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GRISTEDES FOODS INC
Form 10-Q
October 31, 2003

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended August 31, 2003

TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period fromto

Commission File Number 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 10019

(Address of Principal Executive Offices)

(212) 956-5803

(Registrant's Telephone Number, Including Area Code)

N/A

(Former Name, Former Address and Former Fiscal Year,
if Changed Since Last Report)

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

Yes No

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

Yes No

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At October 15, 2003, registrant had issued and outstanding 19,636,574 shares of common stock.

GRISTEDE'S FOODS, INC.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

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Item 1
Financial Statements

GRISTEDE'S FOODS, INC.
CONSOLIDATED BALANCE SHEETS

ASSETS

CURRENT ASSETS:

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Cash
Accounts receivable - net of allowance for doubtful accounts
of \$533,000 at August 31, 2003 and \$481,000 at December 1, 2002
Inventories
Due from related parties - trade
Prepaid expenses and other current assets

Total current assets

PROPERTY AND EQUIPMENT:

Furniture, fixtures and equipment
Capitalized equipment leases
Leaseholds and leasehold improvements

Less accumulated depreciation and amortization

Net property and equipment

Deposits and other assets
Due from related party - trade
Other assets

TOTAL

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES:

Accounts payable, trade
Accrued payroll, vacation and withholdings
Accrued expenses and other current liabilities
Due to affiliates - trade
Capitalized lease obligations - current portion
Current portion of long term debt

Total current liabilities

Long-term debt - noncurrent portion
Due to affiliates
Capitalized lease obligations - noncurrent portion
Deferred rent

Total liabilities

COMMITMENTS AND CONTINGENCIES

STOCKHOLDERS' EQUITY:

Preferred stock, \$50 Par, -shares authorized 500,000; none issued
Common stock, \$0.02 par value - shares authorized 25,000,000; outstanding
19,636,574 shares at August 31, 2003 and December 1, 2002
Additional paid-in capital
Retained deficit

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Total stockholders' equity

TOTAL

See notes to consolidated financial statements (unaudited).

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GRISTEDE'S FOODS, INC.
 UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS
 FOR THE 39 WEEKS AND 13 WEEKS ENDED AUGUST 31, 2003 AND SEPTEMBER 1, 2002

| | 39 weeks ended August 31, 2003 | 13 weeks ended August 31, 2003 |
|---|---|---|
| | ----- | ----- |
| Sales | \$ 210,284,763 | \$ 64,698,051 |
| Cost of sales | 125,878,387 | 38,386,060 |
| | ----- | ----- |
| Gross profit | 84,406,376 | 26,311,991 |
| Net Insurance Proceeds - Northeast Blackout | (1,911,115) | (1,911,115) |
| Store operating, general and administrative expenses | 71,354,920 | 23,299,006 |
| Pre-store opening startup costs and store closing costs | 530,894 | 35,261 |
| Bad Debt Expense | 1,693,436 | 1,657,436 |
| Depreciation and amortization | 7,173,988 | 2,414,819 |
| Insurance proceeds - Terrorist Attacks | -- | -- |
| Write Off of King's Acquisition Costs | 800,000 | 800,000 |
| Litigation Settlement | 1,300,000 | 1,300,000 |
| Non-store operating expenses: | | |
| Administrative payroll and fringes | 6,210,689 | 1,895,009 |
| General office expense | 1,402,040 | 625,161 |
| Professional fees | 299,957 | 77,708 |
| Corporate expense | 200,754 | 78,733 |
| | ----- | ----- |
| Total non-store operating expenses | 8,113,440 | 2,676,611 |
| | ----- | ----- |
| Operating income (loss) | (4,649,187) | (3,960,027) |
| | ----- | ----- |

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Other income (expense):

| | | |
|---|----------------|----------------|
| Interest expense | (2,393,337) | (782,902) |
| Interest income | 3,128 | 779 |
| | ----- | ----- |
| Total other income (expense) - net | (2,390,209) | (782,123) |
| | ----- | ----- |
| Income (loss) before income taxes | (7,039,396) | (4,742,150) |
| Provision for income taxes | -- | -- |
| | ----- | ----- |
| Net income (loss) | \$ (7,039,396) | \$ (4,742,150) |
| | ===== | ===== |
| Income (loss) per share, basic and diluted | (\$0.36) | (\$0.24) |
| | ===== | ===== |
| Weighted average number of shares and equivalents outstanding | 19,636,574 | 19,636,574 |
| | ===== | ===== |

See notes to consolidated financial statements (unaudited).

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GRISTEDE'S FOODS, INC.
 UNAUDITED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
 FOR THE 52 WEEKS ENDED DECEMBER 1, 2002
 AND FOR THE 39 WEEKS ENDED AUGUST 31, 2003

| | Common stock Shares | Amount | Additional Paid-In Capital |
|---|------------------------|------------|----------------------------------|
| | ----- | ----- | ----- |
| Balance at December 2, 2001 | 19,636,574 | \$ 392,732 | 14,136,674 |
| Net loss for the 52 weeks ended December 1, 2002 | -- | -- | -- |
| | ----- | ----- | ----- |
| Balance at December 1, 2002 | 19,636,574 | \$ 392,732 | 14,136,674 |
| Capital Contribution | | | 3,430,636 |
| Net loss for the 39 weeks ended August 31, 2003 | -- | -- | |
| | ----- | ----- | ----- |
| Balance at August 31, 2003 | 19,636,574 | \$ 392,732 | 17,567,310 |
| | ===== | ===== | ===== |

See notes to consolidated financial statements (unaudited).

