WILD OATS MARKETS INC
Form 10-Q
August 11, 2005
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(**X**) QUARTERLY REPORT PURSUANT TO SECTION 13 OR SECTION 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JULY 2, 2005.

OR

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

Commission file number 0-21577

WILD OATS MARKETS, INC.

(Exact name of registrant as specified in its charter)

Delaware	84-1100630
(State or other jurisdiction of	(I.R.S. Employer Identification Number)

Incorporation or organization)

3375 Mitchell Lane

Boulder, Colorado 80301

(Address of principal executive offices, including zip code)

(303) 440-5220

(Registrant s telephone number, including area code)

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

Yes (**X**) No ( )

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2).

Yes (**X**) No ( )

As of August 1, 2005, there were 28,760,651 shares outstanding of the registrant's common stock (par value $.001 per share).

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

WILD OATS MARKETS, INC.

Consolidated Balance Sheets

(in thousands, except share data)

	July 2, 2005 (unaudited)	January 1, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 43,418	$ 30,671
Short-term investments	-	11,144
Inventories (net of reserves of $889 and $815, respectively)	58,475	54,960
Accounts receivable (net of allowance for doubtful accounts of $116 and $153, respectively)	3,211	3,860
Prepaid expenses and other current assets	5,454	5,741
Total current assets	110,558	106,376
Property and equipment, net	176,068	177,830
Goodwill, net	105,124	106,084
Other intangible assets, net	6,271	6,491
Deposits and other assets	8,109	8,361
Deferred tax asset, net	674	418
	$ 406,804	$ 405,560
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		

Accounts payable	$ 57,816	$ 54,428
Book overdraft	20,974	23,325
Accrued liabilities	52,161	53,154
Current portion of debt, capital leases and financing obligations	706	405
Deferred tax liabilities	345	-
Total current liabilities	132,002	131,312
Long-term debt, capital leases and financing obligations	148,453	148,675
Other long-term obligations	24,282	24,472
	304,737	304,459
Commitments and contingencies		
Stockholders equity:		
Preferred stock, $0.001 par value; 5,000,000 shares authorized, no shares issued and outstanding		-
Common stock, $0.001 par value; 60,000,000 shares authorized, 30,645,967 and 30,466,701 shares issued; 28,668,167 and 28,488,901 outstanding, respectively	31	30
Treasury stock, at cost: 1,977,800 shares as of July 2, 2005 and January 1, 2005	(24,999)	(24,999)
Additional paid-in capital	222,820	221,029
Note receivable, related party	(11,730)	(11,416)
Accumulated deficit	(84,738)	(84,509)
Accumulated other comprehensive income	683	966
Total stockholders equity	102,067	101,101

	$ 406,804	$ 405,560

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

WILD OATS MARKETS, INC.

Consolidated Statements of Operations

(in thousands, except per-share data) (unaudited)

	THREE MONTHS ENDED		SIX MONTHS ENDED	
	July 2, 2005	June 26, 2004	July 2, 2005	June 26, 2004
Sales	$ 284,608	$ 251,697	$ 562,687	$ 515,492
Cost of goods sold and occupancy costs	202,049	178,263	399,872	364,652
Gross profit	82,559	73,434	162,815	150,840
Operating expenses:				
Direct store expenses	60,724	56,271	121,095	113,314
Selling, general and administrative expenses	17,201	14,418	32,241	29,939

Loss (gain) on disposal of assets	53	48	44	(69)
Pre-opening expenses	780	1,982	2,697	2,581
Restructuring and asset impairment charges (income), net	909	(134)	2,460	135
Income from operations	2,892	849	4,278	4,940
Loss on early extinguishment of debt	-	-	(559)	-
Interest income	361	222	685	408
Interest expense	(2,144)	(1,306)	(4,311)	(2,341)
Income (loss) before income taxes	1,109	(235)	93	3,007
Income tax expense	187	96	322	1,269
Net income (loss)	$ 922	$ (331)	$ (229)	$ 1,738
Net income (loss) per common share:				
Basic	$ 0.03	$ (0.01)	$ (0.01)	$ 0.06
Diluted	$ 0.03	$ (0.01)	$ (0.01)	$ 0.06
Weighted average common shares outstanding, basic	28,667	29,788	28,622	29,982
Dilutive effect of stock options and restricted stock units	518	-	-	878

Weighted average common shares outstanding, assuming dilution	29,185	29,788	28,622	30,860

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

WILD OATS MARKETS, INC.

