GRISTEDES FOODS INC
Form 10-K
March 05, 2003

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(X) ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For fiscal year ended December 1, 2002

( ) TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from________________ to__________________

Commission File No. 1-7013

GRISTEDE'S FOODS, INC.
(Exact name of registrant as specified in its charter)

DELAWARE (State or Other Jurisdiction of incorporation or organization)	13-1829183 (I.R.S. Employer Identification No.)
823 ELEVENTH AVENUE, NEW YORK, NEW YORK (Address of Principal Executive Offices)	10019-3535 (Zip Code)

(212) 956-5803
(Registrant's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12 (b) of the Act:

Title of each class	Name of each exchange on which registered
COMMON STOCK, $0.02 PAR VALUE	AMERICAN STOCK EXCHANGE

Securities registered pursuant to Section 12(g) of the Act:

NONE

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13, or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes X No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

As of February 25, 2003, 19,636,574 shares of the registrant's common stock, $0.02 par value, were outstanding.

The aggregate market value of the common stock held by nonaffiliates of the registrant (i.e., excluding shares held by executive officers, directors, and control persons as defined in Rule 405) on May 31, 2002 (the last business day of the second fiscal quarter) was $1,678,553 computed at the closing price on

that date.

DOCUMENTS INCORPORATED BY REFERENCE: NONE

This annual report on Form 10-K contains both historical and "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as "anticipates", "believes", "expects", "intends", "future", and similar expressions identify forward-looking statements. Any such "forward-looking" statements in this report reflect the Company's current views with respect to future events and financial performance, and are subject to a variety of factors that could cause the actual results or performance to differ materially from historical results or from the anticipated results or performance expressed or implied by such forward-looking statements. Because of such factors, there can be no assurance that the actual results or developments anticipated by the Company will be realized or, even if substantially realized, that they will have the anticipated results. The risks and uncertainties that may affect the Company's business include, but are not limited to: economic conditions, governmental regulations, technological advances, pricing and competition, acceptance by the marketplace of new products, retention of key personnel, the sufficiency of financial resources to sustain and expand the Company's operations, and other factors described in this report and in prior filings with the Securities and Exchange Commission. Readers should not place undue reliance on such forward-looking statements, which speak only as of the date hereof, and should be aware that except as may be otherwise legally required of the Company, the Company undertakes no obligation to publicly revise any such forward-looking statements to reflect events or circumstances that may arise after the date hereof.

ITEM 1. BUSINESS.

GENERAL

The Company is a Delaware corporation whose principal executive offices are located at 823 Eleventh Avenue, New York, New York 10019-3535. Unless the context otherwise requires, the terms "Company" or "Registrant" as used herein refer to Gristede's Foods, Inc. (which is a holding corporation) and its wholly owned subsidiaries.

The Company operates 49 supermarkets (the "Supermarkets"), and two free standing pharmacies offering health and beauty aids and general merchandise. (Two supermarkets opened in December 2002, subsequent to year end). Forty-one Supermarkets and the two pharmacies are located in Manhattan, New York, three Supermarkets are located in Westchester County, New York, one Supermarket is located in Brooklyn, New York, one Supermarket is located in the Bronx, New York and one Supermarket is located in Long Island, New York. All of the supermarkets / pharmacies are operated under the "Gristede's" name. The Company leases all of its Supermarket locations and its two pharmacies. During fiscal 1999 the Company embarked on a plan to open in-store pharmacies in select Supermarket locations. The Company is currently operating nine in-store pharmacies and two free standing pharmacies.

During fiscal 2002 the Company opened one new in-store pharmacy and opened two additional in-store pharmacies subsequent to the end of fiscal 2002.

The Company also owns City Produce Operating Corp. ("City Produce"), a corporation that operates a warehouse used as an internal distribution center, on leased premises in Bronx County, New York. The warehouse operation supplies the Company's Supermarkets with groceries and fresh produce. The warehouse also sells wholesale fresh produce to third parties.

The Company competes on the basis of providing customer convenience, service and a wide assortment of food products, including those that are appealing to the clientele in the neighborhoods where its Supermarkets are located. The Supermarkets, like most Manhattan supermarkets, are smaller than their suburban counterparts, ranging in size from approximately 6,000 to 24,500 square feet of selling space and averaging 10,200 square feet of selling space.