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GRISTEDE'S FOODS, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THIRTY NINE WEEKS ENDED AUGUST 31, 2003 AND SEPTEMBER 1, 2002

Cash flows from operating activities:

Net income (loss)

Adjustments to reconcile net income (loss) to net cash
provided by operating activities:

Depreciation and amortization
Write Off of Kings Acquisition Costs
Change in allowance for bad debts
Changes in operating assets and liabilities:

Accounts receivable
Inventory
Due from related parties - trade
Prepaid expenses and other current assets
Other assets
Accounts payable, trade
Accrued payroll, vacation and withholdings
Accrued expenses and other current liabilities
Due to related parties - trade
Deferred rent
Current and other assets acquired via capital lease

Net cash provided by operating activities

Cash flows from investing activities:

Capital expenditures

Net cash used in investing activities

Cash flows from financing activities:

Repayments of bank loan
Proceeds from bank loan
Repayment of capitalized lease obligations
Capital Contribution
Advances from (repayments to) affiliates

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Net cash provided by financing activities

Net increase in cash

Cash, beginning of period

Cash, end of period

Supplemental disclosures of cash flow information:

Cash paid for interest

Cash paid (refunded) for taxes

Supplemental schedule of non cash financing activity:

Assets acquired under capitalized lease obligations

See notes to consolidated financial statements (unaudited).

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GRISTEDE'S FOODS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business -

The Company's corporate predecessor was originally incorporated in 1956 in New York under the name Designcraft Industries, Inc., and was engaged in the jewelry business until 1992, when the Company commenced its supermarket operations. The Company became a public company in 1968, listed its common stock on the American Stock Exchange in 1972, and reincorporated in Delaware in 1985. The Company changed its name to Sloan's Supermarkets, Inc. in September 1993 and to Gristede's Sloans, 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.

On November 10, 1997, 29 supermarkets that were owned by John A. Catsimatidis, the Company's majority stockholder, Chairman of the Board and CEO (such 29 supermarkets hereinafter referred to as the "Food Group") were merged into the Company's existing 15 supermarkets. The transaction was accounted for as an acquisition of the Company by the Food Group pursuant to Emerging Issues Task Force 90-13 as a result of the Food Group obtaining control of the Company after the transaction. The assets and liabilities of the Food Group were recorded at their historical cost. The Company's assets and liabilities were recorded at their fair value to the extent acquired. Consideration for the transaction was based on an aggregate of \$36,000,000 in market value of the Company's common stock and the assumption of \$4,000,000 of liabilities. 16,504,298 shares of common stock were issued on the date of the acquisition based on a market price of \$2.18 per share.

The Company operates a total of 49 stores; 40 supermarkets and three free-standing pharmacies in Manhattan, New York, three supermarkets in Westchester County, New York, and one supermarket in each of Brooklyn, New York, Bronx, New York and Long Island, New York. All of the supermarkets and

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pharmacies are leased and operated under the "Gristede's" banner.

The Company also owns City Produce Operating Corp., a company which operates a warehouse and distribution facility on leased premises in the Bronx, New York.

Basis of presentation - The unaudited consolidated financial statements included herein have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). In the opinion of management, the information furnished reflects all adjustments (consisting of normal recurring adjustments), which are necessary for a fair statement of the results of operations and financial position of the Company for the interim period. The interim figures are not necessarily indicative of the results to be expected for the fiscal year.

Principles of Consolidation - The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All material intercompany accounts and transactions have been eliminated in consolidation.

Quarter End - The Company operates using the conventional retail 52/53-week fiscal year. The fiscal quarter ends on the Sunday closest to the end of the quarter. The Company's fiscal year ends on the Sunday closest to November 30.

Inventory - Inventories are valued principally at the lower of cost or market with cost determined under the retail first in, first out (FIFO) method.

Property and Equipment and Depreciation - Property and equipment is stated at cost. Depreciation of furniture, fixtures and equipment is computed by the straight-line method over the estimated useful lives of the assets.

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Leases and Amortization - The Company charges the cost of noncancelable operating lease payments and beneficial leaseholds to operations on a straight-line basis over the lives of the leases.

Provision for income taxes - Income taxes reflect Federal and State alternative minimum tax only, as all regular income taxes have been offset by utilization of the Company's net operating loss carry forward.

Income (loss) per share - Per share data are based on the weighted average number of shares of common stock and equivalents outstanding during each quarter. Income (loss) per share is computed by the treasury stock method; basic and diluted income per share are the same.

The Company's Annual Report on Form 10-K for the 52 week period ended December 1, 2002 contains information which should be read in conjunction herewith.

2. RELATED PARTY TRANSACTIONS

Under a management agreement dated November 10, 1997, Namdor Inc., one of the Company's subsidiaries, performed consulting and managerial services for a supermarket owned by a corporation controlled by John A. Catsimatidis. In consideration of such services, Namdor Inc., was entitled to receive, on a quarterly basis, a cash payment of one and one-quarter percent (1.25%) of all sales of inventory and merchandise made at, in or from the managed supermarket. For the 13 weeks and the 39 weeks ended August 31, 2003, there were no amounts for such services included in income.

The Company leases the following locations from an affiliate, Red Apple Real

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Estate, Inc., a company wholly owned by John A. Catsimatidis: a portion of its warehouse and distribution facility comprising 25,000 square feet, its office facilities and all or a portion of ten store locations. During the 13 weeks and the 39 weeks ended August 31, 2003 the Company paid \$739,480 and \$2,334,019 respectively, to Red Apple Real Estate, Inc., for rent and real estate taxes under such leases. The leases are triple net whereby the tenant pays all real estate taxes, insurance and maintenance.

Certain of the Company's supermarkets have entered into capital and operating leases with an affiliate, Red Apple Lease Corporation, a corporation wholly owned by John A. Catsimatidis. These leases are primarily for store operating equipment. Obligations under these leases at August 31, 2003 were \$2,888,145. These leases require that monthly payments of \$76,790 be made to Red Apple Lease Corporation through March 2007.

Certain of the Company's supermarkets have entered into capital leases with an affiliate, United Acquisition Leasing Corp., a company wholly owned by John A. Catsimatidis. These leases are primarily for store equipment. Obligations under these leases at August 31, 2003 were \$4,059,386. These leases require that monthly payments of \$100,525 be made to United Acquisition Leasing Corp. with various expirations through February 2008.

Amounts due to affiliates, primarily United Acquisition Corp., a corporation indirectly wholly owned by John A. Catsimatidis represent liabilities in connection with the 1997 merger and additional advances made to the Company by United Acquisition Corp. since the merger. These affiliates have agreed not to demand payment of these liabilities in the next year. Accordingly, the liability has been classified as noncurrent. As part of post-closing adjustments in connection with the 1997 merger, approximately \$3,600,000 that is due from certain of the Company's affiliates has been offset against the amounts due to United Acquisition Corp. The net amount due to affiliates at August 31, 2003 was \$21,002,779, of which \$18,300,000 was subordinated to the Company's banks. The liability presently does not bear interest. However, the Company's credit agreement with its banks permits the Company to pay interest on such subordinated debt provided the Company has a positive net income.

