



# Edgar Filing: FLEMING COMPANIES INC /OK/ - Form 10-Q/A

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SIGNATURE

### PART I. FINANCIAL INFORMATION

#### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

##### GENERAL

Concurrent with the completion of the Core-Mark International, Inc. acquisition on June 18, 2002, we entered into a \$975 million credit agreement consisting of a \$425 million tranche B term loan and a \$550 million revolving credit facility. We also sold \$200 million aggregate principal amount of 9 1/4% senior notes due 2010 and 9.2 million shares of common stock at \$19.40 per share. In connection with the consummation of these transactions, we repaid all borrowings outstanding under our \$850 million credit agreement. Our results of operations included the results of Core-Mark from the date of acquisition.

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In April 2002, we acquired Head Distributing Company, an Atlanta, Georgia based piece-pick distributor. Our results of operations included the results of Head Distributing from the date of acquisition. Also, in June 2002, we purchased inventory and other personal property from Albertson's Inc. located at its Tulsa, Oklahoma distribution center and entered into an operating lease of this distribution center.

We recorded net income for the 12 and 28 weeks ended July 13, 2002 of \$2 million and \$27 million, respectively. EBITDAL for the 12 and 28 weeks ended July 13, 2002 was \$94 million and \$231 million, respectively.

The following table sets forth the calculation of EBITDAL (in millions):

	12 WEEKS ENDED		28 WEEKS ENDED	
	JULY 13, 2002	JULY 14, 2001	JULY 13, 2002	JULY 14, 2001
	-----	-----	-----	-----
Income before				
extraordinary charge	\$ 10	\$ (13)	\$ 35	\$ 2
Add back:				
Taxes on income	5	(9)	22	3
Depreciation/amortization	36	37	82	87
Interest expense	43	34	93	92
LIFO adjustments	--	(2)	(1)	(1)
	-----	-----	-----	-----
EBITDAL	\$ 94 (a)	\$ 47	\$ 231 (a)	\$ 183

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- (a) Includes a \$27 million charge in the second quarter of 2002 related to the closure of two distribution facilities and integration costs related to recent acquisitions.
- (b) Includes \$27 million generated in the first quarter of 2001 by our divested conventional retail stores.

EBITDAL is earnings before extraordinary items, interest expense, income taxes, depreciation and amortization, equity investment results and LIFO provision. We present EBITDAL to help us describe our ability to generate cash flows that can be used to service our debt; however, conditions may require conservation of funds for other uses. EBITDAL is a non-GAAP liquidity measure commonly used in our industry and should not be considered as an alternative measure of our net income or cash flows from operations as computed in accordance with GAAP. Amounts presented may not be comparable to similar measures disclosed by other companies.

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RESULTS OF OPERATIONS

Set forth in the following table is information regarding our net sales and certain components of earnings expressed as a percent of sales which are referred to in the accompanying discussion:

FOR THE 12 WEEKS ENDED	JULY 13, 2002	JULY 14, 2001
	-----	-----
Net sales	100.00%	100.00%
Gross margin	7.12	7.64
Less:		
Selling and administrative	5.14	6.13
Interest expense	1.09	1.00
Interest income and other	(0.20)	(0.18)
Impairment/restructuring credit	0.70	--
Litigation charges	--	1.35
	-----	-----
Total expenses	6.73	8.30
	-----	-----
Income (loss) before taxes	0.39	(0.66)
Taxes on income (loss)	0.13	(0.27)
	-----	-----
Income (loss) before extraordinary charge	0.26	(0.39)
Extraordinary charge from early retirement of debt, net of taxes	(0.20)	--
	-----	-----

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Net income (loss) 0.06% (0.39)%

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FOR THE 28 WEEKS ENDED	JULY 13, 2002	JULY 14, 2001
	-----	-----
Net sales	100.00%	100.00%
Gross margin	7.19	8.30
Less:		
Selling and administrative	5.31	6.94
Interest expense	1.08	1.21
Interest income and other	(0.17)	(0.20)
Impairment/restructuring credit	0.32	(0.35)
Litigation charges	--	0.64
	-----	-----
Total expenses	6.54	8.24
	-----	-----
Income before taxes	0.65	0.06
Taxes on income	0.25	0.03
	-----	-----
Income before extraordinary charge	0.40	0.03
Extraordinary charge from early retirement of debt, net of taxes	(0.09)	(0.05)
	-----	-----
Net income (loss)	0.31%	(0.02)%

Included in amounts reported under generally accepted accounting principles (GAAP) for 2001 are charges (credits) related to our strategic plan and certain other unusual items that affect the year-to-year comparisons of operating results (see Impairment/restructuring charge). 2002 amounts are reported in accordance with GAAP. The comparisons below are shown on a GAAP versus GAAP basis.