The Supermarkets offer, at competitive prices, broad lines of merchandise, including nationally and regionally advertised brands, private label and generic brands. Merchandise sold includes food items such as fresh meats, produce, dry groceries, dairy products, baked goods, poultry and fish, fresh fruits and vegetables, frozen foods, and delicatessen and gourmet foods, as well as many non-food items such as cigarettes, soaps, paper products, and health and beauty aids. Check-cashing services are available to qualified customers holding check-cashing cards and, for a small fee, the Company will deliver groceries to a customer's residence. The Supermarkets accept payment by Mastercard, Visa, American Express, IGT and Discover credit cards. Most of the Supermarkets are open sixteen hours per day, seven days a week and on holidays, including Christmas, New Year's and Thanksgiving. Most of the Supermarkets close two hours earlier on Sundays.

The Company's predecessor was incorporated in 1956 in New York. In 1985, the Company's domicile was changed to Delaware by merging the predecessor corporation into a newly formed Delaware corporation, incorporated for such purpose. The Company became a public company in 1968 and listed its common stock on the American Stock Exchange in 1972. Until 1992, the Company engaged in the jewelry business, operating under the name Designcraft Industries, Inc. for most of such time. The Company changed its name to Sloan's Supermarkets, Inc., in September 1993 and to Gristede's Sloan's, Inc., in November 1997. The Company changed its name to Gristede's Foods, Inc. in August 1999 to reflect its strategy of changing its "Sloan's" banner locations to "Gristede's" subsequent to a store remodeling.

GROWTH STRATEGY

On November 10, 1997, a Merger Agreement was consummated pursuant to which 29 Supermarkets indirectly owned by Mr. Catsimatidis, (the "majority shareholder") merged into wholly owned subsidiaries of the Company (the "Merger"). The Company believes that the Merger has allowed it to realize synergies and increased operating leverage while providing management with the necessary resources and focus to streamline operations, automate facilities and capitalize on strategic opportunities. The Company also believes that the Merger has enabled it to achieve the critical mass necessary to execute its future growth strategy.

Subsequent to the Merger, the Company embarked on a capital expenditure program for its Supermarkets that included extensive remodelings, the introduction of a centralized point-of-sale information system and the opening of in-store pharmacies in select Supermarket locations. The Company has a $32,500,000 revolving credit and term loan facility from certain banks maturing in November 2004 and December 2006, respectively, and finance facilities from leasing companies to finance such capital improvements. (see Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operation-Liquidity and Capital Resources").

During the fiscal year ended December 1, 2002, three new stores were

opened, four stores were remodeled, and one new in-store pharmacy opened. Two new stores were opened in December 2002 subsequent to the fiscal year-end. The aggregate capital expenditures for fiscal 2002, including such remodelings and new store openings, was approximately $19,000,000. Included in this amount is $6.4 million for three stores purchased from A&P for $5.5 million. Subject to the availability of financing, during the fiscal year ending November 30, 2003, the Company anticipates it will spend approximately $8 to $10 million in aggregate capital expenditures, including additional remodelings and new store and pharmacy openings. The Company anticipates that it will continue opening new stores and pharmacies in future years. The modernized larger Supermarkets are being re-named "Gristede's Mega Stores".

Average sales increases at the remodeled stores have exceeded 50%. Modernization has resulted in a more enjoyable shopping atmosphere with more rapid check-out lines due to scanners and improved lighting facilities.

The Company may also expand its operations through the acquisition of supermarkets and/or the acquisition of businesses that the Company believes would complement its core supermarket business. However, pursuant to an order embodying a Settlement Agreement between the Federal Trade Commission (the "FTC"), John Catsimatidis, the Company and certain other companies controlled by Mr. Catsimatidis (collectively, the "Companies"), for a period of ten years from March 6, 1995, the Company cannot, without prior FTC approval, acquire any interest in any existing supermarket in certain designated areas in Manhattan. The order does not restrict the Company from acquiring an interest in a supermarket (in such designated areas) by leasing or purchasing a new location that at the time of acquisition (and for six months prior to the acquisition) is not (or was not) being operated as a supermarket. There are no restrictions on the Company acquiring supermarkets that are located outside the designated areas.

The Company has been attempting to acquire Kings Supermarkets, Inc., a chain of 29 stores, mainly located in Northern New Jersey. The Company intends to continue such efforts. No assurance can be given that this acquisition will be consummated.

MARKETING

The Company advertises in local newspapers on a weekly basis. The Company's advertising emphasizes competitive prices and a variety of merchandise. Some of the Company's vendors offer cooperative advertising allowances, which the Company receives for advertising particular products in its newspaper advertisements.