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In October 2002, the Company and Gristede's NY LLC, an affiliate of the Company, acquired the fixtures, leasehold improvements and store leases of three stores from the Great Atlantic & Pacific Tea Company for a total purchase price of \$5,500,000. The affiliate has leased the acquired assets to the Company. Such stores had been closed for more than six months prior to the transaction. Obligations under these capital leases at August 31, 2003 were \$4,617,862 and require monthly payments of \$79,156 through February 2008 and a balloon payment of \$1,629,156 at such time.

In addition, in connection with the foregoing, Gristede's NY LLC, received a term loan of \$5,000,000 from Commerce Bank, N.A., which loan is guaranteed by Gristede's Foods NY, Inc. (a wholly-owned subsidiary of Namdor, Inc.), and the Company's subsidiaries Namdor Inc. and City Produce Operating Corp., and secured by a pledge of all of the capital stock of Gristede's Foods NY, Inc.

Due from related parties - trade, represents amounts due from an affiliated company for merchandise shipped from the Company's subsidiary City Produce Operating Corp., in the ordinary course of business, as well as management fees receivable for administrative and managerial services performed for the affiliated company by the Company. Amounts receivable from the affiliate were guaranteed by a company controlled by John A. Catsimatidis. During the 39 and 13 weeks ended August 31, 2003, merchandise sales to the affiliate were

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approximately \$163,000 and \$0 respectively. During the quarter ended August 31, 2003, amounts due from the affiliate were repaid by another affiliate pursuant to its guarantee. The full collection of all amounts due from the affiliate totaling \$1,639,000, was accounted for as a non-cash bad debt expense, offset by an equal capital contribution reflected as additional paid-in capital.

On February 6, 1998, the Company agreed to purchase substantially all of the assets and assumed certain of the liabilities of a supermarket located at 1644 York Avenue, New York City, that was owned by a corporation controlled by John Catsimatidis. On March 1, 2000 the Company and the affiliate determined to restructure the transaction by rescinding the purchase effective as of February 6, 1998, and entered into an operating agreement which gives the Company full control of the supermarket and the right to operate the supermarket for the account of the Company. The operating agreement presently terminates on December 1, 2004, but the term shall be extended for additional one year periods unless either party gives notice of termination not later than 90 days prior to the end of the then current term of the agreement. Under the operating agreement, the Company shall pay to the affiliate \$1.00 per annum, plus such other consideration as may be approved by the Company's directors (excluding John Catsimatidis). Pursuant to the operating agreement the Company or any designee of the Company, also has the option until December 31, 2005 to purchase the supermarket for \$2,778,000, which price is the fair market price of the supermarket established on October 11, 1999 by the Company's directors (excluding John Catsimatidis).

In May 2000, another affiliate and the Company entered into a similar operating agreement for a store owned by the affiliate. As consideration, the affiliate receives the nominal amount of \$1 per annum, plus such other consideration as may be approved by the Company's directors (excluding John Catsimatidis). The operating agreement presently terminates on May 10, 2004, but the term shall be extended for additional one year periods unless either party gives notice of termination not later than 90 days prior to the end of the then current term of the agreement. Pursuant to the operating agreement, the Company, or any designee of the Company, also has the option until December 31, 2005 to purchase the supermarket for the fair market price of the supermarket as established by the Company's directors (excluding John Catsimatidis) using a valuation criterion similar to that issued for valuing the store at 1644 York Avenue, New York City. It is management's opinion that the fair market value of this store is approximately \$3 million.

The affiliates' intention in entering into these two operating agreements where the Company enjoys full benefits of ownership for the nominal consideration of \$1 per annum per store was to effect post closing adjustments in connection with the Food Group acquisition. If the option to purchase the supermarkets is exercised, the excess of the purchase price over the net book value of the assets will be reflected as a charge to equity.

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The Company uses the services of an affiliate Red Apple Medical, a corporation wholly-owned by John Catsimatidis, as an agent for self-insurance purposes. All employee medical claims are submitted to a third party administrator who processes claims to be remitted through a controlled account. Such amounts are reimbursed by the Company to the agent. No fees have been paid to this entity for the fiscal years 2002 or 2003 to date.

3. COSTS RELATING TO ATTEMPTED KINGS ACQUISITION

The Company has made efforts to acquire Kings Super Markets, Inc., a chain of 27 stores, mainly located in Northern New Jersey, from its UK parent Marks &

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Spencer, plc. ("M&S"). On July 17, 2003, the Company filed a Form 8-K with the Securities and Exchange Commission announcing that it was commencing a \$150 million offering of senior notes to acquire Kings, pay transaction costs, refinance certain of the Company's indebtedness, and for general corporate purposes. The Company's investment bankers received preliminary commitments for a substantial majority of the required funds. Subsequently, the Company revised its purchase offer to include a combination of cash and notes. This was declined by M&S, who took Kings off the market. The Company continues to express an interest in acquiring Kings, and remains in discussions with a number of potential funding sources to fund additional cash to complete a cash transaction. No assurance can be given that this acquisition will be consummated.

Through the quarter ending August 31, 2003, the Company has incurred costs (primarily professional fees) in the total amount of \$1,651,000. Of this total amount: (i) \$851,000 has been capitalized and is included in other assets on the accompanying balance sheet, of which \$523,000 is reimbursable to the Company by its affiliate United Acquisition Corp. ("UAC"). Should the transaction be unsuccessful, the \$851,000 deferred costs will be charged to operations. Reimbursements from UAC will be accounted for as a capital contribution reflected as additional paid-in capital; and (ii) during the quarter ended August 31, 2003, \$800,000 of previously capitalized costs were charged to operations as it was determined such costs did not have future value. Of such costs, \$491,000 were reimbursable and paid for by UAC, and have been accounted for as a capital contribution and reflected as additional paid-in capital.

