

WILD OATS MARKETS INC
Form 10-Q
November 04, 2004
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR SECTION 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 25, 2004

OR

() TRANSITION REPORT PURSUANT TO SECTION 13 OR SECTION 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM _____ TO _____

Commission file number 0-21577

WILD OATS MARKETS, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of

84-1100630

(I.R.S. Employer Identification Number)

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Incorporation or organization)

3375 Mitchell Lane

Boulder, Colorado 80301

(Address of principal executive offices, including zip code)

(303) 440-5220

(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 an accelerated filer (as defined in Exchange Act Rule 12b-2):

Yes No

As of November 1, 2004, there were 28,484,901 shares outstanding of the Registrant's Common Stock (par value \$.001 per share).

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

WILD OATS MARKETS, INC.

Consolidated Balance Sheets

(in thousands, except share data)

September 25,	December 27,
2004	2003

(unaudited)

ASSETS

Current assets:

Cash and cash equivalents	\$ 28,068	\$ 17,400
Short term investments	26,299	-
Inventories, net of reserves	53,059	46,621
Accounts receivable, net of allowance for doubtful accounts	2,701	4,038
Income tax receivable	81	261
Prepaid expenses and other current assets	1,202	2,192
Deferred tax asset	8,106	6,340
	<hr/>	<hr/>
Total current assets	119,516	76,852
Property and equipment, net	151,659	130,989
Goodwill, net	106,084	106,404
Other intangible assets, net	6,692	6,976
Deposits and other assets	6,341	2,932
Deferred tax asset	12,608	12,438
	<hr/>	<hr/>
	\$ 402,900	\$ 336,591
	<hr/>	<hr/>

LIABILITIES AND STOCKHOLDERS EQUITY

Current liabilities:

Accounts payable	\$ 55,835	\$ 47,529
Book overdraft	21,534	26,727
Accrued liabilities	45,731	42,998

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Current portion of capital leases	27	14
	<hr/>	<hr/>
Total current liabilities	123,127	117,268
Long-term debt and capital leases	115,190	30,179
Other long-term obligations	13,674	14,058
Total liabilities	251,991	161,505
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.001 par value; 5,000,000 shares authorized, no shares issued and outstanding	-	-
Common stock, \$0.001 par value; 60,000,000 shares authorized, 30,462,534 and 30,063,421 shares issued, respectively	30	30
Treasury stock, at cost: 1,977,800 shares as of		
September 25, 2004	(24,999)	-
Additional paid-in capital	221,878	217,400
Note receivable, related party	(11,262)	(10,815)
Accumulated deficit	(35,122)	(31,777)
Accumulated other comprehensive income	384	248
	<hr/>	<hr/>
Total stockholders' equity	150,909	175,086
	<hr/>	<hr/>
	\$ 402,900	\$ 336,591
	<hr/>	<hr/>

The accompanying notes are an integral part of the consolidated financial statements.

WILD OATS MARKETS, INC.**Consolidated Statements of Operations***(in thousands, except per-share data) (unaudited)*

	THREE MONTHS ENDED		NINE MONTHS ENDED	
	Sept 25, 2004	Sept 27, 2003	Sept 25, 2004	Sept 27, 2003
Sales	\$ 250,739	\$ 237,028	\$ 766,231	\$ 715,263
Cost of goods sold and occupancy costs	181,864	168,158	547,070	504,312
Gross profit	68,875	68,870	219,161	210,951
Operating expenses:				
Direct store expenses	57,898	53,114	171,212	154,305
Selling, general and administrative expenses	15,517	15,472	45,456	48,246
Loss on disposal of assets	192	661	170	2,029
Pre-opening expenses	1,399	616	3,500	1,639
Restructuring and asset impairment charges (income), net	2,124	134	2,289	(1,747)
(Loss) income from operations	(8,255)	(1,127)	(3,466)	6,479

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Loss on early extinguishment of debt	-	-	-	(186)
Interest income	370	199	778	554
Interest expense	(1,179)	(484)	(1,986)	(2,319)
	_____	_____	_____	_____
(Loss) income before income taxes	(9,064)	(1,412)	(4,674)	4,528
Income tax (benefit) expense	(2,999)	(551)	(1,329)	1,766
	_____	_____	_____	_____
Net (loss) income	\$ (6,065)	\$ (861)	\$ (3,345)	\$ 2,762
	_____	_____	_____	_____
Net (loss) income per common share:				
Basic	\$ (0.21)	\$ (0.03)	\$ (0.11)	\$ 0.09
Diluted	\$ (0.21)	\$ (0.03)	\$ (0.11)	\$ 0.09
Weighted average common shares outstanding, basic	28,458	29,898	29,480	29,792
Dilutive effect of stock options and restricted stock units	-	-	-	377
	_____	_____	_____	_____
Weighted average common shares outstanding, assuming dilution	28,458	29,898	29,480	30,169
	_____	_____	_____	_____

The accompanying notes are an integral part of the consolidated financial statements.