NET SALES.

Net sales for the 12 weeks ended July 13, 2002, increased by \$484 million, or 14.1%, to \$3.9 billion from the same period in 2001. Year to date, net sales increased by \$1.03 billion, or 13.6%, to \$8.6 billion from the same period in 2001.

Net sales for the distribution segment increased by 16.4% for the second quarter of 2002 and 19.3% year to date. The net growth in 2002 was mainly a result of increased activity with Kmart, our largest customer. Kmart accounted for 20% and 15% of our total net sales during the second quarter of 2002 and 2001, respectively, and 21% and 13% for the first two quarters of 2002 and 2001, respectively. Furthermore, Kmart accounted for 51% and 73% of the growth in net sales for the distribution segment for the 12 and 28 weeks ended July 13, 2002,

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respectively. Additionally, growth in distribution sales from a wide variety of new-channel and conventional customers attributed to the increased second quarter sales. New-channel customers, including convenience stores, supercenters, limited assortment stores, drug stores, and self-distributing chains, are an important part of our strategic growth plan and collectively

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represent approximately one-half of our distribution customer sales base. Core-Mark had approximately four weeks of sales included in distribution results.

Retail segment sales for the second quarter of 2002 increased 0.8% and decreased year to date by 12.6% compared to the same periods in 2001. The decrease year to date was due to the disposition of non-strategic conventional retail stores in the first two quarters of 2001 in order to increase focus on our price impact retail stores. Relatively flat sales for the second quarter were also affected by the disposition of conventional retail stores in the first two quarters of 2001, but the loss of sales from those stores was more than offset by new price impact stores added in the first two quarters of 2002. Comparable store sales decreased 4.7% for the quarter. The decline in comparable store sales reflects a number of factors, including stores undergoing remodels, deflationary prices in the meat category and heightened competition. As such, we are evaluating our strategic alternatives related to our price-impact retail stores and anticipate this evaluation to conclude during the third quarter of 2002.

### GROSS MARGIN.

Gross margin for the 12 and 28 weeks ended July 13, 2002 decreased as a percentage of net sales to 7.12% and 7.19%, respectively, from 7.64% and 8.30%, respectively, for the same periods in 2001. The decrease in gross margin rate was an expected result of the change in sales mix. The sales of the distribution segment represent a larger portion of total company sales than the retail segment and the distribution segment has lower margins as a percentage of sales versus the retail segment.

For the distribution segment, gross margin as a percentage of gross distribution sales declined by 20 and 32 basis points for the 12 and 28 weeks ended July 13, 2002, respectively, compared to the same periods in 2001. This reflects the increase in Kmart business, which is lower margin, offset by the benefits of centralizing procurement. For the retail segment, gross margin as a percentage of net retail sales increased for the second quarter of 2002 by 65 basis points, compared to the same period in 2001 but decreased year to date by 34 basis points compared to the same period in 2001. Consistent with the sales variances, the decreasing margin year to date reflects our transition out of non-strategic conventional retail and into price impact retail which has lower shelf prices and gross margins but also lower operating costs. The increasing margin for the second quarter of 2002 reflects improved operations.

### SELLING AND ADMINISTRATIVE EXPENSES.

Selling and administrative expenses for the 12 and 28 weeks ended July 13, 2002 decreased as a percentage of net sales to 5.14% and 5.31%, respectively, for 2002 from 6.13% and 6.94%, respectively, in 2001. The sales of the distribution segment represent a larger portion of total company sales than the retail segment, and the distribution segment has lower operating expenses as a percentage of sales than the retail segment.

For the distribution segment, selling and administrative expenses as a percentage of gross sales improved for the 12 and 28 weeks ended July 13, 2002 by 59 and 56 basis points, respectively, compared to the same periods in 2001, due to sales growth without a corresponding increase in fixed operating costs and company-wide cost savings initiatives. For the retail segment, selling and administrative expenses as a percentage of retail sales increased for the 12 and 28 weeks ended July 13, 2002 by 162 and 5 basis points, respectively, compared to the same periods in 2001. The increase for the 12 week periods was primarily related to a lower sales base as same store sales decreased by 4.7%. The change year to date was minimal due to flat same store sales in first quarter of 2002 and lower operating expenses for our price impact format versus the conventional retail we operated for part of 2001.

#### OPERATING EARNINGS.

For distribution and retail segments, we measure operating earnings as sales less cost of sales less selling and administrative expenses. The change in operating earnings is a combination of the explanations included in net sales, gross margin and selling and administrative expenses described above.