4. IMPACT OF NORTHEAST BLACKOUT OF AUGUST 14-15, 2003

The Company suffered significant losses of perishable inventory during the Northeast Blackout of August 14-15, 2003. To a lesser extent, there were also property repair and damage losses, and related expenses. The Company's inventory is insured for its retail selling price, and property is insured for its new replacement cost. The Company has filed claims for these losses and related expenses with its insurance carriers and expects to recover at least approximately \$5.9 million. The minimum associated inventory costs and related expenses are approximately \$4 million, resulting in a minimum expected net insurance gain of approximately \$1.9 million, which has been recorded in the quarter ended August 31, 2003. The Company is expecting payment for the claim in the upcoming fiscal year.

5. PROPOSED SETTLEMENT OF DELIVERY WORKER'S LITIGATION

As further detailed in Part II, Legal Proceedings herein, although all of the conditions precedent to such proposed settlement have not yet been met, an affiliate of the Company, controlled by John A. Catsimatidis, paid into escrow \$1.3 million on October 16, 2003, which is the initial payment that is payable under the proposed settlement upon satisfaction of all of the conditions precedent. This was recorded as a litigation settlement expense of the Company for the quarter ended August 31, 2003, with an offsetting equal capital contribution reflected as additional paid-in capital. While the court has approved the proposed settlement as fair, all of the conditions precedent for implementation have not yet been met and cannot be assured at this time, including the fact that the Company's banks have not yet approved the granting of a subordinated security interest to the plaintiffs in certain of the Company's assets to secure the payments of the settlement amount, security documents have not yet been executed and the court has not entered a final judgment in the matter. The balance of the proposed settlement amount will be due in equal installments of \$650,000 on the first and second anniversary of the initial payment, without interest. Any amount paid on behalf of the Company will be accounted as a capital contribution and reflected as additional paid-in capital. When the conditions precedent to the proposed settlement have all been met, the Company will record the balance of the settlement liabilities.

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Additionally, recoveries from a \$400,000 security bond posted by Great American / Baur shall be solely for the Company's benefit.

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6. RECENT ACCOUNTING PRONOUNCEMENTS

In July 2001, the FASB issued Statement of Financial Accounting Standards No. 141, "Business Combinations" ("SFAS 141") and Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). SFAS 141 eliminates the pooling-of-interests method of accounting for business combinations initiated after June 30, 2001 and modifies the application of the purchase accounting method effective for transactions that are completed after June 30, 2001. SFAS 142 eliminates the requirement to amortize goodwill and intangible assets having indefinite useful lives but requires that they be assessed at least annually for impairment. Intangible assets that have finite lives will continue to be amortized over their useful lives. The adoption of SFAS 141 and 142 did not have a material effect on the Company's financial position or operations.

In October 2001, the FASB issued Statement of Financial Accounting Standards 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"). SFAS No. 144 addresses the accounting and reporting for the impairment or disposal of long-lived assets. The statement provides a single accounting model for long-lived assets to be disposed of. New criteria must be met to classify the asset as an asset held-for-sale. This statement also focuses on reporting the effects of a disposal of a segment of business. This statement is effective for fiscal years beginning after December 15, 2001. The Company adopted SFAS 144 as of December 2, 2002, and the adoption did not have a material impact on the Company's financial position or results of operations.

In April 2002, Statement of Financial Accounting Standards, No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections" ("SFAS 145") was issued. SFAS 145 rescinds SFAS 4 and 64, which required gains and losses from extinguishment of debt to be classified as extraordinary items. SFAS also rescinds SFAS 44 since the provisions of the Motor Carrier Act of 1980 are complete. SFAS 145 also amends SFAS 13 eliminating inconsistencies in certain sale-leaseback transactions. The provisions of SFAS 145 are effective for fiscal years beginning after May 15, 2002. Any gain or loss on extinguishment of debt that was classified as an extraordinary item in prior periods presented shall be reclassified to interest expense. The adoption of SFAS 145 did not have a material effect on the Company's financial position or results of operations.

Statement of Financial Accounting Standards, No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" ("SFAS 146"), was issued in July 2002. SFAS 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. SFAS 146 supercedes EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring)." SFAS 146 is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. This pronouncement did not have a material effect on the Company's financial position or results of operations.

On December 31, 2002, the FASB issued Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation -Transition and Disclosure" ("SFAS 148"). This standard amends SFAS No. 123, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS

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148 amends the disclosure requirements of SFAS 123 to require more frequent and prominent disclosures in financial statements of the effects of stock-based compensation. The transition guidance and annual disclosure provisions of SFAS 148 are effective for fiscal years ending after December 15, 2002. The interim disclosure provisions are effective for financial reports containing financial statements for interim periods beginning after December 15, 2002. SFAS 148 did not have a material impact on the Company's results of operations, financial position or cash flows, and the Company has adopted the disclosure provisions of SFAS 148 as of March 3, 2003, as required.

In November 2002, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others ("FIN 45"). FIN 45 requires the recognition of a liability for certain guarantee obligations issued or modified after December 31, 2002. It also clarifies disclosure requirements to be made by a guarantor for certain guarantees. The disclosure provisions of FIN 45 are effective for fiscal years ending after December 15, 2002. FIN 45 did not have a material impact on the Company's results of operations, financial position or cash flows, and the Company has adopted the disclosure provisions of FIN 45 as of December 2, 2002.

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On January 17, 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"). FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. FIN 46 did not have a material impact on the Company's results of operations, financial position or cash flows, and the Company has adopted the disclosure provisions of FIN 46 as of December 2, 2002.

In February 2003, the Emerging Issues Task Force ("EITF") addressed EITF Statement No. 02-16 ("EITF 02-16"), "Accounting by a Reseller for Cash Consideration Received From a Vendor." EITF 02-16 provides accounting guidance on how a reseller should characterize consideration given by a vendor and when to recognize and how to measure that consideration in its income statement. EITF 02-16 is effective for all agreements entered into after December 31, 2002. The Company has evaluated the provisions of EITF 02-16 and determined that this statement did not have a material effect on its consolidated financial statements.