WILD OATS MARKETS, INC.

Consolidated Statements of Comprehensive (Loss) Income

(in thousands) (unaudited)

	THREE MONTHS ENDED		NINE MONTHS ENDED	
	Sept 25, 2004	Sept 27, 2003	Sept 25, 2004	Sept 27, 2003
Net (loss) income	\$ (6,065)	\$ (861)	\$ (3,345)	\$ 2,762
Other comprehensive income (loss):				
Foreign currency translation adjustments arising during the period	346	80	127	568
Unrealized gain on available-for-sale securities, net of tax of \$5 and \$5, respectively	7	-	7	-
Recognition of hedge results to interest expense during the period, net of tax of \$51 and \$367, respectively	-	85	-	613
Change in market value of cash flow hedge during the period, net of tax of \$12	-	-	-	(20)
Other comprehensive income	353	165	134	1,161
Comprehensive (loss) income	\$ (5,712)	\$ (696)	\$ (3,211)	\$ 3,923

WILD OATS MARKETS, INC.**Consolidated Statements of Cash Flows***(in thousands) (unaudited)***NINE MONTHS ENDED**

Sept 25, 2004	Sept 27, 2003
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CASH FLOWS FROM OPERATING ACTIVITIES

Net (loss) income	\$ (3,345)	\$ 2,762
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	18,745	16,764
Loss on disposal of property and equipment	170	2,029
Deferred tax (benefit) expense	(1,927)	1,396
Non-cash restructuring and asset impairment expense (income), net	2,251	(1,747)
Income tax benefit of employee stock option exercises	445	239
Other	(447)	79
Change in assets and liabilities:		
Inventories, net	(6,630)	1,500
Receivables, net, and other assets	3,308	533
Accounts payable	10,930	5,698
Accrued liabilities	1,068	(3,051)

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Net cash provided by operating activities	24,568	26,202
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CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(42,980)	(22,070)
Purchase of short term investments	(26,287)	-
Proceeds from sale of property and equipment	988	326
	<hr/>	<hr/>
Net cash used in investing activities	(68,279)	(21,744)
	<hr/>	<hr/>
CASH FLOWS FROM FINANCING ACTIVITIES		
Net repayments under line-of-credit agreement	(30,179)	(6,700)
Net decrease in book overdraft	(5,215)	(489)
Repayments on long-term debt and capital leases	(50)	(37,102)
Proceeds from long term debt	115,150	37,879
Purchase of treasury stock	(24,999)	-
Payment of debt issuance costs	(3,866)	(721)
Proceeds from issuance of common stock, net	3,370	2,455
	<hr/>	<hr/>
Net cash provided by (used in) financing activities	54,211	(4,678)
	<hr/>	<hr/>
Effect of exchange rate changes on cash	168	64
	<hr/>	<hr/>
Net increase (decrease) in cash and cash equivalents	10,668	(156)
Cash and cash equivalents at beginning of period	17,400	11,367

	_____	_____
Cash and cash equivalents at end of period	\$ 28,068	\$ 11,211
	_____	_____

SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING:

Equipment acquired through capital lease	\$ 105

The accompanying notes are an integral part of the consolidated financial statements.

WILD OATS MARKETS, INC.

Notes to Consolidated Financial Statements

(unaudited)

1. Nature of Operations and Basis of Presentation

Wild Oats Markets, Inc. ("Wild Oats" or the "Company"), headquartered in Boulder, Colorado, owns and operates natural and organic foods supermarkets in the United States and Canada. The Company also operates bakeries, commissary kitchens and a distribution center that supply the stores. The Company's operations are concentrated in one market segment, grocery stores, and are geographically concentrated in the western and central parts of the United States.

The consolidated balance sheet as of September 25, 2004, the consolidated statements of operations and comprehensive (loss) income for the three months and nine months ended September 25, 2004 and September 27, 2003, as well as the consolidated statements of cash flows for the nine months ended September 25, 2004 and September 27, 2003 have been prepared without an audit. In the opinion of management, all adjustments, consisting only of normal, recurring adjustments necessary for a fair statement thereof, have been made.

The financial statements have been prepared by the Company in accordance with the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to SEC regulations, therefore, these consolidated financial statements should be read in conjunction with financial statements and notes thereto included in the Company's 2003 Annual Report on Form 10-K. The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, expenses and related disclosures of contingent assets and liabilities. Examples include accounting for self-insurance reserves, restructuring charges and store closing costs, asset impairment charges, goodwill, inventory valuation, and

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contingencies. Actual results may differ from these estimates. The results of operations for interim periods presented are not necessarily indicative of the operating results for the full year.