COMPETITION

The Company's retail business is subject to intense competition, characterized by low profit margins and requiring regular advertising. All of our Supermarkets are in direct competition with Food Emporium, D'Agostino's, A&P, Pathmark and independent supermarket/grocery operators which do business under the names "Pioneer", "Key Food" and "Associated", many of which are larger and have substantially greater resources than the Company. The Supermarkets also compete with other outlets that sell products sold by supermarkets in New York City. Those outlets include gourmet food stores, health and beauty aid stores, drug stores, produce stores, bodegas, delicatessens and other retail food establishments.

SOURCES OF SUPPLY; INVENTORY POLICY

During fiscal 2002 the Company obtained approximately 40% of the merchandise sold in its stores from one supplier, White Rose Foods, and the balance from other vendors, none of which accounted for more than 10% of merchandise purchased by the Company. The Company believes that its supplier relationships are currently satisfactory. The Company is not dependent on these supplier relationships since merchandise is readily available from numerous sources under different brand names, subject to conditions affecting food supplies generally.

The Company's policy is to have its Supermarkets fully stocked with merchandise at all times. This policy requires the Company to carry significant amounts of inventory. As stated above, replenishment merchandise is readily available from the Company's suppliers, and, on average, nearly 90% of the Company's inventory is sold before the Company is required to pay its suppliers.

TRADENAMES

The Company owns the "Gristede's" tradename. Such name has an established reputation in the areas served by the Supermarkets for convenience, competitive prices, service and a wide variety of quality produce and merchandise. "Gristede's" is a federally registered trademark.

LABOR CONTRACTS

All of the employees of the Company other than 161 administrative employees and executives and 95 store managers and co-managers are represented by unions. The table below sets forth the name of each union with which the Company has a collective bargaining agreement and the expiration date of such agreement.

Name of Union	Expiration Date
Retail, Wholesale & Chain Store Food Employees Union, Local 338	October 7, 2006
Amalgamated Meat Cutters and Retail Food Local 342 Store Employees Union, Local 342-50	October 5, 2003
United Food and Commercial Workers Union ("UFCW"), Local 174	December 20, 2006
UFCW, Local 1500	June 25, 2006
UFCW, Local 464A	May 1, 2003
International Brotherhood of Teamsters ("Teamsters"), Local 803	month-to-month
Teamsters, Local 202	December 31, 2003

GOVERNMENTAL APPROVALS

All of the Supermarkets have obtained all necessary governmental approvals, licenses and operating permits to operate the stores.

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EMPLOYEES

At February 1, 2003, the Company had approximately 2,288 employees, 2,086 of which are employed at the Supermarkets or the City Produce warehouse, and 202 of which are employed at the Company's executive offices. Approximately 717 employees were employed on a full-time basis, of which 460 employees work in the Supermarkets.

SEASONALITY

The Company's Supermarkets are predominantly located in the borough of Manhattan in New York City and serve a more affluent clientele often referred to as the "carriage trade." Owing to the significant exodus of such customers during the summer months for vacation and holiday, together with an increased propensity by resident customers for out of home dining during such period, the Company traditionally incurs up to a 20% seasonal drop in sales during the months of July and August each year. The seasonal decline in sales does not have a material impact on the level of inventories carried by the Company.

ENVIRONMENTAL COMPLIANCE

Compliance by the Company with Federal, State and local provisions that have been enacted or adopted regarding the discharge of materials into the environment, or otherwise relating to the protection of the environment, does not have a material financial impact on the Company.

ITEM 2. PROPERTIES.

The Company leases all 49 supermarket locations, its two free standing pharmacies and the warehouse and distribution center operated by City Produce (two supermarkets opened in December 2002, subsequent to year end). Including option renewals, two of such leases expire prior to 2004, 14 of such leases expire on dates from 2004 through 2012 and 36 of such leases expire on dates from 2013 through 2040 (the warehouse is subject to three leases). Several leases have optional renewal periods. It is generally the Company's intention to exercise such options. The supermarkets range in size from approximately 6,000 to 24,500 square feet of selling space, averaging 10,200 square feet of selling space. All of the stores are air-conditioned, have all necessary fixtures and equipment and are suitable for the retail operations conducted therein.

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ITEM 3. LEGAL PROCEEDINGS.

1) RMED International Inc. v. Sloan's Supermarkets Inc. and John A. Catsimatidis.

On August 8, 1994, a lawsuit against the Company and Mr. Catsimatidis was instituted in the United States District Court for the Southern District of New York by RMED International, Inc. ("RMED"), a former stockholder of the Company.

