

SPARTAN STORES INC  
Form 10-Q  
February 07, 2008

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**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 January 5, 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 76<sup>th</sup> 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, or a non-accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act).

Large accelerated filer  Accelerated filer  Non-accelerated filer

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 January 29, 2008 the registrant had 21,905,617 outstanding shares of common stock, no par value.

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## 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 31, 2007 (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 supercenters, warehouse discount stores, supermarkets, pharmacies and product manufacturers. Future sales will be dependent on the number of retail stores that we own and operate, our ability to retain and add to the retail stores to whom we distribute, competitive pressures in the retail industry generally and our geographic markets specifically and our ability to implement effective new marketing and merchandising programs. Competitive pressures in these and other business segments may result in unexpected reductions in sales volumes, product prices or service fees.

Our operating and administrative expenses, 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. 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, or other circumstances beyond our control could have adverse effects on the availability of and our ability to operate our warehouse 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.

Our ability to realize increased sales and earnings as a result of our recent acquisition of certain of the assets of G&R Felpausch Company and its affiliates ("Felpausch") depends on our ability to integrate the acquired assets successfully and to implement our plans and business practices at the acquired locations. Combining the operations of Felpausch with our existing operations is expected to require significant effort and expense. If we are unable to integrate the Felpausch assets as planned, we may not realize the synergies, business opportunities, and growth prospects anticipated in connection with this transaction.

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>  | January 5,<br>2008 | March 31,<br>2007 |
|--|--------------------|-------------------|
| <b>Current assets</b>  |                    |                   |
| Cash and cash equivalents  | \$ 11,396          | \$ 12,063         |
| Accounts receivable, net   | 53,196             | 45,347            |
| Inventories, net   | 133,494            | 106,854           |
| Prepaid expenses and other current assets                          | 9,563              | 7,122             |
| Deferred taxes on income   | 5,501              | 10,214            |
| Property and equipment held for sale                               | 840                | 3,595             |
| <b>Total current assets</b>  | 213,990            | 185,195           |
| <b>Other assets</b>  |                    |                   |
| Goodwill   | 176,383            | 142,888           |
| Other, net   | 31,967             | 16,203            |
| <b>Total other assets</b>  | 208,350            | 159,091           |
| <b>Property and equipment, net</b>                                 | 175,732            | 143,213           |
| <b>Total assets</b>  | \$ 598,072         | \$ 487,499        |
| <br><u>Liabilities and Shareholders' Equity</u>                    |                    |                   |
| <b>Current liabilities</b>   |                    |                   |
| Accounts payable   | \$ 93,939          | \$ 93,729         |
| Accrued payroll and benefits                                       | 31,940             | 33,367            |
| Other accrued expenses   | 21,142             | 19,503            |
| Current portion of exit costs                                      | 8,641              | 8,889             |
| Current maturities of long-term debt and capital lease obligations | 10,567             | 2,494             |
| <b>Total current liabilities</b>                                   | 166,229            | 157,982           |
| <b>Long-term liabilities</b>                                       |                    |                   |
| Postretirement benefits  | 8,608              | 9,208             |
| Other long-term liabilities  | 26,003             | 17,413            |
| Exit costs   | 23,798             | 23,814            |

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|  |            |            |
|--|------------|------------|
| Long-term debt and capital lease obligations   | 173,032    | 106,341    |
|  | <hr/>      | <hr/>      |
| <b>Total long-term liabilities</b>   | 231,441    | 156,776    |
| <b>Commitments and contingencies (Note 8)</b>  |            |            |
| <b>Shareholders' equity</b>  |            |            |
| Common stock, voting, no par value; 50,000 shares authorized; 21,905 and 21,658 shares outstanding | 130,197    | 126,447    |
| Preferred stock, no par value, 10,000 shares authorized; no shares outstanding                     | -          | -          |
| Accumulated other comprehensive income   | 126        | 126        |
| Retained earnings  | 70,079     | 46,168     |
|  | <hr/>      | <hr/>      |
| <b>Total shareholders' equity</b>  | 200,402    | 172,741    |
|  | <hr/>      | <hr/>      |
| <b>Total liabilities and shareholders' equity</b>  | \$ 598,072 | \$ 487,499 |
|  | <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)

|   | 16 Weeks Ended     |                      | 40 Weeks Ended     |                      |
|---|--------------------|----------------------|--------------------|----------------------|
|   | January 5,<br>2008 | December 30,<br>2006 | January 5,<br>2008 | December 30,<br>2006 |
| <b>Net sales</b>  | \$ 826,096         | \$ 714,414           | \$ 2,003,269       | \$ 1,787,954         |
| <b>Cost of sales</b>  | 663,663            | 578,988              | 1,605,345          | 1,439,923            |
| <b>Gross margin</b>   | 162,433            | 135,426              | 397,924            | 348,031              |
| <b>Operating expenses</b>   |                    |                      |                    |                      |
| Selling, general and administrative expenses                      | 146,804            | 122,076              | 349,261            | 305,769              |
| Provision for asset impairments and exit costs                    | -                  | -                    | -                  | 4,464                |
| <b>Total operating expenses</b>                                   | 146,804            | 122,076              | 349,261            | 310,233              |
| <b>Operating earnings</b>   | 15,629             | 13,350               | 48,663             | 37,798               |
| <b>Other income and expenses</b>                                  |                    |                      |                    |                      |
| Interest expense  | 3,818              | 3,873                | 8,813              | 9,601                |
| Other, net  | (153)              | (27)                 | (331)              | (113)                |
| <b>Total other income and expenses</b>                            | 3,665              | 3,846                | 8,482              | 9,488                |
| <b>Earnings before income taxes and discontinued operations</b>   | 11,964             | 9,504                | 40,181             | 28,310               |
| <b>Income taxes:</b>  |                    |                      |                    |                      |
| Net impact of enactment of Michigan Business Tax (Note 11)        | (2,748)            | -                    | -                  | -                    |
| Federal, net of Michigan Business Tax impact                      | 4,229              | 3,293                | 14,104             | 9,876                |
| <b>Total income taxes</b>   | 1,481              | 3,293                | 14,104             | 9,876                |
| <b>Earnings from continuing operations</b>                        | 10,483             | 6,211                | 26,077             | 18,434               |
| <b>Earnings (loss) from discontinued operations, net of taxes</b> | 119                | (317)                | 143                | (517)                |
| <b>Net earnings</b>   | \$ 10,602          | \$ 5,894             | \$ 26,220          | \$ 17,917            |

**Basic earnings per share:**

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|  |                |                |                |                |
|--|----------------|----------------|----------------|----------------|
| Earnings from continuing operations          | \$ 0.49        | \$ 0.30        | \$ 1.22        | \$ 0.88        |
| Earnings (loss) from discontinued operations | 0.01           | (0.02)         | 0.01           | (0.02)         |
| Net earnings                                 | <u>\$ 0.50</u> | <u>\$ 0.28</u> | <u>\$ 1.23</u> | <u>\$ 0.86</u> |

**Diluted earnings per share:**

|  |                |                |                |                |
|--|----------------|----------------|----------------|----------------|
| Earnings from continuing operations          | \$ 0.48        | \$ 0.28        | \$ 1.20        | \$ 0.86        |
| Earnings (loss) from discontinued operations | 0.01           | (0.01)         | 0.01           | (0.02)         |
| Net earnings                                 | <u>\$ 0.49</u> | <u>\$ 0.27</u> | <u>\$ 1.21</u> | <u>\$ 0.84</u> |

**Weighted average shares outstanding:**

|         |        |        |        |        |
|---------|--------|--------|--------|--------|
| Basic   | 21,318 | 21,014 | 21,260 | 20,859 |
| Diluted | 21,660 | 21,455 | 21,668 | 21,260 |

