to-date period to \$612.1 million. The second quarter increase was primarily due to an increase in fuel center sales of \$13.5 million and comparable store supermarket sales growth of \$10.8 million, partially offset by lost sales relating to sold and closed stores of \$6.8 million. The year-to-date increase was primarily due to incremental sales from the recently acquired *Felpausch* retail stores of \$42.5 million, increases in fuel center sales of \$25.4 million and increases in supermarket comparable sales growth of \$11.2 million, partially offset by lost sales relating to sold and closed stores of \$9.2 million.

Total Retail comparable store sales increased 8.3 percent during the second quarter principally due to our ongoing capital investment program, including store remodels and the opening of additional fuel centers. Excluding sales from fuel centers, comparable store sales increased 4.1 percent. Total Retail comparable store sales increased 6.4 percent in the current year-to-date period. Excluding sales from fuel centers and Easter holiday sales in the prior year first quarter, comparable store sales increased 3.0 percent. The Easter holiday occurred in the first and fourth quarters of fiscal 2008. There will be no Easter holiday during fiscal 2009. We define a retail store as comparable when it is in operation for 14 accounting periods (a period equals four weeks), and we include remodeled, expanded and relocated stores in comparable stores.

Gross Margin - Gross margin represents sales less cost of sales, which include purchase costs and promotional allowances. Vendor allowances that relate to our buying and merchandising activities consist primarily of promotional allowances, which are generally allowances on purchased quantities and, to a lesser extent, slotting allowances, which are billed to vendors for our merchandising costs, such as setting up warehouse infrastructure. Vendor allowances associated with product cost are recognized as a reduction in cost of sales when the product is sold. Lump sum payments received for multi-year contracts are amortized over the life of the contracts based on contractual terms.

Gross margin for the second quarter increased \$5.1 million, or 4.2 percent, from \$122.4 million in the prior year second quarter to \$127.5 million. As a percent of net sales, gross margin for the second quarter decreased to 20.3 percent from 20.5 percent. Gross margin for the year-to-date period increased \$21.4 million, or 9.6 percent, from \$221.7 million in the prior year-to-date period to \$243.0 million. As a percent of net sales, gross margin for the year-to-date period increased to 20.0 percent from 19.8 percent. For the second quarter, the decrease in the gross margin rate was driven by growth in lower margin fuel sales, partially offset by improvements in the distribution segment gross margin. On a year-to-date basis, the gross margin rate improvement was primarily due to a larger concentration of higher margin retail sales as a percentage of consolidated sales and an improvement in distribution segment gross margin primarily due to the impact of the elimination of sales to our *Feltpausch* stores, partially offset by an increase in LIFO expense due to higher product costs and growth in lower margin fuel sales.

Operating Expenses - Operating expenses consist primarily of salaries and wages, employee benefits, warehousing costs, store occupancy costs, utilities, equipment rental, depreciation and other administrative costs.

Operating expenses for the second quarter increased \$1.8 million, or 1.8 percent, from \$103.1 million in the prior year second quarter to \$105.0 million. As a percent of net sales, operating expenses were 16.7 percent for the second quarter compared to 17.3 percent in the prior year second quarter. Operating expenses for the year-to-date period increased \$15.0 million, or 7.9 percent, from \$190.5 million in the prior year-to-date period to \$205.5 million. As a percent of net sales, operating expenses were 16.9 percent for the current year-to-date period compared to 17.0 percent in the prior year-to-date period.

The net increase in second quarter operating expenses was primarily due to the following:

- Increases in compensation and benefits of \$1.4 million.
- Increases in transportation fuel costs of \$0.8 million.
- The cost of operating additional fuel centers of \$0.7 million.
- Reduced operating costs related to the sale of two retail stores in the prior year fourth quarter of \$0.8 million.
- Reduced operating expenses due to replacement of the Michigan Single Business Tax (MSBT) with a new income tax for the State of Michigan of \$0.6 million. The MSBT was not considered an income tax and was included in operating expenses.

The net increase in year-to-date operating expenses was primarily due to the following:

- Additional operating costs associated with the acquired *Feltpausch* retail stores of \$10.2 million.

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Increases in compensation and benefits of \$3.9 million.

