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SMART & FINAL INC/DE
Form 10-Q
July 26, 2001

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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 June 17, 2001

OR

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 001-10811

SMART & FINAL INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

No. 95-4079584
(IRS Employer Identification No.)

600 Citadel Drive
City of Commerce, California 90040
(Address of principal executive offices) (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

The registrant had 29,386,585 shares of common stock outstanding as of July 25, 2001.

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SMART & FINAL INC. Index

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SMART & FINAL INC. CONSOLIDATED BALANCE SHEETS (dollars in thousands)

	June 17, 2001 ----- (Unaudited)	December 31, 2000 -----
ASSETS -----		
Current assets:		
Cash & cash equivalents	\$ 24,991	\$ 23,328
Trade notes and accounts receivable, less allowance for doubtful accounts of \$3,478 in 2001 and \$3,182 in 2000	72,840	68,776
Inventories	168,976	170,276
Prepaid expenses	6,793	6,426
Deferred tax asset	11,540	10,890
	-----	-----
Total current assets	285,140	279,696
Property, plant and equipment:		
Land	36,669	36,338
Buildings and improvements	31,029	29,559
Leasehold improvements	108,206	104,646
Fixtures and equipment	191,531	182,678
	-----	-----
	367,435	353,221

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Less - Accumulated depreciation and amortization	157,913	146,904
	-----	-----
Net property, plant and equipment	209,522	206,317
Assets under capital leases, net of accumulated amortization of \$8,799 in 2001 and \$8,098 in 2000	6,484	6,877
Goodwill, net of accumulated amortization of \$5,857 in 2001 and \$5,203 in 2000	52,870	53,524
Deferred tax asset	6,051	6,051
Other assets	27,239	29,876
	-----	-----
Total assets	\$587,306	\$582,341
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		

Current liabilities:		
Current maturities of long-term debt	\$111,345	\$ 91,209
Accounts payable	90,060	102,858
Accrued salaries and wages	11,892	15,538
Other accrued liabilities	38,201	39,688
	-----	-----
Total current liabilities	251,498	249,293
Long-term liabilities:		
Notes payable, net of current maturities	5,069	10,117
Notes payable to Parent	15,965	15,965
Obligations under capital leases	8,763	9,390
Other long-term liabilities	14,557	12,632
Workers' compensation reserve, postretirement and postemployment benefits	20,966	20,079
	-----	-----
Total long-term liabilities	65,320	68,183
Stockholders' equity:		
Preferred stock, \$1 par value (authorized- 10,000,000 shares; no shares issued)	-	-
Common stock, \$0.01 par value (authorized-100,000,000 shares; 29,385,085 shares issued and outstanding in 2001 and 29,203,114 in 2000)	294	292
Additional paid-in capital	206,378	204,898
Notes receivable for stock	(100)	(100)
Accumulated other comprehensive loss	(2,105)	(915)
Retained earnings	66,021	60,690
	-----	-----
Total stockholders' equity	270,488	264,865
	-----	-----
Total liabilities and stockholders' equity	\$587,306	\$582,341
	=====	=====

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

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	Twelve Weeks Ended		Twenty-four
	June 17, 2001	June 18, 2000	June 17, 2001
	(Unaudited)		(Unau
Sales	\$ 463,594	\$ 442,998	\$ 887,762
Cost of sales, buying and occupancy	397,329	382,842	763,444
Gross margin	66,265	60,156	124,318
Operating and administrative expenses	56,539	52,205	110,350
Income from operations	9,726	7,951	13,968
Interest expense, net	2,845	3,237	5,912
Income before provision for income taxes	6,881	4,714	8,056
Provision for income taxes	2,696	1,616	3,121
Income from consolidated subsidiaries	4,185	3,098	4,935
Equity earnings in unconsolidated subsidiary	276	94	396
Net income	\$ 4,461	\$ 3,192	\$ 5,331
Earnings per common share	\$ 0.15	\$ 0.11	\$ 0.18
Weighted average common shares	29,316,731	29,192,368	29,266,744
Earnings per common share, assuming dilution	\$ 0.15	\$ 0.11	\$ 0.18
Weighted average common shares and common share equivalents	29,660,429	29,264,238	29,576,444

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

SMART & FINAL INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)

