

Smart & Final Stores, Inc.
Form 10-Q
April 29, 2015
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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 March 22, 2015

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

For the transition period from _____ to _____.

Commission File Number: 001-36626

Smart & Final Stores, Inc.

(Exact name of registrant as specified in its charter)

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Delaware
(State or other jurisdiction of
Incorporation or organization)

80-0862253
(I.R.S. Employer
Identification No.)

600 Citadel Drive
Commerce, California
(Address of principal executive offices)

90040
(Zip Code)

Registrant's telephone number, including area code: **(323) 869-7500**

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

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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common units, as of the latest practicable date.

Class
common stock, \$0.001 par value

Outstanding at April 24, 2015
73,770,385

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Smart & Final Stores, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(Dollars in Thousands, Except Share and Per Share Amounts)

	March 22, 2015 (Unaudited)	December 28, 2014
Assets		
Current assets:		
Cash and cash equivalents	\$ 124,077	\$ 106,847
Accounts receivable, less allowances of \$796 and \$787 at March 22, 2015 and December 28, 2014, respectively	19,547	23,666
Inventories	211,091	223,404
Prepaid expenses and other current assets	17,650	26,532
Deferred income taxes	22,419	22,419
Total current assets	394,784	402,868
Property, plant, and equipment:		
Land	10,394	11,165
Buildings and improvements	20,441	23,938
Leasehold improvements	186,732	176,114
Fixtures and equipment	214,170	203,473
Construction in progress	16,301	7,344
	448,038	422,034
Less accumulated depreciation and amortization	128,205	115,350
	319,833	306,684
Capitalized software, net of accumulated amortization of \$10,231 and \$9,486 at March 22, 2015 and December 28, 2014, respectively	10,819	10,403
Other intangible assets, net	324,437	325,289
Goodwill	611,242	611,242
Deferred financing costs, net	5,556	5,894
Equity investment in joint venture	11,824	11,924
Other assets	53,565	54,988
Total assets	\$ 1,732,060	\$ 1,729,292
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 165,069	\$ 184,897
Accrued salaries and wages	30,526	28,582

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Accrued expenses	84,766	72,667
Total current liabilities	280,361	286,146
Long-term debt, less current portion and debt discount	588,402	588,117
Deferred income taxes	123,866	125,673
Postretirement and postemployment benefits	126,741	127,004
Other long-term liabilities	90,053	85,144
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.001 par value;		
Authorized shares 10,000,000		
Issued and outstanding shares none		
Common stock, \$0.001 par value;		
Authorized shares 340,000,000		
Issued and outstanding shares - 73,771,218 and 73,755,388 at March 22, 2015 and December 28, 2014, respectively	74	74
Additional paid-in capital	492,096	489,550
Retained earnings	36,884	32,001
Accumulated other comprehensive loss	(6,417)	(4,417)
Total stockholders' equity	522,637	517,208
Total liabilities and stockholders' equity	\$ 1,732,060	\$ 1,729,292

See notes to unaudited condensed consolidated financial statements.

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Smart & Final Stores, Inc. and Subsidiaries

Condensed Consolidated Statements of Operations and Comprehensive Income

(Unaudited)

(Dollars in Thousands, Except Share and Per Share Amounts)

	Twelve Weeks Ended	
	March 22, 2015	March 23, 2014
Net sales	\$ 822,170	\$ 735,016
Cost of sales, buying and occupancy	700,005	630,427
Gross margin	122,165	104,589
Operating and administrative expenses	106,951	92,358
Income from operations	15,214	12,231
Interest expense, net	7,998	8,836
Equity in earnings of joint venture	515	452
Income before income taxes	7,731	3,847
Income tax provision	(2,848)	(1,340)
Net income	\$ 4,883	\$ 2,507
Basic earnings per share	\$ 0.07	\$ 0.04
Diluted earnings per share	\$ 0.06	\$ 0.04
Weighted average shares outstanding:		
Basic	73,084,282	57,171,190
Diluted	76,654,281	59,495,270
Comprehensive income:		
Net income	\$ 4,883	\$ 2,507
Derivative instruments:		
Loss, net of tax of \$(914) and \$(514), respectively	(1,372)	(771)
Reclassification adjustments, net of tax of \$(9) and \$(2), respectively	(13)	(3)
Foreign currency translation	(615)	26
Other comprehensive loss	(2,000)	(748)
Comprehensive income	\$ 2,883	\$ 1,759

See notes to unaudited condensed consolidated financial statements.

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Smart & Final Stores, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(Dollars in Thousands)

	Twelve Weeks Ended	
	March 22, 2015	March 23, 2014
Operating activities		
Net income	\$ 4,883	\$ 2,507
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	8,056	7,652
Amortization	6,445	6,367
Amortization of deferred financing costs and debt discount	655	735
Share-based compensation	2,384	
Excess tax benefits related to share-based payments	(55)	
Deferred income taxes	(883)	
Equity in earnings of joint venture	(515)	(452)
Gain on disposal of property, plant, and equipment	(3)	(2)
Asset impairment	431	73
Changes in operating assets and liabilities:		
Accounts receivable, net	4,120	(118)
Inventories	12,313	19,057
Prepaid expenses and other assets	9,061	(1,111)
Accounts payable	(19,828)	(4,120)
Accrued salaries and wages	1,944	1,244
Other accrued liabilities	9,059	692
Net cash provided by operating activities	38,067	32,524
Investing activities		
Purchases of property, plant, and equipment	(22,920)	(13,645)
Proceeds from disposal of property, plant, and equipment	4,889	15
Investment in capitalized software	(1,463)	(599)
Other	(1,260)	(39)
Net cash used in investing activities	(20,754)	(14,268)
Financing activities		
Proceeds from exercise of stock options	107	
Fees paid in conjunction with debt financing	(31)	(31)
Payments on bank debt		(1,800)
Payments of IPO issuance costs	(214)	
Excess tax benefits related to share-based payments	55	
Contingent consideration related to acquisition of SFHC		(248)
Net cash used in financing activities	(83)	(2,079)
Net increase in cash and cash equivalents	17,230	16,177
Cash and cash equivalents at beginning of period	106,847	53,699
Cash and cash equivalents at end of period	\$ 124,077	\$ 69,876

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Cash paid during the period for:

Interest	\$	212	\$	7,103
Income taxes	\$	770	\$	

Non-cash investing and financing activities

Software development costs incurred but not paid	\$	117	\$	49
Construction in progress costs incurred but not paid	\$	15,947	\$	17,831

See notes to unaudited condensed consolidated financial statements.

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Smart & Final Stores, Inc. and Subsidiaries

Condensed Consolidated Statements of Stockholders' Equity

(Unaudited)

(Dollars in Thousands, Except Share Amounts)

	Common Stock			Additional	Retained	Accumulated	
	Number	Amount		Paid-In	Earnings	Other	Total
	of Shares			Capital		Comprehensive	
						Loss	
Balance at December 28, 2014	73,755,388	\$ 74	\$	489,550	\$ 32,001	\$(4,417)	\$ 517,208
Issuance of restricted stock awards	10,398						
Forfeiture of restricted stock awards	(10,832)						
Share-based compensation				2,384			2,384
Excess tax benefit for exercise of share-based compensation awards				55			55
Stock option exercises	16,264			107			107
Net income					4,883		4,883
Other comprehensive loss						(2,000)	(2,000)
Balance at March 22, 2015	73,771,218	74		492,096	36,884	(6,417)	522,637

See notes to unaudited condensed consolidated financial statements.

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Smart & Final Stores, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

1. Description of Business and Basis of Presentation

Business

Smart & Final Stores, Inc., a Delaware corporation (SFSI or the Successor and, collectively with its wholly owned consolidated subsidiaries, the Company), is engaged primarily in the business of selling fresh perishables and everyday grocery items, together with foodservice, packaging and janitorial products. The Company operates non-membership, warehouse-style stores offering products in a range of product sizes.

SFSI was formed in connection with the acquisition of the Smart & Final and Cash & Carry store businesses through the purchase of all of the outstanding common stock of Smart & Final Holdings Corp. (the Predecessor or SFHC) on November 15, 2012. The principal acquiring entities were affiliates of Ares Management, L.P. (Ares) and the acquisition is referred to as the Ares Acquisition.

The Company operates its stores under the Smart & Final banner and the Cash & Carry banner. As of March 22, 2015, the Company operated 258 stores throughout the Western U.S.

The Company holds a 50% joint venture interest in a Mexican domestic corporation, Smart & Final del Noreste, S.A. de C.V. (SFDN), which operated 15 Smart & Final format stores in northwestern Mexico as of March 22, 2015.

Initial Public Offering

On September 29, 2014, SFSI completed its initial public offering (the IPO), pursuant to which it sold an aggregate of 15,467,500 shares (after giving effect to the underwriters exercise in full of their option to purchase additional shares) of common stock, par value \$0.001 per share (Common Stock), at a public offering price of \$12.00 per share. The Company received aggregate net proceeds of \$167.7 million after deducting underwriting discounts and commissions and other offering expenses. See Note 13, Stockholders Equity.

Basis of Presentation

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The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP) for interim financial statements, and Rule 10-01 of Regulation S-X of the Securities Act of 1933, as amended (the Securities Act). The unaudited condensed consolidated financial statements reflect all adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation of the Company s financial position, results of operations and cash flows for the periods indicated. All intercompany accounts and transactions have been eliminated in consolidation. Interim results are not necessarily indicative of results for a full fiscal year. The information included in these unaudited condensed consolidated financial statements and notes thereto should be read in conjunction with the Company s audited consolidated financial statements as of and for the fiscal year ended December 28, 2014 that were included in the Company s Annual Report on Form 10-K filed with the Securities and Exchange Commission (the SEC) on March 25, 2015.

On September 19, 2014, SFSI s board of directors and stockholders approved a 190-for-one stock split of Common Stock. The accompanying unaudited condensed consolidated financial statements and notes thereto give retroactive effect to the stock split for all periods presented.

Fiscal Years

The Company s fiscal year is the 52- or 53-week period that ends on the Sunday closest to December 31. Each fiscal year typically consists of twelve-week periods in the first, second and fourth quarters and a sixteen-week period in the third quarter. Fiscal year 2015 is a 53-week fiscal year and the fourth quarter consists of a thirteen-week period. Fiscal year 2014 was a 52-week fiscal year.

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2. Significant Accounting Policies

Cash and Cash Equivalents

The Company considers all highly liquid instruments purchased with an original maturity of three months or less to be cash equivalents. All credit card, debit card and electronic benefits transfer transactions that process in less than seven days are classified as cash equivalents. The carrying amount of cash equivalents is approximately the same as their respective fair values due to the short-term maturity of these instruments.

Accounts Receivable, Net

Accounts receivable generally represent billings to customers, billings to vendors for earned rebates and allowances, receivables from SFDN, and other items. The receivable from SFDN primarily relates to billings for the shipment of inventory product to SFDN.

The Company evaluates the collectability of accounts receivable and determines the appropriate reserve for doubtful accounts based on analysis of historical trends of write-offs and recoveries on various levels of aged receivables. When the Company becomes aware of the deteriorated collectability of a specific account, additional reserves are made to reduce the net recognized receivable to the amount reasonably expected to be collectible or zero. When the specific account is determined to be uncollectible, the net recognized receivable is written off in its entirety against such reserves.

The Company is exposed to credit risk on trade accounts receivable. The Company provides credit to certain trade customers in the ordinary course of business and performs ongoing credit evaluations. Concentrations of credit risk with respect to trade accounts receivable are limited due to the number of customers comprising the Company's customer base. The Company currently believes the allowance for doubtful accounts is sufficient to cover customer credit risks.

Inventories

Inventories consist of merchandise purchased for resale which is stated at the weighted-average cost (which approximates FIFO) or market. The Company provides for estimated inventory losses between physical inventory counts at its stores based upon historical inventory losses as a percentage of sales. The provision is adjusted periodically to reflect updated trends of actual physical inventory count results.

Prepaid Expenses and Other Current Assets

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Prepaid expenses and other current assets include primarily prepaid rent, insurance, property taxes, income taxes receivable and other current assets.

Property, Plant, and Equipment

Property, plant, and equipment is stated at cost or estimated fair value based on purchase accounting and depreciated or amortized using the straight-line method. Leased property meeting certain criteria is capitalized and the amortization is based on the straight-line method over the term of the lease.

The estimated useful lives are as follows:

Buildings and improvements	20 - 25 years
Fixtures and equipment	3 - 10 years
Leasehold improvements	Lesser of lease term or useful life of improvement

Costs of normal maintenance and repairs and minor replacements are charged to expense when incurred. Major replacements, remodeling or betterments of properties are capitalized. When assets are sold or otherwise disposed of, the costs and related accumulated depreciation and amortization are removed from the accounts, and any resulting gain or loss is included in the consolidated statements of operations and comprehensive income.

Included in property, plant, and equipment are costs associated with the selection and procurement of real estate sites. These costs are amortized over the remaining lease term of the successful sites with which they are associated.

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In accordance with Accounting Standards Codification (ASC) 360, *Property, Plant, and Equipment* (ASC 360), the Company reviews its long-lived assets, including property, plant and equipment for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company groups and evaluates long-lived assets for impairment at the individual store level, which is the lowest level at which individual cash flows can be identified. The Company regularly reviews its stores' operating performance for indicators of impairment. Factors it considers important that could trigger an impairment review include a significant underperformance relative to expected historical or projected future operating results, a significant change in the manner of the use of the asset or a significant negative industry or economic trend. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized to the extent the sum of the estimated discounted future cash flows from the use of the asset is less than the carrying value. The Company measured the fair value of its long-lived assets on a nonrecurring basis using Level 3 inputs as defined in the fair value hierarchy. See Note 6, Fair Value Measurements.

Capitalized Software

Capitalized software costs are comprised of third-party purchased software costs, capitalized costs associated with internally developed software including internal direct labor costs, and installation costs. Such capitalized costs are amortized over the period that the benefits of the software are fully realizable and enhance the operations of the business, ranging from three to seven years, using the straight-line method.

Capitalized software costs, like other long-lived assets as required by ASC 360, are subject to review for impairment whenever events or changes in circumstances indicate that the carrying amount of the capitalized software may not be recoverable, whether it is in use or under development. Impairment is recognized to the extent the sum of the estimated discounted future cash flows from the use of the capitalized software is less than the carrying value.