*See accompanying notes to condensed consolidated financial statements.*

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

|   | Shares<br>Outstanding | Common<br>Stock | Accumulated<br>Other<br>Comprehensive<br>Income | Retained<br>Earnings | Total      |
|---|-----------------------|-----------------|---|----------------------|------------|
| <b>Balance - April 1, 2007</b>  | 21,658                | \$ 126,447      | \$ 126  | \$ 46,168            | \$ 172,741 |
| Adjustment to initially apply FIN 48  | -                     | -               | -   | 967                  | 967        |
| <b>Comprehensive earnings-</b>  |                       |                 |   |                      |            |
| Net earnings  | -                     | -               | -   | 26,220               | 26,220     |
| Dividends - \$.15 per share   | -                     | -               | -   | (3,276)              | (3,276)    |
| Stock-based employee compensation   | -                     | 2,267           | -   | -                    | 2,267      |
| Issuances of common stock and related<br>tax benefits on stock option exercises | 115                   | 1,552           | -   | -                    | 1,552      |
| Issuances of restricted stock and<br>related income tax benefits                | 177                   | 1,034           | -   | -                    | 1,034      |
| Cancellations of restricted stock   | (45)                  | (1,103)         | -   | -                    | (1,103)    |
| <b>Balance - January 5, 2008</b>  | 21,905                | \$ 130,197      | \$ 126  | \$ 70,079            | \$ 200,402 |

*See accompanying notes to condensed consolidated financial statements.*

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

(In thousands)

(Unaudited)

|  | 40 Weeks Ended     |                      |
|--|--------------------|----------------------|
|  | January 5,<br>2008 | December 30,<br>2006 |
| <b>Cash flows from operating activities</b>  |                    |                      |
| Net earnings   | \$ 26,220          | \$ 17,917            |
| (Earnings) loss from discontinued operations   | (143)              | 517                  |
|  | 26,077             | 18,434               |
| Earnings from continuing operations  | 26,077             | 18,434               |
| Adjustments to reconcile net earnings from continuing operations to net cash provided by operating activities: |                    |                      |
| Provision for asset impairments and exit costs   | -                  | 4,464                |
| Depreciation and amortization  | 18,914             | 16,578               |
| Postretirement benefits expense  | 1,927              | 1,909                |
| Deferred taxes on income   | 13,975             | 8,827                |
| Stock-based compensation expense   | 2,262              | 1,481                |
| Other  | 24                 | 254                  |
| Change in operating assets and liabilities:  |                    |                      |
| Accounts receivable  | (10,038)           | 760                  |
| Inventories  | (18,800)           | (16,337)             |
| Prepaid expenses and other assets  | (3,839)            | (1,173)              |
| Accounts payable   | 4,392              | 5,868                |
| Accrued payroll and benefits   | (2,577)            | 691                  |
| Postretirement benefits payments   | (6,764)            | (2,982)              |
| Other accrued expenses and other liabilities   | (2,421)            | (2,129)              |
|  | 23,132             | 36,645               |
| <b>Net cash provided by operating activities</b>   | 23,132             | 36,645               |
| <b>Cash flows from investing activities</b>  |                    |                      |
| Purchases of property and equipment  | (30,081)           | (20,352)             |
| Net proceeds from the sale of assets   | 24                 | 468                  |
| Acquisitions, net of cash acquired   | (49,413)           | (53,600)             |
| Other  | (17)               | 245                  |
|  | (79,487)           | (73,239)             |
| <b>Net cash used in investing activities</b>   | (79,487)           | (73,239)             |
| <b>Cash flows from financing activities</b>  |                    |                      |
| Net (payments on) proceeds from revolving credit facility  | (47,757)           | 43,131               |
| Proceeds from long-term borrowings   | 110,000            | -                    |
| Repayment of long-term borrowings  | (2,703)            | (1,727)              |
| Financing fees paid  | (3,751)            | -                    |
| Proceeds from sale of common stock   | 729                | 2,944                |
| Dividends paid   | (3,276)            | (3,219)              |
|  |                    |                      |

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|   |                  |                  |
|---|------------------|------------------|
| <b>Net cash provided by financing activities</b>            | 53,242           | 41,129           |
| <b>Cash flows from discontinued operations</b>              |                  |                  |
| Net cash used in operating activities                       | (998)            | (2,110)          |
| Net cash provided by investing activities                   | 3,444            | 3,080            |
| Net cash used in financing activities                       | -                | -                |
| <b>Net cash provided by discontinued operations</b>         | <u>2,446</u>     | <u>970</u>       |
| <b>Net (decrease) increase in cash and cash equivalents</b> | (667)            | 5,505            |
| <b>Cash and cash equivalents at beginning of period</b>     | <u>12,063</u>    | <u>7,655</u>     |
| <b>Cash and cash equivalents at end of period</b>           | <u>\$ 11,396</u> | <u>\$ 13,160</u> |

*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 January 5, 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 June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes", and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Further, FIN 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The provisions of FIN 48 are to be applied prospectively. FIN 48 became effective at the beginning of Spartan Stores' fiscal year 2008, and the effect of adoption of FIN 48 increased retained earnings by \$1.0 million as of the beginning of fiscal year 2008. The adoption of FIN 48 and its effects are more fully described in Note 11.

In June 2006, the FASB ratified the consensus reached on Emerging Issues Task Force (EITF) Issue No. 06-03, "How Sales Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That is, Gross Versus Net Presentation)" (EITF 06-03). The EITF reached a consensus that the presentation of taxes on either a gross or net basis is an accounting policy decision that requires disclosure. EITF 06-03 was effective at the beginning of Spartan Stores' fiscal 2008 first quarter. An entity is not required to reevaluate its existing policies related to taxes assessed by a governmental authority as a result of this consensus. Amounts collected from customers, which under common trade practices are referred to as sales taxes, are and have been recorded on a net basis. Spartan Stores has no intention of modifying this accounting policy; therefore, the adoption of EITF 06-03 did not have any effect on Spartan Stores' financial position or results of operations.

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. The provisions of the Statement are to be applied prospectively, except for limited retrospective application permitted for certain items. Spartan Stores is currently evaluating the impact, if any, that SFAS 157 will have on the consolidated financial statements.

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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 required Spartan Stores to recognize the funded status of defined benefit postretirement plans as an asset or liability in the consolidated balance sheet and to recognize changes in funded status through comprehensive income as of March 31, 2007. SFAS 158 also 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 is currently evaluating the impact of changing the measurement date on the consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB No. 115" (SFAS 159). Under SFAS 159, entities may irrevocably elect to measure many financial instruments and certain other items at fair value on an instrument-by-instrument basis, with changes in fair value recognized in earnings each reporting period. SFAS 159 is effective for fiscal years beginning after November 15, 2007. Spartan Stores does not expect to adopt SFAS 159.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), "Business Combinations" (SFAS 141R), which replaces 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.

### Note 3

#### Acquisition of Assets

On June 15, 2007, Spartan Stores acquired certain assets and assumed certain liabilities related to 20 retail grocery stores, two fuel centers and three convenience stores from G&R Felpausch Company and affiliated companies ("Felpausch"), a privately-held retail grocery operator and customer of its Distribution segment. The Felpausch supermarkets include the operations of nine in-store pharmacies. The cash purchase price paid to Felpausch was \$38.0 million plus \$12.7 million for inventories. Spartan Stores acquired the store locations and operations of Felpausch in an effort to increase its leading market share position in West Michigan and expand its market presence in central Michigan. The purchased assets included leasehold improvements, fixtures, tangible personal property, equipment, intangible property and inventories. Spartan Stores assumed Felpausch's lease obligations for the 20 stores, two fuel centers and three convenience stores.

The following table summarizes the preliminary estimated fair values of the assets acquired and liabilities assumed at the date of acquisition. The preliminary purchase price allocations are estimates as of January 5, 2008 based on a combination of third-party valuations and internal analyses and may be further adjusted during the allocation period, as defined by SFAS No. 141. The primary areas of the purchase price allocation that are not yet finalized relate to the valuation of property and equipment, other intangible assets and residual goodwill. We expect the purchase price allocation to be finalized by the end of fiscal 2008.

| (In thousands)          | June 15,<br>2007 |
|-------------------------|------------------|
| Current assets          | \$ 13,271        |
| Goodwill                | 31,653           |
| Favorable leases        | 2,503            |
| Customer lists          | 2,953            |
| Other intangible assets | 723              |
| Property and equipment  | 11,150           |

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|   |           |
|---|-----------|
| Total assets acquired                           | 62,253    |
| Current liabilities                             | 1,638     |
| Capital lease obligations, less current portion | 4,285     |
| Exit cost reserves, less current portion        | 3,796     |
| Other long-term liabilities                     | 1,827     |
| Total liabilities assumed                       | 11,546    |
| Net assets acquired                             | \$ 50,707 |

Goodwill of \$21.4 million and \$10.3 million was assigned to the Retail and Distribution segments, respectively, based upon the expected benefits to be derived from the business combination. Additionally, \$1.8 million in costs directly related to the acquisition have been included in goodwill, of which \$1.2 million and \$0.6 million were assigned to the Retail and Distribution segments, respectively. Goodwill of \$33.5 million is expected to be deductible for tax purposes.