Twenty-four Weeks Ended	
June 17,	June 18,

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	2001	2000
	----- (Unaudited)	
Cash Flows From Operating Activities:		
Net income	\$ 5,331	\$ 3,828
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on disposal of fixed assets	(426)	(61)
Depreciation and amortization	15,663	15,474
Deferred tax provision (benefit)	(650)	-
Amortization of deferred financing costs	781	873
Equity earnings in unconsolidated subsidiary	(396)	(138)
Decrease (increase) in:		
Trade notes and accounts receivable	(3,942)	1,008
Inventories	1,300	3,621
Prepaid expenses and other	173	411
Increase (decrease) in:		
Accounts payable	(6,831)	(6,115)
Accrued liabilities	(3,646)	3,159
Other liabilities	597	5,907
	-----	-----
Net cash provided by operating activities	7,954	27,967
	-----	-----
Cash Flows From Investing Activities:		
Acquisition of property, plant and equipment	(21,996)	(9,479)
Proceeds from disposal of property, plant and equipment	944	77
Other	(217)	(1,286)
	-----	-----
Net cash used in investing activities	(21,269)	(10,688)
	-----	-----
Cash Flows From Financing Activities:		
Proceeds from issuance of common stock	821	-
Payments on bank line of credit	(5,000)	(17,500)
Borrowings on bank line of credit	22,500	-
Payments on notes payable	(3,343)	(3,146)
	-----	-----
Net cash provided by (used in) financing activities	14,978	(20,646)
	-----	-----
Increase (decrease) in cash and cash equivalents	1,663	(3,367)
Cash and cash equivalents at beginning of period	23,328	42,936
	-----	-----
Cash and cash equivalents at end of period	\$ 24,991	\$ 39,569
	=====	=====

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

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1. Basis of Presentation

Smart & Final Inc. (the "Company") is a Delaware corporation and is a 56.8 percent owned subsidiary of Casino USA, Inc. (the "Parent"). Casino Guichard-Perrachon, S.A. ("Casino France"), a publicly traded French joint stock limited liability company, is the principal shareholder of the Parent. Collectively, Casino France and its subsidiaries currently own approximately 59.8 percent of the Company's common stock.

The consolidated balance sheet as of June 17, 2001 and the consolidated statements of income and cash flows for the twelve and twenty-four weeks ended June 17, 2001 and June 18, 2000 are unaudited. In the opinion of management, all adjustments necessary for a fair presentation of these financial statements in conformity with accounting principles generally accepted in the United States have been included. Such adjustments consisted of normal recurring items as well as the accounting change to adopt Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities", as amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities". Interim results are not necessarily indicative of results for a full year.

These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Form 10-K for the year ended December 31, 2000.

2. Fiscal Years

The Company's fiscal year ends on the Sunday closest to December 31. Each fiscal year consists of twelve-week periods in the first, second and fourth quarters and a sixteen-week period in the third quarter.

3. Accounting Change

Effective January 1, 2001, the Company adopted SFAS No. 133, as amended by SFAS No. 138, which established accounting and reporting standards for derivative instruments and hedging activities. All derivative instruments are required to be measured at fair values and recognized on the balance sheet. Changes in fair values of derivative instruments designated as fair value hedges are recognized in current earnings. The effective portions of changes in fair values of derivative instruments designated as cash flow hedges are recorded as other comprehensive income ("OCI") and are reported on the statement of income when the hedged forecasted transaction affects earnings or the hedged item becomes ineffective. The ineffective portions of cash flow hedges are recognized in current earnings.

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SMART & FINAL INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

The Company uses interest rate collar agreements to minimize the negative impact of interest rate fluctuations on the Company's cash flows. These agreements are designated as cash flow hedges and are considered fully effective. The adoption of SFAS No. 133 on January 1, 2001 resulted in a cumulative pretax reduction of \$480,000 recorded to OCI, representing cumulative losses since inception on the fair values of these derivative instruments as of January 1, 2001.

4. Derivatives

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As of June 17, 2001, the Company had interest rate collar agreements with various banks to limit the impact of interest rate fluctuations on revolving debt. These agreements hedge principal amounts of up to an aggregate of \$100 million. The agreements limit LIBOR fluctuations to interest rate ranges from 4.70% to 8.00% and expire during various periods from October 2002 to September 2004. For the first two quarters of 2001, a pretax reduction of \$1,263,000 was recorded to OCI as a result of changes in the fair values of these agreements. The decrease in fair values of these cash flow hedges during the current reporting period is attributable to the declining market interest rates. For the twelve-week and twenty-four-week periods ended June 17, 2001, net derivative losses reclassified into earnings were \$47,000. The Company estimates that \$1.1 million of net derivative losses included in OCI will be reclassified into earnings within the next twelve months.