Goodwill and Intangible Assets

In connection with the Ares Acquisition, the intangible assets, including trade names, were adjusted and recorded at fair market value in accordance with ASC Topic 805, *Business Combinations* (ASC 805). The recorded fair market value for each of the trade names was determined by estimating the amount of royalty income that could be generated from the trade name if it was licensed to a third-party owner and discounting the resulting cash flows using the weighted-average cost of capital for each respective trade name.

The finite-lived intangible assets are amortized over their estimated useful benefit period and have the following weighted-average amortization periods:

Signature brands	20 years
Non-compete agreement	3 years

Signature brands, leasehold interests and the non-compete agreement are amortized on a straight-line basis.

In accordance with ASC 350, *Intangibles - Goodwill and Other* (ASC 350), goodwill and intangible assets with indefinite lives are evaluated on an annual basis for impairment during the fourth quarter, or more frequently if events or changes in circumstances indicate that the asset might be impaired. The Company evaluates goodwill for impairment by comparing the fair value of each reporting unit to its carrying value including the associated goodwill. The Company has designated its reporting units to be its Smart & Final stores and Cash & Carry stores. The Company determines the fair value of the reporting units using the income approach methodology of valuation that includes the discounted cash flow method as well as other generally accepted valuation methodologies. If the fair value of the reporting unit exceeds the carrying value of the net assets, including goodwill assigned to that unit, goodwill is not impaired. If the carrying value of the reporting unit's net assets, including goodwill, exceeds the fair value of the reporting unit, then the Company determines the implied fair value of the reporting unit's goodwill. If the carrying value of a reporting unit's goodwill exceeds its implied value, then an impairment of goodwill has occurred and the Company would recognize an impairment charge for the difference between the carrying amount and the implied fair value of goodwill.

The Company evaluates its indefinite-lived intangible assets associated with trade names by comparing the fair value of each trade name with its carrying value. The Company determines the fair value of the indefinite-lived trade names using a relief from royalty payments methodology. This methodology involves estimating reasonable royalty rates for each trade name and applying these royalty rates to a revenue stream and discounting the resulting cash flows to determine fair value.

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Finite-lived intangible assets, like other long-lived assets as required by ASC 360, are subject to review for impairment whenever events or changes in circumstances indicate that the carrying amount of the finite-lived intangible asset may not be recoverable. Impairment is recognized to the extent the sum of the discounted estimated future cash flows from the use of the finite-lived intangible asset is less than the carrying value.

Other Assets

Other assets primarily consist of assets held in trusts for certain retirement plans, (See Note 7, Retirement Benefit Plans and Postretirement and Postemployment Benefit Obligations), liquor licenses and other miscellaneous assets.

Accounts Payable

The Company's banking arrangements provide for the daily replenishment and limited monthly advanced payments of vendor payable accounts as checks are presented or payments are demanded. The checks and the advanced payments outstanding in these bank accounts are included in Accounts payable on the accompanying condensed consolidated balance sheets.

Other Long-Term Liabilities

Other long-term liabilities include primarily general liabilities, workers' compensation liabilities, liabilities for deferred compensation plan, leasehold interests and other miscellaneous long-term liabilities. As a result of the Ares Acquisition, leasehold interests were adjusted and recorded at fair market value in accordance with ASC 805. These leasehold interests are amortized over their estimated useful benefit periods. The weighted-average amortization period is 14 years.

Accumulated Other Comprehensive Loss

The Company presents data in the condensed consolidated statements of stockholders' equity in accordance with ASC 220, *Comprehensive Income* (ASC 220). ASC 220 establishes rules for the reporting of comprehensive income (loss) and its components.

Lease Accounting

Certain of the Company's operating leases provide for minimum annual payments that increase over the life of the lease. The aggregate minimum annual payments are charged to expense on a straight-line basis beginning when the Company takes possession of the property and extending over the term of the related lease. The amount by which straight-line rent expense exceeds actual lease payment requirements in the early years

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of the leases is accrued as deferred minimum rent and reduced in later years when the actual cash payment requirements exceed the straight-line expense. ASC 410, *Asset Retirement and Environmental Obligations* (ASC 410), requires an entity to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. Due to the nature of the Company's business, its asset retirement obligation with respect to owned or leased properties is not significant.

Store Opening and Closing Costs

New store opening costs consisting primarily of rent, store payroll and general operating costs are charged to expense as incurred prior to the store opening.

In the event a leased store is closed before the expiration of the associated lease, the discounted remaining lease obligation less estimated sublease rental income, asset impairment charges related to improvements and fixtures, inventory write-downs and other miscellaneous closing costs associated with the disposal activity are recognized when the store closes.

Share-Based Compensation

The Company accounts for share-based compensation in accordance with ASC 718, *Compensation Stock Compensation* (ASC 718). ASC 718 requires all share-based payments to be recognized in the statements of operations and comprehensive income as compensation expense based on the fair value of an award over its requisite service period, taking into consideration estimated forfeiture rates.

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Under the fair value recognition provisions of ASC 718, the Company measures share-based compensation cost at the grant date based on the fair value of the award and recognizes share-based compensation cost as an expense over the award's vesting period. As share-based compensation expense recognized in the consolidated statements of operations and comprehensive income of the Company is based on awards ultimately expected to vest, the amount of expense has been reduced for estimated forfeitures. The Company's forfeiture rate assumption used in determining its share-based compensation expense is estimated primarily based upon historical data. The actual forfeiture rate could differ from these estimates.

The Company uses the Black-Scholes-Merton option-pricing model to determine the grant date fair value for each stock option grant. The Black-Scholes-Merton option-pricing model requires extensive use of subjective assumptions. Application of alternative assumptions could produce significantly different estimates of the fair value of share-based compensation and, consequently, the related amounts recognized in the Company's consolidated statements of operations and comprehensive income. The Company recognizes compensation cost for graded vesting awards as if they were granted in multiple awards. Management believes the use of this multiple award method is preferable because a stock option grant with graded vesting is effectively a series of individual grants that vests over various periods and management believes that this method provides for better matching of compensation costs with the associated services rendered throughout the applicable vesting periods. See Note 9, Share-Based Compensation.

Significant Accounting Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions. Such estimates and assumptions could affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Recognition

Revenues from the sale of products are recognized at the point of sale. Discounts provided to customers at the time of sale are recognized as a reduction in sales as the products are sold. Returns are also recognized as a reduction in sales and are immaterial in relation to total sales. The Company collects sales tax on taxable products purchased by its customers and remits such collections to the appropriate taxing authority in accordance with local laws. Sales tax collections are presented in the consolidated statements of operations and comprehensive income on a net basis and, accordingly, are excluded from reported revenues.

Proceeds from the sale of the Company's Smart & Final gift cards are recorded as a liability at the time of sale, and recognized as sales when they are redeemed by the customer. The Smart & Final gift cards do not have an expiration date. The Company has not recorded any unredeemed gift card revenue or breakage related to its gift card program.

Cost of Sales, Buying and Occupancy

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The major categories of costs included in cost of sales, buying and occupancy are cost of goods, distribution costs, costs of the Company's buying department and store occupancy costs, net of earned vendor rebates and other allowances. Distribution costs consist of all warehouse receiving and inspection costs, warehousing costs, all transportation costs associated with shipping goods from the Company's warehouses to its stores, and other costs of its distribution network. The Company does not exclude any material portion of these costs from cost of sales.

Vendor Rebates and Other Allowances

As a component of the Company's consolidated procurement program, the Company frequently enters into contracts with vendors that provide for payments of rebates or other allowances. As prescribed by ASC 605, Revenue Recognition (ASC 605), these vendor payments are reflected in the carrying value of the inventory when earned or as progress is made toward earning the rebate or allowance and as a component of cost of sales as the inventory is sold. Certain of these vendor contracts provide for rebates and other allowances that are contingent upon the Company meeting specified performance measures such as a cumulative level of purchases over a specified period of time. Such contingent rebates and other allowances are given accounting recognition at the point at which achievement of the specified performance measures are deemed to be probable and reasonably estimable.

Operating and Administrative Expenses

The major categories of operating and administrative expenses include store direct expenses associated with displaying and selling at the store level, primarily labor and related fringe benefit costs, advertising and marketing costs, overhead costs and corporate office costs. The Company charges to expense the costs of advertising as incurred.

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Income Taxes

The Company accounts for income taxes in accordance with ASC 740, *Income Taxes* (ASC 740). In accordance with ASC 740, the Company recognizes deferred tax assets and liabilities based on the liability method, which requires an adjustment to the deferred tax asset or liability to reflect income tax rates currently in effect. When income tax rates increase or decrease, a corresponding adjustment to income tax expense is recorded by applying the rate change to the cumulative temporary differences. ASC 740 prescribes the recognition threshold and measurement principles for financial statement disclosure of tax positions taken or expected to be taken on a tax return. ASC 740 requires the Company to determine whether it is more likely than not that a tax position will be sustained upon examination by the appropriate taxing authorities before any part of the benefit can be recognized. Additionally, ASC 740 provides guidance on recognition measurement, derecognition, classification, related interest and penalties, accounting in interim periods, disclosure and transition.

Foreign Currency Translations

The Company's joint venture in Mexico uses the Mexican Peso as its functional currency. The joint venture's assets and liabilities are translated into U.S. dollars at the exchange rates prevailing at the balance sheet dates. Revenue and expense accounts are translated into U.S. dollars at average exchange rates during the year. Foreign exchange translation adjustments are included in Accumulated other comprehensive loss, which is reflected as a separate component of stockholders' equity, in the accompanying condensed consolidated balance sheets.

Derivative Financial Instruments

The Company uses interest rate swaps to manage its exposure to adverse fluctuations in interest rates. The contracts are accounted for in accordance with ASC Topic 815, *Derivatives and Hedging* (ASC 815). ASC 815 requires every derivative instrument to be recorded in the Company's consolidated balance sheets as either an asset or liability measured at its fair value. The Company designates its interest rate swaps as cash flow hedges and formally documents its hedge relationships, including identification of the hedging instruments and the hedged items, as well as its risk management objectives and strategies for undertaking the hedge transaction. Accordingly, changes in estimated fair value related to the interest rate swaps are recognized in Accumulated other comprehensive loss in the condensed consolidated statements of stockholders' equity and recognized in the consolidated statements of operations and comprehensive income when the hedged items affect earnings. See Note 5, Derivative Financial Instruments.

Debt Discount and Deferred Financing Costs

Costs incurred in connection with the placement of long-term debt paid directly to the Company's lenders are treated as a debt discount. Costs incurred in connection with the placement of long-term debt paid to third parties are capitalized to deferred financing costs. Debt issuance costs are amortized to interest expense over the term of the related debt using the effective interest method.

Debt issuance costs and fees paid to the lenders related to the Ares Acquisition, totaling \$17.5 million, were recorded as a reduction to debt and are amortized to interest expense over the terms of the underlying debt instruments using the effective interest method. See Note 4, Debt.

Debt issuance costs and fees paid to parties other than the lenders related to the Ares Acquisition, totaling \$17.2 million, have been capitalized and are amortized to interest expense over the terms of the underlying debt instruments using the effective interest method. These balances are included in `Deferred financing costs, net` in the condensed consolidated balance sheets.

Self-Insurance

The Company purchases third-party insurance for workers' compensation and general liability costs that exceed certain limits for each respective insurance program. The Company is responsible for the payment of claims in amounts less than these insured excess limits and establishes estimated accruals for its insurance programs based on available claims data, historical trends and experience, and projected ultimate costs of the claims. These accruals are based on estimates prepared with the assistance of outside actuaries and consultants, and the ultimate cost of these claims may vary from initial estimates and established accruals. The actuaries periodically update their estimates and the Company records such adjustments in the period in which such determination is made. These balances are included in `Other long-term liabilities` in the condensed consolidated balance sheets.

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Fair Value of Financial Instruments

The Company's financial instruments recorded in the consolidated balance sheets include cash and cash equivalents, accounts receivable, derivatives, investments in affiliates, accounts payable, accrued expenses and long-term variable rate debt. The carrying amounts of cash and cash equivalents, accounts receivable, derivatives, equity investment in joint venture, accounts payable and accrued expenses approximate fair value.

The Company's debt securities are not listed or traded on an established market. For the purpose of determining the fair value of the Company's first lien term loan facility (the Term Loan Facility), the administrative agent has provided to the debt holders valuations indicating the Term Loan Facility's carrying value approximates fair value.

The Company's condensed consolidated financial statements reflect its investment in Sprouts Farmers Market, Inc. (Sprouts) through the Company's supplemental deferred compensation plan. The investment is presented at fair market value.

Accounting for Retirement Benefit Plans

The Company accounts for its retirement benefit plans and postretirement and postemployment benefit obligations in accordance with ASC 715, *Compensation - Retirement Benefits* (ASC 715). ASC 715 requires the Company to recognize the overfunded or underfunded status of a defined benefit plan, measured as the difference between the fair value of plan assets and the plan's benefit obligation, as an asset or liability in its consolidated balance sheets and to recognize changes to that funded status in the year in which the changes occur through accumulated other comprehensive income. ASC 715 also requires measurement of the funded status of a plan as of the Company's consolidated balance sheet dates.

Earnings per Share

Basic earnings per share is calculated by dividing net income by the weighted average number of shares outstanding during the fiscal period.

Diluted earnings per share is calculated by dividing net income by the weighted average number of shares outstanding, plus, where applicable, shares that would have been outstanding related to dilutive stock options.

3. Recent Accounting Pronouncements

Recently Adopted Accounting Pronouncements

In April 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-08, *Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity* (ASU 2014-08). The amendments in ASU 2014-08 change the criteria for reporting discontinued operations while enhancing disclosures in this area. They also address sources of confusion and inconsistent application related to financial reporting of discontinued operations guidance in U.S. GAAP. Under the new guidance, only disposals representing a strategic shift in operations should be presented as discontinued operations. Those strategic shifts should have a major effect on the entity's operations and financial results. Examples include a disposal of a major geographic area, a major line of business, or a major equity method investment. In addition, the new guidance requires expanded disclosures about discontinued operations that will provide financial statement users with more information about the assets, liabilities, income, and expenses of discontinued operations. The amendments in this ASU are effective for the first quarter of 2015 for public entities with calendar year ends. The adoption of ASU 2014-08 in the first quarter of 2015 did not have a material effect on the Company's consolidated financial statements.