The complaint alleged, among other things, that RMED and a purported class consisting of persons who purchased the Company's common stock on or after March 19, 1993 were damaged by alleged nondisclosures in certain filings made by the Company with the Securities and Exchange Commission between January 1993 and June 1994 relating to an investigation by the FTC. The complaint alleged that such nondisclosures constituted violations of Federal and New York State securities laws, as well as common law fraud, and seeks damages (including punitive damages) in an unspecified amount (although in discovery proceedings, the named plaintiff has claimed that its damages were approximately $800,000) as well as costs and disbursements of the action. On June 2, 1994, the Company issued a press release that disclosed the FTC action.

On September 30, 1994, the defendants filed a motion to dismiss for failure to state a cause of action and for lack of subject matter jurisdiction over the state claims. The motion was denied. In June 1995, the plaintiff filed a motion for class certification, which motion was granted in March 1996. Fact discovery was completed by the end of June 1998. Expert discovery was completed by the end of 1998. Plaintiff's expert prepared a report claiming that

plaintiffs have suffered damages in an amount in excess of $3,000,000. In August 1999, defendants moved to exclude plaintiff's expert report, which motion was denied. In June 2000, the Company filed a motion for summary judgment. In February 2002, the court dismissed plaintiff's state law claim under Article 23-A of the General Business Law of New York, as well as plaintiff's claim for breach of fiduciary duty, but denied the Company's motion with respect to the plaintiff's claim under Section 10(b) of the Securities Exchange Act of 1934, as amended and Rule 10(b)-5 promulgated thereunder, as well as plaintiff's claim of fraud under state common law, finding that there were outstanding issues of fact which needed to be determined at trial.

After a week of trial, in January 2003, the matter was settled. The full amount of the settlement, together with a portion of the Company's legal fees, was paid by the Company's D&O insurance carrier. Neither the Company, nor Mr. Catsimatidis paid any portion of the settlement amount.

2.) Ansoumana v. Great Atlantic & Pacific Tea Company, Inc. d/b/a/ A&P, Shopwell Inc. - d/b/a Food Emporium, Gristede's Operating Corp, Duane Reade, Inc., Charlie Bauer, individually and d/b/a B&B Delivery Service a/k/a Citi Express, Scott Weinstein and Steven Pilavan, ind. and d/b/a Hudson Delivery Service Inc., Chelsea Trucking, Inc. a/k/a Hudson York.

On January 13, 2000, plaintiffs commenced a class action lawsuit in the U.S. District Court for the Southern District of New York (hereinafter referred to as the "Ansoumana Action"). Their complaint alleged violations of the Fair Labor Standards Act and the New York Labor Law. Plaintiffs are claiming damages for the differential between the amount they were paid by the Great American Delivery Service Company and what the minimum wage was in each specific year dating back to 1994. To date, about 35 to 40 delivery workers have opted into the class action.

Specifically, the Company was one of the parties sued in this litigation by delivery workers claiming they were not being paid the minimum wage. The delivery workers are employees of the Great American Delivery Company (formerly known as B&B Delivery Service or Citi Express)("Great American"), not employees of the Company. The Company was under contract with Great American to deliver groceries to the Company's customers.

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In its answer, the Company denied the allegations and cross-claimed against the delivery service co-defendants Weinstein and Baur, based upon their own negligence, theories of contribution and contractual indemnity.

When allegations of underpayment first emerged, the Company, on August 2, 2000, entered into a new contract with Great American. This contract was entered into in order to assure the Company that these delivery workers would be properly and legally paid for their services. The legal hourly wages referred to in the contract were discussed with the New York Attorney General's Office.

On July 23, 2001, the Company terminated its contract with Great American because Great American breached the terms of the contract. Based upon that termination, Great American commenced a breach of contract action in Supreme Court, Nassau County, against the Company and obtained a preliminary injunction compelling the Company to retain Great American as its delivery service contractor.

Thereafter, Great American was found to be in contempt of several orders and added as a party-defendant by motion to amend the complaint in the Ansoumana Action. In response to those proceedings, Great American filed for bankruptcy. Hence, the breach of contract action commenced by Great American against the

Company was stayed. The Company transferred the case to the United States Bankruptcy Court in the Eastern District of New York. Great American's bankruptcy petition was dismissed. Great American's breach of contract action commenced in Nassau County has been stayed pending a resolution of the Ansoumana Action. Nevertheless, Great American posted a $400,000 bond in the breach of contract action pending in Nassau County to obtain a preliminary injunction and the Company intends to recoup these monies from Great American.