Operating earnings as a percentage of net sales for the 12 and 28 weeks ended July 13, 2002 were 1.97% and 1.88%, respectively, up from 1.52% and 1.36%, respectively, for the same periods in 2001. Operating earnings for the distribution segment as a percentage of net sales increased to 3.78% and 3.60% for the 12 and 28 weeks ended July 13, 2002 from 3.41% and 3.37% in 2001. Retail segment operating earnings as a percentage of net sales decreased to 1.72% from 2.04% for the second quarter but increased to 2.05% from 1.97% year to date.

#### INTEREST EXPENSE.

Interest expense for the second quarter of 2002 increased \$8 million to \$43 million compared to the same period in 2001 and increased \$1 million year to date. The increase in the second quarter was a result of higher debt balances compared to the prior year quarter. Year to date also increased due to higher debt balances but was partially offset by lower average interest rates in the first two quarters of 2002. The second quarter of 2002 and the first quarter of 2001 each included \$3 million of interest expense incurred on debt during the call period for the early retirement of debt.

#### INTEREST INCOME AND OTHER.

Interest income of \$8 million for the second quarter of 2002 was \$2 million higher than the same period of 2001 and relatively flat on a year to date comparison. Interest income in the second quarter of 2002 and the first quarter of 2001 each included approximately \$1 million of interest income from cash deposited with a trustee during the call period for the early retirement of debt.

#### IMPAIRMENT/RESTRUCTURING CHARGE.

In the second quarter of 2002, we incurred a \$27 million pre-tax charge related to the closure of two distribution facilities and certain integration costs related to recent acquisitions. See Note 11 in the notes to the condensed consolidated financial statements for further discussion of the charge.

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The strategic plan was fully implemented by the end of 2001 and thus there was no charge in 2002. See Note 12 in the notes to the condensed consolidated financial statements for further discussion regarding the strategic plan. The following table shows which income statement captions were affected by our strategic plan charges and unusual items and reconcile our reported GAAP amounts to adjusted amounts as discussed in our 10-Q for the second quarter of 2001. The adjusted amounts are not presentations made in accordance with GAAP and are not a better indicator of our operating performance.

(IN THOUSANDS)		ADJUSTMENTS		
12 WEEKS ENDED JULY 14, 2001	GAAP	STRATEGIC PLAN	UNUSUAL ITEMS (1)	ADJUSTED
Net sales	\$ 3,445,731	\$ (2,988)	\$ --	\$ 3,442,743
Costs and expenses:				
Cost of sales	3,182,374	(11,806)	--	3,170,568
Selling and administrative	211,092	(5,038)	--	206,054
Interest expense	34,435	--	--	34,435
Interest income and other	(6,067)	--	--	(6,067)
Impairment/restructuring credit	(117)	117	--	--
Litigation charges	46,600	--	(46,600)	--
Total costs and expenses	3,468,317	(16,727)	(46,600)	3,404,990
Income before taxes	\$ (22,586)	\$ 13,739	\$ 46,600	\$ 37,753

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(IN THOUSANDS)		ADJUSTMENTS		
28 WEEKS ENDED JULY 14, 2001	GAAP	STRATEGIC PLAN	UNUSUAL ITEMS (2)	ADJUSTED
Net sales	\$ 7,583,090	\$ (1,327)	\$ --	\$ 7,581,763
Costs and expenses:				
Cost of sales	6,953,489	(29,662)	--	6,923,827
Selling and administrative	526,377	(11,066)	--	515,311
Interest expense	91,937	--	(2,833)	89,104
Interest income and other	(14,988)	--	1,102	(13,886)
Impairment/restructuring credit	(26,976)	26,976	--	--
Litigation charges	48,628	--	(48,628)	--
Total costs and expenses	7,578,467	(13,752)	(50,359)	7,514,356

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Income before taxes	\$ 4,623	\$ 12,425	\$ 50,359	\$ 67,407
	=====	=====	=====	=====

(1) Includes \$46.6 million in charges from litigation settlements (in litigation charges).

(2) Includes net additional interest expense of \$1.7 million due to early retirement of debt (\$2.8 million in interest expense and \$1.1 million in interest income and other) and \$48.6 million in charges from litigation settlements (in litigation charges).

TAXES ON INCOME.