Increases in transportation fuel costs of \$1.5 million.

The cost of operating additional fuel centers of \$1.2 million.

Reduced operating costs related to the sale of two retail stores in the prior year fourth quarter of \$1.7 million.

Reduced operating expenses due to replacement of the MSBT with a new income tax for the State of Michigan of \$1.1 million.

Income Taxes - The effective tax rate is 40.7% and 40.4% for the second quarter and current year-to-date period, respectively. The difference from the statutory rate is due to State of Michigan income taxes. The new state income tax is a larger burden on our net earnings than the former MSBT.

During the prior year second quarter, the Michigan legislature enacted a new business income tax effective January 1, 2008, which replaced the former MSBT that was in effect through December 31, 2007. The new income tax law was subsequently revised on September 30, 2007, two weeks after the end of our prior year second quarter, to correct a deficiency in the tax code that would have significantly penalized Michigan-based companies. Because the legislative revision was not enacted until our fiscal 2008 third quarter, generally accepted accounting principles required recognition of the negative impact of the originally enacted law in our prior year second quarter results, and a credit of this same charge in the third quarter of fiscal 2008 when the revision was enacted. As a result, we recorded a one-time, non-cash charge of \$2.7 million in Income taxes in the prior year second quarter and a corresponding change in deferred taxes on income, and credited the same amount in the third quarter as a reduction to Income taxes of \$2.7 million. As a result of this charge in the prior year second quarter, the effective income tax rate was 51.2% and 45.4% for the second quarter and year-to-date periods ended September 15, 2007, versus the Federal statutory income tax rate of 35%.

Discontinued Operations

Our former insurance operations and certain of our retail and grocery distribution operations have been recorded as discontinued operations. Results of the discontinued operations are excluded from the accompanying notes to the condensed consolidated financial statements for all periods presented, unless otherwise noted.

During the fourth quarter of fiscal year 2008, Spartan Stores approved a plan to close the remaining 14 *The Pharm* stores. In fiscal 2009, we completed the closure and sale of prescription files of all *The Pharm* stores, allowing us to concentrate efforts and resources on business opportunities with the best long-term growth potential and focus more on core distribution and conventional supermarket operations. Cash proceeds of \$13.8 million were received. Asset impairment charges and exit costs of \$6.4 million were recognized.

Liquidity and Capital Resources

The following table summarizes our consolidated statements of cash flows for the year-to-date and prior year-to-date periods:

(In thousands)

| | September 13, 2008 | September 15, 2007 |
|---|-----------------------|-----------------------|
| Net cash provided by operating activities | \$ 23,334 | \$ 4,255 |
| Net cash used in investing activities | (24,468) | (62,362) |
| Net cash (used in) provided by financing activities | (3,997) | 57,051 |
| Net cash provided by discontinued operations | 13,741 | 1,301 |
| Net increase in cash and cash equivalents | 8,610 | 245 |
| Cash and cash equivalents at beginning of period | 19,867 | 12,063 |

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| | | | | |
|--|----|--------|----|--------|
| Cash and cash equivalents at end of period | \$ | 28,477 | \$ | 12,308 |
|--|----|--------|----|--------|

Net cash provided by operating activities increased from the prior year-to-date period primarily due to increased net earnings, timing of new business in the prior year, collection of new customer advances made in the prior year with delayed payment terms and timing of cash flows of inventories and accounts payable.

Net cash used in investing activities decreased during the current fiscal year primarily due to the acquisition of *Felpausch* stores in the prior year. We used cash of \$46.4 million for the acquisition of *Felpausch* stores in the fiscal 2008 year-to-date period. Capital expenditures, which do not include the acquisitions, increased \$9.0 million to \$24.9 million, of which our Retail and Distribution segments utilized 80% and 20%, respectively. Expenditures were used for store remodels and refurbishments, new fuel centers and new equipment and software. Under the terms of our senior secured revolving credit facility, should our available borrowings fall below certain levels, our capital expenditures would be restricted each fiscal year. Our current available borrowings are over \$164 million above these limits as of September 13, 2008 and we do not expect to fall below these levels. We expect capital expenditures to range from \$55 million to \$60 million for fiscal 2009. Our planned capital expenditures, excluding the effects of the VG's acquisition, for the remainder of fiscal 2009 include completion of one replacement store, two or three store remodels, and possibly one new fuel center, in addition to new equipment and software and the beginning of construction of one new store.