Recently Issued Accounting Pronouncements Not Yet Adopted

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers* (Topic 606) (ASU 2014-09). ASU 2014-09 outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The new revenue model is designed to provide a more robust framework for addressing revenue issues and requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 was to be effective for the first interim period within annual reporting periods beginning after December 15, 2016, and early adoption is not permitted. In April 2015, the FASB proposed a one-year deferral of the effective date of this ASU. The Company is currently evaluating this guidance and the impact it will have on its consolidated financial statements.

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In June 2014, the FASB issued ASU No. 2014-12, *Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period* (ASU 2014-12). ASU 2014-12 provides guidance that a performance target that affects vesting of a share-based payment and that could be achieved after the requisite service condition is a performance condition. As a result, the performance target is not reflected in the estimation of the award's grant date fair value. Share-based compensation cost for such award would be recognized over the required service period, if it is probable that the performance condition will be achieved. ASU 2014-12 is effective for annual reporting periods beginning after December 15, 2015. Early adoption is permitted. The guidance should be applied on a prospective basis to awards that are granted or modified on or after the effective date of the standard. Companies also have the option to apply the guidance on a modified retrospective basis for awards with performance targets outstanding on or after the beginning of the first annual period presented after the effective date of the standard. The Company does not expect the adoption of ASU 2014-12 will have a material effect on the Company's consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, *Presentation of Financial Statements - Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern* (ASU 2014-15). ASU 2014-15 provides guidance on determining when and how reporting entities must disclose going-concern uncertainties in their financial statements. The new standard requires management to perform interim and annual assessments of an entity's ability to continue as a going concern within one year of the date of issuance of the entity's financial statements (or within one year after the date on which the financial statements are available to be issued, when applicable). Further, an entity must provide certain disclosures if there is substantial doubt about the entity's ability to continue as a going concern. ASU 2014-15 is effective for annual periods ending after December 15, 2016, and interim periods thereafter and early adoption is permitted. The Company does not expect the adoption of ASU 2014-15 to have a material impact on the Company's consolidated financial statements.

In January 2015, the FASB issued ASU No. 2015-01, *Income Statement - Extraordinary and Unusual Items (Subtopic 225-20), Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items* (ASU 2015-01). ASU 2015-01 eliminates the concept of extraordinary items. Under this new guidance, reporting entities will no longer be required to separately classify, present and disclose extraordinary events and transactions. The amendments in this update are effective for annual and interim periods beginning after December 15, 2015. The Company does not expect the adoption of ASU 2015-01 will have a material effect on the Company's consolidated financial statements.

In February 2015, the FASB issued ASU No. 2015-02, *Amendments to the Consolidation Analysis* (ASU 2015-02). ASU 2015-02 is intended to improve upon and simplify the consolidation assessment required to evaluate whether organizations should consolidate certain legal entities such as limited partnerships, limited liability corporations, and securitization structures. The amendments in this ASU are effective for annual and interim periods beginning after December 15, 2015 for public entities. The Company does not expect the adoption of ASU 2015-02 will have a material impact on the Company's consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-03, *Simplifying the Presentation of Debt Issuance Costs* (ASU 2015-03). ASU 2015-03 changes the presentation of debt issuance costs in the financial statements. Under the ASU, an entity presents such costs in the balance sheet as a direct deduction from the related debt liability rather than as an asset. The amendments in this ASU are effective for annual and interim periods beginning after December 15, 2015 for public entities. The Company is currently evaluating the guidance to determine the impact on its balance sheet presentation.

4. Debt

Long-term debt at March 22, 2015, and December 28, 2014 was as follows (in thousands):

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	March 22, 2015	December 28, 2014
Term Loan Facility, at 4.75% and 4.75%	\$ 594,907	\$ 594,907
Less:		
Discount on debt issuance	(6,505)	(6,790)
Total long-term debt	\$ 588,402	\$ 588,117

In conjunction with the Ares Acquisition, Smart & Final Stores LLC entered into three financing arrangements effective November 15, 2012, including two term loan agreements: the Term Loan Facility and a second lien term loan facility (the Second Lien Term Loan Facility) and an asset-based lending facility (the Revolving Credit Facility and, together with the Term Loan Facility, the Credit Facilities).

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The Term Loan Facility has a term of seven years and originally provided financing of up to a maximum of \$525.0 million in term loans. At November 15, 2012, the Term Loan Facility was drawn to provide \$525.0 million in gross proceeds as a part of the funding for the Ares Acquisition.

All obligations under the Term Loan Facility are secured by (1) a first-priority security interest in substantially all of the property and assets of, as well as the equity interests owned by, Smart & Final Stores and SF CC Intermediate Holdings, Inc., a direct wholly owned subsidiary of SFSI (Intermediate Holdings), and the other guarantors, with certain exceptions, and (2) a second-priority security interest in the Revolving Credit Facility collateral.

Initially, borrowings under the Term Loan Facility bore interest at an applicable margin of 3.50% plus, at Smart & Final Stores' option, a fluctuating rate equal to the highest of (1) the federal funds rate plus 0.50%, (2) a rate of interest published by *The Wall Street Journal* as the Prime Rate, and (3) a LIBOR loan rate based on LIBOR plus 1.00% (the ABR Borrowings). Eurocurrency Borrowings (as defined in the credit agreement governing the Term Loan Facility) bore interest at the adjusted LIBOR rate, which is the greater of (a) the LIBOR rate in effect for the applicable interest period divided by one, minus the Statutory Reserves (as defined in the credit agreement governing the Term Loan Facility) applicable to such Eurocurrency Borrowing, if any, and (b) 1.25% plus the applicable Eurocurrency (as defined in the credit agreement governing the Term Loan Facility) loan rate margin of 4.50%. At both March 22, 2015 and December 28, 2014, the weighted-average interest rate on the amount outstanding under the Term Loan Facility was 4.75%.

The Term Loan Facility contains a provision for quarterly amortization of principal in the amount of 0.25% of the aggregate principal amount of the term loans outstanding under the Term Loan Facility beginning March 31, 2013. The Term Loan Facility has no financial covenant requirements. The Term Loan Facility contains covenants that would restrict the Company's ability to pay cash dividends.

The Second Lien Term Loan Facility had a term of eight years and provided \$195.0 million in gross proceeds at November 15, 2012.

All obligations under the Second Lien Term Loan Facility were secured by (1) a second-priority security interest on all Term Loan Facility collateral and (2) a third-party security interest on the Revolving Credit Facility collateral.

Borrowings under the Second Lien Term Loan Facility bore interest at an applicable margin of 8.25% plus, at Smart & Final Stores' option, a fluctuating rate equal to the highest of (1) the federal funds rate plus 0.50%, (2) a rate of interest published by *The Wall Street Journal* as the Prime Rate, or (3) a LIBOR loan rate based on LIBOR plus 1.00%.

The Second Lien Term Loan Facility could be prepaid, in whole or in part, at any time subject to a prepayment premium of 2.00% of the principal amount of the term loans so prepaid through the first anniversary of the facility and 1.00% of the principal amount of the term loans so prepaid from the first anniversary through the second anniversary of the facility. The Second Lien Term Loan Facility had no financial covenant requirements.

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During the second quarter of 2013, the Company amended the Term Loan Facility, reducing the ABR Borrowings applicable margin from 3.50% to 2.50%, reducing the Eurocurrency Borrowings applicable margin from 4.50% to 3.50% and reducing the Adjusted LIBOR floor rate from 1.25% to 1.00%. Additionally, the Company increased the size of the Term Loan Facility by \$55.0 million through an incremental facility. The proceeds of this additional borrowing were used to reduce the amounts outstanding under the Second Lien Term Loan Facility by \$55.0 million, reducing the outstanding balance to \$140.0 million. Consequently, during the second quarter of 2013, the Company recorded a loss on the early extinguishment of debt of \$7.1 million related to fees and the write-off of unamortized debt discount and deferred financing costs. The Company incurred \$7.5 million of fees in connection with the amendment of the Term Loan Facility. Approximately \$4.9 million of these fees were recorded as debt discount and are amortized over the term of the loan. Quarterly amortization of the principal amount increased to \$1.5 million.

During the fourth quarter of 2013, the Company amended the Term Loan Facility, increasing the ABR Borrowings applicable margin from 2.50% to 2.75%, increasing the Eurocurrency Borrowings applicable margin from 3.50% to 3.75%, and reducing the size of the incremental borrowing facilities that may be incurred without regard to leverage-based limitations from \$125.0 million to \$75.0 million (the

Second Amendment). Under the Second Amendment, the Term Loan Facility may be prepaid, in whole or in part, at any time subject to a prepayment premium of 1.00% of the principal amount of the term loans so prepaid if the prepayment occurs as a result of a repricing transaction and is effective within six months of the

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Second Amendment. Additionally, the Company increased the size of the Term Loan Facility by \$140.0 million through an incremental facility. The proceeds of this borrowing were used to repay all amounts outstanding under the Second Lien Term Loan Facility, which was then terminated. Consequently, during the fourth quarter of 2013, the Company recorded a loss on the early extinguishment of debt of \$17.3 million related to fees and the write-off of unamortized debt discount and deferred financing costs. The Company incurred \$4.8 million of fees in connection with the Second Amendment. Approximately \$1.1 million of these fees were recorded as debt discount and approximately \$0.7 million of these fees were recorded as deferred financing costs. They are both amortized over the term of the Term Loan Facility. Quarterly amortization of the principal amount increased to \$1.8 million.

On September 29, 2014, the Company used the net proceeds from the IPO to repay borrowings of approximately \$115.5 million under the Term Loan Facility. Consequently, the Company recorded a loss on the early extinguishment of debt of \$2.2 million related to the write-off of unamortized debt discount and deferred financing costs during the third quarter of 2014. Quarterly amortization of the principal amount is no longer required.

The Revolving Credit Facility provides financing of up to \$150 million (including up to \$50.0 million for the issuance of letters of credit) subject to a borrowing base, for a term of five years. The borrowing base is a formula based on certain eligible inventory and receivables, minus certain reserves.

All obligations under the Revolving Credit Facility are secured by (1) a first-priority security interest in the accounts receivable, inventory, cash and cash equivalents, and related assets of Smart & Final Stores and Intermediate Holdings and the other guarantors under the facility, and (2) a second-priority security interest in substantially all of the other property and assets of, as well as the equity interests owned by, Smart & Final Stores and Intermediate Holdings and the other guarantors under the facility.

Borrowings under the Revolving Credit Facility bear interest at an applicable margin plus, at Smart & Final Stores' option, a fluctuating rate equal to either (1) adjusted LIBOR (defined as a rate equal to the LIBOR rate in effect for the applicable interest period, as adjusted for statutory reserves) or (2) the alternate base rate (defined as a fluctuating rate equal to the highest of (x) the federal funds effective rate plus 0.50%, (y) the interest rate announced by the administrative agent as its Prime Rate and (z) the adjusted LIBOR rate for an interest period of one month plus 1.00%). The applicable margin is determined by a pricing grid based on the facility availability. At March 22, 2015 and December 28, 2014, the alternate base rate was 3.25% and the applicable margin for alternate base rate loans was 0.25% for a total rate of 3.50%. The calculated borrowing base of the Revolving Credit Facility was \$154.4 million and \$156.3 million at March 22, 2015 and December 28, 2014, respectively. As of March 22, 2015 and December 28, 2014, there was no balance outstanding under the Revolving Credit Facility.

The Revolving Credit Facility also provides for a \$50.0 million sub-limit for letters of credit, of which the Company had \$26.6 million outstanding as of both March 22, 2015 and December 28, 2014. As of both March 22, 2015 and December 28, 2014, the amount available for borrowing under the Revolving Credit Facility was \$123.4 million. The Revolving Credit Facility does not include financial covenant requirements unless a defined covenant trigger event has occurred and is continuing. As of March 22, 2015 and December 28, 2014, no trigger event had occurred.

5. Derivative Financial Instruments

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On April 15, 2013, the Company entered into a five-year interest rate swap agreement (the Swap) to fix the LIBOR component of interest under the Term Loan Facility at 1.7325% on a variable notional amount starting at \$422.7 million and declining to \$359.7 million for the period from September 30, 2014 through March 29, 2018. The Swap has been designated as a cash flow hedge against LIBOR interest rate movements and formally assessed, both at inception and at least quarterly thereafter, as to whether it was effective in offsetting changes in cash flows of the hedged item. The portion of the change in fair value attributable to hedge ineffectiveness was recorded in Interest expense, net in the condensed consolidated statements of operations and comprehensive income. The portion of the change in fair value attributable to hedge effectiveness, net of income tax effects, was recorded to Accumulated other comprehensive loss in the condensed consolidated statements of stockholders' equity.

On May 30, 2013, the Company entered into an amendment to the Swap to change the fixed LIBOR component to 1.5995% and the floor rate to 1.00%.

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As of March 22, 2015 and December 28, 2014, respectively, the fair value carrying amount of the Company's interest rate swaps are recorded as follows (in thousands):

	March 22, 2015		December 28, 2014
Other assets	\$ 296	\$	3,082
Accrued expenses	(1,926)		(2,426)
Total derivatives designated as hedging instruments	\$ (1,630)	\$	656

The following table summarizes the loss recognized in accumulated other comprehensive loss (AOCI) and the amount of loss reclassified from AOCI into earnings for the twelve weeks ended March 22, 2015 (in thousands):

	Amount of Loss Recognized in AOCI on Derivative, Net of Tax (Effective Portion)		Amount of Loss Recognized in Earnings on Derivative, Net of Tax (Ineffective Portion)
Interest rate swaps	\$ (1,385)	\$	(13)

6. Fair Value Measurements

The Company applies the provisions of ASC 820, *Fair Value Measurements and Disclosures* (ASC 820), for its financial and nonfinancial assets and liabilities. ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 establishes a fair value hierarchy, which prioritizes the inputs used in measuring fair value into three broad levels as follows:

Level 1 Quoted prices for identical instruments in active markets

Level 2 Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets

Level 3 Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable

The Company's assets and liabilities measured at fair value on a recurring basis are summarized in the following table by the type of inputs applicable to the fair value measurements (in thousands):

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Description	Fair Value Measurement at March 22, 2015			
	Total as of March 22, 2015	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial assets				
Other assets cash and cash equivalents that fund supplemental executive retirement plan and deferred compensation plan	\$ 2,026	\$ 2,026	\$	\$
Other assets assets that fund supplemental executive retirement plan	2,671	2,671		
Other assets deferred compensation plan investment in Sprouts	6,119	6,119		
Financial liabilities				
Derivatives	(1,630)		(1,630)	
Other long-term liabilities deferred compensation plan	(13,967)	(6,119)	(7,848)	
Total	\$ (4,781)	\$ 4,697	\$ (9,478)	\$

Level 1 Investments include money market funds of \$2.0 million, market index funds of \$2.7 million, and an investment in Sprouts of \$6.1 million. The fair values of these investments are based on quoted market prices in an active market.