A tentative settlement has been reached. The Company estimates that such a possible settlement could result in potential payments of approximately $2,600,000 plus plaintiffs' legal expenses, payable over a number of years, without interest, which amount would be shared approximately 50-50 by the Company with its predecessor private companies. Any amount paid on behalf of the Company will be reflected as a capital contribution. Additionally, recoveries from a $400,000 security bond posted by Great American / Baur shall be solely for the Company's benefit. However, any final settlement must be approved by the Company's banks, the state, the courts, and the plaintiffs. The Company and its legal counsel are not presently able to predict whether the settlement will be implemented. Accordingly, the Company has not recorded any contingent liability in its consolidated financial statements related to this matter. The Company is also pursuing an insurance contribution to the settlement under various policies.

In the meantime, the Company's co-defendant Duane Reade who has continued to aggressively defend itself in this case, without pursuing settlement, has been found liable by summary judgment to be a joint employer with its delivery service provider Weinstein.

3.) Red Apple Supermarkets, Inc., Gristede's Supermarkets, Inc., Supermarket Acquisition Corp., and Gristede's Sloan's Inc., Plaintiffs, against Rite Aid Corporation and Rite Aid of New York, Inc., Defendants

Pursuant to a settlement agreement dated February 22, 1999 (the Settlement Agreement"), between the Company and Rite Aid Corporation ("Rite Aid"), Rite Aid agreed to compromise a dispute between the parties arising out of a written lease purchase agreement dated September 2, 1994 (the "Lease Purchase Agreement). Pursuant to the Settlement Agreement, Rite Aid agreed to pay the sum of $400,000 (the Settlement Sum") to the Company in full and final satisfaction of certain claims and disputes regarding defendants' breaches of the Lease Purchase Agreement. However, Rite Aid failed and refused to pay any portion of the Settlement Sum as required by the Settlement Agreement. Consequently, on June 5, 2000, plaintiffs filed a complaint in the Supreme Court of the State of New York (New York County) which alleged: breach of Settlement Agreement, Breach of Good Faith and Fair Dealing and Breach of Lease Purchase Agreement. Such complaint seeks judgment against Rite Aid in the full amount of the Settlement Sum, together with interest from February 22, 1999.

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As alleged in the complaint, the Lease Purchase Agreement contemplated defendants' purchase of certain commercial leasehold interests held by plaintiffs, in two stores. Pursuant to the Lease Purchase Agreement, defendants agreed to purchase plaintiffs' leasehold interest in the two stores for $1,950,000. However, in violation of the Lease Purchase Agreement - as well as their duty of good faith and fair dealing thereunder - defendants negotiated and obtained their own leasehold interest for both stores directly from each landlord, and failed to compensate plaintiffs as agreed.

The Company has recently settled this litigation where Rite Aid will be returning a store to the Company at 113-119 Fourth Avenue, Manhattan, New York City, which was previously operated by an affiliate of the Company, in

settlement of the litigation.

The Company will be purchasing Rite Aid's prescription records and inventory for this location. In addition, the Company will pay a nominal fee for Rite Aid's furniture and equipment and the Company will also have the benefit of Rite Aid's leasehold improvements at the store at no additional cost. It is expected that Rite Aid will surrender the store within 30 days of the finalization of the settlement. The Company believes that the fair market value of the acquired store lease and leasehold improvements to be in excess of the Settlement Sum plus interest.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITYHOLDERS.

An Annual Meeting of Stockholders of the Company was held on January 31, 2003. The stockholders approved the re-election of the Company's existing seven directors for another term expiring at the next Annual Meeting of Stockholders. 18,485,250 shares voted in favor of the election of each of the directors; 6,089 shares voted against the election of each of the directors; there were no abstentions.

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

MARKET INFORMATION

The Company's Common Stock is listed and traded on the American Stock Exchange. Since November 12, 1997 the Common Stock has been quoted under stock symbol "GRI." Prior thereto it was quoted under the symbol "SLO." For the years ended December 1, 2002 and December 2, 2001, the quarterly high and low price range for such common stock is shown in the following tabulation.

	Fiscal Year Ended December 1, 2002		Fiscal Year Ended December 2, 2001	
Quarter	High	Low	High	Low
First	$1.92	$0.45	$1.63	$0.85
Second	1.33	0.90	1.47	0.85
Third	1.65	0.90	1.85	0.91
Fourth	1.00	0.65	1.45	0.78

The approximate number of holders of record of the Company's Common Stock on February 24, 2003 was 212. The Company believes that there are a significant number of shares of the Company's Common Stock held in street name and, consequently, the Company is unable to determine the actual number of beneficial owners.

DIVIDENDS

The Company has never paid a cash dividend on its Common Stock and does not

expect to pay a cash dividend in the near future.

