SPARTAN STORES INC
Form 10-Q
February 02, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended December 30, 2006.

OR

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

For the transition period from ____________ to ____________.

Commission File Number: 000-31127

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

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

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

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

Yes X No _

Indicate by check mark whether the registrant is 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 X 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 X

As of January 31, 2007 the registrant had 21,620,517 outstanding shares of common stock, no par value.

FORWARD-LOOKING STATEMENTS

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

In addition to other risks and uncertainties described in connection with the forward-looking statements contained in this Quarterly Report on Form 10-Q, Spartan Stores' Annual Report on Form 10-K for the year ended March 25, 2006 (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 strengthen our retail-store performance; maintain or grow sales; 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; 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, may be adversely affected by unexpected costs associated with, among other factors: difficulties in the operation of our business segments; future business acquisitions; adverse effects on business relationships with independent retail grocery store customers; difficulties in the retention or hiring of employees; labor shortages, stoppages or disputes; business and asset divestitures; increased transportation or fuel costs; current or future lawsuits and administrative proceedings; and losses of, or financial difficulties of, customers or suppliers. Our future costs for pension and postretirement benefit costs may be adversely affected by changes in actuarial assumptions and methods, investment return and the composition of the group of employees and retirees covered, changes in our business that result in a withdrawal liability under multi-employer plans, and the actions and contributions of other employers who participate in multi-employer plans to which we contribute. Our operating and administrative expenses, net earnings and cash flow could also be adversely affected by changes in our sales mix. Our ongoing cost reduction initiatives and changes in our marketing and merchandising programs may not be as successful as we anticipate. Acts of terrorism or war have in the past and may in the future result in considerable economic and political uncertainties that could have adverse effects on consumer buying behavior, fuel costs, shipping and transportation, product imports and other factors affecting our company and the grocery industry generally. Our asset impairment and exit cost provisions are estimates and actual costs may be more or less than these estimates.

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

Our ability to realize increased sales and earnings as a result of our recent acquisition of certain of the assets of D&W Food Centers, Inc. ("D&W") depends on our ability to successfully integrate the acquired assets and implement our plans and business practices. Our ability to identify and realize opportunities to grow through acquisition is not assured and depends on a variety of factors, not all of which are within our control.

Our 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.

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

PART I
FINANCIAL INFORMATION

ITEM 1. **Financial Statements**

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

Assets	December 30, 2006	March 25, 2006
Current assets		
Cash and cash equivalents	$ 13,160	$ 7,655
Accounts receivable, net	43,862	45,280
Inventories, net	118,145	95,892
Prepaid expenses and other current assets	7,875	5,433
Deferred taxes on income	8,689	6,801
Property and equipment held for sale	3,418	6,634
Total current assets	195,149	167,695
Other assets		
Goodwill	142,440	72,555
Deferred taxes on income	-	9,061
Other, net	16,899	14,108
Total other assets	159,339	95,724
Property and equipment, net	141,311	115,178
Total assets	$ 495,799	$ 378,597
Liabilities and Shareholders' Equity		
Current liabilities		
Accounts payable	$ 96,411	$ 90,992
Accrued payroll and benefits	31,008	29,423
Other accrued expenses	21,130	18,356
Current portion of exit costs	8,111	6,513
Current maturities of long-term debt and capital lease obligations	5,216	1,675
Total current liabilities	161,876	146,959
Long-term liabilities		
Postretirement benefits	8,081	8,702

Other long-term liabilities	11,767	4,700
Exit costs	26,053	8,804
Long-term debt and capital lease obligations	122,822	64,015
Total long-term liabilities	168,723	86,221
Shareholders' equity		
Common stock, voting, no par value; 50,000 shares authorized; 21,616 and 21,023 shares outstanding	125,468	123,256
Preferred stock, no par value, 10,000 shares authorized; no shares outstanding	-	-
Deferred stock-based compensation	-	(2,873)
Accumulated other comprehensive loss	(276)	(276)
Retained earnings	40,008	25,310
Total shareholders' equity	165,200	145,417
Total liabilities and shareholders' equity	$ 495,799	$ 378,597

See accompanying notes to condensed consolidated financial statements.

