

INGLES MARKETS INC  
Form 10-Q  
August 03, 2016

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 June 25, 2016

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 0-14706.

INGLES MARKETS, INCORPORATED

(Exact name of registrant as specified in its charter)

North Carolina (State or other jurisdiction of incorporation or organization)	56-0846267 (I.R.S. Employer Identification No.)
P.O. Box 6676, Asheville NC (Address of principal executive offices)	28816 (Zip Code)

(828) 669-2941

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No .

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Edgar Filing: INGLES MARKETS INC - Form 10-Q

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company.) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  
No .

As of August 1, 2016, the Registrant had 13,958,976 shares of Class A Common Stock, \$0.05 par value per share, outstanding and 6,300,800 shares of Class B Common Stock, \$0.05 par value per share, outstanding.

1

---

INGLES MARKETS, INCORPORATED

INDEX

	Page No.
Part I — Financial Information	
Item 1. Financial Statements (Unaudited)	
Condensed Consolidated Balance Sheets as of June 25, 2016 and September 26, 2015	3
Condensed Consolidated Statements of Income for the Three Months Ended June 25, 2016 and June 27, 2015	4
Nine Months Ended June 25, 2016 and June 27, 2015	5
Condensed Consolidated Statements of Changes in Stockholders' Equity for the Nine Months Ended June 25, 2016 and June 27, 2015	6
Condensed Consolidated Statements of Cash Flows for the Nine Months Ended June 25, 2016 and June 27, 2015	7
Notes to Unaudited Interim Financial Statements	8
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	14
Item 3. Quantitative and Qualitative Disclosures About Market Risk	22
Item 4. Controls and Procedures	22
Part II — Other Information	
Item 6. Exhibits	23
Signatures	25



## Part I. FINANCIAL INFORMATION

## Item 1. FINANCIAL STATEMENTS

## INGLES MARKETS, INCORPORATED AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	June 25, 2016	September 26, 2015
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 5,435,005	\$ 7,505,040
Receivables - net	72,508,673	66,284,163
Inventories	341,846,076	338,644,128
Other current assets	10,087,625	11,313,152
Total Current Assets	429,877,379	423,746,483
Property and Equipment – Net	1,240,948,398	1,211,458,393
Other Assets	18,860,126	19,623,349
Total Assets	\$ 1,689,685,903	\$ 1,654,828,225
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities:		
Current portion of long-term debt	\$ 10,683,589	\$ 11,367,710
Accounts payable - trade	162,085,483	166,039,952
Accrued expenses and current portion of other long-term liabilities	62,449,995	74,552,234
Total Current Liabilities	235,219,067	251,959,896
Deferred Income Taxes	71,965,000	64,643,000
Long-Term Debt	887,556,544	874,685,817
Other Long-Term Liabilities	35,704,658	34,561,112
Total Liabilities	1,230,445,269	1,225,849,825
Stockholders' Equity		
Preferred stock, \$0.05 par value; 10,000,000 shares authorized; no shares issued	—	—
Common stocks:		
Class A, \$0.05 par value; 150,000,000 shares authorized; 13,948,901 shares issued and outstanding June 25, 2016; 13,924,651 shares issued and outstanding at September 26, 2015	697,445	696,233
Class B, convertible to Class A, \$0.05 par value; 100,000,000 shares authorized; 6,310,875 shares issued and outstanding June 25, 2016; 6,335,125 shares issued	315,544	316,756

Edgar Filing: INGLES MARKETS INC - Form 10-Q

and outstanding at September 26, 2015

Paid-in capital in excess of par value	12,311,249	12,311,249
Retained earnings	445,916,396	415,654,162
Total Stockholders' Equity	459,240,634	428,978,400
Total Liabilities and Stockholders' Equity	\$ 1,689,685,903	\$ 1,654,828,225

See notes to unaudited condensed consolidated financial statements.

3

---

## INGLES MARKETS, INCORPORATED AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Three Months Ended	
	June 25, 2016	June 27, 2015
Net sales	\$ 957,177,645	\$ 945,974,494
Cost of goods sold	724,323,504	723,810,548
Gross profit	232,854,141	222,163,946
Operating and administrative expenses	199,433,998	190,730,349
Loss from sale or disposal of assets	(1,555,179)	(318,664)
Income from operations	31,864,964	31,114,933
Other income, net	512,356	522,876
Interest expense	11,190,865	10,583,124
Income before income taxes	21,186,455	21,054,685
Income tax expense	8,518,000	7,278,000
Net income	\$ 12,668,455	\$ 13,776,685
Per share amounts:		
Class A Common Stock		
Basic earnings per common share	\$ 0.64	\$ 0.70
Diluted earnings per common share	\$ 0.63	\$ 0.68
Class B Common Stock		
Basic earnings per common share	\$ 0.59	\$ 0.63
Diluted earnings per common share	\$ 0.59	\$ 0.63
Cash dividends per common share		
Class A Common Stock	\$ 0.165	\$ 0.165
Class B Common Stock	\$ 0.150	\$ 0.150

See notes to unaudited condensed consolidated financial statements.



## INGLES MARKETS, INCORPORATED AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Nine Months Ended	
	June 25, 2016	June 27, 2015
Net sales	\$ 2,832,603,557	\$ 2,825,806,017
Cost of goods sold	2,145,391,994	2,160,558,522
Gross profit	687,211,563	665,247,495
Operating and administrative expenses	589,654,137	563,287,200
(Loss) gain from sale or disposal of assets	(934,039)	320,340
Income from operations	96,623,387	102,280,635
Other income, net	1,652,297	1,649,603
Interest expense	34,393,394	34,184,004
Income before income taxes	63,882,290	69,746,234
Income tax expense	23,876,000	26,629,000
Net income	\$ 40,006,290	\$ 43,117,234
Per share amounts:		
Class A Common Stock		
Basic earnings per common share	\$ 2.03	\$ 2.19
Diluted earnings per common share	\$ 1.98	\$ 2.13
Class B Common Stock		
Basic earnings per common share	\$ 1.85	\$ 1.99
Diluted earnings per common share	\$ 1.85	\$ 1.99
Cash dividends per common share		
Class A Common Stock	\$ 0.495	\$ 0.495
Class B Common Stock	\$ 0.450	\$ 0.450

See notes to unaudited condensed consolidated financial statements.

## INGLES MARKETS, INCORPORATED AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (UNAUDITED)

NINE MONTHS ENDED JUNE 25, 2016 AND JUNE 27, 2015

	Class A Common Stock		Class B Common Stock		Paid-in Capital in Excess of Par Value	Retained Earnings	Total
	Shares	Amount	Shares	Amount			
Balance, September 27, 2014	13,540,333	\$ 677,017	6,719,443	\$ 335,972	\$ 12,311,249	\$ 369,277,929	\$ 382,602,167
Net income	—	—	—	—	—	43,117,234	43,117,234
Cash dividends	—	—	—	—	—	(9,730,709)	(9,730,709)
Common stock conversions	273,118	13,656	(273,118)	(13,656)	—	—	—
Balance, June 27, 2015	13,813,451	\$ 690,673	6,446,325	\$ 322,316	\$ 12,311,249	\$ 402,664,454	\$ 415,988,692
Balance, September 26, 2015	13,924,651	\$ 696,233	6,335,125	\$ 316,756	\$ 12,311,249	\$ 415,654,162	\$ 428,978,400
Net income	—	—	—	—	—	40,006,290	40,006,290
Cash dividends	—	—	—	—	—	(9,744,056)	(9,744,056)
Common stock conversions	24,250	1,212	(24,250)	(1,212)	—	—	—
Balance, June 25, 2016	13,948,901	\$ 697,445	6,310,875	\$ 315,546	\$ 12,311,249	\$ 445,916,396	\$ 459,240,634

See notes to unaudited condensed consolidated financial statements.



