LANNETT CO INC
Form 10QSB/A
August 21, 2002

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

FORM 10-QSB/A

[x] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2001.

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM ---------- TO ----------.

COMMISSION FILE NO. 0-9036

LANNETT COMPANY, INC.
(EXACT NAME OF SMALL BUSINESS ISSUER AS SPECIFIED IN ITS CHARTER)

| STATE OF DELAWARE | 23-0787-699 |
|---|---|
| (STATE OF INCORPORATION) | (I.R.S. EMPLOYER I.D. NO.) |

9000 STATE ROAD
PHILADELPHIA, PA 19136
(215) 333-9000
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES AND TELEPHONE NUMBER)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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

As of January 28, 2002, there were 13,219,127 shares of the issuer's common stock, $.001 par value, outstanding.

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PART I. FINANCIAL INFORMATION

ITEM I. FINANCIAL STATEMENTS

LANNETT COMPANY, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

ASSETS
------

CURRENT ASSETS:
Cash
Trade accounts receivable (net of allowance of $15,000 and $25,000)
Inventories
Prepaid expenses
Deferred tax asset

Total current assets

PROPERTY, PLANT AND EQUIPMENT
Less accumulated depreciation

RESTRICTED CASH

OTHER ASSETS

Total assets

LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES:
Line of credit
Line of credit-shareholder
Accounts payable
Accrued expenses
Income taxes payable
Current portion of long-term debt

Total current liabilities

LONG-TERM DEBT, LESS CURRENT PORTION

DEFERRED TAX LIABILITY

COMMITMENTS AND CONTINGENCIES

SHAREHOLDERS' EQUITY:
Common stock -
authorized 50,000,000 shares par value $.001:
issued and outstanding, 13,219,127 shares
Additional paid-in capital
Retained earnings

Total shareholders' equity

Total liabilities and shareholders' equity

See notes to consolidated financial statements

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LANNETT COMPANY, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

| | FOR THE THREE MONTHS ENDED | |
|---|---|---|
| | 12/31/01 | 12/31/00 |
| NET SALES | $ 5,391,341 | $ 2,285,091 |
| COST OF SALES | 2,236,715 | 1,881,320 |
| Gross profit | 3,154,626 | 403,771 |
| RESEARCH AND DEVELOPMENT EXPENSES | 367,670 | 376,756 |
| SELLING, GENERAL AND ADMINISTRATIVE EXPENSES | 768,670 | 403,204 |
| Operating profit/(loss) | 2,018,286 | (376,189) |
| OTHER INCOME (EXPENSE): | | |
| Income from settlement of lawsuit, net of fees | -- | -- |
| Interest income-restricted | 6,732 | 27,342 |
| Interest expense | (91,136) | (187,069) |
| | (84,404) | (159,727) |
| INCOME/(LOSS) BEFORE INCOME TAXES | $ 1,933,882 | $ (535,916) |
| INCOME TAX EXPENSE/(BENEFIT) | $ 677,290 | $ (120,885) |
| NET INCOME/(LOSS) | $ 1,256,592 | $ (415,031) |
| BASIC INCOME/(LOSS) PER SHARE | $ .10 | $ (.03) |
| DILUTED INCOME/(LOSS) PER SHARE | $ .09 | $ (.03) |
| BASIC WEIGHTED AVERAGE NUMBER OF SHARES | 13,219,127 | 13,206,128 |
| DILUTED WEIGHTED AVERAGE NUMBER OF SHARES | 13,303,645 | 13,206,128 |

See notes to the consolidated financial statements

LANNETT COMPANY, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

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OPERATING ACTIVITIES:
Net income
Adjustments to reconcile net income to net cash provided by operating activities:
Depreciation and amortization
Deferred tax expense
Changes in assets and liabilities which provided/(used) cash:
Trade accounts receivable
Inventories
Prepaid expenses and other assets
Accounts payable
Accrued expenses
Income taxes payable

Net cash provided by operating activities

INVESTING ACTIVITIES:
Purchases of property, plant and equipment

Net cash used in investing activities

FINANCING ACTIVITIES:
Net borrowings/(repayments) under line of credit
Repayments under line of credit -- shareholder
Repayments of debt
Proceeds from debt, net of restricted cash released
Proceeds from issuance of stock

Net cash provided by/(used in) financing activities

NET INCREASE/(DECREASE) IN CASH

CASH, BEGINNING OF YEAR

CASH, END OF PERIOD

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION
Interest paid during period
Income taxes paid during period

See notes to the consolidated financial statements



LANNETT COMPANY, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

NOTE 1. CONSOLIDATED FINANCIAL STATEMENTS

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the financial position and the results of operations and cash flows.

The results of operations for the three and six months ended December 31, 2001 and 2000 are not necessarily indicative of results for the full year.

While the Company believes that the disclosures presented are adequate to make the information not misleading, it is suggested that these consolidated financial statements be read in conjunction with the consolidated financial statements and the notes included in the Company's Annual Report on Form 10-KSB for the year ended June 30, 2001.

NOTE 2. NEW ACCOUNTING STANDARDS

In July 2000, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 133, Accounting for Derivative Instruments and Hedging Activities. This statement establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives), and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. This statement, as amended by SFAS No. 137, Accounting for Derivative Instruments and Hedging Activities--Deferral of the Effective Date of FASB Statement No. 133, was effective for all fiscal quarters of fiscal years beginning after June 15, 2000. There has been no accounting, or financial effect on the Company for the three and six months ended December 31, 2001 with respect to this Statement. The Company will continue to analyze the impact, if any, of adopting SFAS No. 133 will have on its consolidated financial position and results of operations.

On July 20, 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) 141, Business Combinations, and SFAS 142, Goodwill and Intangible Assets. SFAS 141 is effective for all business combinations completed after June 30, 2001. SFAS 142 is effective for fiscal years beginning after December 15, 2001; however, certain provisions of this Statement apply to goodwill and other intangible assets acquired between

July 1, 2001 and the effective date of SFAS 142. Major provisions of these Statements and their effective dates for the Company are as follows:

- all business combinations initiated after June 30, 2001 must use the purchase method of accounting. The pooling of interest method of accounting is prohibited except for transactions initiated before July 1, 2001.
- intangible assets acquired in a business combination must be recorded separately from goodwill if they arise from contractual or other legal rights or are separable from the acquired entity and can be sold, transferred, licensed, rented or exchanged, either individually or as part of a related contract, asset or liability



- goodwill, as well as intangible assets with indefinite lives, acquired after June 30, 2001, will not be amortized. Effective July 1, 2002, all previously recognized goodwill and intangible assets with indefinite lives will no longer be subject to amortization.
- effective July 1, 2002, goodwill and intangible assets with indefinite lives will be tested for impairment annually and whenever there is an impairment indicator
- all acquired goodwill must be assigned to reporting units for purposes of impairment testing and segment reporting.

Although management is still reviewing the provisions of these Statements, its preliminary assessment is that these Statements will not have a material impact on the Company's financial position or results of operations.

In August 2001, the FASB issued SFAS 143, Accounting for Asset Retirement Obligations. SFAS 143 applies to all entities, including rate-regulated entities, that have legal obligations associated with the retirement of a tangible long-lived asset that result from acquisition, construction or development and (or) normal operations of the long-lived asset. The application of this Statement is not limited to certain specialized industries, such as the extractive or nuclear industries. This Statement also applies, for example, to a company that operates a manufacturing facility and has a legal obligation to dismantle the manufacturing plant and restore the underlying land when it cease operation of that plant. A liability for an asset retirement obligation should be recognized if the obligation meets the definition of a liability and can be reasonably estimated. The initial recording should be at fair value. SFAS 143 is effective for financial statements issued for fiscal years beginning after June 15, 2002, with earlier application encouraged. The provisions of the Statement are not expected to have a material impact on the financial condition or results of operations of the Company.

In August 2001, the FASB issued SFAS 144, Accounting for the Impairment or Disposal of Long-Lived Assets). SFAS No. 144 retains the existing requirements to recognize and measure the impairment of long-lived assets to be held and used or to be disposed of by sale. However, SFAS 144 makes changes to the scope and certain measurement requirements of existing accounting guidance. SFAS 144 also changes the requirements relating to reporting the effects of a disposal or discontinuation of a segment of a business. SFAS 144 is effective for financial statements issued for fiscal years beginning after December 15, 2001 and interim periods within those fiscal years. The adoption of this statement is not expected to have a significant impact on the financial condition or results of operations of the Company.

NOTE 3. INVENTORIES

Inventories consist of the following:

| | December 31, 2001 (unaudited) | June 30, 2001 |
|---|---|---|
| Raw materials | $ 1,689,923 | $ 1,516,030 |
| Work-in-process | 309,632 | 686,359 |
| Finished goods | 1,256,355 | 712,992 |
| Packaging supplies | 204,674 | 240,728 |
| | $ 3,460,584 | $ 3,156,109 |



NOTE 4. INCOME TAXES

The provision for federal and state income taxes for the three months ended December 31, 2001 was $677,290. The benefit recognized for federal and state income taxes for the three months ended December 31, 2000 was $120,885. The provision for federal and state income taxes for the six months ended December 31, 2001 and 2000 was $1,169,000 and $136,000, respectively.

NOTE 5. RELATED PARTY TRANSACTIONS

The Company had sales of approximately $62,000 and $39,000 during the six months ended December 31, 2001 and 2000, respectively, to a distributor (the "related party") in which the owner is a relative of the Chairman of the Board of Directors and principal shareholder of the Company. The Company also incurred sales commissions payable to the related party of approximately $112,000 and $225,000 during the six months ended December 31, 2001 and 2000, respectively. Accounts receivable includes amounts due from the related party of approximately $22,000 and $34,000 at December 31, 2001 and June 30, 2001, respectively. Accrued expenses include amounts due to the related party of approximately $14,000 and $29,000 at December 31, 2001 and June 30, 2001, respectively.

NOTE 6. SETTLEMENT OF LAWSUIT

Included in other income for the six months ended December 31, 2000 is $1,478,277 in income from the settlement of a lawsuit, net of fees. The lawsuit was initiated after a chemical supplier failed to supply the Company with raw material for its manufacturing process, despite the existence of a signed five-year supply contract. Lannett alleged that the breach of contract delayed the introduction of one of its products into the marketplace. Consequently, the Company and the defending party settled the suit out of court. The Company received the proceeds in First Quarter Fiscal 2001. The Company incurred approximately $300,000 in legal fees relating to the lawsuit. These fees were

expensed to operations in Fiscal 2000.

NOTE 7. RECLASSIFICATIONS

Certain prior year amounts have been reclassified to conform to the current year presentation.

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

RESULTS OF OPERATIONS.

In addition to historical information, this Form 10-QSB contains forward-looking information. The forward-looking information contained herein is subject to certain risks and uncertainties that could cause actual results to differ materially from those projected in the forward-looking statements. Important factors that might cause such a difference include, but are not limited to, those discussed in the following section entitled



"Management's Discussion and Analysis of Results of Operations and Financial Condition." Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's analysis only as of the date of this Form 10-QSB. The Company undertakes no obligation to publicly revise or update these forward-looking statements to reflect events or circumstances which arise later. Readers should carefully review the risk factors described in other documents the Corporation files from time to time with the Securities and Exchange Commission, including the Annual report on Form 10-KSB filed by the Corporation in Fiscal 2001, and any Current Reports on Form 8-K filed by the corporation.

RESULTS OF OPERATIONS -- THREE MONTHS ENDED DECEMBER 31, 2001 COMPARED WITH THREE MONTHS ENDED DECEMBER 31, 2000.

Net sales for the three months ended December 31, 2001 ("Second Quarter Fiscal 2002") increased by 135.9% to $5,391,341 from net sales of $2,285,091 for the three months ended December 31, 2000 ("Second Quarter Fiscal 2001"). Sales increased as a result of higher sales of the Company's prescription (Rx) line of products, including Primidone 50 mg tablets, which was first marketed in May of 2001. The increase is also due to improved marketing activities, new customer accounts, increased unit sales, and increased unit revenues on a portion of the Company's niche line of products, which are sold to distributors, wholesalers and retail chains throughout the nation. The increase in Rx sales was offset by a decrease in over-the-counter (OTC) product sales, due to increased competition. Rx sales increased by approximately $3,338,000 from Second Quarter Fiscal 2001 to Second Quarter Fiscal 2002. OTC product sales decreased by approximately $232,000 from Second Quarter Fiscal 2001 to Second Quarter Fiscal 2002.