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

	16 Weeks Ended		40 Weeks Ended	
	December 30, 2006	**December 31, 2005**	**December 30, 2006**	**December 31, 2005**
Net sales	$ 723,547	$ 642,274	$ 1,810,947	$ 1,587,135
Cost of sales	586,320	526,530	1,458,245	1,292,038
Gross margin	137,227	115,744	352,702	295,097
Operating expenses				
Selling, general and administrative expenses	124,074	106,712	310,798	267,591
Provision for asset impairments and exit costs	-	787	4,464	1,057
Total operating expenses	124,074	107,499	315,262	268,648
Operating earnings	13,153	8,245	37,440	26,449
Other income and expenses				
Interest expense	3,920	2,538	9,729	6,070
Other, net	(27)	(1,414)	(113)	(1,506)
Total other income and expenses	3,893	1,124	9,616	4,564
Earnings before income taxes and discontinued operations	9,260	7,121	27,824	21,885
Income taxes	3,208	2,351	9,706	7,232
Earnings from continuing operations	6,052	4,770	18,118	14,653
Loss from discontinued operations, net of taxes	(158)	(1,413)	(201)	(1,791)
Net earnings	$ 5,894	$ 3,357	$ 17,917	$ 12,862
Basic earnings (loss) per share:				
Earnings from continuing operations	$ 0.29	$ 0.23	$ 0.87	$ 0.71
Loss from discontinued operations	(0.01)	(0.07)	(0.01)	(0.09)
Net earnings	$ 0.28	$ 0.16	$ 0.86	$ 0.62
Diluted earnings (loss) per share:				

Earnings from continuing operations	$ 0.28	$ 0.22	$ 0.85	$ 0.69
Loss from discontinued operations	(0.01)	(0.06)	(0.01)	(0.09)
Net earnings	$ 0.27	$ 0.16	$ 0.84	$ 0.60
Weighted average shares outstanding:				
Basic	21,014	20,812	20,859	20,758
Diluted	21,455	21,321	21,260	21,330

See accompanying notes to condensed consolidated financial statements.

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

	Shares Outstanding	Common Stock	Deferred Stock-Based Compensation	Accumulated Other Comprehensive Loss	Retained Earnings	Total
Balance - March 26, 2006	21,023	$ 123,256	$ (2,873)	$ (276)	$ 25,310	$ 145,417
Reclassification of deferred stock-based compensation upon adoption of SFAS 123(R)	-	(2,873)	2,873	-	-	-
Comprehensive income, net of tax:						
Net earnings	-	-	-	-	17,917	17,917
Dividends - $.15 per share	-	-	-	-	(3,219)	(3,219)
Stock-based employee compensation	-	1,492	-	-	-	1,492
Issuances of common stock and related tax benefit on stock option exercises	387	3,743	-	-	-	3,743
Issuances of restricted stock and related income tax benefit	268	228	-	-	-	228
Cancellations of restricted stock	(62)	(378)	-	-	-	(378)
Balance - December 30, 2006	21,616	$ 125,468	$ -	$ (276)	$ 40,008	$ 165,200

See accompanying notes to condensed consolidated financial statements.