Level 2 Liabilities include \$7.8 million of deferred compensation liabilities, of which the fair value is based on quoted prices of similar assets traded in active markets, and \$1.6 million of derivatives, which are interest rate hedges. The fair values of the derivatives are primarily determined based on third-party pricing services with observable inputs, including interest rates and yield curves.

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Description	Fair Value Measurement at December 28, 2014			
	Total as of December 28, 2014	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial assets				
Other assets cash and cash equivalents that fund supplemental executive retirement plan and deferred compensation plan	\$ 739	\$ 739	\$	\$
Other assets assets that fund supplemental executive retirement plan	2,633	2,633		
Other assets deferred compensation plan investment in Sprouts	5,893	5,893		
Derivatives	656		656	
Financial liabilities				
Other long-term liabilities deferred compensation plan	(14,104)	(5,893)	(8,211)	
Total	\$ (4,183)	\$ 3,372	\$ (7,555)	\$

Level 1 Investments include money market funds of \$0.7 million, market index funds of \$2.6 million, and an investment in Sprouts of \$5.9 million. The fair values of these investments are based on quoted market prices in an active market.

Level 2 Assets and liabilities include \$8.2 million of deferred compensation liabilities, of which the fair value is based on quoted prices of similar assets traded in active markets, and \$0.7 million of derivatives, which are interest rate hedges. The fair values of the derivatives are primarily determined based on third-party pricing services with observable inputs, including interest rates and yield curves.

Certain assets are measured at fair value on a nonrecurring basis which means the assets are not measured at fair value on an ongoing basis but, rather, are subject to fair value adjustments only in certain circumstances (for example, when there is evidence of impairment). See Note 2, Summary of Significant Accounting Policies Property, Plant and Equipment, Capitalized Software and Goodwill and Intangible Assets. The fair value measurements were determined using available market capitalization rates and public comparable store sales data at the measurement dates. The Company classifies the measurements as Level 3.

7. Retirement Benefit Plans and Postretirement and Postemployment Benefit Obligations

Defined Benefit Retirement Plan

The Company has a funded noncontributory qualified defined benefit retirement plan (the Single-Employer Plan) that, prior to June 1, 2008, covered substantially all full-time employees following a vesting period of five years of service (the Pension Participants) and provided defined benefits based on years of service and final average salary. The Predecessor froze the accruing of future benefits for the Pension Participants (the Frozen Pension Participants) effective June 1, 2008, with the exception of approximately 450 hourly paid employees in the Company's distribution and transportation operations who remain eligible for pension benefits under the prior terms. No new employees are eligible for participation in the Single-Employer Plan after June 1, 2008, with the exception of new hires in the Company's eligible distribution and transportation operations. Frozen Pension Participants will continue to accrue service for vesting purposes only and future payments from the Single-Employer Plan will be in accordance with the Single-Employer Plan's retirement payment provisions. The Company funds the Single-Employer Plan with annual contributions as required by the Employee Retirement Income Security Act of 1974, as amended (ERISA). The Company uses a measurement date of December 31 for the Single-Employer Plan.

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The components included in the net periodic benefit cost for the periods indicated are as follows (in thousands):

	Twelve Weeks Ended			
	March 22, 2015		March 23, 2014	
Service cost	\$	281	\$	110
Interest cost		1,666		847
Expected return on plan assets		(1,816)		(910)
Amortization of net actuarial gain				(70)
Net periodic benefit cost	\$	131	\$	(23)

During the twelve weeks ended March 22, 2015, the Company made a \$0.4 million contribution to the Single-Employer Plan. The Company expects to fund a total minimum required contribution of \$7.3 million for fiscal year 2015.

Supplemental Executive Retirement Plan

The Company maintains a noncontributory, nonqualified defined benefit supplemental executive retirement plan (the SERP), which provides supplemental income payments for certain current and former corporate officers in retirement. No new participants are eligible for participation and service and compensation accruals were frozen effective June 1, 2008. Accordingly, the retirement benefit for SERP participants who remained employed by the Company was frozen, and future service or compensation increases will not adjust the SERP benefit amount.

To provide partial funding for the SERP, the Company invests in corporate-owned life insurance policies. The Company uses a measurement date of December 31 for the SERP.

The components included in the net periodic benefit cost for the periods indicated are as follows (in thousands):

	Twelve Weeks Ended			
	March 22, 2015		March 23, 2014	
Interest cost	\$	254	\$	277
Net periodic benefit cost	\$	254	\$	277

Postretirement and Postemployment Benefit Obligations

The Company provides health care benefits for certain retired employees. Prior to June 1, 2008, substantially all full-time employees could become eligible for such benefits if they reached retirement age while still working for the Company. The Company froze the accruing of benefits for eligible participants effective June 1, 2008. Participants who were eligible for a retiree medical benefit and retired prior to June 1, 2009 continued to be eligible for retiree medical coverage. The Company retains the right to make further amendments to the benefit formula

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and eligibility requirements. This postretirement health care plan is contributory with participants' contributions adjusted annually. The plan limits benefits to the lesser of the actual cost for the medical coverage selected or a defined dollar benefit based on years of service, applicable to eligible retirees. The Company uses a measurement date of December 31 for this health care plan.

The components included in the postretirement benefit cost for the periods indicated are as follows (in thousands):

	Twelve Weeks Ended	
	March 22, 2015	March 23, 2014
Service cost	\$ 92	\$ 74
Interest cost	162	154
Amortization of net actuarial gain		(15)
Net periodic benefit cost	\$ 254	\$ 213

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8. Income Taxes

The Company's effective tax rate for the twelve weeks ended March 22, 2015 and March 23, 2014 was 36.8% and 34.8%, respectively. The increase in the 2015 effective tax rate was primarily due to equity in earnings of a joint venture not subject to US tax and permanent differences relating to changes in the cash surrender value of corporate-owned life insurance policies, death benefit of corporate-owned life insurance policies and job credits.

The Company's policy is to accrue interest and penalties related to unrecognized tax benefits as a component of income tax expense. At March 22, 2015, the Company had accrued a liability for penalties and interest of \$0.3 million.

SFSI or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction, various U.S. state jurisdictions and Mexico. The Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2004.

The tax years which remain subject to examination or are being examined by major tax jurisdictions as of March 22, 2015 include fiscal years 2005 through 2014 for state purposes and 2007 through 2014 for federal purposes.

9. Share-Based Compensation

2014 Incentive Plan

Effective September 23, 2014, and in connection with the IPO, SFSI adopted the Smart & Final Stores, Inc. 2014 Stock Incentive Plan (the 2014 Incentive Plan), which provides for the issuance of equity-based incentive awards not to exceed 5,500,000 shares of Common Stock to eligible employees, consultants and non-employee directors in the form of stock options, restricted stock, other stock-based awards and performance-based cash awards. In addition, a number of shares of Common Stock equal to the number of shares of Common Stock underlying stock options that were previously issued under the 2012 Incentive Plan (as defined below) and that expire, terminate or are cancelled for any reason without being exercised in full will be available for issuance under the 2014 Incentive Plan.

Effective September 23, 2014, SFSI's board of directors and the compensation committee of SFSI's board of directors (the Compensation Committee) granted 458,645 shares of restricted stock to eligible employees under the 2014 Incentive Plan. These grants were awards with time-based vesting terms, and generally vest over four years, subject to continuous employment. The grant date fair value was \$12.00 per share of restricted stock based on the price of Common Stock sold in the IPO. During the twelve weeks ended March 22, 2015, the Compensation Committee granted an aggregate of 10,398 shares of restricted stock to eligible employees under the 2014 Incentive Plan. These grants were awards with time-based vesting terms, and vest over four years, subject to continuous employment. The grant date fair value was \$15.13 per share of restricted stock based on the closing stock price as reported on the New York Stock Exchange (NYSE). Also, as of March 22, 2015, a total of 10,832 shares of restricted stock related to the September 23, 2014 grant had been forfeited.

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Effective September 23, 2014, SFSI's board of directors and the Compensation Committee also granted stock options to purchase up to a total of 1,543,592 shares of Common Stock to certain management employees and non-employee directors under the 2014 Incentive Plan. The stock options have time-based vesting terms. These stock options collectively with the stock options to purchase up to 6,335,550 shares of Common Stock described below under 2012 Incentive Plan, are referred to herein as the Time-Based Options. Of the Time-Based Options granted on September 23, 2014, stock options to purchase up to 638,889 shares of Common Stock vest over a five-year period from the grant date, with 10% vesting on the first and second anniversaries of the grant date, 20% vesting on the third and fourth anniversaries of the grant date and 40% vesting on the fifth anniversary of the grant date, and stock options to purchase up to 524,999 shares of Common Stock vest over a five-year period from the grant date with 20% vesting at the end of each year. The remaining Time-Based Options granted (to purchase up to 379,704 shares of Common Stock) vest over a four-year period from the grant date with 25% vesting at the end of each year. All of the Time-Based Options granted have a 10-year term and are subject to continuous employment or service.

On September 22, 2014, stock options to purchase up to 821,370 shares of Common Stock previously granted on May 30, 2014 and June 6, 2014 under the 2012 Incentive Plan were cancelled and new grants of stock options to purchase up to 598,987 shares of Common Stock and 222,383 shares of restricted stock were granted to the same individuals under the 2014 Incentive Plan. These grants were awards with time-based vesting terms, and vest over various years from grant date with various percentages vesting at the end of each anniversary of the original grant dates through May 30, 2019. These grants under the 2014

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Incentive Plan are in addition to the aforementioned grants of 458,645 shares of restricted stock and aforementioned grants of stock options to purchase up to 1,543,592 shares of Common Stock. On February 5, 2015, SFSI's board of directors authorized and approved the modification of the vesting terms and amounts to be vested of certain grants. As a result of the modification, stock options to purchase up to 210,875 shares of Common Stock and 69,375 shares of restricted stock vest over a five-year period with 20% vesting at the end of each anniversary of the original grant dates through March 3, 2019 or May 30, 2019, as applicable.

The following table summarizes the restricted stock award activity under the 2014 Incentive Plan for the twelve weeks ended March 22, 2015:

	Shares	Weighted-Average Grant Date Fair Value
Outstanding at December 28, 2014	681,028	\$ 12.00
Granted	10,398	15.13
Forfeited	(10,832)	12.00
Vested	(11,249)	12.00
Outstanding at March 22, 2015	669,345	\$ 12.05

The Company recorded share-based compensation expense related to the restricted stock awards of \$0.7 million for the twelve weeks ended March 22, 2015. As of March 22, 2015, the unrecognized compensation cost was \$5.3 million and related weighted-average period over which restricted stock award expense was expected to be recognized was 2.09 years.

The following table summarizes the Time-Based Option activity under the 2014 Incentive Plan for the twelve weeks ended March 22, 2015, dollars in thousands except weighted average exercise price:

	Shares	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at December 28, 2014	2,131,468	\$ 12.00		
Granted				
Forfeited				
Exercised				
Expired				
Outstanding at March 22, 2015	2,131,468	\$ 12.00	9.52 years	\$ 13,300
Exercisable at March 22, 2015	36,249	\$ 12.00	9.52 years	\$ 226

Aggregate intrinsic value represents the difference between the closing stock price of the Common Stock and the exercise price of outstanding, in-the-money options. The closing stock price of the Common Stock as reported on the NYSE as of March 20, 2015 was \$18.24.

The Company recorded share-based compensation expense for Time-Based Options granted under the 2014 Incentive Plan of \$0.8 million for the twelve weeks ended March 22, 2015. As of March 22, 2015, the unrecognized compensation cost was \$6.8 million and related weighted-average period over which Time-Based Option expense was expected to be recognized was 2.57 years.

2012 Incentive Plan

Effective November 15, 2012, SFSI adopted the SF CC Holdings, Inc. 2012 Stock Incentive Plan (the 2012 Incentive Plan), which provides for the issuance of equity-based incentive awards not to exceed 11,400,000 shares of Common Stock. Effective upon closing of the IPO, no new awards may be granted under the 2012 Incentive Plan.

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The following table summarizes the Time-Based Option activity under the 2012 Incentive Plan for the twelve weeks ended March 22, 2015, dollars in thousands except weighted average exercise price:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at December 28, 2014	5,354,200	\$ 6.58	8.11 years	\$ 47,224
Forfeited	(24,396)	6.58		
Exercised	(16,264)	6.58		
Cancelled				
Expired				
Outstanding at March 22, 2015	5,313,540	\$ 7.14	7.88 years	\$ 58,980
Exercisable at March 22, 2015	2,125,416	\$ 6.58	7.88 years	\$ 24,782

Under the 2012 Incentive Plan and the Company's standard form of stock option award agreement for the 2012 Incentive Plan, the Company had a right to repurchase from the participant all or a portion of the shares of Common Stock issued upon the exercise of a stock option prior to the IPO. For Common Stock issued upon exercise of such stock options granted pursuant to such standard form of stock option award agreement, if a participant's employment was terminated for cause or due to a voluntary termination for any reason, or upon the discovery that the participant engaged in detrimental activity, the repurchase price of such shares of Common Stock was the lesser of the exercise price paid by the participant to exercise the stock option and the fair market value of the Common Stock as of the date of termination or the date on which such detrimental activity occurred, as applicable. If the Company elected to exercise its repurchase rights, it was required to do so within the one-year period commencing on the later of (i) the date of termination and (ii) the date on which the applicable stock option was exercised. Prior to the IPO, Time-Based Options to purchase up to 3,586,820 shares of Common Stock (out of the total Time-Based Options to purchase up to 6,335,550 shares of Common Stock) were subject to such repurchase rights. If the Company exercised such repurchase right at the lesser of the exercise price paid by the participant to exercise the stock option and the fair market value of the Common Stock as of the date of termination, the participant would receive no monetary benefit from such exercise of his or her stock option. Accordingly, as it was not assured nor probable that participants would realize any monetary benefit from the exercise of such stock options, the Company (i) did not record any share-based compensation expense for these stock options prior to the IPO and (ii) was unable to determine the time period over which share-based compensation expense would be recognized. As a result of the IPO and the related termination of various restrictions on the transfer of Common Stock, it was determined that the Company's repurchase right is no longer in effect. Accordingly, as of the consummation of the IPO, it was considered probable that the participants could realize monetary benefit from the exercise of such stock options, and the Company started recording share-based compensation expense related to these option grants, including a one-time catch-up of share-based compensation expense of \$4.5 million from grant date up through the date of the IPO. The Company recorded share-based compensation expense for these Time-Based Options granted under the 2012 Incentive Plan of \$0.3 million for the twelve weeks ended March 22, 2015. As of March 22, 2015, the unrecognized compensation cost was \$1.7 million and related weighted-average period over which Time-Based Option expense was expected to be recognized was 2.40 years.