The effective tax rates for the 28 weeks of 2002 and 2001 were 38.7% and 56.6% (before extraordinary charge), respectively. These were both blended rates taking into account operations activity as well as various permanent and timing differences. The effective tax rate for 2002 was favorably impacted as a result of a refund generated through a change in treatment by the IRS of a closed statute relating to an earlier return year. The 2001 effective tax rate also took into account write-offs of non-deductible goodwill. The tax amount for the second quarter of both years was derived using the 28 week tax amount with that year's estimated effective tax rate compared to the tax amount recorded for the first 16 weeks of the year.

EXTRAORDINARY CHARGE.

We reflected extraordinary after-tax charges of \$8 million (\$13 million pre-tax) in the second quarter of 2002 and \$3 million (\$6 million pre-tax) in the first quarter of 2001, due to the early retirement of debt. See Footnote 8 in the notes to the condensed consolidated financial statements for further discussion.

RECENT DEVELOPMENTS.

On January 22, 2002, Kmart and certain of its U.S. subsidiaries filed voluntary petitions for relief under Chapter 11 of the U.S. Bankruptcy Code. Kmart, our largest customer, accounted for 21% of our net sales in the 28 weeks ended July 13, 2002 and 20% of our net sales for the year ended December 29, 2001. We have a 10-year written distribution agreement with Kmart. Kmart may, however, assume or reject our distribution agreement at any time. Kmart named us as a "critical vendor" in the bankruptcy proceeding and granted to us a junior lien on its inventory to secure the payment of weekly receivables to us arising after the date of the bankruptcy filing.

The impact of Kmart's bankruptcy filing on our future financial results will depend greatly upon whether Kmart assumes or rejects our distribution agreement and upon the success of Kmart's reorganization. Kmart has not filed its plan of reorganization with the bankruptcy court. If, for example, Kmart assumes our distribution agreement and obtains bankruptcy court approval of its plan of reorganization, then it is likely that our future financial results will not be adversely impacted. If, however, Kmart rejects our distribution agreement or, to the contrary, assumes our distribution agreement but fails to obtain bankruptcy court approval of a plan of reorganization, then we may lose our sales to Kmart, be required to close the two distribution facilities dedicated to the Kmart business, eliminate excess inventory, and suffer other damages, including the



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loss of a portion or all of our pre-petition receivable.

### CERTAIN ACCOUNTING MATTERS.

The FASB issued SFAS No. 143 - Accounting for Asset Retirement Obligations. We are studying the impact that SFAS 143 has on our financial statements and planning to implement it in fiscal year 2003, as required. The FASB issued SFAS No. 144 - Accounting for the Impairment or Disposal of Long-Lived Assets. We implemented SFAS 144 as of the beginning of fiscal year 2002, as required. It had no significant impact on our financial statements. In April 2002, the FASB issued SFAS No. 145 - Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections. We had a refinancing transaction in 2002 that has resulted in an extraordinary charge. In 2003 these amounts will be reclassified to selling and administrative expense in accordance with SFAS 145. In August 2002, the FASB issued SFAS No. 146 - Accounting for Costs Associated with Exit or Disposal Activities. The standard currently has no impact on our financial statements, and we will implement it in fiscal year 2003, as required. In December 2001, the AICPA's Accounting Standards Executive Committee issued Statement of Position (SOP) 01-6, Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others. We implemented SOP 01-6 as of the beginning of fiscal year 2002, as required, with no impact on our financial statements. This SOP provides guidance on the accounting for and disclosure of amounts due to us from customers included in our accounts and notes receivable.

### CRITICAL ACCOUNTING POLICIES AND ESTIMATES.

There have been no significant changes to critical accounting policies and estimates since the issuance of our fiscal 2001 Form 10-K.

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### LIQUIDITY AND CAPITAL RESOURCES

For the year-to-date period ended July 13, 2002, our principal source of liquidity was borrowings under our credit facility. Our principal sources of capital were the issuance of common stock, the issuance of long-term senior debt and the sale-leaseback of five case pick distribution centers.

### NET CASH USED IN OPERATING ACTIVITIES.

Net cash used in operating activities was \$126 million for the two quarters ended July 13, 2002 compared to a \$64 million use of cash for the same period in 2001. The primary use of cash was for working capital.

### NET CASH USED IN INVESTING ACTIVITIES.

Total investment-related activity resulted in a \$227 million use of cash for the two quarters ended July 13, 2002 compared to a \$41 million use of cash in the same period of 2001.

Cash expended for businesses acquired was \$290 million for the two quarters ended July 13, 2002 (primarily as a result of our acquisition of Core-Mark and Head Distributing), compared to \$70 million cash expended for businesses acquired during the same period in 2001.