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

	40 Weeks Ended	
	December 30, 2006	**December 31, 2005**
Cash flows from operating activities		
Net earnings	$ 17,917	$ 12,862
Loss from discontinued operations	201	1,791
Earnings from continuing operations	18,118	14,653
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Provision for asset impairments and exit costs	4,464	1,057
Depreciation and amortization	16,712	16,089
Postretirement benefits expense	1,909	1,855
Deferred taxes on income	8,827	6,665
Stock-based compensation expense	1,481	601
(Gain) loss on sale of assets	254	(1,218)
Other	-	368
Changes in operating assets and liabilities:		
Accounts receivable	942	2,332
Inventories	(16,154)	(8,016)
Prepaid expenses and other assets	(1,143)	916
Accounts payable	5,904	4,826
Accrued payroll and benefits	691	(3,379)
Postretirement benefits payments	(2,982)	(2,753)
Other accrued expenses and other liabilities	(2,087)	(822)
Net cash provided by operating activities	36,936	33,174
Cash flows from investing activities		
Purchases of property and equipment	(20,414)	(16,975)
Net proceeds from the sale of assets	468	2,324
Acquisitions, net of cash acquired	(53,600)	-
Other	245	(114)
Net cash used in investing activities	(73,301)	(14,765)
Cash flows from financing activities		
Net proceeds from (payments on) revolving credit facility	43,131	(15,975)
Repayment of long-term debt	(1,727)	(1,882)
Proceeds from sale of common stock	2,944	317
Dividends paid	(3,219)	-
Net cash provided by (used in) financing activities	41,129	(17,540)

Cash flows from discontinued operations (Revised - See note 1)		
Net cash used in operating activities	(2,401)	(3,458)
Net cash provided by investing activities	3,142	-
Net cash used in financing activities	-	(509)
Net cash provided by (used in) discontinued operations	741	(3,967)
Net increase (decrease) in cash and cash equivalents	5,505	(3,098)
Cash and cash equivalents at beginning of period	7,655	14,880
Cash and cash equivalents at end of period	$ 13,160	$ 11,782

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 December 30, 2006 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.

Revision
In fiscal 2007 the operating, investing and financing portions of the cash flows attributable to discontinued operations have been separately disclosed, which in prior periods were reported on a combined basis as a single amount.

Reclassifications
Certain reclassifications have been made to the fiscal 2006 condensed consolidated financial statements to conform to the fiscal 2007 presentation.

Note 2
New Accounting Standards

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 123(R), "Share-Based Payment", that addresses the accounting for share-based payments to employees, including grants of employee stock options and other forms of share-based compensation. Under SFAS No. 123(R), it is no longer acceptable to account for share-based payments to employees using the intrinsic value method in accordance with the provisions of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees". Instead, SFAS No. 123(R) 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. SFAS No. 123(R) became effective for Spartan Stores at the beginning of fiscal 2007. The adoption of SFAS No. 123(R) and its effects are more fully described in Note 9, Stock-Based Compensation.

In June 2006, the 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 is effective for Spartan Stores' at the beginning of fiscal year 2008. Spartan Stores is currently evaluating the impact of FIN 48 on its financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements". SFAS No. 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and states that a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. SFAS No. 157 will become effective for Spartan Stores at the beginning of fiscal 2009. 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 No. 157 will have on its 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 No. 87, 88, 106 and 132(R)", effective for public companies for fiscal years ending after December 15, 2006. SFAS No. 158 requires employers that sponsor a defined benefit postretirement plan to recognize the overfunded or underfunded status of defined benefit postretirement plans, including pension plans, in their balance sheets and to recognize changes in funded status through comprehensive income in the year in which the changes occur. This aspect of SFAS No. 158 is effective for Spartan Stores' current fiscal year ending March 31, 2007. Spartan Stores is awaiting the completion of its actuarial valuation to determine the impact of this aspect of SFAS No. 158 on its financial statements. The Statement 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 this aspect of SFAS No. 158 on its financial statements.

In September 2006, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). SAB 108 provides interpretive guidance on how the effects of prior year uncorrected misstatements should be considered when quantifying misstatements in current year financial statements for the purpose of a materiality assessment. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. SAB 108 is effective for Spartan Stores' annual financial statements for the current fiscal year ending March 31, 2007. Spartan Stores does not expect that the adoption of SAB 108 will have a material impact on its financial statements.