Consolidated Statements of Comprehensive Income (Loss)

(in thousands) (unaudited)

	THREE MONTHS ENDED		SIX MONTHS ENDED	
	July 2, 2005	June 26, 2004	July 2, 2005	June 26, 2004
Net income (loss)	$ 922	$ (331)	$ (229)	$ 1,738
Other comprehensive loss:				
Foreign currency translation adjustments	(198)	(125)	(255)	(217)
Unrealized gain (loss) on available-for-sale securities	2	-	(28)	-

Other comprehensive loss	(196)	(125)	(283)	(217)
Comprehensive income (loss)	$ 726	$ (456)	$ (512)	$ 1,521

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

WILD OATS MARKETS, INC.

Consolidated Statements of Cash Flows

(in thousands) (unaudited)

	SIX MONTHS ENDED	
	July 2, 2005	June 26, 2004
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) income	$ (229)	$ 1,738
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	13,117	14,015
Loss (gain) on disposal of property and equipment	44	(69)

Deferred tax expense	134	671
Restructuring and asset impairment expense, net	2,460	135
Interest on related party receivable	(314)	(297)
Stock based compensation	244	537
Income tax benefit from stock based compensation	-	495
Accretion of debt issuance costs	259	197
Loss on early extinguishment of debt	559	-
Change in assets and liabilities:		
Inventories, net	(3,565)	(4,568)
Receivables, net, and other assets	345	1,227
Accounts payable	3,411	6,642
Accrued liabilities and other liabilities	(1,728)	812
Net cash provided by operating activities	14,737	21,535
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(11,978)	(27,374)
Proceeds from sale of short-term investments	11,116	-
Proceeds from sale of property and equipment	26	964
Net cash used in investing activities	(836)	(26,410)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net repayments under line-of-credit agreement	-	(30,179)

Net decrease in book overdraft	(2,351)	(5,492)
Proceeds from long-term debt	-	115,150
Purchase of treasury stock	-	(24,999)
Payment of debt issuance costs	-	(3,636)
Repayments on notes payable, long-term debt and capital leases	(183)	(64)
Proceeds from issuance of common stock, net	1,548	2,551
Net cash (used in) provided by financing activities	(986)	53,331
Effect of exchange rate changes on cash	(168)	(85)
Net increase in cash and cash equivalents	12,747	48,371
Cash and cash equivalents at beginning of period	30,671	17,400
Cash and cash equivalents at end of period	$ 43,418	$ 65,771
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Equipment acquired through capital lease	$ 262	$ 105

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

WILD OATS MARKETS, INC.

Notes to Consolidated Financial Statements

(unaudited)

1. Nature of Operations and Basis of Presentation

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

The Consolidated Balance Sheet as of July 2, 2005, the Consolidated Statements of Operations and Consolidated Statements of Comprehensive Income (Loss) for the three and six months ended July 2, 2005 and June 26, 2004, as well as the Consolidated Statements of Cash Flows for the six months ended July 2, 2005 and June 26, 2004 have been prepared without an audit. In the opinion of management, all adjustments, consisting only of normal, recurring adjustments necessary for a fair statement thereof, have been made.

The financial statements have been prepared by the Company in accordance with the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to SEC regulations, therefore, these consolidated financial statements should be read in conjunction with financial statements and notes thereto included in the Company's 2004 Annual Report on Form 10-K, as amended. The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, expenses and related disclosures of contingent assets and liabilities. Examples include accounting for self-insurance reserves, restructuring charges and store closing costs, asset impairment charges, goodwill, inventory valuation, and contingencies. Actual results may differ from these estimates. The results of operations for interim periods presented are not necessarily indicative of the operating results for the full year. Certain prior period information has been reclassified to conform to the current year presentation.

The unaudited information included in the consolidated financial statements for the three months and six months ended July 2, 2005 and June 26, 2004 include the results of operations of the Company for the 13 and 26 weeks then ended.

2. Short-Term Investments

The amortized cost of debt securities in this category is adjusted for amortization of premiums and accretion of discounts to maturity computed under the effective interest method. Such amortization and accretion is included in interest income. Realized gains and losses and declines in value judged to be other-than-temporary on available-for-sale securities are included in interest income. The cost of securities sold is based on the specific identification method. Income and dividends on securities classified as available-for-sale are included in interest income. Investments classified as available-for-sale are marked to market each reporting period with the unrealized gain or loss reflected as a component of other comprehensive income (loss).

3. Stock-Based Compensation

At July 2, 2005, the Company had six stock-based employee compensation plans, which are described more fully in *Note 9 Stock Plans and Options* in our fiscal 2004 Annual Report filed on Form 10-K, as amended, for the period ended January 1, 2005. These plans allow for awards of both stock options and restricted stock units ("RSUs"). The Company accounts for those plans in accordance with the intrinsic value based method in Accounting Principles Board ("APB") Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. Some stock-based compensation expense is reflected in net income for options issued at a discount and for RSUs issued as Board of Directors compensation. All other options granted under the plans had an exercise price equal to the market value of the underlying common stock on the date of grant; therefore, no stock-based compensation expense is reflected in net income for these grants. Reflected in results of operations for the first six months of fiscal 2005 and 2004 is compensation expense of $244,000 and $537,000, respectively.