## INGLES MARKETS, INCORPORATED AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Nine Months Ended	
	June 25, 2016	June 27, 2015
Cash Flows from Operating Activities:		
Net income	\$ 40,006,290	\$ 43,117,234
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	79,343,688	76,745,947
Loss (gain) from sale or disposal of assets	934,039	(320,340)
Receipt of advance payments on purchases contracts	3,195,887	3,560,751
Recognition of advance payments on purchases contracts	(2,454,998)	(3,222,415)
Deferred income taxes	7,322,000	3,178,000
Changes in operating assets and liabilities:		
Receivables	(6,224,510)	(6,253,362)
Inventory	(3,201,948)	(5,397,552)
Other assets	1,988,751	(3,183,166)
Accounts payable and accrued expenses	(17,322,748)	(7,073,839)
Net Cash Provided by Operating Activities	103,586,451	101,151,258
Cash Flows from Investing Activities:		
Proceeds from sales of property and equipment	686,480	1,224,645
Capital expenditures	(107,823,914)	(73,524,173)
Net Cash Used by Investing Activities	(107,137,434)	(72,299,528)
Cash Flows from Financing Activities:		
Proceeds from short-term borrowings	577,982,521	579,129,600
Payments on short-term borrowings	(556,186,709)	(587,750,633)
Principal payments on long-term borrowings	(10,570,808)	(10,470,370)
Dividends paid	(9,744,056)	(9,730,709)
Net Cash Provided (Used) by Financing Activities	1,480,948	(28,822,112)
Net (Decrease) Increase in Cash and Cash Equivalents	(2,070,035)	29,618
Cash and cash equivalents at beginning of period	7,505,040	8,613,628
Cash and Cash Equivalents at End of Period	\$ 5,435,005	\$ 8,643,246

See notes to unaudited condensed consolidated financial statements.

INGLES MARKETS, INCORPORATED AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM FINANCIAL STATEMENTS

Nine Months Ended June 25, 2016 and June 27, 2015

A. BASIS OF PREPARATION

In the opinion of management, the accompanying unaudited interim financial statements contain all adjustments necessary to present fairly the financial position of Ingles Markets, Incorporated and Subsidiaries (the “Company”) as of June 25, 2016, the results of operations for the three-month and nine-month periods ended June 25, 2016 and June 27, 2015, and the changes in stockholders’ equity and cash flows for the nine-month periods ended June 25, 2016 and June 27, 2015. The adjustments made are of a normal recurring nature. Certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission for Form 10-Q. It is suggested that these unaudited interim financial statements be read in conjunction with the audited financial statements and the notes thereto included in the Annual Report on Form 10-K for the year ended September 26, 2015 filed by the Company under the Securities Exchange Act of 1934 on December 10, 2015.

The results of operations for the three-month and nine-month periods ended June 25, 2016 are not necessarily indicative of the results to be expected for the full fiscal year.

B. NEW ACCOUNTING PRONOUNCEMENTS

In April 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update ASU 2015-03 “Simplifying the Presentation of Debt Issuance Costs” (ASU 2015-03). ASU 2015-03 changes the presentation of debt issuance costs in financial statements. Upon adoption of ASU 2015-03, debt issuance costs will be reported in the balance sheet as a direct deduction from the related debt liability rather than as an asset. The Company adopted ASU 2015-03 retrospectively during the quarter ended December 26, 2015. As a result, \$8.3 million and \$9.3 million of debt issuance costs were recorded as a reduction of total debt at June 25, 2016 and September 26, 2015, respectively.

In November 2015, the FASB issued Accounting Standards Update ASU 2015-17 “Balance Sheet Classification of Deferred Taxes” (ASU 2015-17). ASU 2015-17 requires entities to present deferred tax assets and deferred tax liabilities as noncurrent in a classified balance sheet. ASU 2015-07 simplifies current guidance, which requires entities to separately present deferred tax assets and deferred tax liabilities as current and noncurrent in a classified balance sheet. The Company adopted ASU 2015-17 retrospectively during the quarter ended December 26, 2015. As a result,

\$7.3 million of deferred tax assets were recorded as a reduction of the caption "Deferred Income Taxes" in the Condensed Consolidated Balance Sheets at June 25, 2016 and September 26, 2015.

#### C. ALLOWANCE FOR DOUBTFUL ACCOUNTS

Receivables are presented net of an allowance for doubtful accounts of \$540,000 at June 25, 2016 and \$400,000 at September 26, 2015.

#### D. INCOME TAXES

The Company's effective tax rate differs from the federal statutory rate primarily as a result of state income taxes and tax credits.

Income tax expense as a percentage of pre-tax income was 37.4% for the nine-month period ended June 25, 2016 compared to 38.2% for the nine-month period ended June 27, 2015. The lower effective tax rate for the fiscal 2016 nine-month period is attributable to certain non-recurring discrete items that occurred during the fiscal 2015 nine-month period.

The Company had approximately \$4.4 million of refundable income taxes included in the caption "Other current assets" in the Condensed Consolidated Balance Sheets at June 25, 2016.

The Company has unrecognized tax benefits and could incur interest and penalties related to uncertain tax positions. These amounts are insignificant and are not expected to significantly increase or decrease within the next twelve months.

On September 13, 2013, the IRS released final tangible property regulations under Sections 162(a) and 263(a) of the Internal Revenue Code regarding the deduction and capitalization of expenditures related to tangible property as well as dispositions of tangible property. These regulations were effective for the Company's fiscal year ending September 26, 2015 and did not have a material impact on the Company's consolidated results of operations, cash flows or financial position for the three and nine month periods ended June 25, 2016 and June 27, 2015.



## E. ACCRUED EXPENSES AND CURRENT PORTION OF OTHER LONG-TERM LIABILITIES

Accrued expenses and current portion of other long-term liabilities consist of the following:

	June 25, 2016	September 26, 2015
Property, payroll and other taxes payable	\$ 15,640,075	\$ 17,882,565
Salaries, wages and bonuses payable	26,042,084	26,336,530
Self-insurance liabilities	13,940,748	14,724,793
Interest payable	2,568,031	12,623,691
Other	4,259,057	2,984,655
	\$ 62,449,995	\$ 74,552,234

Self-insurance liabilities are established for general liability claims, workers' compensation and employee group medical and dental benefits based on claims filed and estimates of claims incurred but not reported. The Company is insured for covered costs in excess of \$750,000 per occurrence for workers' compensation, \$500,000 for general liability and \$325,000 per covered person for medical care benefits for a policy year. The Company's self-insurance liabilities totaled \$35.7 million and \$36.3 million at June 25, 2016 and September 26, 2015, respectively. Of this amount, \$13.9 million is accounted for as a current liability and \$21.8 million as a long-term liability, which is inclusive of \$4.2 million of expected self-insurance recoveries from excess cost insurance or other sources that are recorded as a receivable at June 25, 2016. At September 26, 2015, \$14.7 million is accounted for as a current liability and \$21.6 million as a long-term liability, which is inclusive of \$4.9 million of expected self-insurance recoveries from excess cost insurance or other sources that are recorded as a receivable at September 26, 2015.

Employee insurance expense, including workers' compensation and medical care benefits, net of employee contributions, totaled \$7.7 million and \$9.6 million for the three-month periods ended June 25, 2016 and June 27, 2015, respectively. For the nine-month periods ended June 25, 2016 and June 27, 2015, employee insurance expense, net of employee contributions, totaled \$26.8 million and \$26.0 million, respectively.

## F. LONG-TERM DEBT

In June 2013, the Company issued \$700.0 million aggregate principal amount of senior notes due in 2023 (the "Notes") in a private placement. The Notes bear an interest rate of 5.75% per annum and were issued at par.



The Company filed a registration statement with the Securities and Exchange Commission to exchange the private placement notes with registered notes. The exchange has been completed.

The Company may redeem all or a portion of the Notes at any time on or after June 15, 2018 at the following redemption prices (expressed as percentages of the principal amount), if redeemed during the 12-month period beginning June 15 of the years indicated below:

Year	
2018	102.875%
2019	101.917%
2020	100.958%
2021 and thereafter	100.000%

In connection with the offering of the Notes, the Company extended the maturity date of its \$175.0 million line of credit (the "Line") from December 2015 to June 2018 and modified certain interest rate options and covenants. Outstanding borrowings under the Line totaled \$22.3 million at June 25, 2016.

The Line provides the Company with various interest rate options based on the prime rate, the Federal Funds Rate, or the London Interbank Offering Rate ("LIBOR"). The Line allows the Company to issue up to \$30.0 million in unused letters of credit, of which \$9.7 million of unused letters of credit were issued at June 25, 2016. The Company is not required to maintain compensating balances in connection with the Line.