Cost of sales increased by 18.9%, to $2,236,715 in Second Quarter Fiscal 2002 from $1,881,320 in Second Quarter Fiscal 2001. The cost of sales increase is due to an increase in certain direct variable costs and indirect

overhead costs incurred as a result of the increase in sales, and production activities. These costs include labor and other benefits related expenses, depreciation expense, and manufacturing and laboratory supplies. Gross profit margins for Second Quarter Fiscal 2002 and Second Quarter Fiscal 2001 were 58.5% and 17.7%, respectively. The increase in the gross profit percentage is due to the product sales mix, a higher absorption of fixed overhead and production costs, and improved unit profit margins on the Company's niche line of products. During the current fiscal year, one of the Company's competitors suspended production and distribution of a generic product in which Lannett competed. Consequently, Lannett was able to increase its sales output to meet the unchanged demand for the item. For these reasons, Lannett increased its unit sales output and the total revenue earned for the product, thereby increasing Lannett's total sales for the period compared to the prior period. With its fixed overhead cost structure unchanged, the gross profit margin increased as a result of the higher revenue per unit, and a higher absorption of fixed overhead and production costs.

Selling, general and administrative expenses increased by 90.6% to $768,670 in Second Quarter Fiscal 2002 from $403,204 in Second Quarter Fiscal 2001. This increase is a result of increases in commissions to sales representatives for incremental sales programs, payroll and other benefits related expenses, professional service fees related to the Company's creation of its subsidiary, Lannett Holdings, Inc., and marketing expenses.

As a result of the foregoing, the Company reported an operating profit of $2,018,286 for Second Quarter Fiscal 2002, as compared to an operating loss of $376,189 for Second Quarter Fiscal 2001.

The Company's interest expense decreased from $187,069 in Second Quarter Fiscal 2001 to $91,136 in Second Quarter Fiscal 2002 as a result of principal repayments, and reduced interest rates.

The Company's income tax expense increased from a benefit of $120,885 in Second Quarter Fiscal 2001 to an expense of $677,290 in Second Quarter Fiscal 2002 as a result of the increase in taxable income.



The Company reported net income of $1,256,592 for Second Quarter Fiscal 2002, or $0.10 basic and $0.09 diluted income per share, compared to a net loss of $415,031 for Second Quarter Fiscal 2001, or $0.03 basic and diluted loss per share.

RESULTS OF OPERATIONS -- SIX MONTHS ENDED DECEMBER 31, 2001 COMPARED WITH SIX MONTHS ENDED DECEMBER 31, 2000.

Net sales for the six months ended December 31, 2001 increased by 133.7% to $9,464,173 from net sales of $4,049,056 for the six months ended December 31, 2000. Sales increased during this period as a result of higher sales of the Company's prescription (Rx) line of products, including Primidone 50 mg tablets, which was first marketed in May of 2001. The increase is also due to improved marketing activities, new customer accounts, increased unit sales, and increased unit revenues on a portion of the Company's niche line of products. The increase in Rx sales was offset by a decrease in over-the-counter (OTC) product sales, due to increased competition. Rx sales increased by approximately $5,906,000 from the six months ended December 31, 2000 to the six months ended December 31, 2001. OTC product sales decreased by approximately

$491,000 from the six months ended December 31, 2000 to the six months ended December 31, 2001.

Cost of sales for the six months ended December 31, 2001 increased by 24.4%, to $3,783,159 from $3,042,199 for the six months ended December 31, 2000. The cost of sales increase is due to an increase in direct variable costs and certain indirect overhead costs incurred as a result of the increase in sales, and production activities. These costs include labor and other benefits related expenses, depreciation expense, manufacturing and laboratory supplies, and raw materials. Gross profit margins for the six months ended December 31, 2001 and December 31, 2000 were 60.0% and 24.9%, respectively. The increase in the gross profit percentage is due to the product sales mix, a higher absorption of fixed overhead and production costs, and increased unit profit margins on the Company's niche line of products. During the current fiscal year, one of the Company's competitors suspended production and distribution of a generic product in which Lannett competed. Consequently, Lannett was able to increase its sales output to meet the unchanged demand for the item. For these reasons, Lannett increased its unit sales output and the total revenue earned for the product, thereby increasing Lannett's total sales for the period compared to the prior period. With its fixed overhead cost structure unchanged, the gross profit margin increased as a result of the higher revenue per unit, and a higher absorption of fixed overhead and production costs.

Selling, general and administrative expenses increased by 75.8% to $1,433,974 for the six months ended December 31, 2001 from $815,835 for the six months ended December 31, 2000. This increase is a result of increases in sales commissions, payroll and other benefits related expenses, professional service fees related to the Company's creation of its subsidiary, Lannett Holdings, Inc., and marketing expenses.

As a result of the foregoing, the Company reported an operating profit of $3,532,566 for the six months ended December 31, 2001, as compared to an operating loss of $531,211 for the six months ended December 31, 2000.

Included in other income for the six months ended December 31, 2000 is $1,478,277 in income from the settlement of a lawsuit, net of fees. The lawsuit was initiated after a chemical supplier failed to supply the Company with raw material for its manufacturing process, despite the existence of a signed five-year supply contract. Lannett alleged that the breach of contract delayed the introduction of one of its products into the marketplace. Consequently, the Company and the defending party settled the suit out of court. The Company received the proceeds in First Quarter Fiscal 2001. The Company incurred approximately $305,000 in legal fees relating to the lawsuit. These fees were expensed to operations in Fiscal 2000.



The Company's interest expense decreased from $395,605 for the six months ended December 31, 2000 to $212,434 for the six months ended December 31, 2001 as a result of principal repayments, and reduced interest rates. See Liquidity and Capital Resources below.

The Company's income tax expense increased from $136,000 for the six months ended December 31, 2000 to $1,169,000 for the six months ended December 31, 2001 as a result of the increase in taxable income.

The Company reported net income of $2,169,767 for the six months ended

December 31, 2001, or $0.16 basic and diluted income per share, compared to net income of $472,325 for the six months ended December 31, 2000, or $0.04 basic and diluted income per share.

LIQUIDITY AND CAPITAL RESOURCES -

Net cash provided by operating activities of $3,739,540 for the six months ended December 31, 2001 was attributable to net income of $2,169,767 as adjusted for the effects of non-cash items of $1,236,432 and changes in operating assets and liabilities totaling $333,341. Significant changes in operating assets and liabilities are comprised of: i) a decrease in trade accounts receivable due to receivable collections, and the timing of shipments and related invoices, ii) an increase in inventories of $304,475 due to increases in raw materials and finished goods, offset by a decrease in work-in-process, iii) an increase in prepaid expenses and other assets of $252,318 due to deposits paid by the Company on certain production related equipment not yet received, iv) an increase in accounts payable due to increased operational expenses and capital equipment purchases, and v) an increase in income taxes payable of $33,745 due to higher taxable income and the accrual of the related income taxes, which will be paid when the Company's estimated tax filings and income tax returns are due.

The net cash used in investing activities consisted of $1,042,506 expended during the six months ended December 31, 2001 for equipment and building additions. The Company has increased its budget for capital expenditures in Fiscal 2002 to $2,000,000. The anticipated additional capital expenditure requirements will support the Company's growth related to new product introductions and increased production output due to higher sales levels. As of December 30, 2001, approximately $602,000 from the proceeds of the bonds issued during Fiscal 1999 was available in financing restricted for certain future capital expenditures.

The Company has a $4,250,000 revolving line of credit from a shareholder who is also the Chairman of the Board ("Shareholder Line of Credit"). At December 31, 2001, the Company has $1,871,439 outstanding and $2,378,561 available under this line of credit. The maturity date on the Shareholder Line of Credit was extended to December 1, 2002. Accrued interest at December 31, 2001, and June 30, 2001 was $111,931 and $0, respectively.

In April 1999, the Company entered into a loan agreement (the "Agreement") with a governmental authority (the "Authority") to finance future construction and growth projects of the Company. The Authority has issued $3,700,000 in tax-exempt variable rate demand and fixed rate revenue bonds to provide the funds to finance such growth projects pursuant to a trust indenture (the "Trust Indenture"). A portion of the Company's proceeds from the bonds was used to pay for bond issuance costs of approximately $170,000. The remainder of the proceeds were deposited into a money market account, which is restricted for future plant and equipment needs of the Company as specified in the Agreement. The Agreement requires the Company to repay the Authority loan through installment payments beginning in May 2003 and continuing through May 2014, the year the bonds mature. At December 31, 2001, the Company had $3,700,000 outstanding on the Authority loan, of which $175,718 is classified as currently due. In April 1999, an irrevocable letter of credit of $3,770,000 was issued by a bank to secure payment of the Authority Loan and a portion of the related accrued interest. At December 31, 2001, no portion of the letter of credit has been utilized.

In April 1999, the Company authorized and directed the issuance of $2,300,000 in taxable variable rate demand and fixed rate revenue bonds pursuant to a trust indenture between the Company and a bank as trustee (the "Trust Indenture"). From the proceeds of the bonds, $750,000 was utilized to pay deferred interest owed to the principal shareholder of the Company and approximately $1,440,000 was paid to a bank to refinance a mortgage term loan and equipment term loans. The remainder of the proceeds was used to pay bond issuance costs of approximately $109,000. The Trust Indenture requires the Company to repay the bonds through installment payments beginning in May 2000 and continuing through May 2003, the year the bonds mature. At December 31, 2001, the Company had $552,612 outstanding on the bonds, which is classified as currently due. In April 1999, an irrevocable letter of credit of approximately $2,349,000 was issued by a bank to secure payment of the bonds and a portion of the related accrued interest. At December 31, 2001 no portion of the letter of credit has been utilized.

The Company has a $2,000,000 line of credit from a bank. The line of credit was renewed and extended to November 30, 2002, at which time the Company expects to renew and extend the due date. The line of credit is limited to 80% of qualified accounts receivable and 50% of qualified inventory. At December 31, 2001, the Company had $1,316,690 outstanding and $683,310 available under the line of credit.

The Company believes that cash generated from its operations and the balances available under the Company's existing loans and lines of credit as of December 31, 2001, are sufficient to finance its level operations and currently anticipated capital expenditures.

Except as set forth in this report, the Company is not aware of any trends, events or uncertainties that have or are reasonably likely to have a material adverse impact on the Company's short-term or long-term liquidity or financial condition.

PROSPECTS FOR THE FUTURE

As of December 31, 2001, several additional products are under development. One of these products is being developed and manufactured for another company; and the remainder are being developed as part of the Lannett product line. Three of the Lannett products have been redeveloped and submitted to the Food and Drug Administration ("FDA") for supplemental approval. The remainder of the developmental products are either previously approved Abbreviated New Drug Applications ("ANDA's") which the Company is planning to reintroduce, or new products that the Company is planning to introduce. Since the Company has no control over the FDA review process, management is unable to anticipate when it will be able to begin producing and shipping additional products

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Regulatory Proceedings. The Company is engaged in an industry which is subject to considerable government regulation relating to the development, manufacturing and marketing of pharmaceutical products. Accordingly, incidental to its business, the Company periodically responds to inquiries or engages in administrative and judicial proceedings involving regulatory authorities, particularly the FDA and the Drug Enforcement Agency.

Employee Claims. A claim of retaliatory discrimination has been filed by a former employee with the Pennsylvania Human Relations Commission ("PHRC"), and the Equal Employment Opportunity Commission ("EEOC"). The Company has denied liability in this matter. The PHRC has made a determination that the complaint against the Company should be dismissed because the facts do not establish probable cause of the allegations of discrimination. The matter is still pending before the EEOC. At this time, management is unable to estimate a range of loss, if any, related to this action. However, management believes that the outcome will not have a material adverse impact on the financial position of the Company.