Amortizable intangible assets acquired consisted of favorable leases and customer lists and amounted to \$2.5 million and \$3.0 million, respectively. The weighted average amortization period is 11.7 years for favorable leases and seven years for customer lists. Other intangible assets acquired include \$0.7 million of licenses for the sale of alcoholic beverages. The licenses have an indefinite life and therefore are not amortized.

**Note 4**  
**Goodwill and Other Intangible Assets**

Changes in the carrying amount of goodwill were as follows:

| (In thousands)               | Retail            | Distribution      | Total             |
|------------------------------|-------------------|-------------------|-------------------|
|                              | <u>          </u> | <u>          </u> | <u>          </u> |
| Balance at April 1, 2007     | \$ 89,181         | \$ 53,707         | \$ 142,888        |
| Felpausch stores acquisition | 22,596            | 10,861            | 33,457            |
| Other                        | 38                | -                 | 38                |
|                              | <u>          </u> | <u>          </u> | <u>          </u> |
| Balance at January 5, 2008   | <u>\$ 111,815</u> | <u>\$ 64,568</u>  | <u>\$ 176,383</u> |

The following table reflects the components of amortized intangible assets, included in "Other, net" on the Consolidated Balance Sheets:

| (In thousands)           | January 5, 2008             |                             | March 31, 2007              |                             |
|--------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
|                          | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization |
|                          | <u>          </u>           | <u>          </u>           | <u>          </u>           | <u>          </u>           |
| Non-compete agreements   | \$ 3,874                    | \$ 1,604                    | \$ 3,234                    | \$ 2,096                    |
| Favorable leases         | 6,488                       | 2,098                       | 4,025                       | 1,655                       |
| Customer lists           | 6,439                       | 819                         | 3,293                       | 239                         |
| Franchise fees and other | 1,221                       | 431                         | 1,201                       | 347                         |
|                          | <u>          </u>           | <u>          </u>           | <u>          </u>           | <u>          </u>           |
| Total                    | <u>\$ 18,022</u>            | <u>\$ 4,952</u>             | <u>\$ 11,753</u>            | <u>\$ 4,337</u>             |

The weighted average amortization period for amortizable intangible assets is as follows:

|                          |            |
|--------------------------|------------|
| Non-compete agreements   | 8.9 years  |
| Favorable leases         | 11.4 years |
| Customer lists           | 7.2 years  |
| Franchise fees and other | 11.0 years |
| Total                    | 9.0 years  |



Amortization expense for intangible assets was \$1.3 million and \$0.6 million for the 40 weeks ended January 5, 2008 and December 30, 2006, respectively. Estimated amortization expense for fiscal 2008 and each of the four succeeding fiscal years is as follows:

| (In thousands) | Fiscal Year | Amortization<br>Expense |
|----------------|-------------|-------------------------|
|                | 2008        | \$ 1,794                |
|                | 2009        | 1,952                   |
|                | 2010        | 1,826                   |
|                | 2011        | 1,787                   |
|                | 2012        | 1,655                   |

**Note 5**  
**Discontinued Operations**

During the second quarter of fiscal year 2008, Spartan Stores decided to close five *The Pharm* stores and one *Felpausch Xpressmart*. The decision to close the stores was based on a comprehensive evaluation of the stores' performance trends, long-term growth prospects, on-going capital requirements and lease expiration dates. As Spartan Stores will have no continuing interest in the operations of these stores, they have been classified as discontinued operations for all years presented. Prescription lists and pharmacy inventories of five of the stores were sold during the second quarter of fiscal 2008 for \$3.9 million and of the other store in the third quarter of fiscal 2008 for \$0.8 million. Asset impairment charges of \$0.9 million were recognized in the second quarter of fiscal 2008. The stores were closed early in the third quarter of fiscal 2008.

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)  | 16 Weeks Ended     |                      |
|---|--------------------|----------------------|
|   | January 5,<br>2008 | December 30,<br>2006 |
| Loss from discontinued operations (net of taxes of (\$130) and (\$279)) | \$ (241)           | \$ (317)             |
| Gain on disposal of discontinued operations (net of taxes of \$194)     | 360                | -                    |
| Total earnings (loss) from discontinued operations                      | \$ 119             | \$ (317)             |

| (In thousands) | 40 Weeks Ended     |                      |
|----------------|--------------------|----------------------|
|                | January 5,<br>2008 | December 30,<br>2006 |

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|   |            |          |
|---|------------|----------|
|   | <hr/>      | <hr/>    |
| Loss from discontinued operations (net of taxes of (\$975) and (\$386)) | \$ (1,810) | \$ (517) |
| Gain on disposal of discontinued operations (net of taxes of \$1,051)   | 1,953      | -        |
|   | <hr/>      | <hr/>    |
| Total earnings (loss) from discontinued operations                      | \$ 143     | \$ (517) |
|   | <hr/>      | <hr/>    |

-11-

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Sales for the quarters and year-to-date periods ended January 5, 2008 and December 30, 2006 and significant assets and liabilities of discontinued operations at the end of those periods are included below:

| (In thousands)                    | 16 Weeks Ended     |                      | 40 Weeks Ended     |                      |
|-----------------------------------|--------------------|----------------------|--------------------|----------------------|
|                                   | January 5,<br>2008 | December 30,<br>2006 | January 5,<br>2008 | December 30,<br>2006 |
| Net sales                         | \$ 793             | \$ 9,133             | \$ 14,114          | \$ 22,993            |
| Basic earnings (loss) per share   | 0.01               | (0.02)               | 0.01               | (0.02)               |
| Diluted earnings (loss) per share | 0.01               | (0.01)               | 0.01               | (0.02)               |

| (In thousands)         | January 5,<br>2008 | March 31,<br>2007 |
|------------------------|--------------------|-------------------|
| Current assets *       | \$ 418             | \$ 6,146          |
| Property, net          | 4,156              | 4,544             |
| Other long-term assets | 45                 | -                 |
| Current liabilities    | 4,406              | 6,491             |
| Long-term liabilities  | 931                | 2,637             |

\* Includes property and equipment held for sale

## Note 6 Asset Impairments and Exit Costs

The following table provides the activity of exit costs for our Retail segment for the 40 weeks ended January 5, 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)

|   | Lease and<br>Ancillary Costs |
|---|------------------------------|
| Balance at April 1, 2007                    | \$ 32,703                    |
| Exit costs related to Felpausch acquisition | 4,235                        |
| Payments, net of interest accretion         | (4,499)                      |
| Balance at January 5, 2008                  | \$ 32,439                    |

Exit costs of \$4.2 million were recorded in the purchase price allocation for the Felpausch acquisition (Note 3) for acquired stores that management plans to or has closed. The exit costs 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.

## Note 7

### Long-Term Debt

On May 30, 2007, Spartan Stores issued \$110 million in aggregate principal amount of unsecured 3.375% convertible senior notes due May 15, 2027. The notes are general unsecured obligations and rank equally in right of payment with all of our other existing and future unsecured and unsubordinated obligations. They are effectively subordinated to our existing and any future secured indebtedness to the extent of the assets securing such indebtedness. The net proceeds from the sale of the notes after deducting selling discounts of 2.5% and offering expenses of \$0.7 million were approximately \$106.5 million, and were used to pay down amounts owed under our senior secured revolving credit facility and partially fund the Felpausch stores acquisition.

Interest at an annual rate of 3.375% is payable semi-annually on May 15 and November 15 of each year. Contingent interest will be paid to holders of the notes during the period commencing May 20, 2012 and ending on November 14, 2012 and for any six-month period thereafter, if the average contingent interest trading price per \$1,000 principal amount of the notes for the five-consecutive-trading-day-period ending on the third trading day immediately preceding the first day of such interest period equals 120% or more of the principal amount of the notes. Contingent interest payable with respect to any six-month period will equal 0.25% per annum of the average contingent interest trading price of \$1,000 principal amount of notes during the five-consecutive-trading-day measurement period described above.