Net cash (used in) provided by financing activities includes cash paid and received related to our long-term borrowings, dividends paid, tax benefits of stock compensation and proceeds from the issuance of common stock. In the prior year-to-date period, proceeds of \$110 million from the issuance of convertible senior notes were used to reduce borrowings on the senior secured revolving credit facility, to pay related financing fees and to partially fund the *Felpausch* acquisition. Cash dividends of \$1.1 million and \$2.2 million were paid in the current and prior year-to-date periods, respectively. The decrease in cash dividends paid in the current year was due to timing of the end of the second quarter. Dividends declared were \$2.2 million in each year-to-date period. Although we expect to continue to pay a quarterly cash dividend, adoption of a dividend policy 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. Whether the board of directors continues to declare dividends depends on a number of factors, including our future financial condition and profitability and compliance with the terms of our credit facilities. Our current maturities of long-term debt and capital lease obligations at September 13, 2008 are \$8.0 million. Our ability to borrow additional funds is governed by the terms of our credit facilities.

Net cash provided by discontinued operations contains the net cash flows of our discontinued operations and consists primarily of the proceeds from the sale of assets and the payment of store exit cost reserves, insurance run-off claims and other liabilities. Included in current year cash flows from discontinued operations are proceeds on the disposal of assets of \$13.8 million. We expect cash provided by our discontinued operations will be approximately \$8.0 million to \$9.0 million in fiscal 2009.

Our principal sources of liquidity are cash flows generated from operations and our senior secured revolving credit facility. Interest on our convertible senior notes is payable on May 15 and November 15 of each year. The revolving credit facility matures December 2012, and is secured by substantially all of our assets. As of September 13, 2008, our senior secured revolving credit facility had no outstanding borrowings, available borrowings of \$184.4 million and maximum availability of \$194.4 million, which exceeds the minimum excess availability levels, as defined in the credit agreement. We believe that cash generated from operating activities and available borrowings under the credit facility will be sufficient to meet anticipated requirements for the pending acquisition and working capital, capital expenditures, dividend payments, and debt service obligations for the foreseeable future. However, there can be no assurance that Spartan Stores' business will continue to generate cash flow at or above current levels or that we will maintain our ability to borrow under our credit facility.

Our current ratio increased to 1.20:1.00 at September 13, 2008 from 1.11:1.00 at March 29, 2008 and our investment in working capital was \$38.7 million at September 13, 2008 versus \$20.5 million at March 29, 2008. Our debt to total capital ratio at September 13, 2008 was 0.40:1.00 versus 0.43:1.00 at March 29, 2008. The change in these ratios was primarily due to sales growth and seasonal inventory build.

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For information on contractual obligations, see our Annual Report on Form 10-K for the fiscal year ended March 29, 2008. At September 13, 2008, there have been no material changes to our significant contractual obligations outside the ordinary course of business.

Indebtedness and Liabilities of Subsidiaries

On May 30, 2007, the Company sold \$110 million aggregate principal amount of 3.375% Convertible Senior Notes due 2027 (the "Notes"). The Notes are general unsecured obligations and rank equally in right of payment with all of the Company's other existing and future obligations that are unsecured and unsubordinated. Because the Notes are unsecured, they are structurally subordinated to our subsidiaries' existing and future indebtedness and other liabilities and any preferred equity issued by our subsidiaries. We rely in part on distributions and advances from our subsidiaries in order to meet our payment obligations under the notes and our other obligations. The Notes are not guaranteed by our subsidiaries. Many of our subsidiaries serve as guarantors with respect to our existing credit facility. Creditors of each of our subsidiaries, including trade creditors, and preferred equity holders, generally have priority with respect to the assets and earnings of the subsidiary over the claims of our creditors, including holders of the Notes. The Notes, therefore, are effectively subordinated to the claims of creditors, including trade creditors, judgment creditors and equity holders of our subsidiaries. In addition, our rights and the rights of our creditors, including the holders of the notes, to participate in the assets of a subsidiary during its liquidation or reorganization are effectively subordinated to all existing and future liabilities and preferred equity of that subsidiary. The Notes are effectively subordinated to our existing and future secured indebtedness to the extent of the assets securing such indebtedness and to existing and future indebtedness and other liabilities of our subsidiaries (including subsidiary guarantees of our senior credit facility).