In December 2010, the Company completed the funding of \$99.7 million of Recovery Zone Facility Bonds (the "Bonds") for construction of new warehouse and distribution space in Buncombe County, North Carolina (the "Project"). The final maturity date of the Bonds is January 1, 2036.

The Bonds were issued by the Buncombe County Industrial Facilities and Pollution Control Financing Authority and were purchased by certain financial institutions. Under a Continuing Covenant and Collateral Agency Agreement (the “Covenant Agreement”) between the financial institutions and the Company, the financial institutions would hold the Bonds until January 2, 2018, subject to certain events. Mandatory redemption of the Bonds by the Company in the annual amount of \$4.5 million began on January 1, 2014.

In connection with the offering of the Notes, the Company extended the maturity date of the Covenant Agreement from January 2018 to June 2021 and modified certain interest rate options and covenants. The Company may redeem the Bonds without penalty or premium at any time prior to June 2021.

Interest earned by bondholders on the Bonds is exempt from Federal and North Carolina income taxation. The interest rate on the Bonds is equal to one month LIBOR (adjusted monthly) plus a credit spread, adjusted to reflect the income tax exemption.

The Company’s obligation to repay the Bonds is collateralized by the Project. Additional collateral was required in order to meet certain loan to value criteria in the Covenant Agreement. The Covenant Agreement incorporates substantially all financial covenants included in the Line.

The Notes, the Bonds and the Line contain provisions that under certain circumstances would permit lending institutions to terminate or withdraw their respective extensions of credit to the Company. Included among the triggering factors permitting the termination or withdrawal of the Line to the Company are certain events of default, including both monetary and non-monetary defaults, the initiation of bankruptcy or insolvency proceedings, and the failure of the Company to meet certain financial covenants designated in its respective loan documents. The Company was in compliance with all financial covenants related to its borrowings at June 25, 2016.

The Company’s long-term debt agreements generally have cross-default provisions which could result in the acceleration of payments due under the Company’s Line, Bond and Notes indenture in the event of default under any one instrument.

## G. DIVIDENDS

The Company paid cash dividends of \$0.165 for each share of Class A Common Stock and \$0.15 for each share of Class B Common Stock on October 22, 2015 to stockholders of record on October 8, 2015.

The Company paid cash dividends of \$0.165 for each share of Class A Common Stock and \$0.15 for each share of Class B Common Stock on January 21, 2016 to stockholders of record on January 7, 2016.

The Company paid cash dividends of \$0.165 for each share of Class A Common Stock and \$0.15 for each share of Class B Common Stock on April 14, 2016 to stockholders of record on April 7, 2016.

For additional information regarding the dividend rights of the Class A Common Stock and Class B Common Stock, please see Note 8, "Stockholders' Equity" to the Consolidated Financial Statements of the Annual Report on Form 10-K filed by the Company under the Securities Exchange Act of 1934 on December 10, 2015.

#### H. EARNINGS PER COMMON SHARE

The Company has two classes of common stock: Class A which is publicly traded, and Class B, which has no public market. The Class B Common Stock has restrictions on transfer; however, each share is convertible into one share of Class A Common Stock at any time. Each share of Class A Common Stock has one vote per share and each share of Class B Common Stock has ten votes per share. Each share of Class A Common Stock is entitled to receive cash dividends equal to 110% of any cash dividend paid on Class B Common Stock.

The Company calculates earnings per share using the two-class method in accordance with FASB Accounting Standards Codification ("FASB ASC") Topic 260.

The two-class method of computing basic earnings per share for each period reflects the cash dividends paid per share for each class of stock, plus the amount of allocated undistributed earnings per share computed using the participation percentage which reflects the dividend rights of each class of stock. Diluted earnings per share is calculated assuming conversion of all shares of Class B Common Stock to shares of Class A Common Stock on a share-for-share basis. The tables below reconcile the numerators and denominators of basic and diluted earnings per share for current and prior periods.

Edgar Filing: INGLES MARKETS INC - Form 10-Q

	Three Months Ended		Nine Months Ended	
	June 25, 2016		June 25, 2016	
	Class A	Class B	Class A	Class B
Numerator: Allocated net income				
Net income allocated, basic	\$ 8,973,689	\$ 3,694,766	\$ 28,317,738	\$ 11,688,552
Conversion of Class B to Class A shares	3,694,766	—	11,688,552	—
Net income allocated, diluted	\$ 12,668,455	\$ 3,694,766	\$ 40,006,290	\$ 11,688,552
Denominator: Weighted average shares outstanding				
Weighted average shares outstanding, basic	13,944,818	6,314,958	13,932,356	6,327,420
Conversion of Class B to Class A shares	6,314,958	—	6,327,420	—
Weighted average shares outstanding, diluted	20,259,776	6,314,958	20,259,776	6,327,420
Earnings per share				
Basic	\$ 0.64	\$ 0.59	\$ 2.03	\$ 1.85
Diluted	\$ 0.63	\$ 0.59	\$ 1.98	\$ 1.85

The per share amounts for the third quarter of fiscal 2015 and the nine months ended June 27, 2015 are based on the following amounts:

	Three Months Ended		Nine Months Ended	
	June 27, 2015		June 27, 2015	
	Class A	Class B	Class A	Class B
Numerator: Allocated net income				
Net income allocated, basic	\$ 9,646,468	\$ 4,130,217	\$ 29,934,820	\$ 13,182,414
Conversion of Class B to Class A shares	4,130,217	—	13,182,414	—
Net income allocated, diluted	\$ 13,776,685	\$ 4,130,217	\$ 43,117,234	\$ 13,182,414
Denominator: Weighted average shares outstanding				
Weighted average shares outstanding, basic	13,777,019	6,482,757	13,657,699	6,602,077
Conversion of Class B to Class A shares	6,482,757	—	6,602,077	—
Weighted average shares outstanding, diluted	20,259,776	6,482,757	20,259,776	6,602,077
Earnings per share				
Basic	\$ 0.70	\$ 0.63	\$ 2.19	\$ 1.99
Diluted	\$ 0.68	\$ 0.63	\$ 2.13	\$ 1.99



## I. SEGMENT INFORMATION

The Company operates one primary business segment, retail grocery sales. The “Other” activities include fluid dairy and shopping center rentals. Information about the Company’s operations by lines of business (amounts in thousands) is as follows:

	Three Months Ended		Nine Months Ended	
	June 25, 2016	June 27, 2015	June 25, 2016	June 27, 2015
Revenues from unaffiliated customers:				
Retail	\$ 922,751	\$ 911,698	\$ 2,729,293	\$ 2,717,538
Other	34,427	34,276	103,311	108,268
Total revenues from unaffiliated customers	\$ 957,178	\$ 945,974	\$ 2,832,604	\$ 2,825,806
Income from operations:				
Retail	\$ 28,031	\$ 27,686	\$ 84,669	\$ 92,261
Other	3,834	3,429	11,954	10,020
Total income from operations	\$ 31,865	\$ 31,115	\$ 96,623	\$ 102,281

	June 25,	September
	2016	26, 2015
Assets:		
Retail	\$ 1,558,365	\$ 1,525,682
Other	132,874	131,484
Elimination of intercompany receivable	(1,553)	(2,338)
Total assets	\$ 1,689,686	\$ 1,654,828

Sales by product category (amounts in thousands) are as follows:

	Three Months Ended		Nine Months Ended	
	June 25, 2016	June 27, 2015	June 25, 2016	June 27, 2015
Grocery	\$ 337,030	\$ 335,974	\$ 1,046,616	\$ 1,042,559
Non-foods	207,575	195,484	608,601	571,059
Perishables	257,799	250,895	753,027	731,507
Gasoline	120,347	129,345	321,049	372,413
Total retail	\$ 922,751	\$ 911,698	\$ 2,729,293	\$ 2,717,538

The grocery category includes grocery, dairy, and frozen foods.

The non-foods include alcoholic beverages, tobacco, pharmacy, health and video.

The perishables category includes meat, produce, deli and bakery.