Certain prior period information has been reclassified to conform to the current presentation.

The unaudited information included in the consolidated financial statements for the three months and nine months ended September 25, 2004 and September 27, 2003 include the results of operations of the Company for the 13 weeks and 39 weeks then ended.

2. Short-Term Investment Policy

The amortized cost of debt securities in this category is adjusted for amortization of premiums and accretion of discounts to maturity computed under the effective interest method. Such amortization is included in investment income. Realized gains and losses and declines in value judged to be other-than-temporary on available-for-sale securities are included in investment income. The cost of securities sold is based on the specific identification method. Interest and dividends on securities classified as available-for-sale are included in investment income.

3. Stock-Based Compensation

At September 25, 2004, the Company had six stock-based employee compensation plans, which are described more fully in *Note 9 Stock Plans and Options* in our fiscal 2003 Annual Report filed on Form 10-K for the period ended December 27, 2003. These plans allow for awards of both stock options and restricted stock units ("RSUs"). The Company accounts for those plans in accordance with the intrinsic value based method in APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. Some stock-based compensation expense is reflected in net income for options issued at a discount and for RSUs issued as Board of Directors' compensation. All other options granted under the plans had an exercise price equal to the market value of the underlying common stock on the date of grant; therefore, no stock-based compensation expense is reflected in net income for these grants. Also reflected in results of operations for the fiscal years to date ended September 25, 2003, and September 27, 2004, respectively, is compensation expense of \$315,000 and \$182,000, respectively, relating to the extension of the option exercise period beyond Company-imposed blackout periods for previously granted stock options held by retiring members of the Board of Directors.

As required by Financial Accounting Standards Board Statement Nos. 123, *Accounting for Stock-Based Compensation ("SFAS 123")*, and 148, *Accounting for Stock-Based Compensation-Transition and Disclosure ("SFAS 148")*, the following table illustrates the effect on net income and earnings per share if stock-based compensation costs were to be calculated based on the fair value of the options granted and recognized ratably over the vesting period as prescribed in SFAS No. 123 (in thousands):

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	THREE MONTHS ENDED		NINE MONTHS ENDED	
	Sept 25, 2004	Sept 27, 2003	Sept 25, 2004	Sept 27, 2003
Net (loss) income, as reported	\$ (6,065)	\$ (861)	\$ (3,345)	\$ 2,762
Add: Stock-based compensation expense included in reported net income, net of tax	78	24	414	179
Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of tax	(286)	(727)	(1,776)	(2,136)
Pro forma net income (loss)	\$ (6,273)	\$ (1,564)	\$ (4,707)	\$ 805
Earnings (loss) per share:				
Basic as reported	\$ (0.21)	\$ (0.03)	\$ (0.11)	\$ 0.09
Basic pro forma	\$ (0.22)	\$ (0.05)	\$ (0.16)	\$ 0.03
Diluted as reported	\$ (0.21)	\$ (0.03)	\$ (0.11)	\$ 0.09
Diluted - pro forma	\$ (0.22)	\$ (0.05)	\$ (0.16)	\$ 0.03

In March 2004, the Financial Accounting Standards Board ("FASB") issued a proposed Statement, *Share-Based Payment*, which would be an amendment to SFAS 123. This proposed standard would require share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values, and would eliminate the Company's ability to continue accounting for share-based compensation transactions using the intrinsic method in APB Opinion No. 25. The FASB expects to issue a final standard late in 2004, which would be effective for the Company's third quarter of fiscal year 2005 reporting period. Wild Oats has not yet determined to what degree this proposed standard will impact its future earnings and earnings per share.

4. Property and Equipment

As a result of the significant store closings, remodels and resets, the Company undertook a review of all fixtures and equipment in its stores in fiscal 2003, including a physical inventory in conjunction with an asset tagging exercise. During the first quarter of fiscal 2003, the Company substantially completed the review and recorded a \$1.5 million loss on disposal of fixtures and equipment that will no longer be used in the stores. In the third quarter of fiscal 2003, a physical count of all office and support facility capital assets was completed, and a \$559,000 loss on disposal was recorded.

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5. Long Term Debt and Liquidity

Contingent Convertible Senior Debentures. In June 2004, the Company issued \$115 million aggregate principal amount of its 3.25% Convertible Senior Debentures due May 15, 2034 in a private placement. The debentures bear regular interest at the annual rate of 3.25%, payable semiannually on May 15 and November 15 of each year until May 15, 2011, after which date, no regular interest will be due. Commencing May 20, 2011 and ending November 14, 2011, and for any six-month period thereafter, contingent interest will be due and payable in the amount of 0.25% of the average trading price of the debentures during a specified period, if the average trading price of the debentures equals or exceeds 125% of the principal amount of the debentures.