In connection with the Ares Acquisition on November 15, 2012, certain stock options to purchase shares of common stock of the Predecessor were converted into 3,625,580 stock options to purchase Common Stock (the Rollover Options). For Common Stock issued upon exercise of a Rollover Option, prior to the IPO, the repurchase price was the fair market value of the Common Stock on the date of termination. In the event of a participant's termination of employment for cause or upon discovery that the participant engaged in detrimental activity, if the Company elected to exercise its repurchase right, it was required to do so within a 180-day period commencing on the later of (i) the date of termination and (ii) the date on which such Rollover Option was exercised. In the event of a participant's termination of employment for any other reason, the repurchase right was required to be exercised by the Company during the 90-day period following the date of termination. All Rollover Options were fully vested. The weighted-average exercise price of the Rollover Options was \$2.26. As of March 22, 2015, the weighted-average remaining contractual term was 2.84 years. The aggregate intrinsic value was \$43.2 million.

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10. Accumulated Other Comprehensive Loss

The following table represents the changes in AOCI by each component, net of tax, for the twelve weeks ended March 22, 2015 (in thousands):

	Defined Benefit Retirement Plan	Cash Flow Hedging Activity	Foreign Currency Translation	Total
Balance at December 28, 2014	\$ (3,956)	\$ 385	\$ (846)	\$ (4,417)
OCI before reclassification		(1,372)	(615)	(1,987)
Amounts reclassified out of AOCI		(13)		(13)
Net current period OCI		(1,385)	(615)	(2,000)
Balance at March 22, 2015	\$ (3,956)	\$ (1,000)	\$ (1,461)	\$ (6,417)

The following table represents the items reclassified out of each component of AOCI and the related tax effects for the twelve weeks ended March 22, 2015 (in thousands).

Details about AOCI Components	Amount Reclassified from AOCI	Location within Statement of Operations and Comprehensive Income
Loss on cash flow hedges		
Interest rate swaps	\$	(22) Interest expense, net
		(22) Total before income tax
		9 Income tax benefit
	\$	(13) Reclassification adjustments, net of tax
Total reclassifications for the twelve weeks ended March 22, 2015	\$	(13) Total reclassifications, net of tax

11. Segment Information

The Company is a value-oriented retailer serving a diverse demographic of household and business customers through two complementary store banners. The Smart & Final business focuses on both household and business customers, and the Cash & Carry business focuses primarily on restaurants, caterers and a wide range of other foodservice businesses. The Company's chief operating decision maker regularly reviews the operating performance of each of the store banners including measures of performance based on income (loss) from operations. The Company considers each of the store banners to be an operating segment and has further concluded that presenting disaggregated information of these two operating segments provides meaningful information as certain economic characteristics are dissimilar as well as the characteristics of the customer base served.

The Corporate/Other category is comprised primarily of corporate overhead support expenses and administrative expenses incidental to the activities of the reportable segments.

For the twelve weeks ended March 22, 2015, the operating information for the reportable segments is shown as follows (in thousands):

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	Smart & Final	Cash & Carry	Corporate / Other	Consolidated
Net sales	\$ 628,836	\$ 193,334	\$	\$ 822,170
Cost of sales, distribution and store occupancy	530,620	167,307	2,078	700,005
Operating and administrative expenses	78,247	13,887	14,817	106,951
Income (loss) from operations	\$ 19,969	\$ 12,140	\$ (16,895)	\$ 15,214
As of March 22, 2015:				
Total assets	\$ 1,577,299	\$ 271,651	\$ (116,890)	\$ 1,732,060
Intercompany receivable (payable)	\$ 247,935	\$ (63,500)	\$ (184,435)	\$
Investment in joint venture	\$	\$	\$ 11,824	\$ 11,824
Goodwill	\$ 406,662	\$ 204,580	\$	\$ 611,242
For the twelve weeks ended March 22, 2015:				
Capital expenditures	\$ 20,867	\$ 1,678	\$ 1,838	\$ 24,383
Depreciation and amortization	\$ 11,879	\$ 677	\$ 1,945	\$ 14,501

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For the twelve weeks ended March 23, 2014, the operating information for the reportable segments is shown as follows (in thousands):

	Smart & Final	Cash & Carry	Corporate / Other	Consolidated
Net sales	\$ 561,942	\$ 173,074	\$	\$ 735,016
Cost of sales, distribution and store occupancy	478,359	150,273	1,795	630,427
Operating and administrative expenses	67,588	12,302	12,468	92,358
Income (loss) from operations	\$ 15,995	\$ 10,499	\$ (14,263)	\$ 12,231
For the twelve weeks ended March 23, 2014:				
Capital expenditures	\$ 12,195	\$ 128	\$ 1,921	\$ 14,244
Depreciation and amortization	\$ 10,844	\$ 860	\$ 2,316	\$ 14,019

12. Commitments and Contingencies

Legal Actions

The Company is engaged in various legal actions, claims and proceedings in the ordinary course of business, including claims related to employment related matters, breach of contracts, products liabilities and intellectual property matters resulting from its business activities. The Company does not believe that the ultimate determination of these actions, claims and proceedings will either individually or in the aggregate have a material adverse effect on its consolidated results of operations or financial position.

13. Stockholders Equity

On September 19, 2014, SFSI's board of directors and stockholders approved a 190-for-one stock split of SFSI's outstanding Common Stock and increased the total number of shares that SFSI was authorized to issue to up to 340,000,000 shares of Common Stock and 10,000,000 shares of preferred stock. The accompanying financial statements and notes to the financial statements give retroactive effect to the stock split for all periods presented.

On September 29, 2014, the Company completed its IPO, pursuant to which it sold an aggregate of 15,467,500 shares of Common Stock after giving effect to the underwriters' exercise in full of their option to purchase additional shares at a price of \$12.00 per share. The Company received gross proceeds from the IPO of approximately \$185.6 million, or \$167.7 million after deducting underwriting discounts and commissions of \$12.5 million and other offering expenses of approximately \$5.4 million. The Company used \$115.5 million of the net proceeds from the IPO to make a partial repayment of the Term Loan Facility. See Note 4, Debt.

14. Earnings Per Share

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Basic earnings per share represents net income for the period shares of Common Stock were outstanding, divided by the weighted average number of shares of Common Stock outstanding for the applicable period. Diluted earnings per share represents net income divided by the weighted average number of shares of Common Stock outstanding for the applicable period, inclusive of the effect of dilutive securities such as outstanding stock options.

A reconciliation of the numerators and denominators of the basic and diluted earnings per share calculations is as follows (in thousands, except per share amounts):

	Twelve Weeks Ended	
	March 22, 2015	March 23, 2014
Net income	\$ 4,883	\$ 2,507
Weighted average shares outstanding for basic EPS	73,084,282	57,171,190
Effect of dilutive securities:		
Assumed exercise of time-based stock options	3,569,999	2,324,080
Weighted average shares and share equivalents outstanding for diluted EPS	76,654,281	59,495,270
Basic earnings per share	\$ 0.07	\$ 0.04
Diluted earnings per share	\$ 0.06	\$ 0.04

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Potentially dilutive securities representing 1,634,866 shares of Common Stock for the twelve weeks ended March 22, 2015 were excluded from the computation of diluted earnings per share because their effect would have been antidilutive. There were no securities potentially dilutive to the Common Stock for the twelve weeks ended March 23, 2014 that were excluded from the computation of diluted earnings per share because their effect would have been antidilutive.

15. Subsequent Events

No subsequent events were identified impacting the unaudited condensed consolidated financial statements as presented.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with Item 1, Financial Statements in Part I of this quarterly report on Form 10-Q.

Forward-Looking Statements

The discussion in this quarterly report, including under Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations of Part I and Item 1A, Risk Factors of Part II, contains forward-looking statements within the meaning of federal securities laws. All statements other than statements of historical fact contained in this quarterly report, including statements regarding our future operating results and financial position, business strategy and plans and objectives of management for future operations, are forward-looking statements. In many cases, you can identify forward-looking statements by terms such as may, should, expects, plans, anticipates, could, intends, target, contemplates, believes, estimates, predicts, potential or continue or the negative of these terms or other similar expressions.

The forward-looking statements contained in this quarterly report reflect our views as of the date hereof about future events and are subject to risks, uncertainties, assumptions and changes in circumstances that may cause our actual results, performance or achievements to differ significantly from those expressed or implied in any forward-looking statement. Although we believe that the expectations reflected in the forward-looking statements in this quarterly report are reasonable, we cannot guarantee future events, results, performance or achievements. A number of important factors could cause actual results to differ materially from those indicated by the forward-looking statements in this quarterly report, including, without limitation, those factors described in Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations of Part I and Item 1A, Risk Factors of Part II. Some of the key factors that could cause actual results to differ from our expectations include the following:

- competition in our industry is intense and our failure to compete successfully may adversely affect our sales, financial condition and operating results;

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- our continued growth depends on new store openings and our failure to successfully open new stores could adversely affect our business and stock price;
- real or perceived quality or food safety concerns could adversely affect our business, operating results and reputation;
- we may be unable to maintain or increase comparable store sales, which could adversely affect our business and stock price;
- the current geographic concentration of our stores and our net sales creates an exposure to local or regional downturns or catastrophic occurrences;
- disruption of significant supplier relationships could adversely affect our business;
- any significant interruption in the operations of our distribution centers or common carriers could disrupt our ability to deliver our products in a timely manner;
- our failure to comply with laws, rules and regulations affecting us and our industry could adversely affect our financial condition and operating results;

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- disruptions to or security breaches involving our information technology systems could harm our ability to run our business;
- we have significant debt service obligations and may incur additional indebtedness in the future, which could adversely affect our financial condition and operating results and our ability to react to changes to our business; and
- covenants in our debt agreements restrict our operational flexibility.

Readers are urged to consider these factors carefully in evaluating the forward-looking statements in this quarterly report and are cautioned not to place undue reliance on these forward-looking statements. All of the forward-looking statements in this quarterly report are based on information available to us on the date hereof. We undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise, except as otherwise required by law.

Business Overview

We are a high-growth, value-oriented food retailer serving a diverse demographic of household and business customers through two complementary and highly productive store banners: *Smart & Final* and *Cash & Carry*. As of March 22, 2015, we operated 258 non-membership, warehouse-style stores throughout the Western United States, with an additional 15 stores in Northwestern Mexico in a joint venture. We have a differentiated merchandising strategy that emphasizes high quality perishables, a wide selection of private label products, products tailored to business and foodservice customers and products offered in a broad range of sizes.

We consider each of our store banners to be an operating segment, and have concluded that presenting disaggregated information for our two operating segments provides meaningful information because of differences in their respective economic characteristics and customer bases. For both of the twelve weeks ended March 22, 2015 and the twelve weeks ended March 23, 2014, our *Smart & Final* and *Cash & Carry* segments represented approximately 76.5% and 23.5%, respectively, of our consolidated sales.

Our *Smart & Final* segment is based in Commerce, California and includes, as of March 22, 2015, 103 legacy *Smart & Final* stores and 102 *Extra!* format stores, which focus on household and business customers and are located in California, Arizona and Nevada. Our *Smart & Final* stores offer extensive selections of fresh perishables and everyday grocery items, together with a targeted selection of foodservice, packaging and janitorial products, under both national and private label brands. Our *Extra!* store format offers a one-stop shopping experience with a more expansive selection of items than our legacy *Smart & Final* stores and an emphasis on perishables and household items. The continued development of our *Extra!* store format, through additional new store openings and conversions and relocations of legacy *Smart & Final* stores, is the cornerstone of our growth strategy.

Our *Cash & Carry* segment is based in Portland, Oregon and includes, as of March 22, 2015, 53 *Cash & Carry* stores, which focus primarily on business customers and are located in Washington, Oregon, Northern California, Idaho and Nevada. Our *Cash & Carry* stores offer a wide variety of SKUs tailored to the core needs of foodservice customers such as restaurants, caterers and a wide range of other foodservice

businesses in a flexible mix of case quantity or single unit purchases.

Outlook

We plan to expand our store footprint, primarily through opening new *Extra!* stores in existing and adjacent markets, and by entering new markets. We believe we have a scalable operating infrastructure to support our anticipated growth which, together with our flexible real estate strategy and advanced distribution capabilities, position us to capitalize on our growth opportunities. We plan to continue converting our larger legacy *Smart & Final* stores to our *Extra!* format and investing in our legacy *Smart & Final* stores that are not candidates for conversion to the *Extra!* format by completing major remodel projects and targeted relocations. We also plan to opportunistically grow our *Cash & Carry* store footprint.

In addition, we plan to leverage our significant investments in management, information technology systems, infrastructure and marketing to grow our comparable store sales and enhance our operating margins through execution of a number of key initiatives, including initiatives to increase net sales of perishable products in our *Smart & Final* stores, to increase net sales of private label products in our *Smart & Final* and *Cash & Carry* stores, and to expand our marketing programs in our *Smart & Final* and *Cash & Carry* stores. We expect each of these key initiatives, if successful, to generate increased comparable store sales and also expect our initiative to increase net sales of private label products to enhance our operating margins, as private label products have historically generated higher gross margins relative to national branded products.

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Factors Affecting Our Results of Operations

Various factors affect our results of operations during each period, including:

Store Openings

We expect that a primary driver of our growth in sales and gross margin will be the continued development of our *Extra!* format stores through new store openings, conversions and relocations. We also plan to opportunistically open new *Cash & Carry* stores, which will further amplify sales and gross margin. Our results of operations have been and will continue to be materially affected by the timing and number of new store openings, including conversions and relocations of legacy *Smart & Final* stores to the *Extra!* format, and the amount of associated costs. For example, we typically incur higher than normal employee costs at the time of a new store opening, conversion or relocation associated with set-up and other related costs. Also, our operating margins are typically negatively affected by promotional discounts and other marketing costs associated with new store openings, conversions and relocations, as well as higher inventory markdowns and costs related to hiring and training new employees in new stores. Additionally, promotional activities may result in higher than normalized sales in the first several weeks following a new store opening. Our new *Extra!* and *Cash & Carry* stores typically build a customer base over time and reach a mature sales growth rate in the third and fourth year after opening, respectively. As a result, our new stores generally have lower margins and higher operating expenses, as a percentage of sales, than our more mature stores.