For the three-month periods ended June 25, 2016 and June 27, 2015, respectively, the fluid dairy operation had \$10.1 million and \$11.1 million in sales to the grocery sales operation. The fluid dairy operation had \$32.4 million and \$38.1 million in sales to the grocery sales operation for the nine-month periods ended June 25, 2016 and June 27, 2015, respectively. These sales have been eliminated in consolidation and are excluded from the amounts in the table above.

## J. FAIR VALUES OF FINANCIAL INSTRUMENTS

The carrying amounts for cash and cash equivalents, accounts receivable and accounts payable approximate fair value due to the short-term maturity of these instruments.

The fair value of the Company's debt is estimated using valuation techniques under the accounting guidance related to fair value measurements based on observable and unobservable inputs. Observable inputs reflect readily available data from independent sources, while unobservable inputs reflect the Company's market assumptions. These inputs are classified into the following hierarchy:

Level 1 Quoted prices for identical assets or liabilities in active markets.  
Inputs –

Level 2 Inputs – Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

Level 3 Inputs – Pricing inputs are unobservable for the assets or liabilities and include situations where there is little, if any, market activity for the assets or liabilities. The inputs into the determination of fair value require significant management judgment or estimation.

The carrying amount and fair value of the Company's debt at June 25, 2016 is as follows (in thousands):

	Carrying Amount	Fair Value	Fair Value Measurements
Senior Notes	\$ 700,000	\$ 701,750	Level 2
Facility Bonds	86,150	86,150	Level 2
Secured notes payable and other	89,834	89,838	Level 2
Line of credit payable	22,256	22,256	Level 2
Total debt	\$ 898,240	\$ 899,994	

The fair values for Level 2 measurements were determined primarily using market yields and taking into consideration the underlying terms of the debt.



## K. NONQUALIFIED INVESTMENT PLAN

The purpose of the Executive Nonqualified Excess Plan is to provide retirement benefits similar to the Company's Investment/Profit Sharing Plan to certain of the Company's management employees who are otherwise subject to limited participation in the 401(k) feature of the Company's Investment/Profit Sharing Plan. Participant retirement account balances are liabilities of the Company. Assets of the plan are assets of the Company and are held in trust for employees and distributed upon retirement, death, disability, in-service distributions, or other termination of employment. In accordance with the trust, the Company may not use these assets for general corporate purposes. During the nine months ended June 25, 2016 and June 27, 2015, the Company invested a portion of the proceeds of liquidated life insurance policy assets in marketable securities. These marketable securities have been liquidated and invested in other life insurance policies. Life insurance policies and marketable securities held in the trust are included in the caption "Other assets" in the Condensed Consolidated Balance Sheets.

## L. SUBSEQUENT EVENTS

We have evaluated subsequent events and transactions for potential recognition or disclosure in the financial statements through the day the financial statements were issued.

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

### Overview

Ingles, a leading supermarket chain in the Southeast, operates 201 supermarkets in Georgia (71), North Carolina (70), South Carolina (36), Tennessee (21), Virginia (2) and Alabama (1). The Company locates its supermarkets primarily in suburban areas, small towns and rural communities. Ingles supermarkets offer customers a wide variety of nationally advertised food products, including grocery, meat and dairy products, produce, frozen foods and other perishables and non-food products. Non-food products include fuel centers, pharmacies, health and beauty care products and general merchandise. In addition, the Company focuses on selling high-growth, high-margin products to its customers through the development of certified organic products, bakery departments and prepared foods including delicatessen sections. As of June 25, 2016, the Company operated 99 in-store pharmacies and 93 fuel centers.

Ingles also operates a fluid dairy and earns shopping center rentals. The fluid dairy processing operation sells approximately 25% of its products to the retail grocery operation and approximately 75% of its products to third parties. Real estate ownership is an important component of the Company's operations, providing both operational and

economic benefits.

### Critical Accounting Policies

Critical accounting policies are those accounting policies that management believes are important to the portrayal of the Company's financial condition and results of operations, and require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Estimates are based on historical experience and other factors believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Management estimates, by their nature, involve judgments regarding future uncertainties, and actual results may therefore differ materially from these estimates.

### Self-Insurance

The Company is self-insured for workers' compensation and group medical and dental benefits. Risks and uncertainties are associated with self-insurance; however, the Company has limited its exposure by maintaining excess liability coverage of \$750,000 per occurrence for workers' compensation, \$500,000 for general liability, and \$325,000 per covered person for medical care benefits for a policy year. Self-insurance liabilities are established based on claims filed and estimates of claims incurred but not reported. The estimates are based on data provided by the respective claims administrators. These estimates can fluctuate if historical trends are not predictive of the future. The majority of the Company's properties are self-insured for casualty losses and business interruption; however, liability coverage is maintained. At June 25, 2016 the Company's self-insurance liabilities totaled \$35.7 million. Of this amount, \$13.9 million is accounted for as a current liability and \$21.8 million as a long-term liability, which is inclusive of \$4.2 million of expected self-insurance recoveries from excess cost insurance or other sources that are recorded as a receivable at June 25, 2016.

### Asset Impairments

The Company accounts for the impairment of long-lived assets in accordance with FASB ASC Topic 360. For assets to be held and used, the Company tests for impairment using undiscounted cash flows and calculates the amount of impairment using discounted

cash flows. For assets held for sale, impairment is recognized based on the excess of remaining book value over expected recovery value. The recovery value is the fair value as determined by independent quotes or expected sales prices developed by internal associates. Estimates of future cash flows and expected sales prices are judgments based upon the Company's experience and knowledge of local operations and cash flows that are projected for several years into the future. These estimates can fluctuate significantly due to changes in real estate market conditions, the economic environment, capital spending decisions and inflation. The Company monitors the carrying value of long-lived assets for potential impairment each quarter based on whether any indicators of impairment have occurred. There were no asset impairments during the nine-month period ended June 25, 2016.

#### Vendor Allowances

The Company receives funds for a variety of merchandising activities from the many vendors whose products the Company buys for resale in its stores. These incentives and allowances are primarily comprised of volume or purchase based incentives, advertising allowances, slotting fees, and promotional discounts. The purpose of these incentives and allowances is generally to help defray the costs incurred by the Company for stocking, advertising, promoting and selling the vendor's products. These allowances generally relate to short term arrangements with vendors, often relating to a period of a month or less, and are negotiated on a purchase-by-purchase or transaction-by-transaction basis. Whenever possible, vendor discounts and allowances that relate to buying and merchandising activities are recorded as a component of item cost in inventory and recognized in merchandise costs when the item is sold. Due to system constraints and the nature of certain allowances, it is sometimes not practicable to apply allowances to the item cost of inventory. In those instances, the allowances are applied as a reduction of merchandise costs using a rational and systematic methodology, which results in the recognition of these incentives when the inventory related to the vendor consideration received is sold. Vendor allowances applied as a reduction of merchandise costs totaled \$29.5 million and \$28.7 million for the fiscal quarters ended June 25, 2016 and June 27, 2015, respectively. For the nine-month periods ended June 25, 2016 and June 27, 2015, vendor allowances applied as a reduction of merchandise costs totaled \$88.0 million and \$88.3 million, respectively. Vendor advertising allowances that represent a reimbursement of specific identifiable incremental costs of advertising the vendor's specific products are recorded as a reduction to the related expense in the period in which the related expense is incurred. Vendor advertising allowances recorded as a reduction of advertising expense totaled \$3.4 million for each of the fiscal quarters ended June 25, 2016 and June 27, 2015. For the nine-month periods ended June 25, 2016 and June 27, 2015, vendor advertising allowances recorded as a reduction of advertising expense totaled \$10.2 million and \$10.9 million, respectively.

If vendor advertising allowances were substantially reduced or eliminated, the Company would likely consider other methods of advertising, as well as the volume and frequency of the Company's product advertising, which could increase or decrease the Company's expenditures.

Similarly, the Company is not able to assess the impact of vendor advertising allowances on creating additional revenue, as such allowances do not directly generate revenue for the Company's stores.