Spartan Stores may redeem the notes for cash in whole or in part, at any time or from time to time, on or after May 15, 2014 at 100% of the principal amount of the notes to be redeemed, and prior to that date on or after May 20, 2012 at a price equal to a specified percentage of the principal amount, plus, in each case, any accrued and unpaid interest. Holders may require Spartan Stores to repurchase their notes, in whole or in part, on May 15, 2014, May 15, 2017 and May 15, 2022 for a cash price equal to 100% of the principal amount of the notes to be redeemed, plus accrued and unpaid interest. In addition, upon certain fundamental change transactions, each holder would have the option, subject to certain conditions, to require Spartan Stores to repurchase for cash, in whole or in part, such holder's notes. For the purposes of the notes, a "fundamental change" would include, among other events set forth in the Indenture governing the notes, the acquisition of 50% or more of our common stock by a person or group, a consolidation, merger, or sale of all or substantially all of our assets, certain changes in our board of directors, or a termination of trading of our common stock.

The notes will be convertible at the option of the holder only under certain circumstances summarized as follows:

1. If the closing sale price per share of Spartan Stores common stock is greater than 130% of the applicable conversion price for a specified period of time,
2. If the trading price of the notes was less than 98% of the product of the closing sale price per share of Spartan Stores common stock and the conversion rate in effect for the notes for a specified period of time,
3. If the notes are called for redemption,
4. At any time on or after February 15, 2027 until the close of business on the business day immediately preceding the maturity date,
5. Upon the occurrence of specified corporate transactions.

Upon conversion by the holder, the notes convert at an initial conversion rate of 28.0310 shares of Spartan Stores common stock per \$1,000 principal amount of notes (equal to an initial conversion price of approximately \$35.67 per share), subject to adjustments upon certain events, under the following circumstances: 1) during specified periods if the price of Spartan Stores stock reaches specified thresholds; 2) if the trading price of the notes is below a specified threshold; 3) at any time on or after February 15, 2027; 4) upon the occurrence of certain corporate transactions; or 5) in the case of notes called for redemption, at any time prior to the close of business on the business day prior to the redemption date. Upon a surrender of notes for conversion, Spartan Stores will deliver cash equal to the lesser of the aggregate principal amount of notes to be converted and our total conversion obligation, and shares of Spartan Stores

common stock in respect of the remainder, if any, of our conversion obligation - unless we have elected to satisfy our obligation under such conversion by delivering only shares of our common stock. For the sixteen weeks and forty weeks ended January 5, 2008, the notes had no impact on diluted earnings per share

because the average stock price during the period was below \$35.67 per share, and the notes, if converted, would require only cash at settlement.

In connection with the closing of the sale of the notes, Spartan Stores entered into a registration rights agreement with the initial purchasers of the notes, pursuant to which Spartan Stores filed with the Securities and Exchange Commission (SEC) a shelf registration statement covering resale by security holders of the notes and the shares of Spartan Stores common stock issuable upon conversion of the notes. The registration statement was declared effective by the SEC on September 27, 2007.

On August 17, 2007, Spartan Stores entered into an agreement to increase the maximum credit available under its existing senior secured credit facility from \$225.0 million to \$255.0 million.

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

| (In thousands)  | January 5,<br>2008 | March 31,<br>2007 |
|---|--------------------|-------------------|
|   | _____              | _____             |
| Senior secured revolving credit facility, due December 2012 | \$ 29,068          | \$ 78,182         |
| Convertible subordinated notes, 3.375% due May 2027         | 110,000            | -                 |
| Capital lease obligations (Note 9)                          | 35,773             | 26,354            |
| Other, 5.00% - 9.25% due fiscal 2009 - 2021                 | 8,758              | 4,299             |
|   | _____              | _____             |
|   | 183,599            | 108,835           |
| Less current portion  | 10,567             | 2,494             |
|   | _____              | _____             |
| Total long-term debt  | \$ 173,032         | \$ 106,341        |
|   | _____              | _____             |

At January 5, 2008, long-term debt was due as follows:

| (In thousands) | Fiscal Year |            |
|----------------|-------------|------------|
|                | _____       |            |
|                | 2008        | \$ 3,938   |
|                | 2009        | 7,800      |
|                | 2010        | 2,937      |
|                | 2011        | 3,079      |
|                | 2012        | 3,267      |
|                | Thereafter  | 162,578    |
|                |             | _____      |
|                |             | \$ 183,599 |
|                |             | _____      |

The estimated fair value of our long-term debt, including current maturities, was lower than book value by approximately \$39.9 million and \$19.3 million at January 5, 2008 based upon a twenty-year maturity and seven-year prepayment provision of the convertible subordinated notes, respectively. The estimated fair value was based on market quotes for similar instruments.

**Note 8**  
**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 9**  
**Leases**

In conjunction with the Felpausch acquisition (see Note 3), Spartan Stores assumed the leases of the 20 retail stores, two fuel centers and two convenience stores that it continues to operate. Total future lease commitments of Spartan Stores under capital and operating leases in effect at January 5, 2008 are as follows:

| (In thousands)                             | Capital            |                     |               | Operating          |                     |                   |
|--|--------------------|---------------------|---------------|--------------------|---------------------|-------------------|
|  | Used in Operations | Subleased to Others | Total         | Used in Operations | Subleased to Others | Total             |
| Fiscal Year                                |                    |                     |               |                    |                     |                   |
| 2008                                       | \$ 1,473           | \$ 80               | \$ 1,553      | \$ 7,033           | \$ 238              | \$ 7,271          |
| 2009                                       | 5,671              | -                   | 5,671         | 27,714             | 1,094               | 28,808            |
| 2010                                       | 5,632              | -                   | 5,632         | 25,144             | 1,004               | 26,148            |
| 2011                                       | 5,533              | -                   | 5,533         | 22,105             | 837                 | 22,942            |
| 2012                                       | 5,456              | -                   | 5,456         | 16,594             | 754                 | 17,348            |
| Thereafter                                 | 32,845             | -                   | 32,845        | 49,041             | 1,312               | 50,353            |
| <b>Total</b>                               | <b>56,610</b>      | <b>80</b>           | <b>56,690</b> | <b>\$ 147,631</b>  | <b>\$ 5,239</b>     | <b>\$ 152,870</b> |
| Interest                                   | (20,917)           | -                   | (20,917)      |                    |                     |                   |
| Present value of minimum lease obligations | 35,693             | 80                  | 35,773        |                    |                     |                   |
| Current portion                            | 2,539              | 80                  | 2,619         |                    |                     |                   |
| Long-term obligations at January 5, 2008   | \$ 33,154          | \$ -                | \$ 33,154     |                    |                     |                   |

Assets held under capital leases consisted of the following:

| (In thousands)                | January 5, 2008 | March 31, 2007 |
|-------------------------------|-----------------|----------------|
| Buildings and improvements    | \$ 29,322       | \$ 20,299      |
| Equipment                     | 3,538           | 889            |
|                               | 32,860          | 21,188         |
| Less accumulated depreciation | 5,979           | 4,098          |
| Net property                  | \$ 26,881       | \$ 17,090      |



## Note 10

### Associate Retirement Plans

The following table provides the components of net periodic pension and postretirement benefit costs for the third quarter and year-to-date periods ended January 5, 2008 and December 30, 2006:

(In thousands)

| 16 Weeks Ended                     | Pension Benefits |                  | SERP Benefits   |                  | Postretirement Benefits |                  |
|------------------------------------|------------------|------------------|-----------------|------------------|-------------------------|------------------|
|                                    | Jan. 5,<br>2008  | Dec. 30,<br>2006 | Jan. 5,<br>2008 | Dec. 30,<br>2006 | Jan. 5,<br>2008         | Dec. 30,<br>2006 |
| Service cost                       | \$ 883           | \$ 771           | \$ 13           | \$ 11            | \$ 53                   | \$ 56            |
| Interest cost                      | 683              | 610              | 9               | 9                | 100                     | 102              |
| Expected return on plan assets     | (933)            | (802)            |                 | -                |                         | -                |
| Amortization of prior service cost | (173)            | (173)            |                 |                  | (16)                    | (16)             |
| Recognized actuarial net loss      | 73               | 78               | 7               | 7                | 10                      | 17               |
| Net periodic benefit cost          | <u>\$ 533</u>    | <u>\$ 484</u>    | <u>\$ 29</u>    | <u>\$ 27</u>     | <u>\$ 147</u>           | <u>\$ 159</u>    |