Based on our experience, we expect that certain of our new *Extra!* stores will impact sales at our existing stores in close proximity in the short term. However, we believe that over the longer term any such sales impact will be more than offset by future sales growth and expanded market share.

Developments in Competitive Landscape

We operate in the highly competitive food retail and foodservices industries. We compete on a combination of factors, including price, product selection, product quality, convenience, customer service, store format and location. Our principal competitors include conventional grocers such as Albertsons, Kroger and Safeway, discounters and warehouse clubs such as Costco, mass merchandisers such as Walmart and Target, foodservice delivery companies such as Sysco and US Foods, as well as online retailers and other specialty stores. Some of our competitors may have greater financial or marketing resources than we do and may be able to devote greater resources to sourcing, promoting and selling their products. These competitors could use these advantages to take certain measures, including reducing prices that could adversely affect our competitive position, business, financial condition and operating results.

Pricing Strategy and Investments in Everyday Low Prices

We have a commitment to everyday low prices, which we believe positions both our *Smart & Final* and *Cash & Carry* stores as top of mind destinations for our target customers. Pricing in our *Smart & Final* stores is targeted to be substantially lower than that of conventional grocers and competitive with that of large discounters and warehouse clubs, with no membership fee requirement. Pricing in our *Cash & Carry* stores is

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targeted to be substantially lower than our foodservice delivery competitors, with no membership fee requirement and greater price transparency to customers and no minimum order size, and competitive with typical warehouse clubs.

Our pricing strategy is geared toward optimizing the pricing and promotional activities across our mix of higher-margin perishable items and everyday value-oriented traditional grocery items. This strategy involves determining prices that will improve our operating margins based upon our analysis of how demand varies at different price levels as well as our costs and inventory levels.

Expanded Private Label Offerings

Private label products are key components of our pricing and merchandising strategy, as we believe they build and deepen customer loyalty, enhance our value proposition, generate higher gross margins relative to national brands and improve the breadth and selection of our product offering. We believe that a strong private label offering has become an increasingly important competitive advantage in the food retail and foodservices industries.

As of the March 22, 2015, we had a portfolio of approximately 3,000 private label items, which represented 29% of our *Smart & Final* banner sales for fiscal year 2014. Typically, our private label products generate a higher gross margin as a percentage of sales as compared to a comparable national brand product.

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General Economic Conditions and Changes in Consumer Behavior

The overall economic environment in the markets we serve, particularly California, and related changes in consumer behavior, have a significant impact on our business and results of operations. In general, positive conditions in the broader economy promote customer spending in our stores, while economic weakness results in reduced customer spending. Macroeconomic factors that can affect customer spending patterns, and thereby our results of operations, include employment rates, business conditions, changes in the housing market, the availability of consumer credit, interest rates, tax rates and fuel and energy costs.

Infrastructure Investment

Our historical results of operations reflect the impact of our ongoing investments in infrastructure to support our growth. We have made significant investments in senior management, information technology systems, supply chain systems and marketing. These investments include significant additions to our personnel, including experienced industry executives and management and merchandising teams to support our long-term growth objectives. We plan on continuing to make targeted investments in our infrastructure as necessary to support our growth.

Inflation and Deflation Trends

Inflation and deflation can impact our financial performance. During inflationary periods, our results of operations can be positively impacted in the short term, as we sell lower-priced inventory in a higher price environment. Over the longer term, the impact of inflation is largely dependent on our ability to pass through product cost increases to our customers, which is subject to competitive market conditions. In recent inflationary periods, we have generally been able to pass through most cost increases. We began to experience food inflation starting in early fiscal year 2012, particularly in some commodity driven categories, although we were generally able to pass through the effect of these higher prices. Food inflation moderated in early fiscal year 2013 and was essentially flat through the remainder of calendar year 2013. Food inflation rose sharply in the first half of 2014, but moderated in the second half of 2014 and through the first quarter of 2015.

Components of Results of Operations

Net Sales

We recognize revenue from the sale of products at the point of sale. Discounts provided to customers at the time of sale are recognized as a reduction in sales as the products are sold. Sales tax collections are presented in the statement of operations and comprehensive income on a net basis and, accordingly, are excluded from reported sales revenues. Proceeds from the sale of our *Smart & Final* gift cards are recorded as a liability at the time of sale, and recognized as sales when they are redeemed by the customer. Our *Smart & Final* gift cards do not have an expiration date. We have not recorded any unredeemed gift card revenue or breakage related to our gift card program.

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We regularly review and monitor comparable store sales growth to evaluate and identify trends in our sales performance. With respect to any fiscal period during any year, comparable store sales include sales for stores operating both during such fiscal period in such year and in the same fiscal period of the previous year. Sales from a store will be included in the calculation of comparable store sales after the 60th full week of operations, and sales from a store are also included in the calculation of comparable store sales if (i) the store has been physically relocated, (ii) the selling square footage has been increased or decreased or (iii) the store has been converted to a new format within a store banner (e.g., from a legacy *Smart & Final* store to the *Extra!* format). However, sales from an existing store will not be included in the calculation of comparable store sales if the store has been converted to a different store banner (e.g., from *Smart & Final* to *Cash & Carry*).

Cost of Sales, Buying and Occupancy and Gross Margin

The major categories of costs included in cost of sales, buying and occupancy are cost of goods sold, distribution costs, costs of our buying department and store occupancy costs, net of earned vendor rebates and other allowances. Distribution costs consist of all warehouse receiving and inspection costs, warehousing costs, all transportation costs associated with shipping goods from our warehouses to our stores, and other costs of our distribution network. Store occupancy costs include store rental, common area maintenance, property taxes, property insurance, and depreciation.

Gross margin represents sales less cost of sales, buying and occupancy. Our gross margin may not be comparable to other retailers, since not all retailers include all of the costs related to their distribution network in cost of sales like we do. Some retailers exclude a portion of these costs (e.g., store occupancy and buying department costs) from cost of sales and include them in selling, general and administrative expenses.

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Our cost of sales, buying and occupancy expense and gross margin are correlated to sales volumes. As sales increase, gross margin is affected by the relative mix of products sold, pricing strategies, inventory shrinkage and improved leverage of fixed costs.

Operating and Administrative Expenses

Operating and administrative expenses include direct store-level expenses associated with displaying and selling our products at the store level, including salaries and benefits for our store work force, fringe benefits, store supplies, advertising and marketing and other store-specific costs. Operating and administrative expenses also consist of store overhead costs and corporate administrative costs including salaries and benefits costs, share-based compensation, corporate occupancy costs and amortization expense.

We expect that our operating and administrative expenses will increase in future periods as a result of additional legal, accounting, insurance and other expenses associated with being a public company and increases resulting from our store development program, including the growth in the number of our stores, as well as increased share-based compensation expense related to equity awards granted to our directors and eligible employees under the 2014 Incentive Plan as explained elsewhere in this quarterly report.

Income Tax Provision

We are subject to federal income tax as well as state income tax in various jurisdictions of the United States in which we conduct business. Income taxes are accounted for under the asset and liability method.

Equity in Earnings of Mexico Joint Venture

Our wholly owned subsidiary, Smart & Final de Mexico S.A. de C.V., is a Mexican holding company that owns a 50% interest in a joint venture. The remaining 50% of the joint venture is owned by Grupo Calimax S.A. de C.V., an entity comprising the investment interests of a family group who are also the owners of the Calimax grocery store chain in Mexico. As of March 22, 2015, this joint venture operated 15 *Smart & Final* stores in Northwestern Mexico, which are similar in concept to our legacy *Smart & Final* stores. This joint venture operates as a Mexican domestic corporation under the name Smart & Final del Noroeste, S.A. de C.V. Our interest in this joint venture is not consolidated and is reported using the equity method of accounting.

Factors Affecting Comparability of Results of Operations

Term Loan Facility Amendments

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Our interest expense in any particular period is impacted by our overall level of indebtedness during that period and by changes in the applicable interest rates on such indebtedness. In connection with the Ares Acquisition, we entered into the Term Loan Facility and the Second Lien Term Loan Facility, consisting of \$525.0 million and \$195.0 million of term indebtedness, respectively, and our \$150.0 million Revolving Credit Facility.

During the second quarter of 2013, we amended the Term Loan Facility to reduce the applicable margin from 4.50% to 3.50% and reduce the Adjusted LIBOR floor rate from 1.25% to 1.00%. Additionally, we increased the size of the Term Loan Facility by \$55.0 million through an incremental facility, and used the proceeds of this borrowing to reduce the borrowings outstanding under the Second Lien Term Loan Facility by \$55.0 million. We recorded a \$7.1 million loss on the early extinguishment of debt in the second quarter of 2013.

During the fourth quarter of 2013, we amended the Term Loan Facility to increase the applicable margin from 3.50% to 3.75% and reduce the size of the incremental borrowing facilities that can be incurred without regard to leverage-based limitations from \$125.0 million to \$75.0 million. Additionally, we increased the size of the Term Loan Facility by \$140.0 million through an incremental facility, and used the proceeds of this borrowing to repay all amounts outstanding under the Second Lien Term Loan Facility, which was then terminated. We recorded a \$17.3 million loss on the early extinguishment of debt in the fourth quarter of 2013.

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On September 29, 2014, the Company used the net proceeds from the IPO to repay borrowings of approximately \$115.5 million under the Term Loan Facility. Consequently, the Company recorded a loss on the early extinguishment of debt of \$2.2 million related to the write-off of unamortized debt discount and deferred financing costs during the third quarter and ended October 5, 2014. Quarterly amortization of the principal amount is no longer required.

Initial Public Offering

On September 29, 2014, we completed an initial public offering of our Common Stock, pursuant to which we sold an aggregate of 15,467,500 shares of Common Stock, after giving effect to the underwriters' exercise in full of their option to purchase additional shares, at a price of \$12.00 per share. We received aggregate net proceeds of \$167.7 million after deducting underwriting discounts and commissions and other offering expenses. We used the net proceeds to repay borrowings of \$115.5 million under the Term Loan Facility and we expect to use the remainder to fund growth initiatives and for general corporate purposes.

Basis of Presentation

Our fiscal year is the 52- or 53-week period ending on the Sunday closest to December 31. Each of our 52-week fiscal years consists of twelve-week periods in the first, second and fourth quarters of the fiscal year and a sixteen-week period in the third quarter. Our last three completed fiscal years ended on December 28, 2014, December 29, 2013 and December 30, 2012.

All of the earnings per share data, share numbers, share prices, and exercise prices have been adjusted on a retroactive basis for all periods to reflect the 190-for-one stock split effected on September 19, 2014.

Table of Contents**Results of Operations**

The following table summarizes key components of our results of operations for the periods indicated, both in dollars and as a percentage of sales.

Consolidated Statement of Operations Data

	Twelve Weeks Ended			
	March 22, 2015		March 23, 2014	
	(Dollars in Thousands, Except Per Share Amounts)			
Net sales	\$ 822,170	100.0%	\$ 735,016	100.0%
Cost of sales, buying and occupancy	700,005	85.1%	630,427	85.8%
Gross margin	122,165	14.9%	104,589	14.2%
Operating and administrative expenses	106,951	13.0%	92,358	12.6%
Income from operations	15,214	1.9%	12,231	1.7%
Interest expense, net	7,998	1.0%	8,836	1.2%
Equity in earnings of joint venture	515	0.1%	452	0.1%
Income before income taxes	7,731	0.9%	3,847	0.5%
Income tax provision	(2,848)	-0.3%	(1,340)	-0.2%
Net income	\$ 4,883	0.6%	\$ 2,507	0.3%

Per Share Data:

Basic earnings per share	\$ 0.07	\$ 0.04
Diluted earnings per share	\$ 0.06	\$ 0.04

Other Operating Data

Comparable store sales growth	6.1%	4.2%
Smart & Final banner	4.9%	3.6%
Cash & Carry banner	10.2%	6.1%
Stores at end of period	258	241
Smart & Final banner	205	189
Extra! format	102	70
Cash & Carry banner	53	52

*Twelve weeks Ended March 22, 2015 Compared to the Twelve Weeks Ended March 23, 2014**Net Sales*

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Net sales for the twelve weeks ended March 22, 2015 increased \$87.2 million, or 11.9%, to \$822.2 million as compared to \$735.0 million for the twelve weeks ended March 23, 2014. This increase in net sales was attributable to comparable store sales growth of \$44.9 million in our store banners, and the net sales of \$42.2 million from the opening of four new stores in the twelve weeks ended March 22, 2015 and 14 new stores in 2014.

Comparable store sales for the twelve weeks ended March 22, 2015 increased 6.1% as compared to the twelve weeks ended March 23, 2014. This increase in comparable store sales was attributable to an increase of 4.2% in comparable transaction count and an increase of 1.9% in comparable average transaction size.

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For the twelve weeks ended March 22, 2015, net sales for our *Smart & Final* segment increased \$66.9 million, or 11.9%, to \$628.8 million as compared to \$561.9 million for the twelve weeks ended March 23, 2014. Comparable store sales for our *Smart & Final* segment increased 4.9% as compared to the twelve weeks ended March 23, 2014, primarily attributable to increases in both comparable transaction count of 4.1% and comparable transaction size of 0.8%.

For the twelve weeks ended March 22, 2015, net sales for our *Cash & Carry* segment increased \$20.3 million, or 11.7%, to \$193.3 million as compared to \$173.1 million for the twelve weeks ended March 23, 2014. Comparable store sales for our *Cash & Carry* segment increased 10.2% as compared to the twelve weeks ended March 23, 2014, primarily attributable to increases in both comparable transaction count of 5.1% and comparable transaction size of 4.8%.