The following table shows the indebtedness and other liabilities of our subsidiaries as of September 13, 2008:

Spartan Stores Subsidiaries Only
(In thousands)

| | September 13, 2008 |
|--|-------------------------------|
| Current Liabilities | |
| Accounts payable | \$ 120,083 |
| Accrued payroll and benefits | 25,566 |
| Other accrued expenses | 20,734 |
| Current portion of exit costs | 10,154 |
| Current maturities of long-term debt and capital lease obligations | 7,976 |
| | 184,513 |
| Long-term Liabilities | |
| Postretirement benefits | 7,862 |
| Other long-term liabilities | 13,979 |
| Exit costs | 28,442 |
| Long-term debt and capital lease obligations | 31,957 |
| | 82,240 |
| | 266,753 |
| Operating Leases | 136,314 |
| | 403,067 |
| Total Subsidiary Liabilities and Operating Leases | \$ 403,067 |

Ratio of Earnings to Fixed Charges

Our ratio of earnings to fixed charges was 5.2:1.00 and 4.5:1.00 for the second quarter and prior year second quarter, respectively, and 4.4:1.00 and 3.8:1.00 for the year-to-date and prior year-to-date periods, respectively. For purposes of calculating the ratio of earnings to fixed charges, earnings consist of pretax earnings from continuing operations plus fixed charges (excluding capitalized interest). Fixed charges consist of interest

costs, whether expensed or capitalized, the interest component of rental expense and amortization of debt issue costs, whether expensed or capitalized.

Off-Balance Sheet Arrangements

We had letters of credit of \$4.3 million outstanding and unused at September 13, 2008. The letters of credit are maintained primarily to support payment or deposit obligations. We pay a commission of approximately 2% on the face amount of the letters of credit.

New Accounting Standards

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles, and expands disclosures about fair value measurements. This statement does not require any new fair value measurements, but applies under other accounting pronouncements that require or permit fair value measurements.

In February 2007, the FASB delayed the effective date of SFAS 157 to fiscal years beginning after November 15, 2008 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Effective March 30, 2008, the first day of fiscal year 2009, we adopted the provisions of SFAS 157 related to financial assets and liabilities recognized or disclosed on a recurring basis. Adoption of these provisions had no impact on the consolidated financial statements. We are currently evaluating the impact, if any, that SFAS 157 provisions related to nonfinancial assets and nonfinancial liabilities will have on the consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements Nos. 87, 88, 106 and 132(R)" (SFAS 158). SFAS 158 requires that employers measure plan assets and obligations as of the date of their year-end financial statements beginning with our fiscal year ending March 28, 2009. We adopted the measurement date provisions of SFAS 158 on March 30, 2008, the first day of fiscal year 2009, and recorded the cumulative effect of adopting these provisions by decreasing shareholders' equity by \$0.2 million.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), "Business Combinations" (SFAS 141R), which revises SFAS No. 141. SFAS 141R establishes principles and requirements for the reporting entity in a business combination, including recognition and measurement in the financial statements of the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. The statement also establishes disclosure requirements to enable financial statement users to evaluate the nature and financial effects of the business combination. SFAS 141R will become effective for Spartan Stores at the beginning of fiscal year 2010, and must be applied prospectively to business combinations for which the acquisition date is on or after the beginning of fiscal year 2010. We are currently evaluating the impact that SFAS 141R will have on future consolidated financial statements.

In May 2008, the FASB issued FSP No. APB 14-1, "Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)" (FSP APB 14-1), that changes the accounting treatment for convertible debt instruments that allow for either mandatory or optional cash settlements. FSP APB 14-1 will require Spartan Stores to recognize non-cash interest expense on our \$110 million convertible senior notes based on the market rate for similar debt instruments without the conversion feature as of the date of debt issuance. FSP APB 14-1 will be effective at the beginning of fiscal year 2010 and must be applied on a retrospective basis. Upon adoption on March 29, 2009, we expect to retroactively record additional non-cash interest expense of approximately \$2.7 million and \$3.2 million, pre-tax, for fiscal years 2008 and 2009, respectively. We also expect to record an increase in shareholders' equity of \$27.6 million and a decrease in long-term debt of \$27.6 million.