The debentures are callable and convertible into the Company's common stock prior to maturity at the option of the holders under the following circumstances: (1) during any calendar quarter commencing after June 30, 2004 and before March 31, 2029, if the last reported sale price of our common stock is greater than or equal to 130% of the conversion price of \$17.70 per share; (2) at any time on or after April 1, 2029 if the last reported sale price of our common stock on any date on or after March 31, 2029 is greater than or equal to 130% of the conversion price; (3) subject to certain limitations, during the five business-day period after any five consecutive trading-day period in which the trading price per debenture for each day of that period was less than 98% of the product of the conversion rate and the last reported sale price of the Company's common stock; (4) if the Company calls the debentures for redemption; (5) upon the occurrence of certain corporate transactions; or (6) if the Company obtains credit ratings for the debentures, at any time when the credit ratings assigned to the debentures are below specified levels. The debentures are initially convertible into 56.5099 shares of the Company's common stock per \$1,000 principal amount, which is equivalent to \$17.70 per share, for total initial underlying shares of 6,498,639. Upon conversion, the Company has the right to deliver, in lieu of common stock, cash or any combination of cash and common stock. Pursuant to the underwriting agreement and within 90 days of issuance, the Company intends to file a shelf registration statement covering resales of the debentures and the common stock issuable upon conversion thereof.

On or after May 20, 2011, the Company may redeem for cash some or all of the debentures at any time and from time to time, for a price equal to 100% of the principal amount of the debentures plus accrued and unpaid contingent interest, if any. Holders have the right to require the Company to repurchase any or all debentures for cash, at a repurchase price equal to 100% of the principal amount of the debentures, plus accrued and unpaid interest on: (1) May 15, 2011, May 15, 2014, and May 15, 2024; and (2) the occurrence of change in control (as defined in the debenture).

The debentures are unsecured and un-subordinated obligations, and rank equal in priority with all of the Company's existing and future unsecured and un-subordinated indebtedness and senior in right of payment to all of its subordinated indebtedness. The debentures will effectively rank junior to any of the Company's secured indebtedness and any of its indebtedness that is guaranteed by its subsidiaries. Payment of principal and interest on the debentures will be structurally subordinated to the liabilities of the Company's subsidiaries.

Total proceeds from the issuance were \$115.2 million. The Company used \$25.0 million of the net proceeds to repurchase 1,977,800 outstanding shares of its common stock, \$31.2 million to pay the outstanding balance on its credit facility, and approximately \$3.6 million to pay related debt issuance costs.

Credit Facility. The Company's credit facility has a \$95.0 million limit, and a three-year term with a one-year renewal option. Under the credit facility, the Company has the option to increase the total facility to \$135.0 million through the addition of new lenders and through the agreement of the current lending group to increase their total commitments.

As part of the credit facility, the Company has given its lenders collateral in the form of cash, equipment and fixtures, inventory and other assets. The Company has also granted leasehold mortgages in those leasehold interests previously mortgaged to secure its former credit facility, although it has no obligation to provide a security interest in any new leaseholds. There are various financial covenants included as part of the original credit agreement which are as follows: (1) maximum allowable leverage ratio, (2) minimum fixed charge coverage ratio, (3) maximum allowable annual capital expenditures and (4) a minimum permitted stockholders' equity balance. Amendments to the credit agreement have been made during 2004 to (a) modify the adjusted leverage and the fixed charge ratios, (b) increase the maximum interest rate, and (c) require the Company to maintain through June 2005 minimum cash and cash equivalents balances (as defined per the agreement) of \$25 million, net of letters of credit and outstanding borrowings under the credit facility, with the minimum required balances decreasing to \$10 million beginning July 2005 and continuing through the remaining term of the agreement.

The interest rate on the facility is currently either prime plus 1.0% or one-month LIBOR plus 2.75% at the Company's election, and the rates modify depending on the ratio of average total funded debt, as defined under the credit facility, plus six times rent expense, to earnings before interest, taxes, depreciation, amortization and rent ("EBITDAR") for the four fiscal quarter periods then ended, as calculated on the Company's quarterly compliance certificate. Additionally, the Company is charged a commitment fee on the unused portion of the line ranging from 0.625% to 0.75% based on performance objectives as defined in the credit agreement. The outstanding balance on the credit facility, other than for outstanding letters of credit, was repaid in June 2004 from the proceeds of the private debt issuance. There is no outstanding credit facility balance as of September 25, 2004. The balance outstanding, other than outstanding letters of credit, on the credit facility as of