5. Stockholders' Equity

In the fourth quarter of 2000, the Company's board of directors approved a program for the voluntary exchange (the "Exchange Program") of certain outstanding options having an exercise price of \$14.00 or higher per share for shares of common stock issued as "Restricted Stock" under the terms of the Company's Long-Term Equity Compensation Plan. All options surrendered as a result of an election under the Exchange Program were canceled and returned to the respective plan under which the canceled options were first granted. The Exchange Program expired on March 9, 2001. A total of 178,510 shares of Restricted Stock were issued. The related compensation expense to be recognized over the vesting periods of one year or three years is \$1.6 million.

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SMART & FINAL INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

6. Comprehensive Income (Loss)

Comprehensive income (loss) was computed as follows, amounts in thousands:

	Twelve Weeks Ended		Twenty-four Weeks Ended	
	June 17, 2001	June 18, 2000	June 17, 2001	June 18, 2000
Net income	\$4,461	3,192	5,331	3,828
Other comprehensive income (loss):				
Cumulative effect of accounting change, net of tax	-	-	(305)	-
Net gain (loss) on derivative instruments, net of tax	(203)	-	(788)	-
Foreign currency translation adjustments	31	146	(97)	219
	(172)	146	(1,190)	219
Total other comprehensive income (loss)				
Total comprehensive income	\$4,289	\$3,338	\$ 4,141	\$4,047

See Note 3 regarding cumulative effect of accounting change resulting from

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adoption of SFAS 133 and Note 4 for change in OCI during the reporting period due to changes in fair values of derivative instruments designated as cash flow hedges.

In accordance with generally accepted accounting principles, the functional currency for the Company's Mexico operations has been the Mexican Peso. As such, foreign currency translation gains and losses are included in OCI.

7. Interest Expense

Interest expense was incurred primarily on borrowings under the Company's revolving credit facilities and a loan from its Parent. The Company paid \$5.2 million and \$4.7 million in interest in the twenty-four weeks ended June 17, 2001 and June 18, 2000, respectively.

8. Income Taxes

The Company and the Parent are parties to a tax sharing arrangement covering income tax obligations in the state of California. Under this arrangement, based upon pre-tax income, the Company made tax sharing payments of \$1,246,000 and \$235,000 to the Parent in the twenty-four weeks ended June 17, 2001 and June 18, 2000, respectively. The Company paid \$10,000 and \$40,000 of state income taxes for states other than California in the twenty-four weeks ended June 17, 2001 and June 18, 2000, respectively. The Company paid \$2,150,000 and \$1,185,000 of federal income taxes in the twenty-four weeks ended June 17, 2001 and June 18, 2000, respectively.

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SMART & FINAL INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

9. Earnings per Common Share

Earnings per common share is based on the weighted average number of common shares outstanding. Earnings per common share, assuming dilution includes the weighted average number of common stock equivalents outstanding related to employee stock options and other stock agreements.

10. Segment Reporting

The Company has two reportable segments: Stores and Foodservice. The stores segment provides food and related items in bulk sizes and quantities through non-membership grocery warehouse stores. The foodservice distribution segment provides delivery of food, restaurant equipment and supplies to mainly restaurant customers and Smart & Final stores. Corporate Expense is comprised primarily of the Company's corporate expenses incidental to the activities of the reportable segments and rental income from Smart & Final stores. The Company's reportable segments are strategic business units that offer different products and services. They are managed separately because each segment requires different technology and marketing strategies.

The Company does not allocate interest, income taxes or nonrecurring gains and losses to the reportable segments. These costs are included in Corporate Expense below. The Company evaluates performance based on profit or loss from operations before income taxes not including nonrecurring gains and losses.

The revenues, profit or loss and other information of each segment are as follows, amounts in thousands:

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For the twelve weeks ended June 17, 2001:

	Stores	Foodservice	Corporate Expense	Total
Revenues from external customers	\$365,891	\$97,703	\$ -	\$463,594
Intercompany real estate charge (income)	3,644	119	(3,763)	-
Interest income	-	-	142	142
Interest expense	-	-	2,987	2,987
Pre-tax income (loss)	10,325	(597)	(2,847)	6,881

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SMART & FINAL INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

For the twelve weeks ended June 18, 2000:

	Stores	Foodservice	Corporate Expense	Total
Revenues from external customers	\$348,069	\$ 94,929	\$ -	\$442,998
Intercompany real estate charge (income)	3,180	-	(3,180)	-
Interest income	-	-	301	301
Interest expense	-	-	3,538	3,538
Pre-tax income (loss)	8,210	(907)	(2,589)	4,714

For the twenty-four weeks ended June 17, 2001:

	Stores	Foodservice	Corporate Expense	Total
Revenues from external customers	\$690,464	\$197,298	\$ -	\$887,762
Intercompany real estate charge (income)	6,855	119	(6,974)	-
Interest income	-	-	267	267
Interest expense	-	-	6,179	6,179
Pre-tax income (loss)	17,263	(2,927)	(6,280)	8,056

For the twenty-four weeks ended June 18, 2000:

	Stores	Foodservice	Corporate Expense	Total
Revenues from external customers	\$651,539	\$190,820	\$ -	\$842,359
Intercompany real estate charge (income)	6,347	-	(6,347)	-
Interest income	-	-	694	694
Interest expense	-	-	7,176	7,176
Pre-tax income (loss)	14,018	(699)	(7,640)	5,679

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The basis for allocating distribution expense to stores was changed in 2001, reducing Foodservice pre-tax income and increasing Stores pre-tax income by \$300,000 and \$600,000 for the twelve weeks and twenty-four weeks ended June 17, 2001, respectively.

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SMART & FINAL INC. NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

11. Legal Actions

The Company has been named as a defendant in various legal actions arising in the normal conduct of its business. In the opinion of management, after consultation with counsel, none of these actions are expected to result in significant liability to the Company.

12. Recent Accounting Pronouncements

In July 2001, the Financial Accounting Standards Board issued SFAS No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets". SFAS No. 141 requires that all business combinations be accounted for under the purchase method. The statement further requires separate recognition of intangible assets that meet one of two criteria. The statement applies to all business combinations initiated after June 30, 2001.

SFAS No. 142 requires that an intangible asset that is acquired shall be initially recognized and measured based on its fair value. The statement also provides that goodwill should not be amortized, but shall be tested for impairment annually, or more frequently if circumstances indicate potential impairment, through a comparison of fair value to its carrying amount. Existing goodwill will continue to be amortized through the remainder of fiscal 2001 at which time amortization will cease and the Company will perform a transitional goodwill impairment test. SFAS No. 142 is effective for fiscal periods beginning after December 15, 2001. The Company is currently evaluating the impact of the new accounting standards on existing goodwill and other intangible assets. While the ultimate impact of the new accounting standards has yet to be determined, goodwill amortization expense for the twenty-four weeks ended June 17, 2001 was \$0.7 million.

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

Management's discussion and analysis should be read in conjunction with the accompanying consolidated financial statements and notes thereto and the Company's Form 10-K for the year ended December 31, 2000.

Summary

Smart & Final Inc. (the "Company") reported net income of \$4.5 million, or \$0.15 per diluted share, for the twelve weeks ended June 17, 2001, compared to net income of \$3.2 million, or \$0.11 per diluted share, for the twelve weeks ended June 18, 2000. For the twenty-four weeks ended June 17, 2001, the Company reported net income of \$5.3 million, or \$0.18 per diluted share, compared to net income of \$3.8 million, or \$0.13 per diluted share, in the twenty-four weeks

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ended June 18, 2000.

Operating earnings increased 22.3%, or \$1.8 million, from last year's same quarter to \$9.7 million in the twelve weeks ended June 17, 2001. Stores reported an increase in its operating earnings and Foodservice reported a decrease in its operating loss for the quarter as compared to last year's same quarter. Operating earnings increased 14.9%, or \$1.8 million, to \$14.0 million in the twenty-four weeks ended June 17, 2001. When compared to the same period of last year, for the first half of 2001, store operating results increased \$3.3 million despite a \$2.6 million year-to-year increase in marketing expense and foodservice operating results declined \$2.2 million primarily due to restructuring costs in the northern California unit.

Interest expense, net decreased \$0.6 million in the first half of 2001 compared to the first half of 2000 as a result of lower average outstanding debt and rate reductions caused by the Company's improved financial ratios and declining market rates.

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Results of Operations

The following table shows, for the periods indicated, certain condensed consolidated income statement data, expressed as a percentage of sales. Totals may not aggregate due to rounding.

	Twelve Weeks Ended		Twenty-four Weeks Ended	
	June 17, 2001	June 18, 2000	June 17, 2001	June 18, 2000
Sales:				
Store	78.9%	78.6%	77.8%	77.3%
Foodservice distribution sales	21.1	21.4	22.2	22.7
	-----	-----	-----	-----
Sales, consolidated total	100.0	100.0	100.0	100.0
Cost of sales, buying and occupancy	85.7	86.4	86.0	86.4
	-----	-----	-----	-----
Gross margin	14.3	13.6	14.0	13.6
Operating and administrative expenses	12.2	11.8	12.4	12.1
	-----	-----	-----	-----
Income from operations	2.1	1.8	1.6	1.4
Interest expense, net	0.6	0.7	0.7	0.8
	-----	-----	-----	-----
Income before provision for income taxes	1.5	1.1	0.9	0.7
Provision for income taxes	0.6	0.4	0.4	0.2
	-----	-----	-----	-----
Income from consolidated subsidiaries	0.9	0.7	0.6	0.4
Equity earnings in unconsolidated subsidiary	0.1	-	-	-
	-----	-----	-----	-----
Net income	1.0%	0.7%	0.6%	0.5%
	=====	=====	=====	=====