ITEM 6. SELECTED FINANCIAL DATA

	December 1, 2002	December 2, 2001	Year Ended December 3, 2000	Nov
Sales	$ 250,732,767	$ 229,988,315	$216,325,214	$ 18
Cost of sales	151,435,010	139,180,967	131,259,228	11
Gross profit	99,297,757	90,807,349	85,065,986	6
Direct operating expenses	79,175,726	71,596,708	67,550,165	5
Corporate overhead	9,830,478	8,329,559	7,435,949	
Depreciation and amortization	7,989,625	7,204,281	6,284,971	
Bad debt expense (credits)	72,000	250,354	(350,000)	
Interest expense	2,967,181	3,537,281	3,761,941	
Net income (loss)	$ (926,407)	$ 275,057	$ (190,908)	$ (
Net Income (loss) per share	$ (0.05)	$ 0.01	$ (0.01)	$
At End of Period				
Total assets	$ 120,612,141	$ 101,131,361	$ 96,446,057	$ 7
Long-term debt *	58,137,496	46,682,929	42,378,525	4
Total liabilities	109,946,047	89,538,860	85,128,613	6

Certain reclassifications were made to fiscal 2001 consolidated financial statements to conform to the fiscal 2002 presentation.
* Includes amounts due to affiliates of $14,842,437, $14,525,904, 12,129,031, $9,113,500 and $4,031,394, respectively, for the fiscal years 2002, 2001, 2000, 1999 and 1998, respectively. The affiliates have agreed not to demand payment of these liabilities in the next fiscal year. There is no stated final maturity date, and $14,200,000 of this amount has been subordinated to the banks as of December 1, 2002.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

COMPANY BACKGROUND

The fiscal year ended December 3, 2000 consisted of 53 weeks and the fiscal years ended December 1, 2002 and December 2, 2001 consisted of 52 weeks each.

The following table sets forth, as a percentage of sales, components of the Results of Operations:

	2002	2001	2000
Sales	100.0%	100.0%	100.0%
Cost of sales	60.4%	60.5%	60.7%
Gross profit	39.6%	39.5%	39.3%
Store operating, general and administrative expense	31.6%	31.1%	31.2%
Pre-store opening startup costs	0.3%	0.1%	0.2%
Bad debt expense (credits)	--	--	(0.2%)
Depreciation and amortization	3.2%	3.1%	2.9%
Insurance proceeds - terrorist attack	(0.2)%	(0.7%)	--
Casualty loss - terrorist attack	--	0.5%	--
Non-store operating expense	3.9%	3.6%	3.4%
Operating profit (loss)	0.8%	1.6%	1.7%
Other expense	1.2%	1.4%	1.7%
Profit (loss) from operations before income taxes	(0.4%)	0.2%	(0.1%)
Income taxes	--	0.1%	--
Net income (loss)	(0.4%)	0.1%	(0.1%)

Percentages of individual line items (as a percent of sales) have been rounded to the nearest tenth of a percent, and therefore, the totals may not add to100%.

RESULTS OF OPERATIONS (2002 COMPARED TO 2001)

Sales for the year 2002 were $250,732,767 as compared to sales for the year 2001 of $229,988,315. The sales increase in fiscal 2002 compared to the sales in fiscal 2001 is mainly attributable to sales increases due to new or remodeled stores opened in fiscal 2002 or full years sales for those new or remodeled stores opened during 2001. Same store sales for the year 2002 were 7.1% ahead of 2001. Gross profit was $99,297,757 or 39.6% of sales as compared with $90,807,349 or 39.5% of sales for 2001. The increase in gross profit during 2002 period was primarily due to higher proportion of perishable sales with higher margins, offset by promotional pricing on new store openings and major remodel re-openings.

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Store operating, general and administrative expenses were $79,175,726 or 31.58% of sales for the year 2002 as compared to $71,596,708 or 31.13% of sales for the year 2001. The increase in store operating, general and administrative expenses as a percentage of sales in the 2002 period was mainly due to new and remodeled stores opening in the latter part of the year. Advertising expenses included in store operating, general and administrative expense were $2,180,285 and $1,572,963 for the years 2002 and 2001, respectively.

Pre-store opening startup costs were $741,570 or 0.3% of sales for the year 2002 as compared to $165,000 or 0.1% of sales for the year 2001. There were three new stores and six remodeled stores in 2002 compared to no new stores and six remodeled stores in 2001, leading to increased pre-store opening startup costs in 2002. Furthermore, costs incurred for the year 2002 also included some costs for two stores which opened in December 2002, following the fiscal year end. New stores generally are given heavier promotion than remodeled stores.