#### Results of Operations

Ingles operates on a 52 or 53-week fiscal year ending on the last Saturday in September. There are 13 and 39 weeks of operations included in the unaudited Condensed Consolidated Statements of Income for the three and nine-month periods ended June 25, 2016 and June 27, 2015. Comparable store sales are defined as sales by grocery stores in operation for five full fiscal quarters. Sales from replacement stores, major remodels, minor remodels and the addition of fuel stations to existing stores are included in the comparable store sales calculation from the date thereof. A replacement store is a new store that is opened to replace an existing nearby store that is closed. A major remodel entails substantial remodeling of an existing store and may include additional retail square footage. For the three and nine-month periods ended June 25, 2016 and June 27, 2015, comparable store sales include 199 and 200 stores, respectively.

15

---

Edgar Filing: INGLES MARKETS INC - Form 10-Q

The following table sets forth, for the periods indicated, selected financial information as a percentage of net sales. For information regarding the various segments of the business, see Note I “Segment Information” to the Condensed Consolidated Financial Statements.

	Three Months Ended		Nine Months Ended	
	June 25, 2016	June 27, 2015	June 25, 2016	June 27, 2015
Net sales	100.0 %	100.0 %	100.0 %	100.0 %
Gross profit	24.3 %	23.5 %	24.3 %	23.5 %
Operating and administrative expenses	20.8 %	20.2 %	20.8 %	19.9 %
Loss from sale or disposal of assets	(0.2) %	— %	(0.1) %	— %
Income from operations	3.3 %	3.3 %	3.4 %	3.6 %
Other income, net	0.1 %	0.1 %	— %	— %
Interest expense	1.2 %	1.1 %	1.2 %	1.2 %
Income tax expense	0.9 %	0.8 %	0.8 %	0.9 %
Net income	1.3 %	1.5 %	1.4 %	1.5 %

Three Months Ended June 25, 2016 Compared to the Three Months Ended June 27, 2015

Net income for the third quarter of fiscal 2016 totaled \$12.7 million compared with \$13.8 million for the third quarter of fiscal 2015. Comparing the two third quarters, fiscal 2016 had higher sales and gross profit that were offset by higher expenses, taxes and the demolition of properties that will be redeveloped into larger stores.

Net Sales. Net sales increased by \$11.2 million, or 1.2% to \$957.2 million for the three months ended June 25, 2016 from \$946.0 million for the three months ended June 27, 2015. Lower gasoline sales were offset by higher sales in other products. Comparing the third quarter of fiscal 2016 with the third quarter of fiscal 2015, gasoline sales dollars decreased 6.8% due to a 14.4% decrease in the average sales price per gallon. Gallons sold increased 8.9% over the same comparable periods. Easter occurred in the second quarter of the current fiscal year, but did not occur until the third quarter of the prior fiscal year. Excluding gasoline sales and the effect of extra Easter sales in last year’s third quarter, grocery comparable store sales increased 2.6% over the comparative fiscal third quarters. Comparing the third quarters of fiscal year 2016 and 2015 (and excluding gasoline), the number of customer transactions increased 1.9% and the average transaction size increased 0.6%.

Ingles operated 201 stores at June 25, 2016 and at June 27, 2015. Retail square footage was approximately 11.1 million at June 25, 2016 and 11.0 million at June 27, 2015.

Sales by product category (amounts in thousands) are as follows:

	Three Months Ended	
	June 25, 2016	June 27, 2015
Grocery	\$ 337,030	\$ 335,974
Non-foods	207,575	195,484
Perishables	257,799	250,895
Gasoline	120,347	129,345
Total retail	\$ 922,751	\$ 911,698

The grocery category includes grocery, dairy, and frozen foods.

The non-foods include alcoholic beverages, tobacco, pharmacy, health and video.

The perishables category includes meat, produce, deli and bakery.

Edgar Filing: INGLES MARKETS INC - Form 10-Q

Changes in grocery segment sales for the quarter ended June 25, 2016 are summarized as follows (dollars in thousands):

Total retail sales for the three months ended June 27, 2015	\$ 911,698
Comparable store sales increase (including gasoline)	8,982
Effect of Easter in third quarter of fiscal 2015	(7,084)
Impact of stores opened in fiscal 2015 and 2016	16,175
Impact of stores closed in fiscal 2015 and 2016	(6,999)
Other	(21)
Total retail sales for the three months ended June 25, 2016	\$ 922,751

Gross Profit. Gross profit for the three-month period ended June 25, 2016 increased \$10.7 million, or 4.8%, to \$232.9 million, or 24.3% of sales, compared with \$222.2 million, or 23.5% of sales, for the three-month period ended June 27, 2015.

Excluding gasoline sales, grocery segment gross profit as a percentage of sales increased 39 basis points in the third quarter of fiscal 2016 compared with the same fiscal 2015 period. Gasoline gross profit dollars were also higher for the quarter ended June 25, 2016 compared with the quarter ended June 27, 2015.

In addition to the direct product cost, the cost of goods sold line item for the grocery segment includes inbound freight charges and the costs related to the Company's distribution network. The milk processing operation is a manufacturing process; therefore, the costs mentioned above as well as purchasing, production costs, and internal transfer costs incurred by the milk processing operation are included in the cost of goods sold line item, while these items are included in operating and administrative expenses in the grocery segment.

Operating and Administrative Expenses. Operating and administrative expenses increased \$8.7 million, or 4.6%, to \$199.4 million for the three months ended June 25, 2016, from \$190.7 million for the three months ended June 27, 2015. As a percentage of sales, operating and administrative expenses were 20.8% for the three months ended June 25, 2016 compared with 20.2% for the three months ended June 27, 2015. Excluding gasoline sales and associated gasoline operating expenses (primarily payroll), operating expenses were 23.6% and 23.2% of sales for the third fiscal quarter of 2016 and 2015, respectively.

A breakdown of the major increases (decreases) in operating and administrative expenses is as follows:

	Increase (Decrease) in millions	Increase (Decrease) as a % of sales	
Salaries and wages	\$ 6.4	0.67	%
Depreciation and amortization	\$ 1.0	0.11	%
Taxes and licenses	\$ 0.9	0.09	%
Bank charges	\$ 0.8	0.08	%
Insurance	\$ (1.3)	(0.13)	%

Salaries and wages increased in dollars due to additional labor hours required for the increased sales volume.

Depreciation and amortization expense increased as a result of capital expenditures to improve the Company's store base and distribution operations.

Taxes and licenses increased mostly from municipal taxes and licenses.

Bank charges increased due to higher volume and per transaction costs of credit and debit card transactions.

Insurance expense decreased due to lower claims under the Company's self-insurance programs.

Loss from Sale or Disposal of Assets. Loss from Sale or Disposal of Assets was \$1.6 million for the June 2016 quarter compared with a loss of \$0.3 million for the June 2015 quarter. During the June 2016 quarter, the Company demolished certain buildings for redevelopment into larger and improved store or tenant space.



**Interest Expense.** Interest expense increased \$0.6 million for the three-month period ended June 25, 2016 to \$11.2 million from \$10.6 million for the three-month period ended June 27, 2015. Total debt at June 2016 was \$898.2 million compared to \$918.2 million at June 2015.

**Income Taxes.** Income tax expense as a percentage of pre-tax income was 40.2% for the June 2016 quarter, compared with 34.6% for the June 2015 quarter. During the third quarter of each fiscal year, the Company reconciles estimated prior year tax expense to actual tax returns filed during the quarter. This process increased tax expense during the current fiscal quarter and decreased it in last year's third fiscal quarter.

**Net Income.** Net income totaled \$12.7 million and \$13.8 million for the three-month periods ended June 25, 2016 and June 27, 2015, respectively. Basic and diluted earnings per share for Class A Common Stock were \$0.64 and \$0.63, respectively for the June 2016 quarter. Basic and diluted earnings per share for Class B Common Stock were each \$0.59 for the June 2016 quarter. Basic and diluted earnings per share for Class A Common Stock were \$0.70 and \$0.68, respectively for the June 2015 quarter. Basic and diluted earnings per share for Class B Common Stock were each \$0.63 for the June 2015 quarter.

#### Nine Months Ended June 25, 2016 Compared to the Nine Months Ended June 27, 2015

Net income for the first nine months of fiscal 2016 totaled \$40.0 million compared with net income of \$43.1 million for the nine-month fiscal 2015 period. Non-gas sales, gross profit and gross margin all increased, but expenses increased to a higher degree.