Gross Margin

Gross margin for the twelve weeks ended March 22, 2015 increased \$17.6 million, or 16.8%, to \$122.2 million as compared to \$104.6 million for the twelve weeks ended March 23, 2014. The increase in gross margin attributable to increased sales was \$12.4 million and the increase in gross margin attributable to increased gross margin rate was \$5.2 million. As a percentage of sales, gross margin was 14.9% for the twelve weeks ended March 22, 2015 and 14.2% for the twelve weeks ended March 23, 2014. Compared to the twelve weeks ended March 23, 2014, gross margin as a percentage of sales for the twelve weeks ended March 22, 2015 included higher merchandise product margin rates (including the effect of inventory losses) as a percentage of sales (accounting for an increase of 0.44%, including a 0.48% increase in our *Smart & Final* segment partially offset by a 0.04% decrease in our *Cash & Carry* segment), as well as decreased warehouse and transportation costs as a percentage of sales (accounting for an 0.11% decrease, including a 0.08% decrease in our *Smart & Final* segment and a 0.03% decrease in our *Cash & Carry* segment). Store occupancy costs as a percentage of sales decreased 0.09% including a 0.02% decrease in our *Smart & Final* segment and a 0.07% decrease in our *Cash & Carry* segment, reflecting the relatively fixed nature of these costs.

Operating and Administrative Expenses

Operating and administrative expenses for the twelve weeks ended March 22, 2015 increased \$14.6 million, or 15.8%, to \$107.0 million, as compared to \$92.4 million for the twelve weeks ended March 23, 2014. This increase in operating and administrative expenses was primarily due to \$7.8 million of increased wages, fringe benefits and incentive bonus costs, \$0.8 million of increased marketing costs in support of our increased sales and other marketing initiatives, \$3.7 million of increased other store direct expenses, \$2.4 million of share-based compensation expense associated with our equity compensation program and \$1.4 million increased other expenses. Partially offsetting these increases was a \$1.4 million reduction in consulting costs associated with long-range store development planning (including remodels of our legacy *Smart & Final* stores and conversions of legacy *Smart & Final* stores to our *Extra!* format). As a percentage of sales, operating and administrative expenses for the twelve weeks ended March 22, 2015 increased 0.4% to 13.0% as compared to 12.6% for the twelve weeks ended March 23, 2014. Approximately 0.29% of the increase in operating and administrative expenses as a percentage of sales was due to the recognition of share-based compensation expense associated with our equity compensation program, 0.17% of the increase was due to increased wages, benefits and incentive bonuses (including 0.17% increase in our *Smart & Final* segment partially offset by a 0.01% decrease in our *Cash & Carry* segment). Additionally, 0.17% of the increase was due to increased other store direct expenses in our *Smart & Final* segment. These increases were partially offset by a 0.20% reduction in consulting costs associated with long-range store development planning.

Interest Expense, Net

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Interest expense for the twelve weeks ended March 22, 2015 decreased \$0.8 million, or 9.5%, to \$8.0 million as compared to \$8.8 million for the twelve weeks ended March 23, 2014. This decrease in interest expense was due to lower average debt outstanding, partially offset by a higher average effective interest rate. The increase in the average effective interest rate was primarily due to interest expense associated with an interest rate swap contract.

Income Tax Provision

Our income tax provision for the twelve weeks ended March 22, 2015 increased \$1.5 million to \$2.8 million as compared to \$1.3 million for the twelve weeks ended March 23, 2014. The effective income tax rate, excluding the equity in earnings of our joint venture, for both of the twelve week periods ended March 22, 2015 and March 23, 2014 was 39.5%.

Equity in Earnings of Joint Venture

Equity in earnings of our joint venture was \$0.5 million for both of the twelve week periods ended March 22, 2015 and March 23, 2014.

Table of Contents**Liquidity and Capital Resources**

Historically, our primary source of liquidity has been cash flows from operations. Additionally, we have the availability to make borrowings under our Credit Facilities. Our primary uses of cash are for purchases of inventory, operating expenses, capital expenditures primarily for opening, converting or remodeling stores and debt service. As of March 22, 2015, we had no amounts drawn under our Revolving Credit Facility and \$124.1 million of cash and cash equivalents.

The following table sets forth the major sources and uses of cash for each of the periods set forth below, as well as our cash and cash equivalents at the end of each period.

(dollars in thousands)	Twelve Weeks Ended March 22, 2015		Twelve Weeks Ended March 23, 2014	
Cash and cash equivalents at end of period	\$	124,077	\$	69,876
Cash provided by operating activities		38,067		32,524
Cash used in investing activities		(20,754)		(14,268)
Cash used in financing activities		(83)		(2,079)

Operating Activities

Cash flows from operating activities consist of net income adjusted for non-cash items including depreciation and amortization, deferred taxes and the effect of working capital changes. The increase or decrease in cash provided by operating activities for the twelve weeks ended March 22, 2015 and March 23, 2014 reflects our operating performance before non-cash expenses and charges and including the timing of receipts and disbursements.

Cash provided by operating activities for the twelve weeks ended March 22, 2015 increased \$5.5 million to \$38.1 million as compared to \$32.5 million for the twelve weeks ended March 23, 2014. This increase is primarily attributable to higher net income and improved working capital including lower cash interest payments and cash pension contributions. During the twelve weeks ended March 22, 2015, we made cash interest payments of \$0.2 million and cash pension contributions of \$0.4 million, as compared to cash interest payments of \$7.1 million and cash pension contributions of \$1.3 million during the twelve weeks ended March 23, 2014.

Investing Activities

Cash used in investing activities increased \$6.5 million to \$20.8 million for the twelve weeks ended March 22, 2015 as compared to \$14.3 million in the twelve weeks ended March 23, 2014. This increase was primarily attributable to a \$10.1 million increase in capital expenditures for property, plant and equipment, including capitalized software, largely as a result of increased investment in store construction and equipment under our plan to accelerate openings of new *Extra!* stores and conversions of legacy stores to the *Extra!* format. The increase in capital expenditures was partially offset by \$4.9 million of net proceeds received for the sale and leaseback of one store property.

Financing Activities

Cash used by financing activities decreased \$2.0 million to cash used of \$0.1 million for the twelve weeks ended March 22, 2015, as compared to cash used of \$2.1 million for the twelve weeks ended March 23, 2014. This decrease was primarily attributable to the \$1.8 million decrease in payments on our Term Loan Facility.

At March 22, 2015, we had cash and cash equivalents of \$124.1 million, stockholders' equity of \$522.6 million and debt, net of debt discount, of \$588.4 million. At March 23, 2014, we had working capital of \$115.4 million as compared to \$56.9 million at March 23, 2014. This increase in working capital was primarily due to an increase in cash and cash equivalents as a result of our IPO.

Table of Contents**Contractual Obligations**

The following table sets forth our future payments due by period of our contractual obligations as of March 22, 2015, in thousands:

	Total	Less than one year	1 - 3 Years	3 - 5 Years	Thereafter
Long-term debt	\$ 594,907	\$	\$	\$	\$ 594,907
Interest on long-term debt	158,635	31,165	62,884	64,586	
Operating leases	978,769	96,566	180,591	151,303	550,309
Total contractual obligations	\$ 1,732,311	\$ 127,731	\$ 243,475	\$ 215,889	\$ 1,145,216

The primary changes in our contractual obligations as of March 22, 2015 as compared to our contractual obligations as of December 28, 2014 relate to additional operating leases entered into during the twelve weeks ended March 22, 2015 primarily related to our new store growth program.

The interest payments on our Term Loan Facility outstanding as of March 22, 2015 incorporate the effect of the interest rate swap, which effectively converts the variable rate under the Term Loan Facility to a fixed rate. The five-year interest rate swap fixed the LIBOR component of interest at 1.5995% on a variable notional amount through March 29, 2018. See Note 4, Debt, and Note 5, Derivative Financial Instruments, to our unaudited condensed consolidated financial statements for additional information on our interest requirements and interest rate swap contract.

Purchase orders or contracts for the purchase of goods for resale in our stores and other goods and services are not included in the table above. We are not able to reasonably determine the aggregate amount of such purchase orders that may constitute established contractual obligations, as purchase orders may represent individual authorizations to purchase rather than binding agreements. Other than with respect to Unified Grocers (as described immediately below), we do not have significant agreements for the purchase of goods for resale in our stores or other goods and services that exceed our expected requirements or that are not cancelable on short notice.

We have a contractual obligation under our supply agreement with Unified Grocers to purchase a minimum amount of food and related items during any twelve-month period covered by the agreement. This contractual obligation does not exceed our expected requirements over any twelve-month period covered by the agreement. This agreement, as amended, expires in December 2015. The related amounts are not included in the above table.

The table above also excludes funding of pension and other postretirement benefit and postemployment obligations. See Note 8, Retirement Benefit Plans and Postretirement and Postemployment Benefit Obligations, to our unaudited condensed consolidated financial statements for additional information on funding of our plans.

We also have asset retirement obligations with respect to owned or leased properties. Due to the nature of our business, such asset retirement obligation is immaterial.

Off Balance Sheet Arrangements

As of March 22, 2015, we had no off-balance sheet arrangements.

Critical Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported assets, liabilities, sales and expenses in the accompanying financial statements. Critical accounting estimates are those that require the most subjective and complex judgments, often employing the use of estimates about the effect of matters that are inherently uncertain. These critical accounting estimates, under different conditions or using different assumptions or estimates, could show materially different results on our financial condition and results of operations. The following are considered our most critical accounting estimates that, under different conditions or using different assumptions or estimates, could show materially different results on our financial condition and results of operations.

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Share-Based Compensation

We account for share-based compensation in accordance with ASC 718, *Compensation - Stock Compensation*. ASC 718 requires all share-based payments to be recognized in the statements of operations and comprehensive income (loss) as compensation expense based on their fair values over the requisite service period of the award, taking into consideration estimated forfeiture rates.

We use the Black-Scholes-Merton option-pricing model to estimate the fair value of the options on the date of each grant. The Black-Scholes-Merton option-pricing model utilizes highly subjective and complex assumptions to determine the fair value of share-based compensation, including the option's expected term and price volatility of the underlying stock.

Given the absence of a public trading market for our Common Stock prior to the IPO, the fair value of the Common Stock underlying our share-based awards was determined by our board of directors, with input from management and, in some cases, a contemporaneous valuation report prepared by an unrelated nationally recognized third-party valuation specialist, in each case using the income and market valuation approach. We believe that our board of directors had the relevant experience and expertise to determine the fair value of our Common Stock. In accordance with the American Institute of Certified Public Accountants Accounting and Valuation Guide: *Valuation of Privately-Held-Company Equity Securities Issued as Compensation*, our board of directors exercised reasonable judgment and considered numerous objective and subjective factors to determine the best estimate of the fair value of our Common Stock. These estimates are no longer necessary to determine the fair value of new awards now that the underlying shares are publicly traded.

In addition to assumptions used in the Black-Scholes-Merton option pricing model, we must also estimate a forfeiture rate to calculate the share-based compensation cost for our awards. Our forfeiture rate is based on an analysis of our actual historical forfeitures.

The assumptions referred to above represent management's best estimates. These estimates involve inherent uncertainties and the application of management's judgment. If these assumptions change and different factors are used, our share-based compensation expense could be materially different in the future.

We recognize compensation cost for graded vesting awards as if they were granted in multiple awards. We believe the use of this multiple award method is preferable because a stock option grant with graded vesting is effectively a series of individual grants that vests over various periods. Management also believes that this provides for better matching of compensation costs with the associated services rendered throughout the applicable vesting periods.

Inventories

Inventories consist of merchandise purchased for resale which is stated at the lower of the weighted-average cost (which approximates FIFO) or market. We provide for estimated inventory losses between physical inventory counts at our stores based upon historical inventory losses as a percentage of sales. The provision is adjusted periodically to reflect updated trends of actual physical inventory count results.

The proper valuation of inventory also requires us to estimate the net realizable value of our slow-moving inventory at the end of each period. We base net realizable values upon many factors, including historical recovery rates, the aging of inventories on hand, the inventory movement of specific products and the current economic conditions. When we have determined inventory to be slow-moving, the inventory is reduced to its net realizable value by recording an obsolescence valuation allowance.

With regard to the proper valuation of inventories, we review our valuation methodologies on a recurring basis and make refinements where the facts and circumstances dictate.

Goodwill and Intangible Assets

We account for goodwill and identified intangible assets in accordance with ASC 350, *Intangibles - Goodwill and Other*. Goodwill and identifiable intangible assets with indefinite lives are not amortized, but instead are evaluated on an annual basis for impairment, or more frequently if events or changes in circumstances indicate that the asset might be impaired.

We evaluate goodwill for impairment by comparing the fair value of each reporting unit to its carrying value including the associated goodwill. We have designated our reporting units to be our *Smart & Final* banner and our *Cash & Carry* banner. We determine the fair value of the reporting units using the income approach methodology of valuation that includes the discounted cash flow method as well as other generally accepted valuation methodologies.

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Our detailed impairment analysis involves the use of discounted cash flow models. Significant management judgment is necessary to evaluate the impact of operating and macroeconomic changes on existing and forecasted results. Determining market values using a discounted cash flow method requires that we make significant estimates and assumptions, including long-term projections of cash flows, market conditions and appropriate market rates. Our judgments are based on historical experience, current market trends and other information. In estimating future cash flows, we rely on internally generated forecasts for operating profits and cash flows, including capital expenditures. Critical assumptions include projected comparable store sales growth, timing and number of new store openings, operating profit rates, general and administrative expenses, direct store expenses, capital expenditures, discount rates, royalty rates and terminal growth rates. We determine discount rates based on the weighted average cost of capital of a market participant. Such estimates are derived from our analysis of peer companies and consider the industry weighted average return on debt and equity from a market participant perspective. We also use comparable market earnings multiple data and our Company's market capitalization to corroborate our reporting unit valuation. Factors that could cause us to change our estimates of future cash flows include a prolonged economic crisis, successful efforts by our competitors to gain market share in our core markets, our inability to compete effectively with other retailers or our inability to maintain price competitiveness.

If the fair value of the reporting unit exceeds the carrying value of the net assets, including goodwill assigned to that unit, goodwill is not impaired. If the carrying value of the reporting unit's net assets, including goodwill, exceeds the fair value of the reporting unit, we are required to perform a second step, as this is an indication that the reporting unit's goodwill may be impaired. In this step, we compare the implied fair value of the reporting unit's goodwill with the carrying amount of the reporting unit's goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit to all of the assets and liabilities of the reporting unit in a manner similar to a purchase price allocation. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill.

If the carrying amount of a reporting unit's goodwill exceeds its implied value, then an impairment of goodwill has occurred and we would recognize an impairment charge for the difference between the carrying amount and the implied fair value of goodwill.