(In thousands)

| 40 Weeks Ended                     | Pension Benefits |                  | SERP Benefits   |                  | Postretirement Benefits |                  |
|------------------------------------|------------------|------------------|-----------------|------------------|-------------------------|------------------|
|                                    | Jan. 5,<br>2008  | Dec. 30,<br>2006 | Jan. 5,<br>2008 | Dec. 30,<br>2006 | Jan. 5,<br>2008         | Dec. 30,<br>2006 |
| Service cost                       | \$ 2,649         | \$ 2,313         | \$ 40           | \$ 33            | \$ 158                  | \$ 168           |
| Interest cost                      | 2,050            | 1,828            | 26              | 26               | 301                     | 307              |
| Expected return on plan assets     | (2,799)          | (2,405)          |                 | -                |                         | -                |
| Amortization of prior service cost | (518)            | (518)            | (1)             |                  | (48)                    | (48)             |
| Recognized actuarial net loss      | 217              | 233              | 21              | 21               | 29                      | 50               |
| Net periodic benefit cost          | <u>\$ 1,599</u>  | <u>\$ 1,451</u>  | <u>\$ 86</u>    | <u>\$ 80</u>     | <u>\$ 440</u>           | <u>\$ 477</u>    |

Spartan Stores expects to contribute \$7.6 million to its defined benefit pension plans in fiscal 2008 consisting of \$2.6 million to meet the minimum funding requirements and a voluntary contribution of \$5.0 million. The voluntary contribution will eliminate certain Pension Benefits Guaranty Corporation premiums, move the plan closer to a fully funded status and reduce future pension expense. Contributions of \$3.7 million were made in the fiscal year ended March 31, 2007. As of January 5, 2008 and December 30, 2006, \$7.0 million and \$3.0 million, respectively, had been contributed.

## Note 11

### Taxes on Income

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

new income tax, or Michigan Business Tax (MBT), is reported in Income taxes in the consolidated statements of earnings, whereas the former SBT was included in Selling, general and administrative expenses in the accompanying consolidated statements of earnings. The new income tax law was subsequently revised on September 30, 2007, two weeks after the end of Spartan Stores' 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' 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 second quarter and a corresponding change in deferred taxes on income. This charge was credited in the third quarter as a reduction to Income taxes of \$2.7 million. As a result of this credit in the third quarter, and five days of MBT expense, the effective income tax rate was 12.4% and 35.1% for the third quarter and year-to-date period, respectively, versus the Federal statutory income tax rate of 35%.

Spartan Stores adopted the provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48) on April 1, 2007, the first day of fiscal year 2008. Spartan Stores recorded the cumulative effect of adopting FIN 48 by increasing shareholders' equity by \$1.0 million. As of April 1, 2007, unrecognized tax benefits were not material. Spartan Stores recognizes interest and penalties accrued related to unrecognized tax benefits in income tax expense. Accrued interest and penalties are not material.

Spartan Stores files income tax returns with federal, state and local tax authorities within the United States. With few exceptions, we are no longer subject to U.S. federal or state examinations by tax authorities for fiscal years before 2004, and are no longer subject to local examination by tax authorities for fiscal years before 2003. In February 2005, the Internal Revenue Service (IRS) completed its examination of Spartan Stores' federal income tax returns for fiscal years 2001 through 2003. In October 2007, the IRS began its examination of the fiscal 2006 tax return.

As of January 5, 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 January 3, 2009.

## Note 12

### 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 \$0.6 million (\$0.03 per diluted share) and \$0.4 million (\$0.02 per diluted share) in the third quarter of fiscal 2008 and 2007, respectively, as a component of Selling, general and administrative expenses in the Consolidated Statements of Earnings. Stock-based compensation expense (net of tax) was \$1.5 million (\$0.07 per diluted share) and \$1.0 million (\$0.05 per diluted share) for the year-to-date period ended January 5, 2008 and December 30, 2006, respectively.

The following table summarizes activity in the share-based compensation plans for the year-to-date period ended January 5, 2008:

|                                       | Shares<br>Under<br>Options | Weighted<br>Average<br>Exercise Price | Restricted<br>Stock<br>Awards | Weighted<br>Average<br>Grant-Date<br>Fair Value |
|---------------------------------------|----------------------------|---------------------------------------|-------------------------------|---|
| <b>Outstanding at April 1, 2007</b>   | 609,397                    | \$ 9.44                               | 546,704                       | \$ 10.86  |
| Granted                               | 97,138                     | 28.00                                 | 168,553                       | 28.03   |
| Exercised/Vested                      | (115,245)                  | 6.31                                  | (132,789)                     | 10.02   |
| Cancelled/Forfeited                   | (1,783)                    | 6.48                                  | (3,836)                       | 14.91   |
| <b>Outstanding at January 5, 2008</b> | 589,507                    | \$ 13.12                              | 578,632                       | \$ 16.03  |

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|   |                |           |              |
|---|----------------|-----------|--------------|
| <b>Vested and expected to vest in the future at January 5, 2008</b> | <u>572,160</u> | <u>\$</u> | <u>12.90</u> |
| <b>Exercisable at January 5, 2008</b>                               | <u>297,173</u> | <u>\$</u> | <u>8.82</u>  |

The weighted average grant-date fair value of stock options granted during the third quarter ended January 5, 2008 was \$8.59. The weighted average grant-date fair value of stock options granted during the 40 weeks ended January 5, 2008 and December 30, 2006 was \$10.91 and \$4.84, 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:

|                         | 40 Weeks Ended     |                      |
|-------------------------|--------------------|----------------------|
|                         | January 5,<br>2008 | December 30,<br>2006 |
| Dividend yield          | 0.70% - 0.89%      | 1.00% - 1.46%        |
| Expected volatility     | 32.84% - 34.51%    | 30.43% - 31.70%      |
| Risk-free interest rate | 4.37% - 4.76%      | 4.58% - 5.05%        |
| Expected life of option | 6.25 years         | 6.25 years           |

As of January 5, 2008, total unrecognized compensation cost related to nonvested share-based awards granted under the stock incentive plans was \$1.4 million for stock options and \$7.9 million for restricted stock. The remaining compensation costs not yet recognized are expected to be recognized over a weighted average period of 2.3 years for stock options and approximately 3.6 years for restricted stock.

### Note 13

#### Supplemental Cash Flow Information

Non-cash financing activities include the issuance of restricted stock to employees and directors of \$4.7 million and \$3.8 million for the year-to-date periods ended January 5, 2008 and December 30, 2006, respectively. Non-cash investing and financing activities include capital leases of \$6.7 million for the year-to-date period ended January 5, 2008.

**Note 14****Operating Segment Information**

The following tables set forth information about Spartan Stores by operating segment:  
(In thousands)

|   | Distribution                | Retail                      | Total                       |
|---|-----------------------------|-----------------------------|-----------------------------|
|   | <u>                    </u> | <u>                    </u> | <u>                    </u> |
| <b>16 Weeks Ended January 5, 2008</b>   |                             |                             |                             |
| Net sales                               | \$ 410,710                  | \$ 415,386                  | \$ 826,096                  |
| Depreciation and amortization           | 2,374                       | 5,369                       | 7,743                       |
| Operating earnings                      | 11,587                      | 4,042                       | 15,629                      |
| Capital expenditures                    | 2,455                       | 11,622                      | 14,077                      |
| <b>16 Weeks Ended December 30, 2006</b> |                             |                             |                             |
| Net sales                               | \$ 386,996                  | \$ 327,418                  | \$ 714,414                  |
| Depreciation and amortization           | 2,099                       | 4,092                       | 6,191                       |
| Operating earnings                      | 7,782                       | 5,568                       | 13,350                      |
| Capital expenditures                    | 2,157                       | 6,134                       | 8,291                       |
| <b>40 Weeks Ended January 5, 2008</b>   |                             |                             |                             |
| Net sales                               | \$ 986,945                  | \$ 1,016,324                | \$ 2,003,269                |
| Depreciation and amortization           | 5,840                       | 12,639                      | 18,479                      |
| Operating earnings                      | 25,449                      | 23,214                      | 48,663                      |
| Capital expenditures                    | 6,211                       | 23,870                      | 30,081                      |
| <b>40 Weeks Ended December 30, 2006</b> |                             |                             |                             |
| Net sales                               | \$ 944,320                  | \$ 843,634                  | \$ 1,787,954                |
| Depreciation and amortization           | 5,953                       | 10,170                      | 16,123                      |
| Operating earnings                      | 20,957                      | 16,841                      | 37,798                      |
| Capital expenditures                    | 5,036                       | 15,316                      | 20,352                      |
|   | <u>January 5,</u>           | <u>March 31,</u>            |                             |
|   | <u>2008</u>                 | <u>2007</u>                 |                             |
| <b>Total assets</b>                     |                             |                             |                             |
| Distribution                            | \$ 225,170                  | \$ 193,475                  |                             |
| Retail                                  | 368,283                     | 283,334                     |                             |
| Discontinued operations                 | 4,619                       | 10,690                      |                             |
|   | <u>                    </u> | <u>                    </u> |                             |
| Total                                   | <u>\$ 598,072</u>           | <u>\$ 487,499</u>           |                             |