**Net Sales.** Net sales totaled \$2.83 billion for each of the nine month periods ended June 25, 2016 and June 27, 2015. Decreases in retail gasoline prices and sales dollars were offset by increases in other areas. Excluding gasoline, total sales increased 2.3% over the comparative nine month 2016 and 2015 periods.

Grocery segment comparable store sales, excluding the effect of gasoline increased 2.1%. The number of customer transactions (excluding gasoline) increased 1.4%, while the average transaction size (excluding gasoline) increased by 1.2%.

Sales by product category (amounts in thousands) are as follows:

	Nine Months Ended	
	June 25, 2016	June 27, 2015
Grocery	\$ 1,046,616	\$ 1,042,559
Non-foods	608,601	571,059
Perishables	753,027	731,507
Gasoline	321,049	372,413
Total retail	\$ 2,729,293	\$ 2,717,538

The grocery category includes grocery, dairy, and frozen foods.

The non-foods include alcoholic beverages, tobacco, pharmacy, health and video.

The perishables category includes meat, produce, deli and bakery.

Changes in grocery segment sales for the nine months ended June 25, 2016 can be summarized as follows (dollars in thousands):

Total retail sales for the nine months ended June 27, 2015	\$ 2,717,538
Comparable store sales decrease (including gasoline)	(8,319)
Impact of stores opened in fiscal 2015 and 2016	41,436
Impact of stores closed in fiscal 2015 and 2016	(21,236)
Other	(126)
Total retail sales for the nine months ended June 25, 2016	\$ 2,729,293

Sales growth for the remainder of fiscal 2016 will depend upon the pace of economic improvement, inflation and market prices for gasoline and raw milk. In addition to recently opened new and remodeled stores, the Company expects that the maturation of previous new and expanded stores will contribute to sales growth. The Company continues to remodel existing stores in order to increase sales at a lower cost compared with construction cost of adding additional square footage.

**Gross Profit.** Gross profit for the nine months ended June 25, 2016 increased \$22.0 million, or 3.3%, to \$687.2 million compared with \$665.2 million, for the nine months ended June 27, 2015. As a percentage of sales, gross profit totaled 24.3% for the nine months ended June 25, 2016 and 23.5% for the nine months ended June 27, 2015.



Excluding gasoline sales, retail grocery segment gross profit as a percentage of sales increased 18 basis points in the first three quarters of fiscal 2016 compared with the same fiscal 2015 period. Gasoline gross profit dollars were lower for the nine months ended June 25, 2016 compared with the nine months ended June 27, 2015.

Operating and Administrative Expenses. Operating and administrative expenses increased \$26.4 million, or 4.7%, to \$589.7 million for the nine months ended June 25, 2016, from \$563.3 million for the nine months ended June 27, 2015. As a percentage of sales, operating and administrative expenses were 20.8% for the June 2016 nine-month period compared with 19.9% for the same period last year. Excluding gasoline sales and associated gasoline operating expenses (primarily payroll), operating expenses were 23.3% and 22.8% of sales for the nine-month fiscal 2016 and 2015 periods, respectively.

A breakdown of the major increases in operating and administrative expenses is as follows:

	Increase in millions	Increase as a % of sales
Salaries and wages	\$ 16.9	0.60 %
Repairs and maintenance	\$ 2.9	0.10 %
Advertising and promotion	\$ 1.8	0.06 %
Bank charges	\$ 1.8	0.06 %
Depreciation and amortization	\$ 1.6	0.06 %

Salaries and wages increased in dollars due to additional labor hours required for the increased sales volume.

Repairs and maintenance increased due to more sophisticated equipment in our stores and to a higher level of building maintenance.

Advertising and promotion increased from expanded print and television investments and in response to the current competitive environment.

Bank charges increased due to higher volume and per transaction costs of credit and debit card transactions.

Depreciation and amortization expense increased as a result of capital expenditures to improve the Company's store base and distribution operations.

Loss or gain from sale or disposal of assets. Loss from Sale or Disposal of Assets was \$0.9 million for the June 2016 nine month period compared with a gain of \$0.3 million for the June 2015 nine month period. During the June 2016 quarter, the Company demolished certain buildings for redevelopment into larger and improved store or tenant space.

Interest Expense. Interest expense increased \$0.2 million to \$34.4 million for the nine months ended June 25, 2016 from \$34.2 million for the nine months ended June 27, 2015.

Income Taxes. Income tax expense as a percentage of pre-tax income was 37.4% in the June 2016 nine-month period compared to 38.2% in the June 2015 nine-month period.

Net Income. Net income totaled \$40.0 million for the nine-month period ended June 25, 2016. Basic and diluted earnings per share for Class A Common Stock were \$2.03 and \$1.98, respectively, for the June 2016 nine-month period. Basic and diluted earnings per share for Class B Common Stock were each \$1.85 for the June 2016 nine-month period. Net income totaled \$43.1 million for the nine-month period ended June 27, 2015. Basic and diluted earnings per share for Class A Common Stock were \$2.19 and \$2.13, respectively, for the June 2015 nine-month period. Basic and diluted earnings per share for Class B Common Stock were each \$1.99 for the June 2015 nine-month period.

## Liquidity and Capital Resources

### Capital Expenditures

The Company believes that a key to its ability to continue to develop a loyal customer base is providing conveniently located, clean and modern stores which provide customers with good service and a broad selection of competitively priced products. Therefore, the Company has invested and plans to continue to invest significant amounts of capital toward the modernization of its store base. The Company's modernization program includes the opening of new stores, the completion of remodels and expansion of selected existing



stores, and the relocation of selected existing stores to larger, more convenient locations. The Company will also add fuel centers, pharmacies and other products complementary to grocery sales where market conditions and real estate considerations warrant.

Capital expenditures totaled \$107.8 million for the nine-month period ended June 25, 2016. These capital expenditures focused on construction of stores that opened in 2016 or will open in fiscal 2017, the addition of fuel centers and smaller scale remodeling projects in a number of the Company's stores. Capital expenditures also included the costs of upgrading and replacing store equipment, technology investments, capital expenditures related to the Company's milk processing plant.

Ingles' capital expenditure plans for fiscal 2016 include investments of approximately \$120 to \$145 million. The majority of the Company's fiscal 2016 capital expenditures will be dedicated to continued improvement of its store base and also include investments in stores expected to open in fiscal 2017 as well as technology improvements, upgrading and replacing existing store equipment and warehouse and transportation equipment and improvements to the Company's milk processing plant.

The Company expects that its net annual capital expenditures will be in the range of approximately \$100 to \$160 million going forward in order to maintain a modern store base. Planned expenditures for any given future fiscal year will be affected by the availability of financing, which can affect both the number of projects pursued at any given time and the cost of those projects. The number of projects may also fluctuate due to the varying costs of the types of projects pursued including new stores and major remodel/expansions. The Company makes decisions on the allocation of capital expenditure dollars based on many factors including the competitive environment, other Company capital initiatives and its financial condition.

The Company does not generally enter into commitments for capital expenditures other than on a store-by-store basis at the time it begins construction on a new store or begins a major or minor remodeling project. Outstanding construction commitments totaled \$5.8 million at June 25, 2016.

## Liquidity

The Company generated net cash from operations of \$103.6 million in the June 2016 nine-month period compared to \$101.2 million for the comparable 2015 period. There were no individually significant changes in components of cash from operations over the comparative nine-month periods.

Cash used by investing activities for the nine-month period ended June 25, 2016 totaled \$107.1 million, compared with cash used of \$72.3 million for the nine-month period ended June 27, 2015. During the fiscal 2016 period, capital expenditures were higher than in the prior fiscal year period.

Cash provided by financing activities totaled \$1.5 million for the nine months ended June 25, 2016 compared with a \$28.8 million use of cash by financing activities for the nine months ended June 27, 2015. The Company has borrowed more on its Line to finance a higher level of capital expenditures in the current fiscal year.

In June 2013, the Company issued \$700.0 million aggregate principal amount of senior notes due in 2023 (the "Notes"). The Notes bear an interest rate of 5.75% per annum and were issued at par.

In connection with the offering of the Notes, the Company extended the maturity date of its \$175.0 million Line from December 2015 to June 2018 and modified certain interest rate options and covenants. At June 25, 2016 the Company had \$22.3 million borrowing outstanding under the Line.