Additionally, two separate claims of discrimination have been filed against the Company with the PHRC and the EEOC. The Company was notified of the Complaints in June 2001 and July 2001, respectively. The Company has filed answers with the PHRC and EEOC denying the allegations. The PHRC and the EEOC are investigating the claims pursuant to their normal procedures. At this time, management is unable to estimate a range of loss, if any, related to these actions. However, management believes that the outcomes will not have a material adverse impact on the financial position of the Company.

DES Cases. The Company is currently engaged in several civil actions as a co-defendant with many other manufacturers of Diethylstilbestrol ("DES"), a synthetic hormone. Prior litigation established that the Company's pro rata share of any liability is less than one-tenth of one percent. The Company was represented in many of these actions by the insurance company with which the Company maintained coverage during the time period that damages were alleged to have occurred. The insurance company denied coverage of actions filed after January 1, 1992. With respect to these actions, the Company paid nominal damages or stipulated to its pro rata share of any liability. The Company has either settled or is currently defending over 500 such claims. At this time, management is unable to estimate a range of loss, if any, related to these actions. However, management believes that the outcomes will not have a material adverse impact on the financial position of the Company.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

NONE

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

NONE

ITEM 5. OTHER INFORMATION

NONE

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) A list of the exhibits required by Item 601 of Regulation S-B to be filed as a part of this Form 10-QSB is shown on the Exhibit Index filed herewith.

(b) The Company did not file any reports on Form 8-K during the six months ended December 31, 2001.



SIGNATURE

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

LANNETT COMPANY, INC.

Dated: August 21, 2002 By: /s/ Larry Dalesandro

Larry Dalesandro
Chief Operating Officer



EXHIBIT INDEX

| Exhibit Number | Description | Method of Filing |
|---|---|---|
| 3(a) | Articles of Incorporation | Incorporated by reference to the filed with respect to the Annual Shareholders held on December 6, Proxy Statement"). |

| | | |
|---|---|---|
| 3(b) | By-Laws, as amended | Incorporated by reference to the Statement. |
| 4(a) | Specimen Certificate for Common Stock | Incorporated by reference to Exhi Form 8 dated April 23, 1993 (Amen Form 10-K f/y/e June 30, 1992) (" |
| 10(a) | Loan Agreement dated August 30, 1991 between the Company and William Farber | Incorporated by reference to the on Form 10-K f/y/e June 30, 1991 |
| 10(b) | Amendment #1 to Loan Agreement dated March 15, 1993 | Incorporated by reference to Exhi the Annual Report on Form 10-KSB 1993 ("1993 Form 10-K") |
| 10(c) | Amendment #2 to Loan Agreement dated August 1, 1994 | Incorporated by reference to Exhi the Annual Report on Form 10-KSB 1994 ("1994 Form 10-K") |
| 10(d) | Amendment #3 to Loan Agreement dated May 15, 1995 | Incorporated by reference to Exhi the Annual Report on Form 10-KSB 1995 ("1995 Form 10-K") |
| 10(e) | Amendment #4 to Loan Agreement dated December 31, 1995 | Incorporated by reference to Exhi the Annual Report on Form 10-KSB 1996 ("1996 Form 10-K") |
| 10(f) | Amendment #5 to Loan Agreement dated June 30, 1996 | Incorporated by reference to Exhi the Annual Report on Form 10-KSB 1996 ("1996 Form 10-K") |
| 10(g) | Amendment #6 to Loan Agreement dated November 1, 1996 | Incorporated by reference to Exhi the Annual Report on Form 10-KSB 1997 June 30, 199 ("1997 Form 10- |
| 10(h) | Amendment #7 to Loan Agreement dated September 9, 1997 | Incorporated by reference to Exhi the Annual Report on 1997 Form 10 |
| 10(i) | Amendment #8 to Loan Agreement dated June 30, 1998 | Incorporated by reference to Exhi the Annual Report on Form 10-KSB 1998 ("1998 Form 10-KSB") |
| 10(j) | Amendment #9 to Loan | Incorporated by reference to Exhi |

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| Exhibit Number | Description | Method of Filing |
|---|---|---|
| | Agreement dated December 30, 1998 | the Annual Report on Form 10-KSB 1999 ("1999 Form 10-KSB") |
| 10(k) | Amendment #10 to Loan Agreement dated December 31,1999 | Incorporated by reference to Exhi the Annual Report on Form 10-KSB 1999 ("1999 Form 10-KSB") |

| | | |
|---|---|---|
| 10(l) | Amendment #11 to Loan Agreement dated December 1, 2001 | Filed Herewith |
| 10(m) | Loan Agreement dated May 4, 1993 between the Company and Meridian Bank | Incorporated by reference to Exhi the 1993 Form 10-K |
| 10(n) | Amendment to Loan Documents between the Company and Meridian Bank dated as of December 8, 1993 | Incorporated by reference to Exhi the Annual Report on Form 10-KSB 1994 ("1994 Form 10-K") |
| 10(o) | Letter Agreement between the Company and Meridian Bank dated December 21, 1993 | Incorporated by reference to Exhi the Annual Report on Form 10-KSB 1994 ("1994 Form 10-K") |
| 10(p) | Third Amendment to Loan Agreement dated as of June 9, 1994 | Incorporated by reference to Exhi the Annual Report on Form 10-KSB 1994 ("1994 Form 10-K") |
| 10(q) | Fourth Amendment to Loan Documents between the Company and Meridian Bank as of October 27, 1994 | Incorporated by reference to Exhi the Annual Report on Form 10-KSB 1995 ("1995 Form 10-K") |
| 10(r) | Letter Agreement between the Company and Meridian Bank dated October 27, 1994 | Incorporated by reference to Exhi the Annual Report on Form 10-KSB 1995 ("1995 Form 10-K") |
| 10(s) | Letter Agreement between the Company and Meridian Bank dated July 10, 1995 | Incorporated by reference to Exhi the Annual Report on Form 10-KSB 1995 ("1995 Form 10-K") |
| 10(t) | Amendment to Security Agreement between the Company and Meridian Bank dated as of July 31, 1995 | Incorporated by reference to Exhi the Annual Report on Form 10-KSB 1995 ("1995 Form 10-K") |
| 10(u) | Line of Credit Note dated July 31, 1995 | Incorporated by reference to Exhi the Annual Report on Form 10-KSB June 30, 1995 ("1995 Form 10-K") |



| Exhibit Number | Description | Method of Filing |
|---|---|---|
| 10(v) | Fifth Amendment to Loan Agreement dated July 31, 1995 | Incorporated by reference to Exhi the Annual Report on Form 10-KSB 1995 ("1995 Form 10-K") |
| 10(w) | Amendment to Loan agreement between the Company and Meridian Bank, dated March 5, 1996. | Incorporated by reference to Exhi the Annual Report on Form 10-KSB 1996 ("1996 Form 10-K") |

| | | |
|---|---|---|
| 10(x) | Amendment to Loan agreement between the Company and Corestates Bank, dated March 20, 1997. | Incorporated by reference to Exhi the Annual Report on 1997 Form 10 |
| 10(y) | Amendment to Loan agreement between the Company and Corestates Bank, dated March 20, 1997. | Incorporated by reference to Exhi the Annual Report on 1997 Form 10 |
| 10(z) | Amendment to Loan agreement between the Company and Corestates Bank, dated May 23, 1997. | Incorporated by reference to Exhi the Annual Report on 1997 Form 10 |
| 10(aa) | Amendment to Loan agreement between the Company and Corestates Bank, dated September 24, 1997. | Incorporated by reference to Exhi the Annual Report on 1997 Form 10 |
| 10(ab) | Amendment to Loan agreement between the Company and Corestates Bank, dated December 10, 1997. | Incorporated by reference to Exhi the Annual Report on 1997 Form 10 |
| 10(ac) | Amendment to Loan agreement between the Company and Corestates Bank, dated December 10, 1997. | Incorporated by reference to Exhi the Annual Report on 1997 Form 10 |
| 10(ad) | Amendment to Loan agreement between the Company and Corestates Bank, dated June 11, 1998. | Incorporated by reference to Exhi the Annual Report on 1998 Form 10 |
| 10(ae) | Amendment to Loan agreement between the | Incorporated by reference to Exhi the Annual Report on 1998 Form 10 |



| Exhibit Number | Description | Method of Filing |
|---|---|---|
| | Company and Corestates Bank, dated June 1998. | |
| 10(af) | Line of Credit Note dated March 11, 1999 | Incorporated by reference to Exhi the Annual Report on 1999 Form 10 |
| 10(ag) | Taxable Variable Rate Demand/Fixed Rate Revenue Bonds, Series of 1999 | Incorporated by reference to Exhi the Annual Report on 1999 Form 10 |
| 10(ah) | Philadelphia Authority for Industrial Development | Incorporated by reference to Exhi the Annual Report on 1999 Form 10 |

| | | |
|---|---|---|
| | Tax-Exempt Variable Rate Demand/Fixed Revenue Bonds (Lannett Company, Inc. Project) Series of 1999 | |
| 10(ai) | Reimbursement and Agreements supporting bond issues | Incorporated by reference to Exhi the Annual Report on 1999 Form 10 |
| 10(aj) | Amendment No. 1 to Reimbursement Agreement and Waiver | Incorporated by reference to Exhi the Annual Report on 1999 Form 10 |
| 10(ak) | Employment Agreement between the Company and Vlad Mikijanic | Incorporated by reference to Exhi the Annual Report on 1994 Form 10 |
| 10(al) | Supply Agreement dated January 14, 1997 | Incorporated by reference to Exhi the Annual Report on 1998 Form 10 |
| 10(am) | Supply Agreement dated January 17, 1997 | Incorporated by reference to Exhi the Annual Report on 1998 Form 10 |
| 10(an) | Supply Agreement dated January 17, 1997 | Incorporated by reference to Exhi the Annual Report on 1998 Form 10 |
| 10(ao) | Supply Agreement dated February 11, 1997 | Incorporated by reference to Exhi the Annual Report on 1998 Form 10 |
| 10(ap) | Supply Agreement dated May 27, 1997 | Incorporated by reference to Exhi the Annual Report on 1998 Form 10 |
| 11 | Computation of Per Share Earnings | Filed Herewith |
| 22 | Subsidiaries of the Company | Incorporated by reference to the on Form 10-K f/y/e June 30, 1990 |
| 23(b) | Consent of Deloitte & Touche | Incorporated by reference to Exhi the Annual Report on 1999 Form 10 |

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D> 17,000 3,500 3,000

Golden
60,000 (1)(2) 13,000 (3) 3,500 3,000
Hafner
70,000 (1)(2) 26,500 (3) 3,500 3,000
Merrill
65,000 (1)(2) 28,500 (3) 3,500 3,000
Newcomb(4)
25,000 10,000
Sewell
60,000 (1)(2) 22,000 (3) 3,500 3,000
Tilghman
70,000 (1) 34,500 3,500 3,000
Ward
65,000 (1)(2) 23,000 (3) 3,500 3,000

(1) All of the non-employee directors except for Ms. Newcomb (who was ineligible because she was appointed as a director during the fiscal year) elected to receive 50% of their retainer fees in the form of common stock. The Company issued one additional share for every two elected shares. Amounts shown do not reflect the value of the additional shares.

(2) One-half of these retainer fees were deferred under the Directors Deferred Compensation Plan.

(3) All of these meeting attendance fees were deferred under the Directors Deferred Compensation Plan.

(4) Ms. Newcomb became a director on February 17, 2006.

*Fees*

We pay non-employee directors who serve as committee chairpersons $70,000 per year and all other non-employee directors $60,000 per year plus reimbursement of expenses for all services as a director, including committee participation or special assignments. Directors are encouraged to have their spouses accompany them to dinners and other functions held in connection with board meetings, and the company pays, either directly or through reimbursement, all expenses associated with their travel to and attendance at these business-related functions.