Non-store operating expenses were $9,830,478 or 3.9% of sales for the year 2002 as compared to $8,329,559 or 3.6% of sales for the year 2001. Administrative payroll and fringes were 2.8% of sales for the 2002 period as compared with 2.4% of sales for the 2001 period. The increase in the 2002 period reflects the addition of department and divisional managers to handle the additional business generated by the store remodeling program and higher health costs. General office expenses as a percentage of sales were 0.8% for the 2002 period as compared to 0.9% for the 2001 period. The decrease during the 2002 period was primarily due to effective control of back office expenses in relation to the increased sales. Professional fees were 0.2% of sales for the 2001 period as compared to 0.3% for the 2001 period. Corporate expenses as a percentage of sales were 0.1% for both the 2002 period and the 2001 period.

Depreciation expense was $7,989,625 or 3.2% of sales for the year 2002 as compared to $7,204,281 or 3.1% of sales for the year 2001. The increase in the 2002 period was primarily a result of significant capital expenditures incurred in connection with the Company's store renovation and remodeling program.

Management has filed claims with its insurance carriers as a result the September 11 terrorist attacks for its losses, including business interruption. The Company settled these claims with the insurance company in October 2002 for approximate net proceeds of $1.5 million, and incurred costs of approximately $1.1 million which amounts were reflected in fiscal 2001. The Company further has applied for various government grants amounting to approximately $400,000 net of fees and expects to receive these in full during fiscal 2003. The grants, which along with an insurance claim for a theft loss from its warehouse, were recorded in fiscal 2002.

Interest expense was $2,967,181 or 1.2% of sales for year 2002 as compared to $3,537,281 or 1.5% of sales for year 2001. The decrease in the 2002 period was primarily attributable to lower prevailing interest rates under the Company's bank credit facility, partially offset by increased capitalized equipment leasing.

Interest income for the year 2002 was $5,116 as compared with $9,016 for the year 2001. The decrease in the 2002 period was due to lower prevailing interest rates in the 2002 period.

Other income for the year 2002 was $0 as compared with $173,112 for the year 2001. This mainly results from the sale of a store lease resulting from a closed store in 2001.

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Bad debt expense was $72,000 for the year 2002 as compared with $250,354 for the year 2001. Bad debt expense was higher in the year 2001 primarily as a result of the Company's expansion of its pharmacy business and systems relating thereto and the resulting increase in third party receivables.

As a result of the items discussed above, the income (loss) before provision for income taxes for the year 2002 was ($886,407) as compared to $373,897 for the year 2001.

RESULTS OF OPERATIONS (2001 COMPARED TO 2000)

Sales for the year 2001 were $229,988,315 as compared to sales for the year 2000 of $216,325,214. The sales increase in fiscal 2001 compared to the sales in fiscal 2000, offset by the sales for the extra week in fiscal 2000 of approximately $4.5 million, is mainly attributable to sales increases due to new or remodeled stores opened in fiscal 2001 or full years sales for those new or remodeled stores opened during 2000. Same store sales for the year 2001 were 5.5% ahead of 2000. Gross profit was $90,807,349 or 39.5% of sales as compared with $85,065,986 or 39.3% of sales for 2000. The increase in gross profit during 2001 period was primarily due to fewer promotional price reductions in connection with the grand re-opening periods of the new and newly remodeled stores.

Store operating, general and administrative expenses were $71,596,708 or 31.13% of sales for the year 2001 as compared to $67,550,165 or 31.23% of sales for the year 2000. The virtually unchanged result in store operating, general and administrative expenses as a percentage of sales in the 2001 period was mainly due to effective cost controls in relation to the increased sales. Advertising expenses included in store operating, general and administrative expense were $1,572,963 and 1,555,707 for the years 2001 and 2000, respectively.

Pre-store opening startup costs were $165,000 or 0.1% of sales for the year 2001 as compared to $518,981 or 0.2% of sales for the year 2000. There were six stores remodeled in 2001 compared to eight in 2000, leading to reduced pre-store opening startup costs in 2001.

Non-store operating expenses were $8,329,559 or 3.6% of sales for the year 2001 as compared to $7,435,949 or 3.4% of sales for the year 2000. Administrative payroll and fringes were 2.4% of sales for the 2001 period as compared with 2.3% of sales for the 2000 period. The increase in the 2001 period reflects the addition of department and divisional managers to handle the additional business generated by the store remodeling program. General office expenses as a percentage of sales were 0.9% for the 2001 period as compared to 0.8% for the 2000 period. The increase during the 2001 period was primarily due to additional back office expenses in relation to the increased sales. Professional fees were 0.3% of sales for both the 2001 period and the 2000 period. Corporate expenses as a percentage of sales were 0.1% for both the 2001 period and the 2000 period.