In April 2003, the FASB issued SFAS 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" ("SFAS 149"). SFAS 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS 133. The new guidance amends SFAS 133 for decisions made: (a) as part of the Derivatives Implementation Group process that effectively required amendments to SFAS 133, (b) in connection with other Board projects dealing with financial instruments, and (c) regarding implementation issues raised in relation to the application of the definition of a derivative, particularly regarding the meaning of an "underlying" and the characteristics of a derivative that contains financing components. The amendments set forth in SFAS 149 improve financial reporting by requiring that contracts with comparable characteristics be accounted for similarly. SFAS 149 is generally effective for contracts entered

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into or modified after June 30, 2003 (with a few exceptions) and for hedging relationships designated after June 30, 2003. The guidance is to be applied prospectively. The adoption of SFAS 149 did not have a material impact on the Company's financial position or results of operations.

In May 2003, the FASB issued Statement No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" ("SFAS 150"). SFAS 150 improves the accounting for certain financial instruments that, under previous guidance, issuers could account for as equity. The new Statement requires that those instruments be classified as liabilities in statements of financial position. The adoption of SFAS 150 did not have a material impact on the Company's financial position or results of operations.

7. ACCOUNTING FOR STOCK-BASED COMPENSATION

The Company complies with Statement of Financial Accounting Standards No. 123 "Accounting for Stock-Based Compensation" ("SFAS No. 123"). This statement defines a fair value based method whereby compensation cost is measured at the grant date based on the fair value of the award and is recognized over the service period, which is usually the vesting period. Under SFAS No. 123, companies are encouraged, but are not required, to adopt the fair value method of accounting for employee stock-based transactions. The Company accounts for such transactions under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, but discloses pro forma net income (loss) as if the Company had applied the SFAS No. 123 method of accounting.

Pro forma information, assuming the Company had accounted for its employee stock options granted under the fair value method prescribed by SFAS No. 123, as amended by Financial Accounting Standards Board Statement No. 148, "Accounting for Stock Based Compensation - Transition and Disclosure, an Amendment of FASB Statement No. 123" is presented below. The fair value of each option grant is estimated on the date of each grant using the Black-Scholes option-pricing model. There were no stock options granted in fiscal 2003 or in fiscal 2002. The fair value generated by the Black-Scholes model may not be indicative of the future benefit, if any, that may be received by the option holder.

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| | 39 Weeks Ended | | 13 Weeks Ended | |
|---|----------------|--------|----------------|----------|
| | (\$000s) | | (\$000s) | |
| | 8/31/03 | 9/1/02 | 8/31/03 | 9/1/02 |
| Net income/(loss): | \$(7,039) | \$189 | \$(4,742) | \$(77) |
| Less: stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | 2 | 2 | 1 | 1 |
| | - | - | - | - |
| Pro forma net income/(loss) | \$(7,041) | \$187 | \$(4,743) | \$(77) |
| | ===== | ===== | ===== | ===== |
| Earnings (loss) per share: | | | | |
| Basic, as reported | \$(0.36) | \$0.01 | \$(0.24) | \$(0.01) |
| Basic, pro forma | \$(0.36) | \$0.01 | \$(0.24) | \$(0.01) |

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| | | | | |
|----------------------|-----------|--------|-----------|-----------|
| Diluted, as reported | \$ (0.36) | \$0.01 | \$ (0.24) | \$ (0.24) |
| Diluted, pro forma | \$ (0.36) | \$0.01 | \$ (0.24) | \$ (0.24) |

This pro forma information may not be representative of the amounts to expected in future years as the fair value method of accounting prescribed by SFAS No. 123 has not been applied to options granted prior to fiscal 1996.

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GRISTEDE'S FOODS, INC. AND SUBSIDIARIES

PART I

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE 39 WEEKS AND THE 13 WEEKS ENDED AUGUST 31, 2003 AND SEPTEMBER 1, 2002

Critical Accounting Policies

Financial Reporting Release No. 60, which was recently released by the Securities and Exchange Commission, requires all companies to include a discussion of critical accounting policies or methods used in the preparation of financial statements. Note 1 of the Notes to the Consolidated Financial Statements includes a summary of the significant accounting policies and methods used in the preparation of our consolidated financial statements. The following is a brief discussion of the more significant accounting policies and methods used by the Company.

General

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. The most significant estimates and assumptions relate to the recoverability of internally developed software costs, fixed assets and other intangibles, inventories, realization of deferred income taxes and the adequacy of allowances for doubtful accounts. Actual amounts could differ significantly from these estimates.

Accounts Receivable

We continuously monitor collections and payments from our customers, third party and vendor receivables and maintain a provision for estimated credit losses based upon our historical experience and any specific collection issues that we have identified. While such credit losses have historically been within our expectations and the provisions established, we cannot guarantee that we will continue to experience the same credit loss rates that we have in the past.

Inventories

We value our inventory at the lower of cost or market with cost determined under the retail method. We regularly review inventory quantities on hand and record a provision for excess and obsolete inventory where appropriate based primarily on our historical shrink and spoilage rates.

Intangibles and Other Long-Lived Assets

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Property, plant and equipment, intangible and certain other long-lived assets are amortized over their useful lives. Useful lives are based on management's estimates of the period that the assets will generate revenue. Intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

Accrued Self-Insurance

Insurance expense for employee-related health care benefits are estimated using historical experience.

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RESULTS OF OPERATIONS

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

| | 39 weeks ended 8/31/03 ----- | 39 weeks ended 9/1/02 ----- |
|---|---------------------------------------|--------------------------------------|
| Sales | 100.0 | 100.0 |
| Cost of sales | 59.9 | 60.0 |
| | ----- | ----- |
| Gross profit | 40.1 | 40.0 |
| Store operating, general and administrative expenses | 33.9 | 31.7 |
| Pre-store opening startup costs | 0.3 | 0.2 |
| Depreciation and amortization | 3.4 | 3.2 |
| Insurance and grant proceeds | -0.9 | -0.3 |
| Non-store operating expense | 3.9 | 3.9 |
| Bad debt expense | 0.8 | 0.0 |
| Litigation settlement | 0.6 | 0.0 |
| Write off Kings acquisition costs | 0.4 | 0.0 |
| | ----- | ----- |
| Operating income (loss) | -2.2 | 1.3 |
| Other income (expense) | -1.1 | -1.2 |
| | ----- | ----- |
| Income (loss) from operations before income taxes | -3.3 | 0.1 |
| Provisions for income taxes | 0.0 | 0.0 |
| | ----- | ----- |
| Net income (loss) | -3.3 | 0.1 |
| | ----- | ----- |

Sales were \$210,284,763 and \$64,698,051 for the 39 weeks and 13 weeks ended August 31, 2003, respectively, as compared to \$182,175,544 and \$60,505,818 for the 39 weeks and 13 weeks ended September 1, 2002, respectively. The increase in sales for the 2003 periods primarily resulted from new stores opened during the fourth quarter of fiscal 2002 and the first two quarters of fiscal 2003.