Note 3
Acquisitions of Assets

On March 27, 2006, Spartan Stores acquired certain operating assets of D&W Food Centers, Inc. and D&W Associate Resources, LLC (together "D&W"), a privately-held Grand Rapids, Michigan-based retail grocery operator with retail stores located in West Michigan. The acquisition was made to obtain the store locations and operations of D&W, to diversify our retail offering with a more perishable oriented operation, to solidify and grow market share and to realize numerous synergies. The purchased assets included leasehold improvements, fixtures, tangible personal property, equipment, trademarks, trade names, intangible property and inventories. Spartan Stores paid a total cash purchase price of $47.9 million for these operations. Spartan Stores assumed D&W's lease obligations for the 20 stores and the central commissary as well as specified contracts. Spartan Stores continues to operate 16 of the former D&W stores and the commissary. The funds used for the transaction were drawn under Spartan Stores' existing bank credit facilities. Additional information regarding the acquisition of D&W is included in Spartan Stores' Annual Report on Form 10-K for the year ended March 25, 2006.

Pro forma financial information

The following pro forma financial information illustrates estimated results of operations for the 16 weeks and 40 weeks ended December 31, 2005 after giving effect to the acquisition of D&W described above at the beginning of the period presented. The pro forma results are presented for comparative purposes only and do not purport to be indicative of results that would have actually been reported had the acquisition taken place on the date assumed, or to project Spartan Stores' results of operations which may be reported in the future.

(In thousands, except per share amounts)

	16 Weeks Ended Dec. 31, 2005		40 Weeks Ended Dec. 31, 2005	
Net sales	$	705,118	$	1,745,601
Earnings from continuing operations	$	4,826	$	16,216
Earnings from continuing operations per share:				
Basic	$	0.23	$	0.78
Diluted	$	0.23	$	0.76
Weighted average shares outstanding:				
Basic		20,812		20,758
Diluted		21,321		21,330

In the first quarter of fiscal 2007, Spartan Stores incurred approximately $1.1 million, $0.7 million after tax, in start-up costs related to training, remerchandising and rebranding the stores. These charges are included in "Selling, general and administrative expenses".

During the third quarter of fiscal 2007, Spartan Stores acquired certain equipment at five closed grocery stores from Carter's Inc. in a Chapter 7 federal bankruptcy liquidation proceeding. Store lease obligations were assumed for two of the store locations. The stores will remain closed. The acquisition was made to increase market share of existing retail stores. Spartan Stores also acquired certain operating assets and assumed certain liabilities of a subsidiary of PrairieStone Pharmacy, LLC that were used in the operations of in-store pharmacies in 12 of Spartan Stores' retail grocery stores. The acquisition was made to allow us to better coordinate in-store operations and improve our overall customer service at these locations. For the two acquisitions, Spartan Stores paid a cash purchase price of $5.4 million. The funds used for the transaction were drawn under Spartan Stores' existing bank credit facilities. The estimated fair value of assets acquired consisted of $1.6 million for inventory, $0.6 million for equipment $2.9 million for customer lists and $1.1 million for goodwill and liabilities assumed consisted of $0.6 million for lease obligations and $0.2 million for accrued expenses. Goodwill of $1.0 million and $0.1 million was assigned to the Retail and Distribution segments, respectively, based upon the expected benefits to be derived from the business combination. Goodwill of $1.1 million is expected to be deductible for tax purposes. Spartan Stores is also committed to purchasing the real estate of one store for $0.6 million, subject to certain contractual conditions being met.

Note 4
Goodwill and Other Intangible Assets

Changes in the carrying amount of goodwill were as follows:

(In thousands)	Retail	Distribution	Total
Balance at March 25, 2006	$ 42,209	$ 30,346	$ 72,555
D&W acquisition	45,564	23,116	68,680
Carter's Inc. and PrairieStone acquisitions	1,068	137	1,205
Balance at December 30, 2006	$ 88,841	$ 53,599	$ 142,440

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

(In thousands)	December 30, 2006		March 25, 2006	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Non-compete agreements	$ 4,432	$ 2,361	$ 4,277	$ 2,054
Favorable leases	4,025	1,587	2,660	