Depreciation expense was $7,204,281 or 3.1% of sales for the year 2001 as compared to $6,284,971 or 2.9% of sales for the year 2000. The increase was primarily a result of significant capital expenditures incurred in connection with the Company's store renovation and remodeling program.

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Management has filed claims with its insurance carriers as a result the September 11 terrorist attacks for its losses, including business interruption, and estimates net proceeds of approximately $1.5 million, along with costs incurred of approximately $1.1 million. The Company has suffered property damage losses, including inventory, costs to repair and clean fixtures and facilities and loss of revenue. The Company received an advance of $300,000 against these claims in October 2001.

Interest expense was $3,537,281 or 1.5% of sales for year 2001 as compared to $3,761,941 or 1.7% of sales for year 2000. The decrease in the 2001 period was primarily attributable to lower prevailing interest rates under the Company's bank credit facility, partially offset by increased capitalized equipment leasing.

Interest income for the year 2001 was $9,016 as compared with $24,113 for the year 2000. The decrease in the 2001 period was due to lower prevailing interest rates in the 2001 period.

Other income (expenses) for the year 2001 was $173,112 as compared with ($27,000) for the year 2000. This mainly results from the sale of a store lease resulting from a closed store.

Bad debt expense (credits) was $250,354 for the year 2001 as compared with ($350,000) for the year 2000. As a result of the increase in the amount of the Company's receivables, in the 1999 period, management deemed it prudent to set up an allowance for doubtful accounts in the amount of $500,000 in the 1999 period, and to reduce that amount by $350,000 in the 2000 period as a result of progress in pursuing collection of a $400,000 receivable. Bad debt expense increased in the year 2001 primarily as a result of the Company's expansion of its pharmacy business and systems relating thereto and the resulting increase in third party receivables.

As a result of the items discussed above, the income before provision for income taxes for the year 2001 was $373,897 as compared to a loss of $138,908 for the year 2000.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity:

The consolidated financial statements of the Company indicate that at December 1, 2002 current assets exceed current liabilities by $2,162,426 and stockholders' equity was $10,666,094. Management believes that cash flows generated from operations, supplemented by financing from its bank facility, third party leasing companies and/or additional financing from the Company's majority shareholder, will be sufficient to pay the Company's debts as they may come due, provide for its capital expenditure program and meet its other cash requirements.

Debt and Debt Service:

Effective October 2001, the Company's credit agreement with a group of banks was amended and increased to an aggregate total of $32,500,000, consisting of a $15,500,000 term loan and a $17,000,000 revolving line of credit. As of December 1, 2002, the credit facility as amended, provides for (i) a maturity date of November 28, 2004 for the revolving line of credit, and December 3, 2006 for the term loan, at which time all amounts outstanding thereunder are due, (ii) certain financial covenants, and (iii) amortization of the term loan in monthly

amortizations totaling $2,000,000, $2,300,000, $2,600,000, $2,900,000 and $3,200,000 respectively in each year during its term, and a $2,500,000 balloon payment at maturity.

Borrowings under the facility bear interest at a spread over either the prime rate of the bank acting as agent for the group of banks or a LIBOR rate, with the spread dependent on the ratio of the Company's funded debt to EBITDA ratio, as defined in the credit agreement. The average interest rate on amounts outstanding under the facility during the year 2002 was 5.09% per annum.

The credit facility contains covenants, representations and events of default typical of credit facility agreements, including financial covenants which require the Company to meet, among other things, a minimum tangible net worth, debt service coverage ratios and fixed charge coverage ratios, and which limit transactions with affiliates. The facility is secured by equipment, inventories and accounts receivable.

The following is a summary of the Company's significant contractual cash obligations for the periods indicated that existed as of December 1, 2002, and is based on information appearing in the notes to consolidated financial statements (amounts in thousands).

	2003	2004	2005	2006	2007	THEREAFTER	
Long-term debt	$ 2,501	$19,675*	$ 2,975	$ 3,200	$ 2,500	$ --	$
Operating leases	17,972	18,235	17,854	17,569	15,975	116,522	
Capital lease obligations	6,887	6,113	4,055	3,096	1,966	1,867	
Total contractual cash obligations	$27,360	$ 44,023	$24,884	$23,865	$20,441	$ 118,389	$