Same store sales declined 2.2% and 6.7% for the 39 weeks and 13 weeks ended

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August 31, 2003, respectively, as compared to the 39 weeks and 13 weeks ended September 1, 2002. The decline in same store sales during the 2003 periods was attributable to promotional pricing by a competitor, decrease in sales of certain product categories due to unseasonably cool and wet summer, and the August 14, 2003 Northeast blackout. Same store sales are calculated using stores that were open for business both in the current period and in the same period last year.

Gross profit was \$84,406,376 or 40.1% of sales and \$26,311,991 or 40.7% of sales for the 39 weeks and 13 weeks ended August 31, 2003, respectively, as compared to \$72,890,207 or 40.0% of sales and \$24,221,233 or 40.0% of sales for the 39 weeks and 13 weeks ended September 1, 2002, respectively. The increase in gross profit as a percentage of sales during the 2003 periods was primarily due to increased sales of perishables, which have higher gross margins, and an overall improvement in margins.

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Store operating, general and administrative expenses were \$71,354,920 or 33.9% of sales and \$23,299,006 or 36.0% of sales for the 39 weeks and 13 weeks ended August 31, 2003, respectively, as compared \$57,764,780 or 31.7% of sales and \$20,170,495 or 33.3% of sales for the 39 weeks and 13 weeks ended September 1, 2002, respectively. Store operating, general and administrative expenses increased as a percentage of sales during the 2003 periods mainly due to occupancy costs of the newly opened stores, and higher real estate taxes.

Pre-store opening startup costs and store closing costs were \$530,894 and \$35,261 for the 39 weeks and 13 weeks ended August 31, 2003 as compared to \$312,040 and \$130,041 for the 39 weeks and 13 weeks ended September 1, 2002, respectively. During the 39 weeks ended August 31, 2003, four new stores were opened. No new stores were opened during the 13 weeks ended August 13, 2003. There were no new stores opened during both comparable 2002 periods. One store was remodeled during both the 39 weeks and 13 weeks ended August 31, 2003, and 7 stores and 4 stores were remodeled during the comparable 2002 periods, respectively. New stores have higher pre-store openings costs than remodeled stores.

Non-store operating expenses were \$8,113,440 or 3.9% of sales and \$2,676,611 or 4.1% of sales for the 39 weeks and 13 weeks ended August 31, 2003, respectively, as compared with \$7,151,728 or 3.9% of sales and \$2,422,547 or 4.0% of sales for the 39 weeks and for the 13 weeks ended September 1, 2002, respectively. Administrative payroll and fringes were 3.0% and 2.9% of sales for the 39 weeks and 13 weeks ended August 31, 2003, respectively, as compared to 2.8% and 2.9% of sales for the 39 weeks and 13 weeks ended September 1, 2002, respectively. The increase as a percentage of sales during the 39 weeks ended August 31, 2003, primarily reflects the addition of supervisory personnel in anticipation of acquiring Kings Super Markets and also owing to additional business generated by the new stores. General office expenses were 0.7% and 1.0% of sales for the 39 weeks and 13 weeks ended August 31, 2003, respectively, and 0.9% of sales for both the 39 weeks and 13 weeks ended September 1, 2002. Professional fees were 0.1% of sales for each of the 39 weeks and 13 weeks periods for both 2003 and 2002. Corporate expenses were also 0.1% of sales for each of the 39 weeks and 13 weeks periods for both 2003 and 2002.

During the 13 weeks ended August 31, 2003, amounts due from related party - trade were repaid by an affiliate controlled by John A. Catsimatidis, pursuant to its guarantee of such obligations. The full collection of this receivable was accounted for as a \$1,639,000 non-cash bad debt expense offset by an equal contribution to additional paid-in capital.

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As further detailed in Part II, Legal Proceedings herein, although all of the conditions precedent to such proposed settlement have not yet been met, an affiliate of the Company, controlled by John A. Catsimatidis, paid into escrow \$1.3 million on October 16, 2003, which is the initial payment that is payable under the proposed settlement upon satisfaction of all of the conditions precedent. This was recorded as a litigation settlement expense of the Company for the quarter ended August 31, 2003, with an offsetting equal capital contribution reflected as additional paid-in capital. While the court has approved the proposed settlement as fair, all of the conditions precedent for implementation have not yet been met and cannot be assured at this time, including the fact that the Company's banks have not yet approved the granting of a subordinated security interest to the plaintiffs in certain of the Company's assets to secure the payments of the settlement amount, security documents have not yet been executed and the court has not entered a final judgment in the matter. The balance of the proposed settlement amount will be due in equal installments of \$650,000 on the first and second anniversary of the initial payment, without interest. Any amount paid on behalf of the Company will be accounted as a capital contribution and reflected as additional paid-in capital. When the conditions precedent to the proposed settlement have all been met, the Company will record the balance of the settlement liabilities. Additionally, recoveries from a \$400,000 security bond posted by Great American / Baur shall be solely for the Company's benefit.

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During the 39 weeks and 13 weeks ended August 31, 2003, \$800,000 of previously capitalized costs in connection with efforts by the Company to acquire Kings Super Markets, Inc. was charged to operations as it was determined that such costs did not have future value. Of such costs, \$491,000 was reimbursable and paid by the affiliate United Acquisition Corp. during the quarter and has been accounted for as a contribution to additional paid-in capital. At August 31, 2003, \$851,000 of costs to acquire Kings remain capitalized (of which costs, \$523,000 is reimbursable by United Acquisition Corp.) and is included in other assets on the accompanying balance sheet.