The Line provides the Company with various interest rate options based on the prime rate, the Federal Funds Rate, or the London Interbank Offering Rate. The Line allows the Company to issue up to \$30.0 million in unused letters of credit, of which \$9.7 million of unused letters of credit were issued at June 25, 2016. The Company is not required to maintain compensating balances in connection with this Line.

On December 29, 2010, the Company completed the funding of \$99.7 million of Recovery Zone Facility Bonds (the "Bonds") for the construction of new warehouse and distribution space located in Buncombe County, North Carolina. The final maturity date of the Bonds is January 1, 2036.

Under a Continuing Covenant and Collateral Agency Agreement (the "Covenant Agreement") between certain financial institutions and the Company, the financial institutions would hold the Bonds until January 2, 2018, subject to certain events. Mandatory redemption of the Bonds by the Company in the annual amount of \$4.5 million began on January 1, 2014.

In connection with the offering of the Notes, the Company extended the maturity date of the Covenant Agreement from January 2018 to June 2021 and modified certain interest rate options and covenants. The Company may redeem the Bonds without penalty or premium at any time prior to June 2021.

The Company's long-term debt agreements generally have cross-default provisions which could result in the acceleration of payments due under the Company's Line, Bond and Notes indenture in the event of default under any one instrument.





The Notes, the Bonds and the Line contain provisions that under certain circumstances would permit lending institutions to terminate or withdraw their respective extensions of credit to the Company. Included among the triggering factors permitting the termination or withdrawal of the Line to the Company are certain events of default, including both monetary and non-monetary defaults, the initiation of bankruptcy or insolvency proceedings, and the failure of the Company to meet certain financial covenants designated in its respective loan documents. As of June 25, 2016, the Company was in compliance with these covenants. Under the most restrictive of these covenants, the Company would be able to incur approximately \$371 million of additional borrowings (including borrowings under the Line) as of June 25, 2016.

The Company's principal sources of liquidity are expected to be cash flow from operations, borrowings under the Line and long-term financing. The Company believes, based on its current results of operations and financial condition, that its financial resources, including the Line, short- and long-term financing expected to be available to it and internally generated funds, will be sufficient to meet planned capital expenditures and working capital requirements for the foreseeable future, including any debt service requirements of additional borrowings. However, there is no assurance that any such sources of financing will be available to the Company when needed on acceptable terms, or at all.

It is possible that, in the future, the Company's results of operations and financial condition will be different from that described in this report based on a number of factors. These factors may include, among others, increased competition, changing regional and national economic conditions, adverse climatic conditions affecting food production and delivery and changing demographics, as well as the additional factors discussed below under "Forward Looking Statements." It is also possible, for such reasons, that the results of operations from the new, expanded, remodeled and/or replacement stores will not meet or exceed the results of operations from existing stores that are described in this report.

#### Contractual Obligations and Commercial Commitments

There have been no material changes in contractual obligations and commercial commitments subsequent to September 26, 2015 other than as disclosed elsewhere in this Form 10-Q.

#### Off Balance Sheet Arrangements

The Company is not a party to any off-balance sheet arrangements that have, or are reasonably likely to have, a current or future material effect on the Company's financial condition, revenues, expenses, results of operations, liquidity, capital expenditures or capital resources.

## Quarterly Cash Dividends

Since December 27, 1993, the Company has paid regular quarterly cash dividends of \$0.165 (sixteen and one-half cents) per share on its Class A Common Stock and \$0.15 (fifteen cents) per share on its Class B Common Stock for an annual rate of \$0.66 and \$0.60 per share, respectively.

The Company expects to continue paying regular cash dividends on a quarterly basis. However, the Board of Directors periodically reconsiders the declaration of dividends. The Company pays these dividends at the discretion of the Board of Directors and the continuation of these payments, the amount of such dividends, and the form in which the dividends are paid (cash or stock) depends upon the results of operations, the financial condition of the Company and other factors which the Board of Directors deems relevant. In addition, the Notes, the Bonds, and the Line contain provisions that, based on certain financial parameters, restrict the ability of the Company to pay additional cash dividends in excess of current quarterly per share amounts. Further, the Company is prevented from declaring dividends at any time that it is in default under the indenture governing the Notes.

## Seasonality

Sales in the grocery segment of the Company's business are subject to a slight seasonal variance due to holiday related sales and due to sales in areas where seasonal homes are located. Sales are traditionally higher in the Company's first fiscal quarter due to the inclusion of sales related to Thanksgiving and Christmas. The Company's second fiscal quarter traditionally has the lowest sales of the year, unless Easter falls in that quarter. In the third and fourth quarter, sales are affected by the return of customers to seasonal homes in our market area. The fluid dairy operation of the Company's business has slight seasonal variation to the extent of its sales into the grocery industry. The Company's real estate operation is not subject to seasonal variations.

## Impact of Inflation

The following table from the United States Bureau of Labor Statistics lists annualized changes in the Consumer Price Index that could have an effect on the Company's operations. One of the Company's significant costs is labor, which increases with general inflation. Inflation or deflation in energy costs affects the Company's gasoline sales, distribution expenses, utility expenses and plastic supply costs.

	Three Months Ended June	
	25, 2016	June 27, 2015
All items	0.3 %	(0.8) %
Food and beverages	0.0 %	0.6 %
Energy	2.0 %	(17.6)%

## Forward Looking Statements

This Quarterly Report contains certain forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. The words "expect", "anticipate", "intend", "plan", "likely", "goal", "believe", and similar expressions are intended to identify forward-looking statements. While these forward-looking statements and the related assumptions are made in good faith and reflect the Company's current judgment regarding the direction of the Company's business, actual results will almost always vary, sometimes materially, from any estimates, predictions, projections, assumptions or other future performance suggested herein. Such statements are based upon a number of assumptions and estimates which are inherently subject to significant risks and uncertainties many of which are beyond the Company's control. Some of these assumptions inevitably will not materialize, and unanticipated events will occur which will affect the Company's results. Some important factors (but not necessarily all factors) that affect the Company's revenues, growth strategies, future profitability and operating results, or that otherwise could cause actual results to differ materially from those expressed in or implied by any forward-looking statement, include business and economic conditions generally in the Company's operating area; the Company's ability to successfully implement its expansion and operating strategies and to manage rapid expansion; pricing pressures and other competitive factors; reduction in per gallon retail gasoline prices; the maturation of new and expanded stores; the Company's ability to reduce costs and achieve improvements in operating results; the availability and terms of financing; increases in labor and utility costs; success or failure in the ownership and development of real estate; changes in the laws and government regulations applicable to the Company; and changes in accounting policies, standards, guidelines or principles as may be adopted by regulatory agencies as well as the Financial Accounting Standards Board.

Consequently, actual events affecting the Company and the impact of such events on the Company's operations may vary significantly from those described in this report or contemplated or implied by statements in this report. The Company does not undertake and specifically denies any obligation to update any such statements or to publicly announce the results of any revisions to any such statements to reflect future events or developments.

### Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company does not typically utilize financial instruments for trading or other speculative purposes, nor does it typically utilize leveraged financial instruments. There have been no material changes in the market risk factors from those disclosed in the Company's Annual Report on Form 10-K for the year ended September 26, 2015.

### Item 4. CONTROLS AND PROCEDURES

#### (a) Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures designed to provide reasonable assurance of achieving the objective that information in its Exchange Act reports is recorded, processed, summarized and reported within the time periods specified and pursuant to the regulations of the Securities and Exchange Commission. Disclosure controls and procedures, as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act, include controls and procedures designed to ensure the information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. It should be noted that the Company's system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met.

As required by SEC Rule 13a-15(b), the Company carried out an evaluation, under the supervision and with participation of its management, including its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of its

disclosure controls and procedures as of June 25, 2016, the end of the period covered by this report. In making this evaluation, it considered matters previously identified and disclosed in connection with the filing of its Form 10-K for fiscal 2015. After consideration of the matters discussed above, the Company has concluded that its controls and procedures were effective as of June 25, 2016.

(b) Changes in Internal Control over Financial Reporting

The Company is currently performing tests of internal controls over financial reporting for fiscal year 2016.

No other change in internal control over financial reporting occurred during the Company's last fiscal quarter that materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Part II. OTHER INFORMATION

Item 6. EXHIBITS

(a) Exhibits.