In addition to the annual retainer, non-employee directors receive the following fees for attendance at meetings:

For committee meetings held in conjunction with regular Board meetings, committee chairmen who attend in person (or who participate by telephone because of illness or the inability to travel) will receive $1,500 and

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committee members who attend in person (or who participate by telephone because of illness or the inability to travel) will receive $1,000;

For special committee meetings (not held in conjunction with regular Board meetings), committee chairmen who attend in person or who participate by telephone will receive $1,500 and committee members who attend in person or who participate by telephone will receive $1,000; and

For special Board meetings, all non-employee directors who attend in person or who participate by telephone will receive $1,000.

Non-employee directors may also receive discounts on products carried by the Company and its subsidiaries comparable to the discounts offered to Company employees.

*Directors Deferred Compensation Plan*

Non-employee directors may defer all or a portion of their annual retainer and meeting attendance fees under the Directors Deferred Compensation Plan. Non-employee directors may choose from a variety of investment options, including Moody s Average Corporate Bond Yield plus 1%, with respect to amounts deferred. Such deferred amounts will be credited with investment gains or losses until the non-employee director s retirement from the Board or until the occurrence of certain other events.

*Non-Employee Directors Stock Plan*

In September 2005, the Board of Directors adopted, and in November 2005 the stockholders subsequently approved, the 2005 Non-Employee Directors Stock Plan. The Plan provides for grants of stock options, restricted stock, elected shares in lieu of a portion of the annual retainer, and retainer stock awards.

*Options.* Under the Plan, non-employee directors are eligible to receive stock options at the discretion of the Board with the size of individual grants and vesting terms set by the Board at the time of grant. In fiscal 2006, we granted options to purchase an aggregate of 31,500 shares to nine non-employee directors. These options have an exercise price of $30.70, vest ratably over a three-year period and expire seven years after the date of grant. In September 2006 (fiscal 2007), we granted options to purchase an aggregate of 31,500 shares to nine non-employee directors. These options have an exercise price of $31.73, vest ratably over a three-year period and expire seven years after the date of grant.

*Elected Shares.* The Plan also permits each non-employee director to elect to receive up to one-half of his or her annual retainer in Common Stock, in which case we will provide a matching grant of 50% of the number of shares received as a portion of the retainer.

*Retainer Shares.* Under the Plan, each non-employee director who has not previously received a retainer award is granted a one-time retainer award of 6,000 shares on the date of the annual meeting. These shares vest ratably over a three-year period. Each of Ms. Newcomb and Mr. Fernandez will receive a retainer stock award of 6,000 shares if they are elected (or, in the case of Ms. Newcomb, re-elected) to the Board on November 10, 2006.

*Restricted Stock.* Under the Plan, the Board is authorized to issue restricted stock to non-employee directors on terms set forth in the Plan. Each non-employee member of the Board received a grant of 3,000 restricted shares in November 2005. These restricted shares vest ratably over a three-year period. In September 2006 (fiscal 2007), we granted each non-employee member of the Board 3,000 restricted shares.

The Plan grants the Board broad authority and, although it is not required by the terms of the Plan, the Board may choose (upon the recommendation of the Corporate Governance and Nominating Committee) to grant Mr. Fernandez stock options and shares of restricted stock (in addition to the one-time retainer award) if he is elected to the Board on November 10, 2006.

See also Certain Relationships and Related Transactions.



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**Board Meetings and Attendance**

The Board of Directors held 13 meetings (including five regular meetings and eight special meetings) during fiscal 2006 and all directors attended 75% or more of the aggregate of:

the total number of meetings of the Board of Directors, and

the total number of meetings held by all committees of the Board on which he or she served during fiscal 2006.

It is the policy of the Board that all directors attend the Annual Meeting of Stockholders. In fiscal 2006, all directors who were in office at that time attended the Annual Meeting.

**Committees of the Board**

The following directors serve on the committees indicated:

| Name | Audit Committee | Compensation Committee | Corporate Governance and Nominating Committee |
|---|---|---|---|
| John M. Cassaday | | X* | X |
| Judith B. Craven | | | X |
| Joseph A. Hafner, Jr. | X | | |
| Richard G. Merrill | X | X | |
| Nancy S. Newcomb | X | | |
| Phyllis S. Sewell | X | | X |
| Richard G. Tilghman | X* | X | |
| Jackie M. Ward | | X | X* |

* Chairman of the Committee

The Audit Committee held 13 meetings during fiscal 2006. The function of the Audit Committee includes oversight of various auditing and accounting matters, including the selection of our independent public accountants, the scope of the audit procedures, the nature of all audit and non-audit services to be performed, the fees to be paid to the independent public accountants, the performance of our independent public accountants and our accounting practices and policies.

The Compensation Committee held ten meetings during fiscal 2006. The function of the Compensation Committee is to evaluate and determine the annual compensation of the Chief Executive Officer, to consider the annual compensation of executive officers, and to oversee the administration of SYSCO s Management Incentive Plan, stock incentive and option plans, the 2004 Long-Term Incentive Cash Plan, the Supplemental Performance Based Bonus Plan and other executive benefit plans.

The Corporate Governance and Nominating Committee held five meetings during fiscal 2006. The function of the Corporate Governance and Nominating Committee is to propose directors, committee members and officers to the Board for election or reelection, to over see the evaluation of management, including the Chief Executive Officer, to

review the performance of the members of the Board and its committees, to consider the annual compensation of non-employee directors, and to review and make recommendations regarding the organization and effectiveness of the Board and its committees, the establishment of corporate governance principles, the conduct of meetings, succession planning and SYSCO s governing documents.

The Board of Directors also has a Finance Committee which held five meetings during fiscal 2006. The function of the Finance Committee is to assist the Board in satisfying its fiduciary responsibilities relating to financial performance and financial planning of the Company in pursuing its financial objectives. The Committee reviews policies regarding capital structure, dividends and liquidity; reviews risk assessment and risk management policies; reviews and recommends the sale or issuance of equity and certain debt securities; reviews acquisitions and financing alternatives; reviews and approves certain capital expenditures; establishes and monitors high-level

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investment and funding objectives and investment performance and funding of the Company s tax-qualified retirement and non-qualified benefit plans; and reviews and oversees the Company s environmental, health, safety and security matters. The Finance Committee is chaired by Joseph A. Hafner, Jr., and its members include Dr. Craven, Mr. Golden, Ms. Newcomb and Mr. Schnieders.

The Board of Directors also has an Executive Committee which did not meet during fiscal 2006. The Executive Committee is authorized to exercise all of the powers of the Board when necessary, to the extent permitted by applicable law. The Executive Committee is chaired by Mr. Schnieders and its members include Mr. Cassaday, Mr. Hafner, Mr. Tilghman and Ms. Ward.

The Board of Directors also has an Employee Benefits Committee that oversees the maintenance and administration of the Corporation s employee stock purchase, employee welfare benefit, and tax-qualified retirement plans. Mr. Schnieders chairs, and Mr. Stubblefield serves as a member of, this Committee.

Current copies of the charters for the Audit Committee, the Compensation Committee, the Corporate Governance and Nominating Committee and the Finance Committee are published on the Company s website at *www.sysco.com/investor/governance.html* and are available in print by writing to the Investor Relations Department, SYSCO Corporation, 1390 Enclave Parkway, Houston, Texas 77077-2099. The Audit Committee Charter is also attached to this Proxy Statement as Annex A.

**Compensation Committee Interlocks and Insider Participation**

Mr. Merrill, Chairman, Mrs. Sewell, Mr. Tilghman and Ms. Ward each served on the Compensation Committee during fiscal 2006 prior to March 1. Mr. Campbell also served on the Compensation Committee during fiscal 2006 prior to his resignation. From March 1, 2006 to the present, the members of the Compensation Committee have been Mr. Cassaday, Chairman, Mr. Merrill, Mr. Tilghman and Ms. Ward. During fiscal 2006, none of the members of the Committee, while serving as such, was an officer or employee of SYSCO or any of its subsidiaries or served as an officer of any company with respect to which any executive officer of SYSCO served on such company s board of directors, and none had any relationship with the Company requiring disclosure under Item 404 of SEC Regulation S-K. In addition, none of the current or former members of the Committee listed above are former employees of SYSCO or any of its subsidiaries.

**Succession Planning**

The Board plans for succession to the position of CEO and the Corporate Governance and Nominating Committee oversees this succession planning process. To assist the Board, the CEO periodically provides the Board with an assessment of senior executives and their potential to succeed to the position of CEO, as well as perspective on potential candidates from outside the Company. The Board has available on a continuing basis the CEO s recommendation should he be unexpectedly unable to serve. The CEO also provides the Board with an assessment of potential successors to key positions.

## CORPORATE GOVERNANCE

**Corporate Governance Guidelines**

The Board of Directors has adopted the Sysco Corporation Corporate Governance Guidelines. These guidelines outline the functions of the Board, director responsibilities, and various processes and procedures designed to ensure effective and responsive governance. These guidelines also outline considerations for determining qualification for membership to the Board such as diversity, skills, experience, time available and the number of other boards the

member sits on in the context of the needs of the Board and the Company. The guidelines are reviewed from time to time in response to changing regulatory requirements and best practices and are revised accordingly. The guidelines were last revised in September 2006. The Corporate Governance Guidelines are published on our website at *www.sysco.com/investor/governance.html*, and are available in print by writing to the Investor Relations Department, SYSCO Corporation, 1390 Enclave Parkway, Houston, Texas 77077-2099.

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**Code of Business Conduct**

All of our directors, officers and employees, including our principal executive officer, principal financial officer, principal accounting officer and controller, are required to comply with our long-standing Code of Business Conduct to help ensure that our business is conducted in accordance with the highest standards of moral and ethical behavior. Our Code of Business Conduct addresses professional conduct, including customer relationships, equal opportunity, payment of gratuities and receipt of payments or gifts, competition and fair dealing, political contributions, antitrust, conflicts of interest, insider trading, financial disclosure, intellectual property and confidential information, as well as requiring strict adherence to all laws and regulations applicable to our business. Employees are required to report any violations or suspected violations of the Code and may do so by using SYSCO s ethics hotline. The Code also includes an anti-retaliation statement. The Code of Business Conduct is published on our website at *www.sysco.com/investor/governance.html* and is available in print by writing to the Investor Relations Department, SYSCO Corporation, 1390 Enclave Parkway, Houston, Texas 77077-2099.

**Presiding Director; Communicating with the Board**

The non-management directors meet in executive session without members of management present at every regular Board meeting. During fiscal 2006, the non-management directors held five executive sessions without the CEO or any other member of management present. Richard G. Tilghman, chairman of the Audit Committee, presided at these executive sessions during fiscal 2006. The independent members of the Board have adopted a rotation system by which, beginning on the first day of the Company s 2007 fiscal year, the chairs of the Corporate Governance and Nominating, Compensation, Finance (if such chair has been determined to be independent) and Audit Committees will rotate for one-year terms as presiding director. The presiding director will, among other things, preside at meetings of the non-employee directors. In addition, the independent directors, exclusive of all directors who have not been determined to be independent, meet in executive session at least once a year and the presiding director shall preside at such meetings.

Interested parties may communicate with the presiding director, the non-management directors as a group and the other members of the Board by confidential email. All emails will be delivered to the parties to whom they are addressed. The Board requests that items unrelated to the duties and responsibilities of the Board not be submitted, such as product inquiries and complaints, job inquiries, business solicitations and junk mail. The form to communicate by email is accessible in the corporate governance section of SYSCO s website at *www.sysco.com/investor/contactboard.html*.

**Director Independence**

Our Corporate Governance Guidelines require that at least a majority of our directors meet the criteria for independence established by the New York Stock Exchange for continued listing, and all applicable legal requirements. Additionally, all members of the Audit Committee, Compensation Committee and Corporate Governance and Nominating Committee are required to be independent.

Under New York Stock Exchange listing standards, to be considered independent, a director must be determined to have no material relationship with SYSCO other than as a director. The standards specify the criteria by which the independence of directors will be determined, including guidelines for directors and their immediate family members with respect to employment or affiliation with SYSCO or its independent public accountants.