In June 2008, the FASB issued FSP No. EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities" (FSP EITF 03-6-1). FSP EITF 03-6-1 clarifies that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents are

participating securities and must be included in the computation of earnings per share pursuant to the two-class method described in FASB Statement No. 128, "Earnings Per Share." FSP EITF 03-6-1 will be effective at the beginning of fiscal year 2010 and must be applied on a retrospective basis. We are currently evaluating the impact that FSP EITF 03-6-1 will have on the consolidated financial statements.

Critical Accounting Policies

This discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts. On an ongoing basis, we evaluate our estimates, including those related to bad debts, inventories, intangible assets, assets held for sale, long-lived assets, income taxes, self-insurance reserves, exit costs, retirement benefits, stock-based compensation and contingencies and litigation. We base our estimates on historical experience and on various other assumptions and factors that we believe to be reasonable under the circumstances. Based on our ongoing review, we make adjustments we consider appropriate under the facts and circumstances. We have discussed the development, selection and disclosure of these estimates with the Audit Committee. The accompanying condensed consolidated financial statements are prepared using the same critical accounting policies discussed in our Annual Report on Form 10-K for the fiscal year ended March 29, 2008.

ITEM 3. Quantitative and Qualitative Disclosure About Market Risk

There have been no material changes in market risk of Spartan Stores from the information provided under Part II, Item 7A, "Quantitative and Qualitative Disclosure About Market Risk", of the Company's Annual Report on Form 10-K for the fiscal year ended March 29, 2008.

ITEM 4. Controls and Procedures

An evaluation of the effectiveness of the design and operation of Spartan Stores' disclosure controls and procedures (as currently defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) was performed as of September 13, 2008 (the "Evaluation Date"). This evaluation was performed under the supervision and with the participation of Spartan Stores' management, including its Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"). As of the Evaluation Date, Spartan Stores' management, including the CEO and CFO, concluded that Spartan Stores' disclosure controls and procedures were effective as of the Evaluation Date to ensure that material information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the reports that we file or submit under the Securities and Exchange Act of 1934 is accumulated and communicated to management, including our principal executive and principal financial officers as appropriate to allow for timely decisions regarding required disclosure. During the last fiscal quarter there was no change in Spartan Stores' internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, Spartan Stores' internal control over financial reporting.

PART II
OTHER INFORMATION

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table provides information regarding the Company's purchases of its own common stock during the second quarter. The Company has no public stock repurchase plans or programs. All transactions reported are with associates under stock compensation plans. These include: (1) shares of Spartan Stores, Inc. stock delivered in satisfaction of the exercise price and/or tax withholding obligations by holders of employee stock options who exercised options, and (2) shares submitted for cancellation to satisfy tax withholding obligations that occur upon the vesting of the restricted shares. The value of the shares delivered or withheld is determined by the applicable stock compensation plan.

Spartan Stores, Inc. Purchases of Equity Securities

| Period | Total Number of Shares Purchased | Average Price Paid per Share |
|---|---|------------------------------------|
| June 22 - July 19, 2008 | | |
| Employee Transactions | - | \$ - |
| July 20 - August 16, 2008 | | |
| Employee Transactions | 55 | \$ 25.37 |
| August 17 - September 13, 2008 | | |
| Employee Transactions | 305 | \$ 23.76 |
| Total for Second Quarter ended September 13, 2008 | 360 | \$ 24.01 |

ITEM 4. Submission of Matters to a Vote of Security Holders

Spartan Stores held its 2008 annual meeting on August 13, 2008. At the meeting, the following matters were submitted to a vote of the shareholders:

1. Election of three directors; and
2. Ratification of the selection of Deloitte & Touche LLP as Spartan Stores' independent auditors for fiscal 2009.