Depreciation and amortization expense was \$7,173,988 or 3.4% of sales and \$2,414,819 or 3.7% of sales for the 39 weeks and 13 weeks ended August 31, 2003, respectively, as compared to \$5,902,418 or 3.2% of sales and \$2,032,828 or 3.4% of sales for the 39 weeks and 13 weeks ended September 1, 2002, respectively. The increase in depreciation and amortization expense was primarily the result of capital expenditures incurred in connection with our new store program.

Interest expense was \$2,393,337 and \$782,902 or 1.1% and 1.2% of sales for the 39 weeks and 13 weeks ended August 31, 2003 as compared to \$2,136,709 and \$730,555 or 1.2% of sales for both the 39 weeks and 13 weeks ended September 1, 2002.

As a result of the items reviewed above, loss before provision for income taxes were (\$7,039,396) and (\$4,742,150) for the 39 weeks and 13 weeks ended August 31, 2003, respectively, as compared to income (loss) of \$214,245 and (\$777,264) for the 39 weeks and 13 weeks ended September 1, 2002, respectively.

Liquidity and Capital Resources

Liquidity:

Our consolidated financial statements indicate that at August 31, 2003 current assets exceed current liabilities by \$1,980,822 and stockholders' equity was \$7,057,334. Management believes that cash flows generated from operations,

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supplemented by financing from our bank facility, third party leasing companies and/or additional financing from the Company's majority shareholder, will be sufficient to pay our debts as they may come due, provide for our capital expenditure program and meet our other cash requirements.

Debt and Debt Service:

Effective October 2001, our 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 August 31, 2003, our 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 our credit 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 our funded debt to EBITDA ratio, as defined in our credit facility. The average interest rate on amounts outstanding under our credit facility during the quarter ended August 31, 2003 was 4.43% per annum.

Our credit facility contains covenants, representations and events of default typical of credit agreements, including financial covenants which require us 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. Our credit facility is secured by equipment, inventories and accounts receivable.

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The Company's majority shareholder, through affiliates, has contributed \$21,002,779 through August 31, 2003, in the form of unsecured non-interest bearing loans, of which \$18,300,000 is subordinated to the Company's banks. The liability presently does not bear interest. However, the Company's credit agreement with its banks permits the Company to pay interest on such subordinated debt provided the Company has a positive net income.

The Company has available affiliate leasing lines of credit sufficient to lease finance equipment for its ongoing store remodeling and expansion program.

Capital Expenditures:

Capital expenditures were \$7.7 million for the 39 weeks ended August 31, 2003, including property acquired under capital leases, as compared to \$9.2 million for the 39 weeks ended September 1, 2002.

We have not incurred any material commitments for capital expenditures, although we anticipate spending approximately \$8 -10 million, inclusive of new capital leases on our store remodeling and expansion program in fiscal 2003. Such amount is subject to adjustment based on the availability of funds.

Cash Flow:

Cash provided by operating activities amounted to \$1,363,984 for the 39 weeks ended August 31, 2003 as compared to \$4,883,923 for the 39 weeks ended

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September 1, 2002. The change in cash flow from operating activities was primarily due to an increase in accounts payable, an increase in accounts receivable related to insurance recoveries, and an increase in inventory, primarily due to new stores opened in the period. Net cash used for investing activities was \$5,805,943 in 2003 as compared to \$5,639,418 in 2002. Cash provided by financing activities was \$4,569,048 for the 39 weeks ended August 31, 2003 as compared to \$839,452 for the 39 weeks ended September 1, 2002 reflecting contributions to additional paid-in capital and additional proceeds provided by an affiliate of the Company, offset by repayments of bank loans and capital leases.

Recent Accounting Pronouncements:

In July 2001, the FASB issued Statement of Financial Accounting Standards No. 141, "Business Combinations" ("SFAS 141") and Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). SFAS 141 eliminates the pooling-of-interests method of accounting for business combinations initiated after June 30, 2001 and modifies the application of the purchase accounting method effective for transactions that are completed after June 30, 2001. SFAS 142 eliminates the requirement to amortize goodwill and intangible assets having indefinite useful lives but requires that they be assessed at least annually for impairment. Intangible assets that have finite lives will continue to be amortized over their useful lives. The adoption of SFAS 141 and 142 did not have a material effect on the Company's financial position or operations.

In October 2001, the FASB issued Statement of Financial Accounting Standards 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"). SFAS No. 144 addresses the accounting and reporting for the impairment or disposal of long-lived assets. The statement provides a single accounting model for long-lived assets to be disposed of. New criteria must be met to classify the asset as an asset held-for-sale. This statement also focuses on reporting the effects of a disposal of a segment of business. This statement is effective for fiscal years beginning after December 15, 2001. The Company adopted SFAS 144 as of December 2, 2002, and the adoption did not have a material impact on the Company's financial position or results of operations.

In April 2002, Statement of Financial Accounting Standards, No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections" ("SFAS 145") was issued. SFAS 145 rescinds SFAS 4 and 64, which required gains and losses from extinguishment of debt to be classified as extraordinary items. SFAS also rescinds SFAS 44 since the provisions of the Motor Carrier Act of 1980 are complete. SFAS 145 also amends SFAS 13 eliminating inconsistencies in certain sale-leaseback transactions. The provisions of SFAS 145 are effective for fiscal years beginning after May 15, 2002. Any gain or loss on extinguishment of debt that was classified as an extraordinary item in prior periods presented shall be reclassified to interest expense. The adoption of SFAS 145 did not have a material effect on the Company's financial position or results of operations.

Statement of Financial Accounting Standards, No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" ("SFAS 146"), was issued in July 2002. SFAS 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. SFAS 146 supercedes EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring)." SFAS 146 is to be applied prospectively to exit or disposal activities initiated

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after December 31, 2002. This pronouncement did not have a material effect on the Company's financial position or results of operations.

On December 31, 2002, the FASB issued Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation -Transition and Disclosure" ("SFAS 148"). This standard amends SFAS No. 123, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of SFAS 123 to require more frequent and prominent disclosures in financial statements of the effects of stock-based compensation. The transition guidance and annual disclosure provisions of SFAS 148 are effective for fiscal years ending after December 15, 2002. The interim disclosure provisions are effective for financial reports containing financial statements for interim periods beginning after December 15, 2002. SFAS 148 did not have a material impact on the Company's results of operations, financial position or cash flows, and the Company has adopted the disclosure provisions of SFAS 148 as of March 3, 2003, as required.