In addition to the NYSE s standards for independence, the Company s Corporate Governance Guidelines provide that the following relationships will not impair a director s independence: (i) if a SYSCO director is an executive officer of another company that does business with SYSCO and the annual sales to, or purchases from, SYSCO are less than

two percent of the annual revenues of the company he or she serves as an executive officer; (ii) if a SYSCO director is an executive officer of another company which is indebted to SYSCO, or to which SYSCO is indebted, and the total amount of either company s indebtedness to the other is less than two percent of the total consolidated assets of the company he or she serves as an executive officer; and (iii) if a SYSCO director serves as an officer, director or trustee of a charitable organization, and SYSCO s discretionary charitable contributions to the organization are less than two percent of that organization s total annual charitable receipts

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(SYSCO s automatic matching of employee charitable contributions to higher education will not be included in the amount of SYSCO s contributions for this purpose).

After reviewing all relevant relationships of the directors, the Board of Directors has determined that Mr. Cassaday, Dr. Craven, Mr. Hafner, Mr. Merrill, Ms. Newcomb, Mrs. Sewell, Mr. Tilghman and Ms. Ward, as well as Mr. Fernandez, are independent under the NYSE standards and the categorical standards set forth in the Corporate Governance Guidelines and described above. There were no such relationships that were not covered by the categorical standards. The Board has also determined that each member of the Audit Committee, Compensation Committee and Corporate Governance and Nominating Committee is independent. The Corporate Governance Guidelines provide, effective September 2006, that no independent director who is a member of the Audit, Compensation or Nominating and Corporate Governance Committees may receive any compensation from the Company other than compensation received in their capacity as a non-employee director or committee member. The Board has determined that none of the above-named directors has received any compensation (other than compensation received in their capacity as a non-director or committee member) from the Company since July 2005, and no member of the Audit Committee has received any compensation (other than compensation received in their capacity as a non-employee director or committee member) from the Company while he or she has served as such.

**Nominating Committee Procedures**

In accordance with its Charter, the Corporate Governance and Nominating Committee will observe the following procedures in identifying and evaluating candidates for election to the Company s Board of Directors:

1. In considering candidates for election to the Board, the Committee will determine the incumbent directors whose terms expire at the upcoming annual meeting and who wish to continue their service on the Board. The Committee will also identify and evaluate new candidates for election to the Board for the purpose of filling vacancies.

The Committee will solicit recommendations for nominees from persons that the Committee believes are likely to be familiar with qualified candidates. These persons may include members of the Board and management of the Company. The Committee may also determine to engage a professional search firm to assist in identifying qualified candidates. Where such a search firm is engaged, the Committee shall set its fees and scope of engagement.

In making its selection, the Committee will also consider nominations made by stockholders in conformity with Section 8 of the Company s Bylaws. The Committee will evaluate candidates proposed by stockholders in conformity with Section 8 of the Company s Bylaws under the same criteria used to evaluate other candidates.

2. As to all incumbent and new candidates that the Committee believes merit consideration, the Committee will:

cause to be assembled information concerning the background and qualifications of the candidate, including information required to be disclosed in the Company s proxy statement under the rules of the SEC or any other regulatory agency or exchange or trading system on which the Company s securities are listed, and any relationship between the candidate and the person or persons recommending the candidate;

determine if the candidate satisfies the qualifications required by the Company s Corporate Governance Guidelines of candidates for election as director as set forth under Corporate Governance Guidelines above;

determine if the candidate possesses qualities, experience or skills that the Committee has determined to be desirable;

consider the contribution that the candidate can be expected to make to the overall functioning of the Board;

consider the candidate s capacity to be an effective director in light of the time required by the candidate s primary occupation and service on other boards;

consider the extent to which the membership of the candidate on the Board will promote diversity among the directors; and

consider, with respect to an incumbent director, whether the director satisfactorily performed his or her duties as director during the preceding term, including attendance and participation at Board and Committee meetings, and other contributions as a director.

3. In its discretion, the Committee may designate one or more of its members (or the entire Committee) to interview any proposed candidate.

4. Based on all available information and relevant considerations, the Committee will recommend to the full Board for nomination those candidates who, in the view of the Committee, are most suited for membership on the Board.

5. The Committee shall maintain appropriate records regarding its process of identifying and evaluating candidates for election to the Board.

As indicated above, the Corporate Governance and Nominating Committee will consider candidates for director recommended by stockholders of the Company. The procedures for submitting stockholder recommendations are explained below under Stockholder Proposals on page 37.

**Stock Ownership Guidelines**

The Corporate Governance Guidelines provide that after five years of service as a non-employee director, such individuals are expected to continuously own a minimum of 10,000 shares of SYSCO common stock. All of the current directors other than Ms. Newcomb, who has served on the Board for less than one year, beneficially held the requisite number of shares as of September 12, 2006. Stock ownership guidelines applicable to executive officers are described on page 22.

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## EXECUTIVE OFFICERS

The following persons currently serve as executive officers of SYSCO. Each person listed below has served as an officer of SYSCO and/or its subsidiaries for at least the past five years.

| Name | Title (and Date Since Which Individual Has Served in Position) | Age |
|---|---|---|
| Larry J. Accardi* | Executive Vice President (2000), Contract Sales and President, Specialty Distribution Companies (2002) | 57 |
| Kenneth J. Carrig | Executive Vice President and Chief Administrative Officer (2005) | 49 |
| Kirk G. Drummond | Senior Vice President of Finance and Treasurer (2005) | 51 |
| G. Mitchell Elmer | Vice President, Controller (2000) and Chief Accounting Officer (2005) | 47 |
| Michael C. Nichols | Senior Vice President (2006), General Counsel (1999) and Corporate Secretary (2002) | 54 |
| Larry G. Pulliam* | Executive Vice President, Merchandising Services (2005) | 50 |
| Richard J. Schnieders* | Chairman, Chief Executive Officer (2003) and President (2005**) | 58 |
| Kenneth F. Spitler* | Executive Vice President (2002); President of North American Foodservice Operations (2005) | 57 |
| John K. Stubblefield, Jr.* | Executive Vice President, Finance and Chief Financial Officer (2000***) | 60 |

* Named Executive Officer

** Mr. Schnieders served as the Company s President from July 2000 to December 2002. He re-assumed the role of President in July 2005 following the retirement of the Company s President and Chief Operating Officer.

*** Although Mr. Stubblefield has acted as the Company s principal financial officer since the mid-1990s, he was given the official title of Chief Financial Officer in 2005.

Several additional Senior Vice Presidents were listed as executive officers in prior years. Although many of such officers remain employed by the Company in the same positions they previously held, the Board of Directors determined as of May 12, 2006 that such persons did not actually perform policy making functions and should no longer be deemed executive officers for purposes of filings under the Securities Exchange Act of 1934. However, for the sole purpose of this Proxy Statement, each of Stephen F. Smith and James E. Lankford is still considered to be a Named Executive Officer of the Company, as required by SEC regulations.

## STOCK OWNERSHIP

The following table sets forth certain information with respect to the beneficial ownership of Company Common Stock, as of September 12, 2006, by (i) each director and director nominee, (ii) each Named Executive Officer (as hereinafter defined), and (iii) all directors, director nominees and executive officers as a group. To our knowledge, no person or group beneficially owns 5% or more of our Common Stock. Unless otherwise indicated, each stockholder identified in the table has sole voting and investment power with respect to his or her shares.

| | Shares of Common Stock Owned Directly(1) | Shares of Common Stock Owned Indirectly | Shares of Common Stock Underlying Options(2) | Total Shares of Common Stock Beneficially Owned(1)(2) | Percent of Outstanding Shares(3) |
|---|---|---|---|---|---|
| Larry J. Accardi | 165,115 | | 313,600 | 478,715 | * |
| John M. Cassaday | 17,634 | 3,500(4) | 2,766 | 23,900 | * |
| Judith B. Craven | 30,380 | | 31,566 | 61,946 | * |
| Manuel A. Fernandez | | | | | |
| Jonathan Golden | 37,910 | 18,500(4) | 55,566 | 111,976 | * |
| Joseph A. Hafner, Jr. | 13,664 | | 9,166 | 22,830 | * |
| James E. Lankford(5) | 204,330 | | 199,728 | 404,058 | * |
| Richard G. Merrill | 38,547 | | 63,566 | 102,113 | * |
| Nancy S. Newcomb | 3,000 | | | 3,000 | * |
| Larry G. Pulliam | 108,376 | | 177,000 | 285,376 | * |
| Richard J. Schnieders | 328,321 | 61,604(6) | 398,000 | 787,925 | * |
| Phyllis S. Sewell | 35,385 | | 55,566 | 90,951 | * |
| Stephen F. Smith(5) | 76,597 | | 134,643 | 211,240 | * |
| Kenneth F. Spitler | 117,877 | 53,062(7) | 265,600 | 436,539 | * |
| John K. Stubblefield, Jr. | 92,110 | | 330,600 | 422,710 | * |
| Richard G. Tilghman | 19,197 | 1,958(6) | 15,566 | 36,721 | * |
| Jackie M. Ward | 19,958 | | 23,566 | 43,524 | * |
| All Directors, Director Nominees and Executive Officers as a Group (19 Persons)(8) | 1,102,961(9) | 139,181(10) | 2,210,928(11) | 3,453,070(9)(10)(11) | * |

(*) Less than 1% of outstanding shares.

(1) Includes an aggregate of 4,126 shares of Common Stock that have been elected to be received by the non-employee directors in lieu of retainer fees during the first half of calendar 2006, and 2,059 matching shares of Common Stock. Pursuant to the Non-Employee Directors Stock Plan, these shares will be issued on December 31, 2006 or within 60 days after a non-employee director ceases to be a director, whichever occurs first. Such shares of Common Stock are deemed outstanding for computing the percentage ownership of the

persons holding such shares, but are not deemed outstanding for computing the percentage ownership of any other persons.

(2) Includes shares of Common Stock underlying options that are presently exercisable or will become exercisable within 60 days after September 12, 2006. Shares of Common Stock subject to options that are presently exercisable or will become exercisable within 60 days after September 12, 2006 are deemed outstanding for computing the percentage ownership of the person holding such options, but are not deemed outstanding for computing the percentage ownership of any other persons.

(3) Applicable percentage ownership at September 12, 2006 is based on 619,713,705 shares of Common Stock outstanding, adjusted in the case of certain options and retainer shares.

(4) These shares are held by a family trust or corporation affiliated with the director.

(5) Messrs. Smith and Lankford, who were executive officers for a portion of fiscal 2006, are included in the Summary Compensation Table, and therefore the Stock Ownership table, as Named Executive Officers. Although Messrs. Smith and Lankford still hold the offices indicated above, as of May 12, 2006 it was

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determined that they did not actually perform policy making functions and should no longer be deemed executive officers for purposes of filings under the Securities Exchange Act of 1934. However, for the sole purpose of this Proxy Statement, each of Messrs. Smith and Lankford is still considered to be a Named Executive Officer of the Company, as required by SEC regulations.

(6) These shares are held by the spouse of the director or executive officer.

(7) The total number of shares owned indirectly by Mr. Spitler includes 190 shares held by his children and 52,872 shares held by a family limited partnership.

(8) Does not include beneficial ownership by Mr. Smith or Mr. Lankford, each of whom is considered a Named Executive Officer for purposes of this proxy, but is not considered an executive officer of the Company.

(9) Includes an aggregate of 75,487 shares directly owned by the current executive officers other than the Named Executive Officers.

(10) Includes an aggregate of 557 shares owned by the spouses and/or dependent children of current executive officers other than the Named Executive Officers.

(11) Includes an aggregate of 468,800 shares of Common Stock underlying options that are presently exercisable or will become exercisable within 60 days after the date of this proxy statement held by current executive officers other than the Named Executive Officers.

## SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Pursuant to Section 16(a) of the Securities Exchange Act of 1934 and the rules issued thereunder, our executive officers and directors and any persons holding more than ten percent (10%) of our Common Stock are required to file with the Securities and Exchange Commission and the New York Stock Exchange reports of initial ownership of our Common Stock and changes in ownership of such Common Stock. To our knowledge, no person beneficially owns more than 10% of our Common Stock. Copies of the Section 16 reports filed by our directors and executive officers are required to be furnished to us. Based solely on our review of the copies of the reports furnished to us, or written representations that no reports were required, we believe that, during fiscal 2006, all of our executive officers and directors complied with the Section 16(a) requirements. However, Robert J. Davis, the Company s Senior Vice President of Contract Sales, was designated as an executive officer for a portion of fiscal 2005 and fiscal 2006. Mr. Davis original Form 3 filing for January 1, 2005 inadvertently understated his holdings by 337 shares. An amended Form 3 was filed on November 17, 2005 (during fiscal 2006) to correct the information.

## CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Mr. Golden is the sole stockholder of Jonathan Golden, P.C., a partner in the law firm of Arnall Golden Gregory LLP, Atlanta, Georgia, counsel to SYSCO. During fiscal year 2006, Sysco paid this firm approximately $3.8 million in legal fees, which fees we believe were fair and reasonable in view of the level and extent of services rendered.

Larry Accardi serves as the Company s Executive Vice President of Contract Sales and President of the Specialty Distribution Companies. His daughter, Michelle Connors, serves as one of Sysco s regional corporate trainers. Ms. Connors total compensation in fiscal year 2006 included $81,302 in salary and bonus. Her current annual salary is $76,425 and she received options to purchase 2,000 shares of SYSCO common stock in September 2006 with an aggregate Black-Scholes value of $13,420. Mr. Accardi s brother-in-law, Stephen Hemphill, serves as an account executive at Hardin s-Sysco Food Services, LLC, one of the Company s subsidiaries. Mr. Hemphill s total compensation

in fiscal year 2006 included $69,410 in salary and bonus, and his current annual salary is $54,600.

James E. Lankford and Stephen F. Smith both serve as Senior Vice Presidents of Foodservice Operations and were considered executive officers for a portion of the 2006 fiscal year. Solely for purposes of this proxy statement, they are also considered Named Executive Officers . Mr. Lankford s brother, Frederick Lankford, serves as the President of Lankford-Sysco Food Services, LLC, one of the Company s subsidiaries. Frederick Lankford s total compensation in fiscal year 2006 included $481,074 in salary and bonus. His current annual salary is $315,000 and he received options to purchase 16,500 shares of SYSCO common stock in September 2006 with an

aggregate Black-Scholes value of $115,830. Another of Mr. Lankford s brothers, Thomas E. Lankford, retired from his position as a Director, President and Chief Operating Officer of SYSCO in July 2005, and received approximately $25,344 under the Company s retirement plan, $960,840 under the Company s Supplemental Executive Retirement Plan and $650,942 under the Company s Executive Deferred Compensation Plan during fiscal year 2006.

Mr. Smith s daughter, Callie F. Smith Davis, serves as the Director of Business Review for Sysco Food Services-Gulf Coast, Inc., one of the Company s subsidiaries. Ms. Davis s total compensation in fiscal year 2006 included $86,323 in salary and bonus plus a one-time payment of $28,659 for relocation expenses and options to purchase 2,500 shares of SYSCO Common stock with an aggregate Black-Scholes value of $19,225. Her current annual salary is $70,200 and she received options to purchase 2,500 shares of SYSCO common stock in September 2006 with an aggregate Black-Scholes value of $16,775.

Similarly, James C. Graham and James M. Danahy both serve as Senior Vice Presidents of Foodservice Operations and were considered executive officers for a portion of the 2006 fiscal year. Mr. Graham s brother, Gordon Graham, serves as the President of Sysco Food Services of Atlanta, LLC, one of the Company s subsidiaries. Gordon Graham s total compensation in fiscal year 2006 included $539,137 in salary and bonus. His current annual salary is $247,200 and he received options to purchase 16,500 shares of SYSCO common stock in September 2006 with a Black-Scholes value of $115,830. Mr. Danahy s brother-in-law, William F. MacDonald, serves as a marketing associate at Hallsmith-Sysco Food Services, LLC, one of the Company s subsidiaries. Mr. McDonald s total compensation in fiscal year 2006, which was paid on a commission basis, totaled $85,674.

Gregory K. Marshall served as one of the Company s Senior Vice Presidents until September 2005. His son-in-law, Gregory Keller, serves as Vice President of Sales at The SYGMA Network, Inc., one of the Company s subsidiaries. Mr. Keller s total compensation in fiscal year 2006 included $168,700 in salary and bonus and his current annual salary is $139,000.

**EQUITY COMPENSATION PLAN INFORMATION**

The following table sets forth certain information regarding equity compensation plans as of July 1, 2006.

| Plan Category | Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights (a) | Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights (b) | Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a)) (c) |
|---|---|---|---|
| Equity compensation plans approved by security holders | 65,377,585(1)(2) | $ 28.63 | 28,029,391(3)(4) |
| Equity compensation plans not approved by security holders | 0 | 0 | 0 |

| Total | 65,377,585(1)(2) | $ 28.63 | 28,029,391(3)(4) |
|---|---|---|---|

(1) Does not include 139,084 shares of Common Stock subject to options that were assumed in connection with our acquisition of Guest Supply, Inc. in March 2001. These options have a weighted average exercise price per share of $13.07.

(2) Does not give effect to options to purchase approximately 6,504,200 shares of Common Stock granted in September 2006 under our 2004 Stock Option Plan at an exercise price per share of $31.70 or options to purchase 31,500 shares of Common Stock granted in September 2006 under our 2005 Non-Employee Directors Stock Plan at an exercise price per share of $31.73.

(3) Includes 18,656,450 shares of Common Stock issuable pursuant to our 2004 Stock Option Plan; 478,593 shares issuable pursuant to our Non-Employee Directors Stock Plan; 4,000,000 shares issuable under our 2000 and 2005 Management Incentive Plans; and 4,894,348 shares issuable pursuant to our Employees Stock Purchase Plan as of July 1, 2006. Does not reflect the issuance of options to purchase approximately 6,504,200 shares of

Common Stock in September 2006 pursuant to our 2004 Stock Option Plan; the issuance of options to purchase 31,500 shares of Common Stock in September 2006 pursuant to our 2005 Non-Employee Directors Stock Plan; the issuance of 27,000 shares of restricted Common Stock in September 2006 pursuant to our Non-Employee Directors Stock Plan; the issuance of 323,822 shares in August 2006 pursuant to the 2000 Management Incentive Plan; or the issuance of 475,448 shares in July 2006 pursuant to the 1974 Employees Stock Purchase Plan.

(4) As of September 12, 2006, a total of 70,797,876 options remained outstanding under all of the Company s option plans. These options have a weighted average exercise price of $29.05 and an average remaining term of 4.96 years. The remaining pool of available shares under the Company s option plans includes approximately 12,179,800 shares authorized under the 2004 Stock Option Plan and 420,093 shares under the 2005 Non-Employee Directors Stock Plan. Additionally, there are 2,800,000 shares available for issuance under the 2005 Management Incentive Plan. There are also 4,418,900 shares remaining available for issuance under the 1974 Employees Stock Purchase Plan.

**Report of the Compensation Committee**

This report documents the components of SYSCO s compensation programs for its executive officers and describes the basis on which fiscal 2006 compensation determinations were made with respect to the executive officers of SYSCO, including Mr. Schnieders, who has served as Chief Executive Officer since January 1, 2003. All fiscal 2006 compensation decisions with respect to base salaries, annual incentive compensation and option grants under stock option plans for our executive officers, including the CEO, were made by the Compensation Committee.

*Overall Executive Compensation Philosophy*

Since SYSCO became a publicly held corporation in 1970, we have directly linked the compensation of executive officers to SYSCO s performance. Specifically, the Committee has tied the level of SYSCO s executive compensation to increases in SYSCO s earnings per share, return on shareholders equity and operating company performance. We have historically accomplished this through the following means:

A pay-for-performance orientation, with respect to compensation other than base salary, based upon a combination of SYSCO performance and operating company performance for corporate officers, and operating company performance for operating company senior management;

A significant portion of total cash compensation is at risk, i.e., linked to Company performance;

Base salaries generally at or below the 25th percentile of the range of base salaries payable to corporate officers of certain surveyed industrial corporations who have job content and/or responsibilities comparable to those of SYSCO s corporate officers;

Potentially significant annual incentive bonuses under SYSCO s management incentive plan;

Long-term incentives primarily in the form of stock options; and

The addition, in fiscal 2005, of a long-term incentive cash plan for MIP participants and a supplemental bonus plan for the CEO, and in fiscal 2007, of a supplemental bonus plan covering the CEO, all Executive Vice Presidents and all Senior Vice Presidents of the Company.

The factors and criteria upon which the determination of the fiscal 2006 compensation of the Chief Executive Officer were based were the same as those discussed below with respect to all executive officers, except as otherwise

described below with respect to SYSCO s senior vice presidents of foodservice operations, and as described below with respect to the CEO s supplemental bonus plan.

In fiscal 2006, Mr. Schnieders earned total compensation equal to $2,141,900, exclusive of perquisites, which were valued at less than $50,000. This compensation amount included (a) salary of $1,062,500 and (b) 140,000 options with a Black-Scholes grant date present value of $1,129,800. No executive officers, including Mr. Schnieders, received incentive bonuses for fiscal 2006. Further information regarding these components is included below as well as in the tables that follow this report.

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*Base Salaries*

We have established base salaries of our executive officers in the range of compensation payable to executive officers of U.S. industrial corporations without reference to specific SYSCO performance criteria. We reexamine this range of compensation from time to time through a survey of compensation practices by an independent compensation consultant across a broad cross-section of U.S. industrial corporations. The survey sample does not necessarily include those companies in the peer group included in the performance graph on page 32 due to the differing size, management responsibilities and organizational structures of those corporations relative to SYSCO. We last reviewed base salaries for the executive officers on November 10, 2005, and increases were made effective January 1, 2006. At that time, Mr. Schnieders annual base salary was increased approximately 2.4% from $1,050,000 to $1,075,000. It has been our consistent practice to maintain the Chief Executive Officer s base salary at or below the 25th percentile of the range of base salaries payable to chief executive officers of the surveyed industrial corporations who have chief executive officers with job content and/or responsibilities comparable to those of SYSCO s Chief Executive Officer.

*Incentive Compensation*

*Management Incentive Bonus*

SYSCO provides annual incentive compensation to all executive officers through the SYSCO Corporation Management Incentive Plan (the MIP ). The current MIP, or 2005 MIP, was approved by stockholders in November 2005. Bonuses for 2006 were determined under the previous MIP, or 2000 MIP. Participants in the MIP include all of SYSCO s corporate officers (including the executive officers) and senior management (generally the presidents and executive vice presidents) of SYSCO s operating companies. The MIPs are designed to offer opportunities for compensation that is tied directly to our performance. In addition, the MIPs are designed to foster significant equity ownership in SYSCO by the executive officers and all other participants in the MIP. MIP bonuses earned during the fiscal year are paid during the first quarter of the following fiscal year.

For executive officers, no incentive bonuses were paid under the MIP for fiscal 2006, based on the criteria established by the Committee. The bonus determination was based on a two-part formula. The first part was based on the overall performance of SYSCO and was based upon the percentage increase in earnings per share and the return on shareholders equity. The MIP utilized a matrix based on these two factors to determine award levels, resulting in no awards to any such executive officer participating in this portion of the MIP. The second portion of the fiscal 2006 incentive bonus under the MIP for executive officers was based upon the number of SYSCO operating companies that achieved a target return on capital. This portion of the incentive bonus is paid only when the operating companies achieving the goals, in the aggregate, represent at least 50% of the total capital of all of SYSCO s operating companies; provided, however, that no bonus is earned under this part unless a bonus is earned under the first part. As a result, no executive officer earned a bonus under this portion of the bonus for 2006.

For senior vice presidents of foodservice operations (who are not generally considered executive officers, but Messrs. Smith and Lankford are treated as Named Executive Officers for purposes of this proxy statement), a portion of their bonus was based upon the two-part calculation set forth above, and accordingly no bonus for this portion was earned, and a portion was based upon the aggregate financial results of those operating subsidiaries or divisions for which they were responsible, considered as one company. The second portion is based upon the interplay between the aggregate percentage increase in pretax earnings and operating pretax earnings of their supervised operations and the aggregate return on capital of their supervised operations, adjusted in certain instances for operating companies that are involved in SYSCO s facility expansion ( fold-out ) program. Aggregate bonuses of $1,470,113 were paid to senior vice presidents of foodservice operations pursuant to this portion of the MIP bonus program in fiscal 2007 for fiscal 2006 performance.