**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, Ohio 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 102 corporate owned stores. Our Retail segment operates 88 retail supermarkets in Michigan under the banners *Family Fare Supermarkets*, *Glen's Markets*, *D&W Fresh Markets* and *Felpausch Food Centers*, 14 deep-discount food and drug stores in Ohio and Michigan under the banner *The Pharm*, 16 fuel centers and 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 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. All quarters are 12 weeks, except for our third quarter, which is 16 weeks and includes the Thanksgiving and Christmas holidays. 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.

On April 24, 2007, we reached an agreement to significantly expand our distribution supply relationship with Martin's Super Markets, an independent supermarket retailer with locations in southwest Michigan and north central Indiana. Our existing supply relationship expanded to include dry groceries, dairy and frozen products and our portfolio of corporate private label brands in addition to the existing health and beauty care products, general merchandise and pharmacy products. The expanded relationship includes all 20 locations of Martin's Super Markets. We expect annual distribution sales to increase by approximately \$100 million after we have fully transitioned the customer, which occurred during September 2007. This new relationship, our first major move to distribute to independent retailers outside the state of Michigan, significantly increases our distribution presence in Indiana and demonstrates a successful beginning to fulfill our stated business strategy of growing our distribution customer base to contiguous midwestern states.

On June 15, 2007, we acquired certain assets and assumed certain liabilities related to 20 retail grocery stores, two fuel centers and three convenience stores from G&R Felpausch Company and affiliated companies ("Felpausch"), a privately-held retail grocery operator serving south and central Michigan. The retail stores include the operations of nine in-store pharmacies. The transaction represents another step in the component of our business strategy focused on growing our business through opportunistic acquisitions of other grocery operators that are adjacent to or in markets where we operate today. The Felpausch stores serve many communities where we previously had no retail presence. They also provide a geographic fit with our current retail store footprint, while providing expansion into central Michigan.

The Felpausch transaction is expected to increase annual retail segment sales by approximately \$200 million, but annual consolidated sales are expected to increase by approximately \$100 million as Felpausch is an existing distribution customer. The Company expects to realize many operational synergies from the transaction, however, the gains are initially expected to be more than offset by transition expenditures of approximately \$5.0 million to \$6.0 million. These transitional expenses are for marketing and promotional activities associated with merchandising, product and branding initiatives, as well as initial employee training and other costs associated with integrating the acquired operations and are expected to be primarily incurred over the first 15 to 21 months of operation.



## 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 |                 |
|--|-------------------------|------------------|-----------------|------------------|-------------------|-----------------|
|  | 16 Weeks Ended          |                  | 40 Weeks Ended  |                  | 16 Weeks Ended    | 40 Weeks Ended  |
|  | Jan. 5,<br>2008         | Dec. 30,<br>2006 | Jan. 5,<br>2008 | Dec. 30,<br>2006 | Jan. 5,<br>2008   | Jan. 5,<br>2008 |
| Net sales  | 100.0                   | 100.0            | 100.0           | 100.0            | 15.6              | 12.0            |
| Gross margin   | 19.7                    | 19.0             | 19.9            | 19.5             | 19.9              | 14.3            |
| Selling, general and administrative                        | 17.8                    | 17.1             | 17.5            | 17.1             | 20.3              | 14.2            |
| Provision for asset impairments and exit costs             | 0.0                     | 0.0              | 0.0             | 0.3              | 0.0               | (100.0)         |
| Operating earnings   | 1.9                     | 1.9              | 2.4             | 2.1              | 17.1              | 28.7            |
| Other income and expenses                                  | 0.5                     | 0.5              | 0.4             | 0.5              | (4.7)             | (10.6)          |
| Earnings before income taxes and discontinued operations   | 1.4                     | 1.4              | 2.0             | 1.6              | 25.9              | 41.9            |
| Income taxes   | 0.1                     | 0.5              | 0.7             | 0.6              | (55.0)            | 42.8            |
| Earnings from continuing operations                        | 1.3                     | 0.9              | 1.3             | 1.0              | 68.8              | 41.5            |
| Earnings (loss) from discontinued operations, net of taxes | 0.0                     | (0.1)            | 0.0             | (0.0)            | *                 | *               |
| Net earnings   | 1.3                     | 0.8              | 1.3             | 1.0              | 79.9              | 46.3            |

\* Percentage change is not meaningful

**Net Sales** - Net sales for the quarter ended January 5, 2008 ("third quarter") increased \$111.7 million, or 15.6 percent, from \$714.4 million in the quarter ended December 30, 2006 ("prior year third quarter") to \$826.1 million. Net sales for the year-to-date period ended January 5, 2008 ("current year-to-date") increased \$215.3 million, or 12.0 percent, from \$1,788.0 million in the prior year-to-date period ended December 30, 2006 ("prior year-to-date") to \$2,003.3 million.

Net sales for the third quarter in our Distribution segment increased \$23.7 million, or 6.1 percent, from \$387.0 million in the prior year third quarter to \$410.7 million. Net sales for the current year-to-date period increased \$42.6 million, or 4.5 percent, from \$944.3 million in the prior year-to-date period to \$986.9 million. The third quarter increase was due to the addition of new distribution customers of \$57.1 million and an increase in sales to existing customers primarily as a result of a retail competitor exiting the eastern Michigan market, partially offset by the elimination of sales to Felpausch stores of \$34.4 million (due to the acquisition). The increase for the current year-to-date period was due to the addition of new distribution customers of \$110.0 million and an increase in sales to existing customers, partially offset by the elimination of sales to Felpausch stores of \$60.6 million and lost sales of

\$7.7 million as a result of the terminated relationships. In April of 2007, we reached an agreement to significantly expand our supply relationship with Martin's Super Markets. As a result, we expect annual distribution sales to increase by approximately \$100 million after we have fully transitioned the customer, which occurred during September 2007. Year-to-date incremental sales to Martin's Super Markets were approximately \$61.0 million. As a result of the acquisition of Felpausch, we expect annual Distribution sales to decline approximately \$100 million due to the elimination of intercompany sales.

Net sales for the third quarter in our Retail segment increased \$88.0 million, or 26.9 percent, from \$327.4 million in the prior year third quarter to \$415.4 million. Net sales for the year-to-date period increased \$172.7 million, or 20.5 percent, from \$843.6 million in the prior year-to-date period to \$1,016.3 million. The third quarter increase was primarily due to incremental sales from the recently acquired Felpausch retail stores of \$62.0 million,

continued increases in fuel center sales of \$15.0 million, supermarket comparable store sales growth of \$10.4 million and incremental sales from the acquisition of the PrairieStone pharmacies of \$2.8 million. The year-to-date increase was primarily due to incremental sales from the recently acquired Felpausch retail stores of \$114.2 million, continued increases in fuel center sales of \$30.4 million, supermarket comparable sales growth of \$23.3 million, and incremental sales resulting from the acquisition of the PrairieStone pharmacies of \$12.5 million, partially offset by lost sales relating to the previously disclosed closing of two retail stores near the end of the prior year first quarter of \$3.1 million.