In November 2002, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others ("FIN 45"). FIN 45 requires the recognition of a liability for certain guarantee obligations issued or modified after December 31, 2002. It also clarifies disclosure requirements to be made by a guarantor for certain guarantees. The disclosure provisions of FIN 45 are effective for fiscal years ending after December 15, 2002. FIN 45 did not have a material impact on the Company's results of operations, financial position or cash flows, and the Company has adopted the disclosure provisions of FIN 45 as of December 2, 2002.

On January 17, 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"). FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. FIN 46 did not have a material impact on the Company's results of operations, financial position or cash flows, and the Company has adopted the disclosure provisions of FIN 46 as of December 2, 2002.

In February 2003, the Emerging Issues Task Force ("EITF") addressed EITF Statement No. 02-16 ("EITF 02-16"), "Accounting by a Reseller for Cash Consideration Received From a Vendor." EITF 02-16 provides accounting guidance on how a reseller should characterize consideration given by a vendor and when to recognize and how to measure that consideration in its income statement. EITF 02-16 is effective for all agreements entered into after December 31, 2002. The Company evaluated the provisions of EITF 02-16 and determined that this statement did not have a material effect on its consolidated financial statements.

In April 2003, the FASB issued SFAS 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" ("SFAS 149"). SFAS 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS 133. The new guidance amends SFAS 133 for decisions made: (a) as part of the Derivatives Implementation Group process that effectively required amendments to SFAS 133, (b) in connection with other Board projects dealing with financial instruments, and (c) regarding implementation issues raised in relation to the application of the definition of a derivative, particularly regarding the

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meaning of an "underlying" and the characteristics of a derivative that contains financing components. The amendments set forth in SFAS 149 improve financial reporting by requiring that contracts with comparable characteristics be accounted for similarly. SFAS 149 is generally effective for contracts entered into or modified after June 30, 2003 (with a few exceptions) and for hedging relationships designated after June 30, 2003. The guidance is to be applied prospectively. The adoption of SFAS 149 did not have a material impact on the Company's financial position or results of operations.

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In May 2003, the FASB issued Statement No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" ("SFAS 150"). SFAS 150 improves the accounting for certain financial instruments that, under previous guidance, issuers could account for as equity. The new Statement requires that those instruments be classified as liabilities in statements of financial position. The adoption of SFAS 150 did not have a material impact on the Company's financial position or results of operations.

Forward-looking information:

This report and documents incorporated by reference contain 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. A more detailed description of some of the risk factors is set forth in the Company's Annual Report on Form 10-K, dated December 1, 2002.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Market risk represents the risk of loss that may impact the consolidated financial position, results of operations or cash flow of the Company due to adverse changes in financing rates. The Company is exposed to market risk in the area of interest rates. This exposure is directly related to its term loan and borrowing activities under the working capital facility. The Company does not currently maintain any interest rate hedging arrangements due to the reasonable risk that near-term interest rates will not rise significantly. The Company is continuously evaluating this risk and will consider implementing interest rate hedging arrangements when deemed appropriate.

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ITEM 4. CONTROLS AND PROCEDURES

(a) Based on an evaluation of the Company's disclosure controls and procedures as of the end of the quarter ended August 31, 2003, each of John Catsimatidis, Chairman and Chief Executive Officer of the Company, and Kishore Lall, Executive Vice President and Chief Financial Officer of the Company, have concluded that the Company's disclosure controls and procedures were effective.

Notwithstanding the foregoing, a control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that it will detect or uncover failures within the Company to disclose material information otherwise required to be set forth in the Company's periodic reports.

(b) There has not been any significant change in the Company's internal controls over financial reporting that occurred during the most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect the Company's internal controls over financial reporting.

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GRISTEDE'S FOODS INC. AND SUBSIDIARIES

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

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.

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.

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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.

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In August 2003 the Company entered into a stipulation and agreement of settlement, pursuant to which the Company will be obligated to pay \$2,600,000 plus up to \$650,000 in legal fees. The full amount of the proposed settlement will be shared approximately 50/50 by the Company and an affiliate controlled by John A. Catsimatidis. Payment of the legal fees is due in the same percentage installments commencing the later of (i) November 28, 2003, or (ii) 10 days after the court approves the payment of attorneys fees and costs. While the court has approved the proposed settlement as fair, all of the conditions precedent for implementation have not yet been met and cannot be assured at this time, including the fact that the Company's banks have not yet approved the granting of a subordinated security interest to the plaintiffs in certain of the Company's assets to secure the payments of the settlement amount, security documents have not yet been executed and the court has not entered a final judgment in the matter.

Since all of the conditions precedent have not been met, the initial payment of \$1.3 million (50%) on October 16, 2003, was made by an affiliate, controlled by John A. Catsimatidis, on behalf of the Company. This was recorded as a litigation settlement expense of the Company for the quarter ended August 31, 2003, with an offsetting equal capital contribution reflected as additional paid-in capital. The balance of the proposed settlement amount will be due in equal installments of \$650,000 on the first and second anniversary of the initial payment, without interest. Future amounts paid on behalf of the Company will be accounted as a capital contribution and reflected as additional paid-in capital. Additionally, recoveries from a \$400,000 security bond posted by Great American / Baur shall be solely for the Company's benefit.

Item 2. Change 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.

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Item 5. Other Information

None.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits filed with this Form 10-Q

Exhibit 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 31.2 Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 32.1 Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K

A report on Form 8-K was filed on July 17, 2003, containing Items 7 and 9, relating to an offering by the Company of securities in connection with a proposed acquisition of Kings Super Markets, Inc, together with unaudited pro forma condensed financial information.

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SIGNATURES

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

Gristede's Foods, Inc.

By: /s/ John A. Catsimatidis

John A. Catsimatidis
Chairman of the Board and
Chief Executive Officer

Dated: October 31, 2003

By: /s/ Kishore Lall

Kishore Lall
Executive Vice President and
Chief Financial Officer

Dated: October 31, 2003