Cash expended for the purchase of property and equipment totaled \$98 million for the two quarters ended July 13, 2002 compared to \$112 million for the same

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period in 2001. We intend to spend a total of approximately \$185 million on our capital programs in 2002 compared to \$238 million spent in 2001.

Cash proceeds from the sale of property and equipment was \$142 million, primarily related to the sale-leaseback of five case pick distribution centers located in Phoenix, Massillon, Salt Lake City, Miami and Sacramento (see Footnote 10 for sale-leaseback details) for the two quarters ended July 13, 2002 compared to \$12 million from the sale of property and equipment during the same period in 2001.

### NET CASH PROVIDED BY FINANCING ACTIVITIES.

Net cash generated by financing activities was \$432 million for the two quarters ended July 13, 2002 compared to \$89 million for the same period last year.

On April 15, 2002, we sold \$260 million of 9 7/8% senior subordinated notes due 2012. The net proceeds were used to redeem the 10 1/2% senior subordinated notes due 2004.

At the end of the second quarter of 2002, outstanding borrowings under the credit facility totaled \$425 million of term loans, \$75 million of revolver loans, and \$71 million of letters of credit. If

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we had terminated Core-Mark's accounts receivable securitization on or before July 13, 2002, then we would have had \$330 million available to borrow under this facility. We paid Core-Mark's accounts receivable securitization as of July 18, 2002.

On June 18, 2002, we purchased Core-Mark International, Inc. In conjunction with the acquisition, we refinanced our \$850 million senior secured credit facility with a \$975 million senior secured credit facility, sold \$200 million of 9 1/4% senior notes due June 15, 2010 and sold 9.2 million shares of common stock at \$19.40 per share, raising \$178 million of gross proceeds (\$170 million net of underwriting discount and other issuance costs).

As part of our acquisition of Core-Mark, we assumed \$132 million of additional debt, consisting of \$77 million of 11 3/8% senior subordinated notes and a \$55 million accounts receivable securitization. On June 18, we deposited \$80 million in a trust to be used to redeem the 11 3/8% senior subordinated notes, including an amount to cover accrued interest and the redemption premium and received a satisfaction and discharge to release us from this debt. Simultaneously, on June 18, we deposited \$55 million in a trust which was used to redeem the accounts receivable securitization, including an amount to cover accrued interest. The redemption of the accounts receivable securitization took place during the third quarter of 2002.

Our principal sources of liquidity and capital are expected to be cash flows from operating activities and our ability to borrow under our credit facility, in addition, lease financing may be employed for our distribution facilities, retail stores and equipment. We believe these sources will be adequate to meet working capital needs in the normal course of business for the next 12 months.

### CONTINGENCIES

See Footnote 7 in our notes to the consolidated financial statements and Item 1, Part II of this report.

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### FORWARD-LOOKING INFORMATION

This report includes forward-looking statements regarding future events and our future financial performance. These forward-looking statements and our business are subject to a number of factors that could cause actual results to differ materially from those stated in this report, including without limitation: unanticipated problems with product procurement; adverse effects of the changing industry and increased competition; sales declines and loss of customers; exposure to litigation and other contingent losses; elimination of sales to Kmart due to their rejection of our distribution agreement; the ability of Kmart to continue as a going concern, to operate pursuant to the terms of its debtor-in-possession financing, or to complete its reorganization according to its plan; the inability to integrate acquired companies and to achieve operating improvements at those companies; increases in labor costs and disruptions in labor

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relations with union bargaining units representing our associates; and negative effects of our substantial indebtedness and the limitations imposed by restrictive covenants contained in our debt instruments. These and other risk factors are described in our Securities and Exchange Commission reports, including but not limited to the 10-K Report for the 2001 fiscal year. We undertake no obligation to update forward-looking statements to reflect developments or information obtained after the date hereof.

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### SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

FLEMING COMPANIES, INC.

October 11, 2002

/s/ MARK D. SHAPIRO

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Mark D. Shapiro  
Senior Vice President  
Finance and Operations Control  
(Duly Authorized Officer of Registrant  
and Principal Accounting Officer)

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CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER

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I, Mark S. Hansen, Chairman and Chief Executive Officer of Fleming Companies, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Fleming Companies, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report; and
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report.

Date: October 10, 2002

/s/ MARK S. HANSEN

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Mark S. Hansen  
Chairman and Chief Executive Officer

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CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER

I, Neal J. Rider, Executive Vice President and Chief Financial Officer of Fleming Companies, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Fleming Companies, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report; and
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report.

Date: October 10, 2002

/s/ NEAL J. RIDER

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Neal J. Rider  
Executive Vice President and Chief  
Financial Officer

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