We evaluate our indefinite-lived intangible assets associated with trade names using a two-step approach. The first step screens for potential impairment by comparing the fair value of each trade name with its carrying value. The second step measures the amount of impairment. We determine the fair value of the indefinite-lived trade names using a "relief from royalty payments" methodology. This methodology involves estimating reasonable royalty rates for each trade name and applying these royalty rates to a revenue stream and discounting the resulting cash flows to determine fair value. In the periods presented, we did not recognize any indefinite-lived trade name impairment loss as a result of such evaluation.

Finite-lived intangible assets, like other long-lived assets as required by ASC 360 (as defined below), are subject to review for impairment whenever events or changes in circumstances indicate that the carrying amount of the finite-lived intangible asset may not be recoverable. Impairment is recognized to the extent the sum of the discounted estimated future cash flows from the use of the finite-lived intangible asset is less than the carrying value.

Impairments of Long-Lived Assets

In accordance with ASC 360, *Property, Plant, and Equipment*, (ASC 360), we assess review our long-lived assets, including property, plant and equipment and assets under capital leases, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. We believe that impairment assessment of long-lived assets is critical to the financial statements because the recoverability of the amounts, or lack thereof, could significantly affect our results of operations. Determining whether an impairment has occurred typically requires various estimates and assumptions, including determining which cash flows are directly related to the potentially

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impaired asset, the useful life over which cash flows will occur, amount of such cash flows, and the asset's residual value, if any. In turn, measurement of an impairment loss requires a determination of fair value, which is based on the best information available. We use internal discounted cash flow estimates and independent appraisals as appropriate to determine fair value. We derive the required cash flow estimates from our historical experience and our internal business plans and apply an appropriate discount rate. We group and evaluate long-lived assets for impairment at the individual store level, which is the lowest level at which individual identifiable cash flows are available. We regularly review our stores' operating performance for indicators of impairment, which include a significant underperformance relative to expected historical or projected future results of operations or a significant negative industry or economic trend.

Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its future undiscounted cash flows, an impairment charge is recognized equal to the excess of the carrying value over the estimated fair value of the asset.

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We measure the fair value of our long-lived assets on a nonrecurring basis using Level 3 inputs as defined in the fair value hierarchy.

Capitalized software costs are subject to review for impairment whenever events or changes in circumstances indicate that the carrying amount of the capitalized software may not be recoverable, whether it is in use or under development. Impairment is recognized to the extent the sum of the future discounted cash flows from the use of the capitalized software is less than the carrying value.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities for a change in tax rates is recognized in income in the period that includes the enactment date. Under applicable accounting guidance, we are required to evaluate the realizability of our deferred tax assets. The realization of our deferred tax assets is dependent on future earnings. Applicable accounting guidance requires that we recognize a valuation allowance when it is more likely than not that all or a portion or all of a deferred tax asset will not be realized due to the inability to generate sufficient taxable income in future periods. Accordingly, significant accounting judgment is required in our assessment of deferred tax assets and valuation allowances and deferred liabilities, and determining the provision for income taxes and related accruals.

In the ordinary course of business, there are transactions and calculations where the ultimate tax outcome is uncertain. In addition, we are subject to periodic audits and examinations by the Internal Revenue Service and other state and local taxing authorities. Although we believe that our estimates are reasonable, actual results could materially differ from these estimates.

Self-Insurance

We purchase third-party insurance for risks related to workers' compensation and general liability costs that exceed certain limits for each respective insurance program.

We are also responsible for the payment of claims less than the insured amount. We establish estimated accruals for our insurance programs based on certain factors, including available claims data, historical trends and experience, as well as projected ultimate costs of the claims. These accruals are based on estimates prepared with the assistance of outside actuaries, and the ultimate cost of these claims may vary from initial estimates and established accruals. We believe that the use of actuarial studies to determine self-insurance accruals represents a consistent method of measuring these subjective estimates. The actuaries periodically update their estimates and we record such adjustments in the period in which such determination is made. The inherent uncertainty of future loss projections could cause actual claims to differ from our estimates.

Closed Store Reserve

The Company maintains reserves for costs associated with closures of operating stores and other properties that are no longer being utilized in current operations. In the event a leased store is closed before the expiration of the associated lease, the discounted remaining lease obligation less estimated sublease rental income, asset impairment charges related to improvements and fixtures, inventory write-downs and other miscellaneous closing costs associated with the disposal activity are recognized when the store closes. Adjustments to closed store liabilities primarily relate to changes in subtenant income and actual exit costs differing from original estimates. Adjustments are made for changes in estimates in the period in which the change becomes known.

Retirement Benefit Plans and Postretirement Benefit Plans

Certain of our employees are covered by a funded noncontributory qualified defined benefit pension plan. U.S. GAAP requires that we measure the benefit obligations and fair value of plan assets that determine our plans' funded status as of our fiscal year end date.

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The determination of our obligation and expense for retirement benefits plans and postretirement benefit plans is dependent, in part, on our selection of certain assumptions used by us and our actuaries in calculating such amounts. Those assumptions are described in Note 7, Retirement Benefit Plans and Postretirement and Postemployment Benefit Obligations, in the unaudited condensed consolidated financial statements contained herein. Pension assumptions are significant inputs to the actuarial models that measure pension benefit obligations and related effects on operations. Three assumptions, among others discount rate, expected long-term return on plan assets and rate of compensation increases are important elements of plan expense and asset/liability measurement. We evaluate these critical assumptions at least annually. We periodically evaluate other assumptions involving demographic factors, such as retirement age, mortality and turnover, and update them to reflect our experience and expectations for the future. Recently, the Society of Actuaries released revised mortality tables, which update life expectancy assumptions. In consideration of these tables, we modified the mortality assumptions used in determining our retirement benefit plans and postretirement benefit plans as of December 28, 2014. The impact of these new mortality assumptions has resulted in an increase to the SERP and postretirement benefit plan obligations and an increase in future related expense. Actual results in any given year will often differ from actuarial assumptions because of economic and other factors.

In accordance with U.S. GAAP, the amount by which actual results differ from the actuarial assumptions is accumulated and amortized over future periods and, therefore, affects recognized expense in such future periods. While we believe our assumptions are appropriate, significant differences in actual results or significant changes in our assumptions may materially affect our pension and other postretirement obligations and future expenses.

We determine the discount rate using current investment yields on high quality fixed income investments. The discount rate assumption used to determine the year-end projected benefit obligation is increased or decreased to be consistent with the change in yield rates for high quality fixed-income investments for the expected period to maturity of the pension benefits. A lower discount rate increases the present value of benefit obligations and increases pension expense.

Vendor Rebates and Other Allowances

As a component of our consolidated procurement program and consistent with standard practices in the retail industry, we frequently enter into contracts with vendors that provide for payments of rebates or other allowances. These rebates and allowances are primarily comprised of volume or purchase-based incentives, advertising allowances and promotional discounts. The purpose of these incentives and allowances is generally to help defray the costs we incur for stocking, advertising, promoting and selling the vendor's products.

As prescribed by U.S. GAAP, these vendor payments are reflected in the carrying value of the inventory when earned or as progress is made toward earning the rebate or allowance and as a component of cost of sales as the inventory is sold. Certain of these vendor contracts provide for rebates and other allowances that are contingent upon us meeting specified performance measures such as a cumulative level of purchases over a specified period of time. Such contingent rebates and other allowances are given accounting recognition at the point at which achievement of the specified performance measures are deemed to be probable and reasonably estimable.

We review the relevant or significant factors affecting proper performance measures, rebates and other allowances on a recurring basis and make adjustments where the facts and circumstances dictate.

Recently Issued Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers* (Topic 606). ASU 2014-09 outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The new revenue model is designed to provide a more robust framework for addressing revenue issues and requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 was to be effective for the first interim period within annual reporting periods beginning after December 15, 2016, and early adoption is not permitted. In April 2015, the FASB proposed a one-year deferral of the effective date of this ASU. The Company is currently evaluating this guidance and the impact it will have on its consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-12, *Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period*. ASU 2014-12 provides guidance that a performance target that affects vesting of a share-based payment and that could be achieved after the requisite service condition is a performance condition. As a result, the performance target is not reflected in the estimation of the award's grant date fair value. Share-based compensation cost for such award would be recognized over the required service period, if it is probable that the performance condition will be achieved. ASU 2014-12 is effective for annual reporting periods beginning after December 15, 2015. Early adoption is permitted. The guidance should be applied on a prospective basis to awards that are granted or modified on or after the effective date of the standard. Companies also have the option to apply the guidance on a modified retrospective basis for awards with performance targets outstanding on or after the beginning of the first annual period presented after the effective date of the standard. We do not expect the adoption of ASU 2014-12 will have a material effect on the Company's consolidated financial statements.

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In August 2014, the FASB issued ASU No. 2014-15, *Presentation of Financial Statements – Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern*. ASU 2014-15 provides guidance on determining when and how reporting entities must disclose going-concern uncertainties in their financial statements. The new standard requires management to perform interim and annual assessments of an entity’s ability to continue as a going concern within one year of the date of issuance of the entity’s financial statements (or within one year after the date on which the financial statements are available to be issued, when applicable). Further, an entity must provide certain disclosures if there is substantial doubt about the entity’s ability to continue as a going concern. ASU 2014-15 is effective for annual periods ending after December 15, 2016, and interim periods thereafter and early adoption is permitted. We do not expect the adoption of ASU 2014-15 to have a material impact on the Company’s consolidated financial statements.

In January 2015, the FASB issued ASU No. 2015-01, *Income Statement – Extraordinary and Unusual Items (Subtopic 225-20), Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items*. ASU 2015-01 eliminates the concept of extraordinary items. Under this new guidance, reporting entities will no longer be required to separately classify, present and disclose extraordinary events and transactions. The amendments in this update are effective for annual and interim periods beginning after December 15, 2015. We do not expect the adoption of ASU 2015-01 will have a material effect on the Company’s consolidated financial statements.

In February 2015, the FASB issued ASU No. 2015-02, *Amendments to the Consolidation Analysis*. ASU 2015-02 is intended to improve upon and simplify the consolidation assessment required to evaluate whether organizations should consolidate certain legal entities such as limited partnerships, limited liability corporations, and securitization structures. The amendments in this ASU are effective for annual and interim periods beginning after December 15, 2015 for public entities. We do not expect the adoption of ASU 2015-02 will have a material impact on the Company’s consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-03, *Simplifying the Presentation of Debt Issuance Costs*. ASU 2015-03 changes the presentation of debt issuance costs in the financial statements. Under the ASU, an entity presents such costs in the balance sheet as a direct deduction from the related debt liability rather than as an asset. The amendments in this ASU are effective for annual and interim periods beginning after December 15, 2015 for public entities. We are currently evaluating the guidance to determine the impact on our consolidated balance sheet presentation.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

Market risk represents the risk of changes in the value of market risk sensitive instruments caused by fluctuations in interest rates, foreign exchange rates and commodity prices. Changes in these factors could cause fluctuations in the results of our operations and cash flows. In the ordinary course of business, we are primarily exposed to foreign currency and interest rate risks. We do not use derivative financial instruments in connection with these commodity market risks.

Commodity Risk

We are subject to volatility in food costs as a result of market risk associated with commodity prices. Although we typically are able to mitigate these cost increases, our ability to continue to do so, either in whole or in part, may be limited by the competitive environment we operate in.

Interest Rate Market Risk

Based on our variable rate debt balance as of March 22, 2015, a 1% increase in interest rates would increase our annual interest cost by approximately \$2.0 million. This impact reflects any offset from our current hedging activities. There would be no impact if the interest rate were to decrease 1% due to an interest rate floor that exists on the Term Loan Facility.

Foreign Currency Exchange Rate Market Risk

We are exposed to market risks relating to fluctuations in foreign exchange rates between the U.S. dollar and other foreign currencies, primarily the Mexican Peso. Our exposure to foreign currency risk is limited to our operations in Mexico and the equity earnings of our joint venture. Such exposure is primarily related to our \$11.8 million equity investment in the Mexico joint venture. The remainder of our business is conducted in U.S. dollars and thus is not exposed to fluctuation in foreign currency. We do not hedge our foreign currency exposure and therefore are not exposed to such hedging risk.

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Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a- 15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of the end of the period covered by this report. Disclosure controls and procedures are designed to provide reasonable assurance that the information required to be disclosed in the reports that we file or submit under the Exchange Act has been appropriately recorded, processed, summarized and reported on a timely basis and are effective in ensuring that such information is accumulated and communicated to the Company s management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure. Based on such evaluation, our CEO and CFO have concluded that, as of March 22, 2015 our disclosure controls and procedures are effective.

Changes in Internal Control Over Financial Reporting

There were no changes in the Company s internal control over financial reporting for the twelve weeks ended March 22, 2015 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

Part II - OTHER INFORMATION

Item 1. Legal Proceedings.

We are engaged in various legal actions, claims and proceedings arising in the ordinary course of business, including claims related to employment related matters, breach of contracts, products liabilities and intellectual property matters resulting from our business activities. We do not believe that the ultimate resolution of these pending claims will have a material adverse effect on our business, financial condition, results of operation or cash flows. However, litigation is subject to many uncertainties, and the outcome of certain individual litigated matters may not be reasonably predictable and any related damages may not be estimable. Some litigation matters could result in an adverse outcome to us, and any such adverse outcome could have a material adverse effect on our business, financial condition, results of operation and cash flows.

Item 1A. Risk Factors.

For a discussion of our potential risks and uncertainties, see the information in Part I, Item 1A Risk Factors in our Annual Report on Form 10-K, for the year ended December 28, 2014 filed with the SEC on March 25, 2015. There have been no material changes to the risk factors disclosed in our Annual Report on Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

Use of Proceeds

There has been no material change in the planned use of proceeds from our initial public offering as described in our final prospectus dated September 23, 2014 and filed with the SEC on September 25, 2014 pursuant to Rule 424(b) of the Securities Act and our Quarterly Report on Form 10-Q for the quarterly period ended October 5, 2014, as filed with the SEC on November 17, 2014.

Item 3. Defaults Upon Senior Securities.

None.

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Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

None.

Item 6. Exhibits.

Exhibit No.	Description
31.1	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of CEO and CFO Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

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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 persons undersigned thereunto duly authorized.

SMART & FINAL STORES, INC.
(Registrant)

April 29, 2015

/s/ David G. Hirz
David G. Hirz
Chief Executive Officer
(Principal Executive Officer)

April 29, 2015

/s/ Richard N. Phegley
Richard N. Phegley
Chief Financial Officer
(Principal Financial Officer)