Total Retail comparable store sales increased 7.2 percent during the third quarter due to our continued capital investments, including store remodels, the opening of additional fuel centers and the PrairieStone Pharmacy acquisition. Fuel center sales contributed a positive 3.8 percentage points toward the total comparable store sales increase. Total Retail comparable store sales increased 6.4 percent in the current year-to-date period, while fuel center sales contributed a positive 3.0 percent to the total. 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.

**Cost of Sales and Gross Margin** - Gross margin represents net 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 third quarter increased \$27.0 million, or 19.9 percent, from \$135.4 million in the prior year third quarter to \$162.4 million. As a percent of net sales, gross margin for the third quarter increased to 19.7 percent from 19.0 percent. Gross margin for the year-to-date period increased \$49.9 million, or 14.3 percent, from \$348.0 million in the prior year-to-date period to \$397.9 million. As a percent of net sales, gross margin for the year-to-date period increased to 19.9 percent from 19.5 percent. 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, partially offset by growth in lower margin fuel and pharmacy sales and additional promotional activity during grand re-openings of four remodeled stores and one replacement store which have resulted in increased sales and market share.

**Selling, General and Administrative Expenses** - Selling, general and administrative ("SG&A") expenses consist primarily of salaries and wages, employee benefits, warehousing costs, store occupancy costs, utilities, equipment rental, depreciation and other administrative costs.

SG&A expenses for the third quarter increased \$24.7 million, or 20.3 percent, from \$122.1 million in the prior year third quarter to \$146.8 million. As a percent of net sales, SG&A expenses were 17.8 percent for the current quarter compared to 17.1 percent in the prior year third quarter. SG&A expenses for the year-to-date period increased \$43.5 million, or 14.2 percent, from \$305.8 million in the prior year-to-date period to \$349.3 million. As a percent of net sales, SG&A expenses were 17.5 percent year-to-date versus 17.1 percent for the prior year-to-date period.

The net increase in third quarter SG&A expenses was primarily due to the following:

- Incremental operating costs associated with the acquired retail stores of \$16.6 million, including costs of grand re-openings of two remodeled stores
- Increases in other compensation and benefits of \$2.3 million due to increased sales volume
- Increased store labor of \$2.1 million primarily due to increases in volume, including costs associated with grand re-openings of four remodeled stores and one replacement store

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The cost of operating additional fuel centers of \$0.9 million

Increased advertising costs of \$0.8 million

Increased transportation fuel costs of \$0.7 million

Increased depreciation and amortization of \$0.7 million

The net increase in year-to-date SG&A expenses was primarily due to the following:

- Incremental operating costs associated with the acquired retail stores of \$30.4 million, including approximately \$0.8 million of training and other start-up related costs, and also including costs of grand re-openings of two remodeled stores
- Increases in other compensation and benefits of \$5.5 million due to increased sales volume and the absence of a \$1.3 million insurance reserve adjustment recorded in the prior year quarter due to positive loss trends in health care and workers' compensation
- Increased store labor of \$4.3 million primarily due to increases in volume, including costs associated with grand re-openings of four remodeled stores and one replacement store
- The cost of operating additional fuel centers of \$1.9 million
- Increased transportation fuel costs of \$0.8 million
- Increased depreciation and amortization of \$0.8 million
- Increased advertising of \$0.6 million

The increased SG&A expenses were partially offset by reduced operating costs due to the closure of two supermarkets near the end of the prior year first quarter of \$1.1 million.

***Provision for Asset Impairments and Exit Costs*** - In the prior year first quarter, the Retail segment recognized charges of \$4.5 million for asset impairment and lease and related ancillary costs related to the closure of two *Family Fare Supermarkets* stores and moving the central bakery operation into individual retail stores. The store base rationalization and associated charge was incurred due to the proximity of acquired stores to our existing store base. This limited reduction of our store network was based on an evaluation of stores that were best positioned to provide customers with the highest quality overall shopping experience. The central bakery decision was based on the desire to move the production of bakery products closer to the consumer, and the economics of the central bakery operation.

***Interest Expense*** - Interest expense for the third quarter decreased \$0.1 million, or 1.4 percent, from \$3.9 million in the prior year third quarter to \$3.8 million. Interest expense for the year-to-date period decreased \$0.8 million, or 8.2 percent, from \$9.6 million in the prior year-to-date period to \$8.8 million. The decrease in interest expense is primarily due to the amendment of our existing revolving credit facility and the issuance of the convertible senior notes, the proceeds of which were used to pay down amounts owed under our revolving credit facility, which has a higher interest rate. The effect of the lower rates was partially offset by an increase in outstanding debt due to the Felpausch acquisition. See the Liquidity section for additional information on the issuance of convertible senior notes.

***Income Taxes*** - During the second quarter, the Michigan legislature enacted a new business income tax effective January 1, 2008, which replaced the former Michigan Single Business Tax (SBT) that was in effect through December 31, 2007. The new income tax, or Michigan Business Tax (MBT), is reported in Income taxes in the consolidated statements of earnings, whereas the former SBT is included in Selling, general and administrative expenses in the accompanying consolidated statements of earnings through December 31, 2007. The new income tax law was subsequently revised on September 30, 2007, two weeks after the end of our 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 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 second quarter and a corresponding change in deferred taxes on income. This charge was credited in the third quarter as a reduction to Income taxes of \$2.7 million. As a result of this credit in the third quarter, and five days of MBT expense, the effective income tax rate was 12.4% and 35.1% for the third quarter and year-to-date period, respectively, versus the Federal statutory income tax rate of 35%.



## Discontinued Operations

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

During the second quarter of fiscal year 2008, we decided to close five *The Pharm* stores and one *Felpausch Xpressmart*. The decision to close the stores was based on a comprehensive evaluation of the stores' performance trends, long-term growth prospects, on-going capital requirements and lease expiration dates. Prescription lists and pharmacy inventories of five of the stores were sold during the second quarter of fiscal 2008 for \$3.9 million and of the other store in the third quarter of fiscal 2008 for \$0.8 million. Asset impairment charges of \$0.9 million, pre-tax, were recognized in the second quarter of fiscal 2008. The stores were closed early in the third quarter of fiscal 2008.

## 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)

|  | January 5,<br>2008 | December 30,<br>2006 |
|--|--------------------|----------------------|
|  | <hr/>              | <hr/>                |
| Net cash provided by operating activities            | \$ 23,132          | \$ 36,645            |
| Net cash used in investing activities                | (79,487)           | (73,239)             |
| Net cash provided by financing activities            | 53,242             | 41,129               |
| Net cash provided by discontinued operations         | 2,446              | 970                  |
|  | <hr/>              | <hr/>                |
| Net (decrease) increase in cash and cash equivalents | (667)              | 5,505                |
| Cash and cash equivalents at beginning of year       | 12,063             | 7,655                |
|  | <hr/>              | <hr/>                |
| Cash and cash equivalents at end of period           | \$ 11,396          | \$ 13,160            |
|  | <hr/>              | <hr/>                |

Net cash provided by operating activities decreased from the prior year-to-date period primarily due to changes in working capital requirements related to sales growth, delayed payment terms for customers opening stores previously closed by a competitor, a pension plan funding contribution and the timing of benefit accruals, partially offset by increased net earnings.

Our Federal income tax net operating loss carryforward was fully utilized during the second quarter.

Net cash used in investing activities increased during the current fiscal year primarily due to the acquisition of Felpausch and related capital expenditures. Capital expenditures, which do not include the acquisitions, increased \$9.7 million to \$30.1 million, of which our Retail and Distribution segments utilized 79.4% and 20.6%, respectively. Expenditures were used for store replacements, 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 \$142 million above these limits as of January 5, 2008 and we do not expect to fall below these levels. We expect capital expenditures to range from \$47.0 million to \$52.0 million for fiscal 2008, which would be allowed even

if the restriction applied.

Net cash provided by financing activities includes cash paid and received related to our long-term borrowings, dividends paid and proceeds from the issuance of common stock. 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 \$3.3 million and \$3.2 million were paid in each year-to-date period and cash dividends of \$1.1 million and \$2.2 million were paid in the current year quarter and prior year quarter, respectively. 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 January 5, 2008 are \$10.6 million. Our ability to borrow additional funds is governed by the terms of our credit facilities.