3.1 Articles of Incorporation of Ingles Markets, Incorporated (included as Exhibit 3.1 to Ingles Markets, Incorporated's Registration Statement on Form S-1, File No. 33-23919, previously filed with the Commission and incorporated herein by this reference).

3.2 Articles of Amendment to Articles of Incorporation of Ingles Markets, Incorporated (included as Exhibit 3.3 to Ingles Markets, Incorporated's Annual Report on Form 10-K for the fiscal year ended September 25, 2004, File No. 0-14706, previously filed with the Commission and incorporated herein by this reference).

3.3 Articles of Amendment to Articles of Incorporation of Ingles Markets, Incorporated dated April 23, 2012 (included as Exhibit 3.3 to Ingles Markets, Incorporated Quarterly Report on Form 10-Q for the fiscal quarter ended March 24, 2012, File No. 0-14706, previously filed with the Commission and incorporated herein by this reference).

4

3.4 Amended and Restated By-Laws of Ingles Markets, Incorporated (included as Exhibit 99.1 to Ingles Markets, Incorporated's Current Report on Form 8-K, File No. 0-14706, previously filed with the Commission on August 30, 2007 and incorporated herein by this reference).

4.1 Articles 4 and 9 of the Articles of Incorporation of Ingles Markets, Incorporated (included as Exhibit 3.1 to Ingles Markets, Incorporated's Registration Statement on Form S-1, File No. 33-23919, and Exhibit 3.3 to Ingles Markets, Incorporated's Annual Report on Form 10-K for the fiscal year ended September 25, 2004, File No. 0-14706, respectively, each of which were previously filed with the Commission and are incorporated herein by this reference).

4.2 Articles 2, 3, 10, 11 and 14 of the Amended and Restated By-Laws of Ingles Markets, Incorporated (included as Exhibit 99.1 to Ingles Markets, Incorporated's Current Report on Form 8-K, File No. 0-14706, previously filed with the Commission on August 30, 2007 and incorporated herein by this reference).

3

4.3 Indenture, dated as of June 12, 2013, between Ingles Markets, Incorporated and Branch Banking and Trust Company, as Trustee, governing the 5.75% Senior Notes Due 2023, including the form of unregistered 5.75% Senior Note Due 2023 (included as Exhibit 4.1 to Ingles Markets, Incorporated's Current Report on Form 8-K, File No. 0-14706, previously filed with the Commission on June 12, 2013 and incorporated herein by this reference).

4.4 Registration Rights Agreement, dated June 12, 2013, among the Company and Merrill Lynch, Pierce, Fenner and Smith Incorporated, Wells Fargo Securities, LLC, BB&T Capital Markets, a division of BB&T Securities, LLC and SunTrust Robinson Humphrey, Inc. (included as Exhibit 4.3 to Ingles Markets, Incorporated's Current Report on Form 8-K, File No. 0-14706, previously filed with the Commission on June 12, 2013 and incorporated herein by this reference).

10

- 10.1 Credit Agreement, dated May 12, 2009, among the Company and the lenders party thereto, Bank of America, as administrative agent, swing line lender and l/c issuer, Branch Banking and Trust Company, as syndication agent, Wachovia Bank, National Association, as documentation agent, and Banc of America Securities LLC, Branch Banking and Trust Company and Wachovia Capital Markets, LLC, as joint lead arrangers and book managers (included as Exhibit 10.1 to Ingles Markets, Incorporated's Current Report on Form 8-K, File No. 0-14706, previously filed with the Commission on May 15, 2009 and incorporated herein by this reference).

23

---



Edgar Filing: INGLES MARKETS INC - Form 10-Q

- 10.2 Exhibits and Schedules to Credit Agreement dated May 12, 2009, among the Company and the lenders party thereto, Bank of America, as administrative agent, swing line lender and l/c issuer, Branch Banking and Trust Company, as syndication agent, Wachovia Bank, National Association, as documentation agent, and Banc of America Securities LLC, Branch Banking and Trust Company and Wachovia Capital Markets, LLC, as joint lead arrangers and joint book managers (included as Exhibit 10.1 to Ingles Markets, Incorporated's Current Report on Form 8-K, File No. 0-14706, previously filed with the Commission on May 15, 2009 and incorporated herein by this reference).
- 10.3 Waiver and First Amendment to the Credit Agreement dated as of July 31, 2009, among the Company the lenders from time to time party thereto, Bank of America, N.A., as administrative agent, swing line lender and l/c issuer, and the other agents, joint lead arrangers and joint book managers party thereto (included as Exhibit 10.3 to Ingles Markets, Incorporated's Annual Report on Form 10-K for the fiscal year ended September 29, 2012, File No. 0-14706, previously filed with the Commission and incorporated herein by this reference).
- 10.4 Second Amendment to the Credit Agreement dated as of December 29, 2010, among the Company the lenders from time to time party thereto, Bank of America, N.A., as administrative agent, swing line lender and l/c issuer, and the other agents, joint lead arrangers and joint book managers party thereto (included as Exhibit 10.1 to Ingles Markets, Incorporated's Current Report on Form 8-K, File No. 0-14706, previously filed with the Commission on January 4, 2011 and incorporated herein by this reference).
- 10.5 Third Amendment to the Credit Agreement dated as of September 6, 2012, among the Company the lenders from time to time party thereto, Bank of America, N.A., as administrative agent, swing line lender and l/c issuer, and the other agents, joint lead arrangers and joint book managers party thereto (included as Exhibit 10.5 to Ingles Markets, Incorporated's Annual Report on Form 10-K for the fiscal year ended September 29, 2012, File No. 0-14706, previously filed with the Commission and incorporated herein by this reference).
- 10.6 Fourth Amendment to the Credit Agreement dated as of June 12, 2013, among the Company the lenders from time to time party thereto, Bank of America, N.A., as administrative agent, swing line lender and l/c issuer, and the other agents, joint lead arrangers and joint book managers party thereto (included as Exhibit 10.6 to Ingles Markets, Incorporated's Quarterly Report on Form 10-Q for the quarter ended December 28, 2013, File No. 0-14706, previously filed with the Commission and incorporated herein by this reference).

10.7 Fifth Amendment to the Credit Agreement dated as of January 31, 2014, among the Company the lenders from time to time party thereto, Bank of America, N.A., as administrative agent, swing line lender and l/c issuer, and the other agents, joint lead arrangers and joint book managers party thereto (included as Exhibit 10.7 to Ingles Markets, Incorporated's Quarterly Report on Form 10-Q for the quarter ended December 28, 2013, File No. 0-14706, previously filed with the Commission and incorporated herein by this reference).

10.8 Sixth Amendment to the Credit Agreement dated as of June 23, 2014, among the Company the lenders from time to time party thereto, Bank of America, N.A., as administrative agent, swing line lender and l/c issuer, and the other agents, joint lead arrangers and joint book managers party thereto (included as Exhibit 10.1 to Ingles Markets, Incorporated's Current Report on Form 8-K, File No. 0-14706, previously filed with the Commission on June 24, 2014 and incorporated herein by this reference).

31.1 \* Rule 13a-14(a) Certification

31.2 \* Rule 13a-14(a) Certification

32.1 \* Certification Pursuant to 18 U.S.C. Section 1350

32.2 \* Certification Pursuant to 18 U.S.C. Section 1350

101 \* The following financial information from the Quarterly Report on Form 10-Q for the fiscal quarter ended June 25, 2016, formatted in XBRL (Extensible Business Reporting Language) and furnished electronically herewith: (i) the Consolidated Statements of Earnings; (ii) the Consolidated Balance Sheets; (iii) the Consolidated Statements of Cash Flows; (iv) the Consolidated Statements of Comprehensive Income; and (v) the Notes to the Consolidated Financial Statements.

\* Filed herewith.

24

---

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Form 10-Q to be signed on its behalf by the undersigned thereunto duly authorized.

INGLES MARKETS, INCORPORATED

Date: August 3, 2016 /s/ James W. Lanning

James W. Lanning  
Chief Executive Officer and President

Date: August 3, 2016 /s/ Ronald B. Freeman

Ronald B. Freeman  
Vice President-Finance and Chief Financial Officer