*Supplemental Performance Based Bonus Plan and Agreement*

In February 2006, the Company and Mr. Schnieders entered into a Supplemental Performance Based Bonus Agreement under the Supplemental Performance Based Bonus Plan approved by the Committee in November 2004. Pursuant to this agreement, Mr. Schnieders bonus for fiscal 2006 was subject to increase or decrease by up to 25% depending upon whether he exceeded or failed to meet certain pre-established performance criteria in the areas of

long-term strategy, growth, financial performance, corporate governance, and human capital. Supplemental bonus amounts paid under this plan do not qualify as performance based compensation under Section 162(m) of the Code. In approving the plan, the Committee concluded that the importance of aligning a portion of Mr. Schnieders compensation with additional performance goals not taken into account under the MIP, combined with the desirability of preserving a certain level of Committee discretion over the total amount of Mr. Schnieders bonus payments, outweighed the potential cost to the Company that could result from the non-deductibility of any compensation paid under such plan. Because Mr. Schnieders did not earn a bonus under the Management Incentive Plan for fiscal 2006, as discussed above, no bonus was payable under the Supplemental Performance Based Bonus Agreement. In May 2006, the Committee and the Board approved a new Supplemental Performance Based Bonus Plan in which the Chief Executive Officer, all Executive Vice Presidents and all Senior Vice Presidents (including Senior Vice Presidents of Foodservice Operations) are eligible to participate. See Management Incentive Plan, Supplemental Performance Based Bonus Plan and Related Agreements on page 28.

*Stock Election and Matching Grant*

The 2000 MIP, which was in effect for fiscal 2006, provided that participants could voluntarily elect to receive up to 40% of their annual incentive bonus in the form of SYSCO Common Stock, based on a per-share price equal to the closing price on the New York Stock Exchange of SYSCO Common Stock on the last trading day of the fiscal year for which the MIP bonus was calculated. If such election was made, the participant was awarded additional matching shares on the basis of one additional share for each two shares received in accordance with the foregoing election.

Under the 2000 MIP, participants who elected to receive a portion of their bonus in Common Stock in lieu of cash and received additional matching shares were entitled to receive additional cash equal to the product of:

- the value of such matching shares received by the participant (based on the closing price of such shares on the last trading day of the fiscal year), and

- the effective tax rate applicable to SYSCO.

Restricted shares issued under the MIP are not transferable by the recipient for two years following issuance and are subject to certain repurchase rights on the part of SYSCO or forfeiture upon demand by SYSCO in the event of the termination of the participant s employment other than termination of employment due to death, normal retirement or disability.

Under the 2005 MIP, which is in effect for fiscal 2007 and later years, participants will receive an automatic 28% stock match of their MIP bonus, if any, and will no longer be able to elect to receive a portion of their bonus in SYSCO Common Stock. No tax minimization payments will be made under the 2005 MIP.

*Deferred Compensation Election*

MIP participants may defer up to 40% of their annual incentive bonus (without considering any election to receive a portion of the bonus in stock for fiscal 2006) under the current Executive Deferred Compensation Plan ( EDCP ). MIP participants may also elect to defer all or a portion of their salary under the EDCP. MIP participants who defer may choose from a variety of investment options, including Moody s Average Corporate Bond Yield plus 1%, with respect to amounts deferred. Amounts deferred under the EDCP are generally payable upon death, disability, retirement or termination of employment pursuant to distribution elections made under the EDCP.

For fiscal 2006 deferrals of up to 20% of the annual incentive bonus, the EDCP currently provides for SYSCO to credit the participant s deferred compensation account in an amount equal to 15% of the amount deferred. This

matching credit and associated earnings, which accrue interest at a rate equal to Moody s Average Corporate Bond Yield plus 1%, fully vest upon the earliest to occur of:

- the 10th anniversary of the date the matching payment is credited to the participant s account;
- the participant s reaching age 60;

the death or permanent disability of the participant; or

a change in control of SYSCO.

The matching credit and associated earnings not otherwise fully vested under one of the above provisions may vest under an alternative schedule when the participant is at least age 55 and has participated in the MIP for at least 15 years. Once such minimum requirements are satisfied, the vesting percentage is based on the sum of the participant s full years of age plus full years of MIP participation, with percentages ranging from 50% when a participant s age plus years of service equal 70 to 100% when a participant s age plus years of service equal 80.

*Stock Options*

After reviewing the Company s overall compensation strategy, the Compensation Committee has determined that option grants may be made at the discretion of the Committee in fiscal years following a fiscal year in which annual Management Incentive Plan bonuses were not paid to senior executives as a result of the Company s failure to meet the Management Incentive Plan performance criteria. Although the Company did grant options to senior executives in two years in which they did not earn bonuses during the 1980s, since 1994 the Compensation Committee of the Board of Directors has indicated that its practice is to consider issuing options on a performance basis; that is, only in years when participants in the Company s Management Incentive Plan have earned a bonus. However, options are only one part of the Company s multi-faceted compensation program used to strengthen short-term, mid-term and long-term performance. In general, the Company s cash bonus plans are based on the Company s overall annual financial performance. In contrast, the Committee believes that the determination of whether to grant options should take into consideration a number of other criteria relating to the Company s long-term performance, including (but not limited to) the Company s sales, gains in market share, implementation of the Company s strategy and long-range plans, acquisitions and similar items, as well as the Company s overall performance. The Compensation Committee believes that considering such factors will benefit employee retention and insure that longer term strategic initiatives are not compromised in pursuit of short-term profitability. Such longer-term focus will benefit the Company and its shareholders.

The Committee has not historically considered the current number of outstanding options held by an individual when making its grant decisions.

*2004 Stock Option Plan.* The 2004 Stock Option Plan (the 2004 plan ) was approved by stockholders and became effective in November 2004. The Committee administers the 2004 plan which provides for the grant of stock options only; restricted stock is not authorized to be issued under the 2004 plan. The 2004 plan limits the number of shares that may be issued in any given year to 1.5% of common shares outstanding on the first day of the fiscal year in which grants are made. The 2004 plan also limits the number of options that may be granted to any named executive officer in any given year to 200,000. The 2004 plan prohibits repricing, discounted stock options, reload stock options and material changes without stockholder approval. Options will have a maximum term of seven years and will be subject to a minimum ratable vesting period of three years. Shares which are cancelled or forfeited from prior plans will not be again available for grant under the Plan. In the event of a change of control, the 2004 plan provides that all outstanding options would vest and become fully exercisable.

In September 2005, approximately 4,827,500 options were granted to approximately 1,200 employees, including the then executive officers, under the 2004 plan. Of the total options granted in September 2005, an aggregate of 876,000 options were granted to the then executive officers. Options granted to the Named Executive Officers represented approximately 7% of all options granted. All of the options granted in September 2005 have an exercise price of $33.01, a seven-year term and, except for options granted to first-time MIP participants, vest ratably over a five-year

period. Those options granted to first-time MIP participants vest ratably over a three-year period beginning in September 2008.

In September 2006 (fiscal 2007), approximately 6,504,200 options were granted to approximately 1,600 employees, including the executive officers, under the 2004 plan. Of the total options granted in September 2006, an aggregate of 594,000 options were granted to the executive officers. Options granted to the Named Executive Officers represented approximately 8% of all options granted. All of the options granted in September 2006 have an exercise price of $31.70, a seven-year term and, except for options granted to first-time MIP participants, vest ratably over a five-year period. Those options granted to first-time MIP participants vest ratably

over a three-year period beginning in September 2009. As of September 12, 2006, there were approximately 12,179,000 shares remaining available for grant under the 2004 Stock Option Plan.

In September 2005 (fiscal 2006), Mr. Schnieders received an option grant under the 2004 plan to purchase 140,000 shares at an exercise price of $33.01 per share. These options have a Black-Scholes grant date present value of $1,129,800. In September 2006 (fiscal 2007), he also received a grant under the 2004 plan to purchase 140,000 shares at an exercise price of $31.70 per share.

*Long-Term Incentive Cash Plan*

In September 2004, the Committee recommended and the Board approved the SYSCO Corporation 2004 Long-Term Incentive Cash Plan (the LTICP ) pursuant to which the executive officers and other key employees have the opportunity to receive cash incentive payments based on a performance measurement period of at least three years. At the beginning of each performance period, participants may be granted a number of performance units, the value of which is established at that time by the Committee. A participant s cash incentive payments under the LTICP are based on the number of performance units granted to the participant, the value of the participant s performance units, and a percentage (established by the Committee) that correlates to the level of performance that is achieved under performance criteria set by the Committee. The Committee believes that the design of the LTICP focuses the Company s executive officers and other key employees on SYSCO s long-term financial success. The LTICP also reduces the use of option grants and their dilutive effect.

The performance criteria set by the Committee for the three-year period ending June 30, 2007 are based on the participant s supervised operations with respect to the following: (i) for operating company participants, the average increase in the supervised operations operating pre-tax earnings over the performance period, and (ii) for corporate participants, the average increase in SYSCO s net after-tax earnings per share over the performance period. The performance criteria set by the Committee for the three-year period ending June 28, 2008 and the three-year period ending June 27, 2009 are based on the participant s supervised operations with respect to the following: (i) for operating company participants, the average increase in the supervised operations operating pre-tax earnings and sales growth (sales are adjusted for inflation and deflation) over the performance period, and (ii) for corporate participants, the average increase in SYSCO s net after-tax earnings per share and sales growth (sales are adjusted for inflation and deflation) over the performance period.

In September 2004 (fiscal 2005), the Committee approved grants of performance units under the LTICP that could result in a maximum aggregate payout after the end of the three-year performance period that includes fiscal years 2005 through 2007 of $23,454,375. Mr. Schnieders grant with respect to the 2005 through 2007 performance period has a maximum potential value of $4,147,500.

In September 2005 (fiscal 2006), the Committee approved grants of performance units under the LTICP that could result in a maximum aggregate payout after the end of the three-year performance period that includes fiscal years 2006 through 2008 of $24,808,875. Mr. Schnieders grant with respect to the 2006 through 2008 performance period has a maximum potential value of $5,880,000.

In September 2006 (fiscal 2007), the Committee approved grants of performance units under the LTICP that could result in a maximum aggregate payout after the end of the three-year performance period that includes fiscal years 2007 through 2009 of $22,391,250. Mr. Schnieders grant with respect to the 2007 through 2009 performance period has a maximum potential value of $5,880,000.

*Other Benefits*

Executive officers also participate in SYSCO s regular employee benefit programs, which include a pension plan, a 401(k) plan, group medical and dental coverage, group life insurance and other group benefit plans. Executive officers are also provided with additional life insurance benefits, as well as long-term disability coverage. Further details with respect to SYSCO s tax-qualified pension plan are provided on pages 30 and 31.

In addition, MIP participants are provided with a Supplemental Executive Retirement Plan (the SERP ) which is currently designed, generally, to provide post-retirement annual payments equal to 50%, subject to certain years of service and age requirements, of a qualified participant s final average annual compensation, in

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combination with other retirement benefits. Other retirement benefits include any benefit received from SYSCO s pension plan (or similar qualified plan of an acquired company), employer provided benefits from SYSCO s 401(k) plan (or similar qualified plan of an acquired company) and Social Security.

MIP participants, including the executive officers, are encouraged to have their spouses accompany them at dinners and other functions in connection with certain business meetings and other corporate sponsored events, and SYSCO pays, either directly or by reimbursement, all expenses associated with their travel to and attendance at these business-related functions. The Company owns fractional interests in private aircraft which are made available to executive officers and other employees for business use. Spouses may from time to time receive flights on these aircraft in connection with travel to a business-related function.

Executive officers, as well as many other employees who travel for business purposes, are reimbursed for their membership in travel clubs and may receive travel credits that may be used for personal travel. Officers, as well as many other employees, are provided with cell phones and PDA devices which are paid for by the Company and which are intended primarily for business use. All employees, including executive officers, are also entitled to receive discounts on all products carried by the Company and its subsidiaries.