Net cash (used in) provided by discontinued operations contains the net cash flows of our discontinued operations and consists primarily of the payment of store exit cost reserves, insurance run-off claims and other liabilities and proceeds from the sale of assets. Included in current year cash flows from discontinued operations are proceeds on the disposal of assets of \$3.6 million. We expect cash provided by discontinued operations to approximate \$1.2 million to \$2.0 million in fiscal 2008.

Our principal sources of liquidity are cash flows generated from operations, proceeds from the issuance of convertible senior notes and our senior secured revolving credit facility. Net proceeds from the issuance of the convertible senior notes, after deducting the initial purchasers' discounts of 2.5% and offering expenses of \$0.7 million, of \$106.5 million were used to pay down the senior secured revolving credit facility and to partially fund the Felpausch acquisition. Interest on our convertible senior notes is payable on May 15 and November 15 of each year, beginning on November 15, 2007. The revolving credit facility matures December 2012, and is secured by substantially all of our assets. As of January 5, 2008, our revolving credit facility had outstanding borrowings of \$29.1 million, available borrowings of \$167.4 million and maximum availability of \$177.4 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 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 revolving credit facility.

Our current ratio increased to 1.29:1.00 at January 5, 2008 from 1.17:1.00 at March 31, 2007 and our investment in working capital was \$47.8 million at January 5, 2008 versus \$27.2 million at March 31, 2007. Our debt to total capital ratio at January 5, 2008 was .48:1.00 versus .39:1.00 at March 31, 2007. The change in these ratios was primarily due to obligations assumed related to the Felpausch acquisition, sales growth, seasonal inventory build-up and delayed payment terms to customers opening stores previously closed by a competitor.

For information on contractual obligations, see our Annual Report on Form 10-K for the fiscal year ended March 31, 2007. At January 5, 2008, there have been no material changes to our significant contractual obligations outside the ordinary course of business, except for the assumption of lease obligations in the Felpausch acquisition. As of January 5, 2008, our obligations under the leases assumed in the Felpausch acquisition are as follows:

| (In thousands)   | Payment Due by Period |                  |                 |                 |                   |
|--|-----------------------|------------------|-----------------|-----------------|-------------------|
|  | Total                 | Less than 1 year | 1-3 years       | 3-5 years       | More than 5 years |
| Operating leases   | \$ 15,863             | \$ 3,130         | \$ 6,089        | \$ 4,359        | \$ 2,285          |
| Capital leases   | 4,520                 | 431              | 877             | 1,039           | 2,173             |
| Interest on capital leases   | 1,939                 | 349              | 612             | 454             | 524               |
| Lease and ancillary costs of closed stores, including imputed interest | 4,782                 | 816              | 1,605           | 841             | 1,520             |
| <b>Total</b>   | <b>\$ 27,104</b>      | <b>\$ 4,740</b>  | <b>\$ 9,183</b> | <b>\$ 6,693</b> | <b>\$ 6,502</b>   |

#### *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") in an offering exempt from registration under the Securities Act of 1933. 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 preferred 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 January 5, 2008:

|  | <b>January 5,<br/>2008</b> |
|--|----------------------------|
| <b>Spartan Stores Subsidiaries Only</b>                            |                            |
| <b>(In thousands)</b>  |                            |
| <b>Current Liabilities</b>   |                            |
| Accounts payable   | \$ 93,839                  |
| Accrued payroll and benefits                                       | 30,083                     |
| Other accrued expenses   | 20,613                     |
| Current portion of exit costs                                      | 8,641                      |
| Current maturities of long-term debt and capital lease obligations | 10,567                     |
| <b>Total current liabilities</b>                                   | <b>163,743</b>             |
| <b>Long-term Liabilities</b>                                       |                            |
| Postretirement benefits  | 7,954                      |
| Other long-term liabilities  | 17,798                     |
| Exit costs   | 23,798                     |
| Long-term debt and capital lease obligations                       | 33,964                     |
| <b>Total long-term liabilities</b>                                 | <b>83,514</b>              |
| <b>Total Subsidiary Liabilities</b>                                | <b>247,257</b>             |
| <b>Operating Leases</b>  | <b>146,485</b>             |
| <b>Total Subsidiary Liabilities and Operating Leases</b>           | <b>\$ 393,742</b>          |

#### *Ratio of Earnings to Fixed Charges*

Our ratio of earnings to fixed charges was 2.65:1.00 and 2.39:1.00 for the third quarter and prior year third quarter, respectively, and 3.36:1.00 and 2.66:1.00 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 \$5.3 million outstanding and unused at January 5, 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 June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" (FIN 48). FIN 48 clarifies the

accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes", and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Further, FIN 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The provisions of FIN 48 are to be applied prospectively. FIN 48 became effective at the beginning of our fiscal year 2008, and the adoption of FIN 48 increased retained earnings by approximately \$1.0 million as of the beginning of fiscal year 2008. The adoption of FIN 48 and its effects are more fully described in Note 11 to the consolidated financial statements for the quarter ended January 5, 2008.

In June 2006, the FASB ratified the consensus reached on Emerging Issues Task Force (EITF) Issue No. 06-03, "How Sales Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That is, Gross Versus Net Presentation)" (EITF 06-03). The EITF reached a consensus that the presentation of taxes on either a gross or net basis is an accounting policy decision that requires disclosure. EITF 06-03 was effective at the beginning of our fiscal 2008 first quarter. An entity is not required to reevaluate its existing policies related to taxes assessed by a governmental authority as a result of this consensus. Amounts collected from members, which under common trade practices are referred to as sales taxes, are and have been recorded on a net basis. We have no intention of modifying this accounting policy; therefore, the adoption of EITF 06-03 did not have any effect on our financial position or results of operations.

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. SFAS 157 will become effective at the beginning of our fiscal year 2009. The provisions of the Statement are to be applied prospectively, except for limited retrospective application permitted for certain items. We are currently evaluating the impact, if any, that SFAS 157 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 required that we recognize the funded status of defined benefit postretirement plans as an asset or liability in the consolidated balance sheet and to recognize changes in funded status through comprehensive income as of March 31, 2007. SFAS 158 also 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 are currently evaluating the impact of changing the measurement date on the consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB No. 115" (SFAS 159). Under SFAS 159, entities may irrevocably elect to measure many financial instruments and certain other items at fair value on an instrument-by-instrument basis, with changes in fair value recognized in earnings each reporting period. SFAS 159 is effective for fiscal years beginning after November 15, 2007. We do not expect to adopt SFAS 159.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), "Business Combinations" (SFAS 141R), which replaces 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 at the beginning of our 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 our future 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.

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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 31, 2007.

**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 31, 2007.

**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 January 5, 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 1A. Risk Factors**

In addition to the risk factors contained in Part I, Item 1A, "Risk Factors," of our Annual Report on Form 10-K for the fiscal year ended March 31, 2007, we have identified the following modification to our risk factors disclosure:

*The accounting treatment of our convertible subordinated notes could change in a manner that has a negative impact on our reported earnings and earnings per share.*

The Financial Accounting Standards Board is considering a proposed staff position that would change the accounting principles that govern our accounting treatment of the convertible subordinated notes. The proposal would, if issued, require us to record interest expense for the notes from time to time in amounts that exceed the amounts we actually pay. Such an increase in our recorded interest expense would result in a decrease in our reported net earnings and earnings per share.

**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 third 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 withheld 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<br>Number of<br>Shares<br>Purchased | Average<br>Price Paid<br>per Share |
|---------------------------------|---|------------------------------------|
| September 16 - October 13, 2007 |   |                                    |
| Employee Transactions           | 1,064                                     | \$ 22.16                           |
| October 14 - November 10, 2007  |   |                                    |
| Employee Transactions           | 15  | \$ 19.92                           |
| November 11 - December 8, 2007  |   |                                    |
| Employee Transactions           | -   | \$ -                               |
| December 9 - January 5, 2008    |   |                                    |
| Employee Transactions           | -   | \$ -                               |

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|   |                             |                             |
|---|-----------------------------|-----------------------------|
|   | <u>                    </u> | <u>                    </u> |
| Total for Third Quarter ended January 5, 2008 | 1,079                       | \$ 22.12                    |
|   | <u>                    </u> | <u>                    </u> |

**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. |
| 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.   |
| 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.   |



**EXHIBIT INDEX**

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