The following three persons were duly elected at the meeting:

| | <u>Term Expiring</u> | <u>Votes For</u> | <u>Votes Withheld</u> |
|----------------------|----------------------|------------------|-----------------------|
| Elizabeth A. Nickels | 2011 | 17,136,744 | 2,610,998 |
| Kenneth T. Stevens | 2011 | 17,136,225 | 2,611,517 |
| James F. Wright | 2011 | 19,230,483 | 517,259 |

The following six persons continue to serve as directors of Spartan Stores: M. Shan Atkins, Dr. Frank M. Gambino and Timothy J. O'Donovan are currently serving terms that will expire at Spartan Stores' 2009 annual meeting of shareholders, and Craig C. Sturken, Frederick J. Morgenthall, II and Dennis Eidson are currently serving terms that will expire at Spartan Stores' 2010 annual meeting of shareholders.

The shareholders voted on a proposal to ratify the selection of Deloitte & Touche LLP as Spartan Stores' independent auditors for fiscal year 2009. With respect to this proposal, shares were voted as follows:

| <u>Proposal</u> | <u>For</u> | <u>Against</u> | <u>Abstain</u> | <u>Broker Non-Votes</u> |
|---|------------|----------------|----------------|-------------------------|
| Proposal to ratify the selection of Deloitte & Touche LLP as Spartan Stores' independent auditors for fiscal year 2009. | 15,225,418 | 4,507,825 | 14,497 | - |

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ITEM 6. Exhibits

The following documents are filed as exhibits to this Quarterly Report on Form 10-Q:

| <u>Exhibit Number</u> | <u>Document</u> |
|-----------------------|--|
| 2.1 | Asset Purchase Agreement, dated March 19, 2007, by and among G&R Felpausch Company, Felpausch Food Centers, LLC, Hastings Catalog Sales, Inc., and Felpausch Kalamazoo, LLC as Seller, and Family Fare, LLC, Prevo's Family Markets, Inc., MSFC, LLC, and Spartan Stores Fuel, LLC as Purchaser, previously filed as an exhibit to Spartan Stores' Current Report on Form 8-K, filed March 23, 2007. Here incorporated by reference. |
| 2.2 | Third Amendment to the Asset Purchase Agreement, dated June 15, 2007, by and among G&R Felpausch Company, Felpausch Food Centers, LLC, Hastings Catalog Sales, Inc., Felpausch Kalamazoo, LLC, and Felpausch-Kelly, L.L.C. as Seller, and Family Fare, LLC, Prevo's Family Markets, Inc., MSFC, LLC, and Spartan Stores Fuel, LLC as Purchaser, previously filed as an exhibit to Spartan Stores' Current Report on Form 8-K, filed June 21, 2007. Here incorporated by reference. |
| 2.3 | Asset purchase agreement dated March 31, 2008 between Rite Aid of Ohio, Inc. and Seaway Food Town, Inc., with amendments. Previously filed as an exhibit to Spartan Stores' Current Report on Form 8-K, filed May 30, 2008. Here incorporated by reference. |
| 2.4 | Asset Purchase Agreement, dated October 13, 2008, by and among V.G.'s Food Center, Inc. and VG's Pharmacy, Inc. as Seller and Family Fare, LLC as Purchaser, previously filed as an exhibit to Spartan Stores' Current Report on Form 8-K, filed October 15, 2008. Here incorporated by reference. |
| 3.1 | Amended and Restated Articles of Incorporation of Spartan Stores, Inc. Previously filed as an exhibit to Spartan Stores' Quarterly Report on Form 10-Q for the quarter ended September 10, 2005. Here incorporated by reference. |
| 3.2 | Bylaws of Spartan Stores, Inc., as amended. Previously filed as an exhibit to Spartan Stores' Current Report on Form 8-K on August 20, 2007. Here incorporated by reference. |
| 10.1 | Spartan Stores, Inc. Stock Incentive Plan of 2005. |
| 10.2 | Spartan Stores, Inc. Annual Executive Incentive Plan of 2005. |
| 10.3 | Spartan Stores, Inc. 2001 Stock Incentive Plan. |
| 10.4 | Spartan Stores, Inc. 2001 Stock Bonus Plan. |
| 10.5 | Spartan Stores, Inc. 2000 Annual Incentive Plan. |
| 10.6 | Spartan Stores, Inc. 1991 Stock Option Plan. |
| 31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

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