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

	THREE MONTHS ENDED		SIX MONTHS ENDED	
	July 2, 2005	June 26, 2004	July 2, 2005	June 26, 2004

Net income (loss), as reported	$ 922	$ (331)	$ (229)	$ 1,738
Add: Stock-based compensation expense included in reported net income, net of tax*	70	60	146	287
Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of tax	(145)	(687)	(1,110)	(1,275)
Pro forma net income (loss)	$ 847	$ (958)	$ (1,193)	$ 750
Net income (loss) per share:				
Basic as reported	$ 0.03	$ (0.01)	$ (0.01)	$ 0.06
Basic pro forma	$ 0.03	$ (0.03)	$ (0.04)	$ 0.03
Diluted as reported	$ 0.03	$ (0.01)	$ (0.01)	$ 0.06
Diluted - pro forma	$ 0.03	$ (0.03)	$ (0.04)	$ 0.02

* Amounts are net of a pro-forma tax rate which is not necessarily indicative of our effective tax rate for the respective periods.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), *Share-Based Payment* ("SFAS No. 123R"). SFAS No. 123R is a revision of SFAS No. 123, and supersedes APB Opinion No. 25. The new standard establishes accounting standards for transactions in which an entity exchanges its equity instruments for goods or services, including stock option and restricted stock grants. The provisions of SFAS No. 123R will be effective for the Company s first quarter of fiscal year 2006 beginning January 1, 2006. The Company is currently evaluating the impact on its results from adopting SFAS No. 123R, but expects it to be comparable to the pro forma effects of applying the original SFAS No. 123. Accordingly, the adoption of SFAS No. 123R is expected to have a material effect on the Company s results of operations.

In February 2005, the Company approved the acceleration of all non-director, non-officer options that were unvested with an exercise price of $9.00 or higher, resulting in the accelerated vesting of an aggregate of 219,190 options. The effect of the accelerated vesting of these options is included in the SFAS No. 123 calculation above. The purpose of this acceleration was driven by the Company s efforts to reduce non-cash compensation expense that will be required beginning with the first quarter of 2006 in accordance with SFAS No. 123R.

4. Property and Equipment

Property, plant and equipment are recorded at cost and consist of the following (*in thousands*):

	July 2, 2005	January 1, 2005
Machinery and equipment	$ 137,842	$ 131,133
Buildings and leasehold improvements	160,185	156,829
Construction in progress	8,754	14,283
	306,781	302,245
Less: accumulated depreciation	(130,713)	(124,415)
	$ 176,068	$ 177,830

Depreciation expense was $6.3 million and $6.6 million for the three months ended July 2, 2005 and June 26, 2004, respectively, and $12.9 million and $13.9 million for the six months ended July 2, 2005 and June 26, 2004, respectively.

5. Debt

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

The debentures are callable and convertible into the Company's common stock prior to maturity at the option of the holders under the following circumstances: (1) during any calendar quarter commencing after June 30, 2004 and before March 31, 2029, if the last reported sale price of the Company s common stock is greater than or equal to 130% of the conversion price of $17.70 per share; (2) at any time on or after April 1, 2029 if the last reported sale price of the Company s common stock on any date on or after March 31, 2029 is greater than or equal to 130% of the conversion price; (3) subject to certain limitations, during the five business-day period after any five consecutive trading-day period in which the trading price per debenture for each day of that period was less than 98% of the product of the conversion rate and the last reported sale price of the Company's common stock; (4) if the Company calls the debentures for redemption; (5) upon the occurrence of certain corporate transactions; or (6) if the Company obtains credit ratings for the debentures, at any time when the credit ratings assigned to the debentures are below specified levels. The debentures are initially convertible into 56.5099 shares of the Company's common stock per $1,000 principal amount, which is equivalent to approximately $17.70 per share, for total initial underlying shares of 6,498,639. The conversion rate will be subject to adjustment upon the occurrence of specified events. During the second quarter of 2005, the Company made an irrevocable election to pay the principal amount of debentures in cash upon conversion, however, the Company retains the ability to satisfy the remainder of any conversion payment, in cash or any combination of cash and common stock. Pursuant to the underwriting agreement and within 90 days of issuance, the Company filed a shelf registration statement covering resales of the debentures and the common stock issuable upon conversion thereof.

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