*Stock Ownership Guidelines for Executive Officers*

The Company s Corporate Governance Guidelines provide that after three years of service as an executive officer, such individuals are expected to continuously own a minimum number of shares equal in value to 200% of their base salary. Except for Mr. Carrig, all of the executive officers listed on page 13 who have served as executive officers for at least three years met this requirement as of September 12, 2006. In September 2006, the Board of Directors waived the stock ownership guidelines with respect to Mr. Carrig on the condition that he will be in compliance with the requirement within 18 months.

*Severance Agreements*

In May 2004, the Committee approved Severance Agreements for Messrs. Schnieders, Stubblefield, Accardi and Spitler. The Severance Agreements are described on pages 29 and 30.

*Income Deduction Limitations*

Section 162(m) of the Internal Revenue Code of 1986, as amended (the Code ), generally sets a limit of $1 million on the amount of compensation (other than certain performance-based compensation that complies with the requirements of Section 162(m)) that SYSCO may deduct for federal income tax purposes in any given year with respect to the compensation of each of the Named Executive Officers. The Committee has determined, after reviewing the effect of Section 162(m), that our general policy will be to structure the performance-based compensation arrangements (other than the Supplemental Performance-Based Bonus Plan) for such Named Executive Officers to satisfy Section 162(m) s conditions for deductibility, to the extent feasible and taking into account all relevant considerations. However, the Committee also believes that the Company needs flexibility to meet its incentive and retention objectives, even if the Company may not deduct all of the compensation paid to the Named Executive Officers. In the analysis given to the Committee by its compensation consultant, it was determined that Mr. Schnieders was at or below the 25th percentile for the Company s peer group and industry group. The Committee granted Mr. Schnieders a 2.4% raise from $1,050,000 to $1,075,000. effective January 1, 2006 in order to remain competitive under its compensation parameters. The Committee determined that the additional base compensation is appropriate even if the additional funds would not be deductible under Section 162(m) of the Code. Furthermore, amounts paid under the supplemental bonus plan (described above under Supplemental Performance Based Bonus Plan and Agreement ) do not qualify as performance based compensation under Section 162(m) of the Code. In approving the plan, the Committee concluded

that the importance of aligning a portion of the executive officers compensation with additional performance goals not taken into account under the MIP, combined with the desirability of preserving a certain level of Committee

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discretion over the total amount of the executives officers bonus payments, outweighed the potential cost to the Company that could result from the non-deductibility of any compensation paid under such plan.

COMPENSATION COMMITTEE

John M. Cassaday,
Chairman
Richard G. Merrill
Richard G. Tilghman
Jackie M. Ward

FORMER MEMBER OF COMPENSATION COMMITTEE

Phyllis S. Sewell
(served during fiscal 2006 until March 1, 2006)

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## EXECUTIVE COMPENSATION

### Summary Compensation Table

The following table sets forth information with respect to the Chief Executive Officer, the four other most highly compensated executive officers of SYSCO and its subsidiaries employed at the end of fiscal 2006 whose total annual salary and bonus exceeded $100,000 for the fiscal year ended July 2, 2006, and two additional individuals who were executive officers for a portion of the fiscal year ended July 2, 2006 and are required to be included by SEC regulations (collectively, the Named Executive Officers ).

| | | Annual Compensation | | | Long-Term Compensation | | |
|---|---|---|---|---|---|---|---|
| Name And Principal Position | Fiscal Year | Salary($) | Bonus($) (1) | Other Annual Compensation($) (2) | Restricted Stock Awards($) (1)(3) | Securities Underlying Options(#) (4) | All Other Compensation($) (5) |
| Richard J. Schnieders | 2006 | $ 1,062,500 | | | | 140,000 | $ 83,464 |
| Chairman, Chief Executive | 2005 | 981,250 | $ 1,758,335 | | $ 1,235,400 | 85,000 | 270,784 |
| Officer and President | 2004 | 912,500 | 1,887,835 | | 1,673,080 | 90,000 | 370,544 |
| John K. Stubblefield, Jr. | 2006 | 580,000 | | | | 73,000 | 81,400 |
| Executive Vice President, | 2005 | 547,083 | 753,311 | | 670,661 | 40,000 | 175,388 |
| Finance and Chief | 2004 | 532,500 | 1,055,245 | | 935,215 | 70,000 | 246,735 |
| Financial Officer | | | | | | | |
| Larry J. Accardi | 2006 | 547,500 | | | | 73,000 | 40,272 |
| Executive Vice President, | 2005 | 526,250 | 713,672 | | 635,354 | 40,000 | 133,710 |
| Contract Sales and | 2004 | 512,500 | 1,016,548 | | 900,868 | 70,000 | 187,324 |
| President, Specialty Distribution | | | | | | | |
| Companies | | | | | | | |
| Kenneth F. Spitler | 2006 | 547,500 | | | | 73,000 | 55,402 |
| Executive Vice President, | 2005 | 526,250 | 713,672 | | 635,354 | 40,000 | 148,938 |
| President of North American | 2004 | 512,500 | 1,016,548 | | 900,868 | 70,000 | 204,776 |
| Foodservice Operations | | | | | | | |
| Larry G. Pulliam | 2006 | 510,000 | | | | 73,000 | 27,128 |
| Executive Vice President, | 2005 | 440,417 | 660,833 | | 588,265 | 26,000 | 120,988 |
| Merchandising Services | 2004 | 425,000 | 842,256 | | 746,460 | 45,000 | 152,717 |
| Stephen F. Smith* | 2006 | 455,000 | 194,525 | | 173,092 | 39,000 | 59,030 |
| Senior Vice President, | 2005 | 436,250 | 467,324 | | 416,005 | 26,000 | 91,400 |
| Foodservice Operations | 2004 | 425,000 | 717,280 | | 635,657 | 45,000 | 138,004 |
| James E. Lankford* | 2006 | 465,000 | 187,873 | | 167,194 | 39,000 | 49,580 |
| Senior Vice President, | 2005 | 455,416 | 567,944 | | 505,579 | 26,000 | 97,462 |
| Foodservice Operations | 2004 | 447,500 | 770,773 | | 683,089 | 45,000 | 128,226 |

* Messrs. Smith and Lankford, who were executive officers for a portion of fiscal 2006, are included in the Summary Compensation Table as Named Executive Officers. Although Messrs. Smith and Lankford still hold

the offices indicated above, as of May 12, 2006 it was determined that they did not actually perform policy making functions and should no longer be deemed executive officers for purposes of filings under the Securities Exchange Act of 1934. However, for the sole purpose of this Proxy Statement, each of Messrs. Smith and Lankford is still considered to be a Named Executive Officer of the Company, as required by SEC regulations.

(1) Pursuant to the 2000 Management Incentive Plan and Executive Deferred Compensation Plan, each of the Named Executive Officers was eligible for fiscal years 2004, 2005 and 2006 to voluntarily elect to receive up to 40% of his bonus in restricted stock and to defer up to 40% (calculated prior to any election to receive stock). These elections, if made, entitled the participant to receive additional stock and cash pursuant to the match features of these plans as follows: (a) one additional share for each two shares elected to be received in lieu of cash, (b) additional cash to minimize the tax effect of matching shares received in lieu of cash, and (c) for deferrals of up to 20%, a credit to the participant s deferred compensation account in an amount equal to a specified percentage (50% in fiscal 2004 and 2005 and 15% in fiscal 2006) of the amount deferred. The terms of these plans are described in more detail in the Report of the Compensation Committee beginning on page 17.

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The amounts reported in the Bonus column include amounts paid in cash and amounts deferred by each of the Named Executive Officers. The Bonus column also includes cash received to minimize the tax effect of any additional shares received pursuant to the match feature of the 2000 Management Incentive Plan. The components of the amounts reported in the Bonus column for Messrs. Smith and Lankford in fiscal 2006 are set forth below:

| Name | Cash Portion of Base Bonus | Cash Tax Effect | Deferred Amount | Bonus Column Amount |
|---|---|---|---|---|
| Smith | $ 115,421 | $ 21,402 | $ 57,702 | $ 194,525 |
| Lankford | 111,469 | 20,671 | 55,733 | 187,873 |

The value of any shares elected to be received in lieu of cash and any matching shares is included in the Restricted Stock Awards column and additional information about such shares is included in footnote 3 below. Any amounts credited pursuant to the deferred match feature of the current EDCP are included in the All Other Compensation column and described in footnote 5 below.

For Mr. Schnieders, this column also includes a supplemental bonus of $370,629 in fiscal 2005. See Incentive Compensation in the Report of the Compensation Committee.

(2) Does not include perquisites and other personal benefits because they did not exceed for any individual $50,000 in the aggregate. See Other Benefits in the Report of the Compensation Committee.

(3) Each of the Named Executive Officers elected to receive a portion of his bonus in shares of restricted Common Stock pursuant to the 2000 Management Incentive Plan. Pursuant to the 2000 Management Incentive Plan, the Company made a matching grant of one additional share for each two shares received pursuant to such election. The amount presented in the Restricted Stock Awards column in fiscal 2006 is determined by multiplying the number of shares earned during the fiscal year by the closing price of our Common Stock on the New York Stock Exchange on the last trading day of such fiscal year.

The number of restricted shares earned by the Named Executive Officers in fiscal 2006 and issued in the first quarter of fiscal 2007 was as follows:

Mr. Smith, 5,664 shares, and

Mr. Lankford, 5,471 shares.

The aggregate number and dollar value (computed using the closing price of our Common Stock on June 30, 2006 ($30.56)) of all restricted shares held as of the last business day of fiscal 2006 by the Named Executive Officers were as follows:

Mr. Schnieders 82,157 shares at $2,510,718;

Mr. Stubblefield 45,375 shares at $1,386,660;

Mr. Accardi 43,414 shares at $1,326,732;

Mr. Spitler 43,414 shares at $1,326,732;

Mr. Pulliam 37,678 shares at $1,151,440;

Mr. Smith 29,742 shares at $908,916; and

Mr. Lankford 33,576 shares at $1,026,082.

The restricted shares are not transferable by the recipient for two years following issuance and are subject to certain repurchase rights on the part of SYSCO in the event of the employee s death or termination of employment other than by normal retirement or disability. The recipient receives dividends on the shares during the two-year restricted period.

(4) Information regarding stock options granted to the Named Executive Officers in fiscal 2006, including the Black-Scholes grant date present value, is included below under Stock Option Grants.

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(5) The amounts reported in the All Other Compensation column include the following:

a SYSCO match equal to a specified percentage (50% in fiscal 2004 and 2005 and 15% in fiscal 2006) of the first 20% of the annual incentive bonus which each individual elected to defer under the Executive Deferred Compensation Plan (the terms of this plan are described in more detail in the Report of the Compensation Committee beginning on page 17);

the amount paid for term life insurance coverage for each individual;

the amount paid for 401(k) Plan matching contributions during the fiscal year; and

above-market interest credited to deferred compensation account balances as of June 30 of each fiscal year (above-market interest is the amount by which the interest actually earned on deferred account balances during the year exceeded the interest that would have been earned based on an interest rate equal to 120% of the applicable federal long-term rate as provided in Section 1274(d) of the Code on a compounded basis), which amounts are set forth below:

| Name | Fiscal Year | Deferred Match | Term Life Insurance | 401(k) Contributions | Above-Market Interest | All Other Compensation Total |
|---|---|---|---|---|---|---|
| Schnieders | 2006 | | $ 907 | $ 2,625 | $ 79,932 | $ 83,464 |
| | 2005 | $ 205,905 | 907 | 6,625 | 57,347 | 270,784 |
| | 2004 | 278,850 | 871 | 6,000 | 84,823 | 370,544 |
| Stubblefield | 2006 | | 907 | 2,800 | 77,693 | 81,400 |
| | 2005 | 111,777 | 907 | 6,500 | 56,204 | 175,388 |
| | 2004 | 155,870 | 868 | 6,000 | 83,997 | 246,735 |
| Accardi | 2006 | | 907 | n/a | 39,365 | 40,272 |
| | 2005 | 105,894 | 907 | n/a | 26,909 | 133,710 |
| | 2004 | 150,150 | | | | |