The following table sets forth pre-tax profit or loss, in millions, for each of the Company's various reportable segments:

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	Twelve Weeks Ended		Twenty-four Weeks Ended	
	June 17, 2001	June 18, 2000	June 17, 2001	June 18, 2000
Stores	\$10.4	\$ 8.2	\$17.3	\$14.0
Foodservice	(0.6)	(0.9)	(2.9)	(0.7)
Segment totals	9.8	7.3	14.4	13.3
Interest and other corporate expenses	2.9	2.6	6.3	7.6
Consolidated pre-tax income	\$ 6.9	\$ 4.7	\$ 8.1	\$ 5.7

The basis for allocating distribution expense to stores was changed in 2001, reducing Foodservice pre-tax income and increasing Stores pre-tax income by \$0.3 million and \$0.6 million for the twelve-week and twenty-four-week periods ended June 17, 2001, respectively.

Stores segment improved as a result of strong sales and margin rates. Foodservice segment reported a loss due to costs related to restructuring northern California distribution operations; however, despite the restructuring costs, the loss decreased by \$0.3 million in the second quarter from prior year's same quarter. The year-to-year improvement in the second quarter at the Foodservice segment is the result of sales increases and continued effort in cost reductions.

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Background

During the first half of 2001, the Company opened five new stores and relocated one store. Additional new store growth is planned for the remainder of fiscal 2001.

	Twelve Weeks Ended		Twenty-four Weeks Ended		Year Ended
	June 17, 2001	June 18, 2000	June 17, 2001	June 18, 2000	December 31, 2000
USA:					
Beginning store count	218	212	214	212	212
Stores opened:					
New stores	1	1	5	1	2
Relocations	-	-	1	1	1
Stores relocated or closed	-	-	(1)	(1)	(1)
Ending store count	219	213	219	213	214
MEXICO:					
Beginning store count	7	6	7	6	6
New stores opened	-	-	-	-	1

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	----	----	----	----	---
Ending store count	7	6	7	6	7
	----	----	----	----	---
Grand Total	226	219	226	219	221
	====	====	====	====	===

Mexico operations are not consolidated and are reported on the equity basis of accounting.

Management continually assesses each store's profitability on a pre-tax profit basis after allocation of all corporate expenses. Stores not meeting strategic management objectives for profitability, market penetration, and/or other measures are evaluated for closure or relocation. Generally, stores opened in mature markets are expected to achieve profitability within 18 months of operations. However, there can be no assurance that the Company will be able to open new stores in a timely manner; hire, train and integrate employees; continue locating and obtaining favorable store sites; or adapt distribution, management information and other operating systems sufficiently to grow in a successful and profitable manner.

Each of the Company's 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.

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Comparison of Twelve Weeks Ended June 17, 2001 with Twelve Weeks Ended June 18, 2000.

Sales. Second quarter 2001 sales were \$463.6 million, up 4.6% from \$443.0 million in the second quarter of 2000.

Store sales increased 5.1%, from \$348.1 million in second quarter 2000 to \$365.9 million in second quarter 2001. Comparable store sales for the second quarter of 2001 increased 4.0% over the prior year's same quarter. Average comparable transaction size also increased, by 1.1%, to \$38.64 in the second quarter of 2001.

Foodservice distribution sales increased 2.9%, from \$94.9 million in the second quarter of 2000 to \$97.7 million in the current year's second quarter. Florida foodservice sales increased 15.7% while northern California foodservice sales declined 10.3% in part as a result of the restructuring program now in progress.

Gross Margin. Gross margin improved 10.2%, from \$60.2 million in the second quarter of 2000 to \$66.3 million in the current year quarter. As a percentage of sales, gross margin improved from 13.6% in the prior year's second quarter to 14.3% in second quarter 2001. The primary factors of the increase in gross margin rates were lower purchase costs due to the continuing effort in national procurement and corporate brand expansion programs, better store assortment mix and reduced distribution costs resulting from improved efficiency at the Commerce distribution center and cost reductions at Florida foodservice. These improvements were partially offset by a change in sales mix at Florida foodservice that generated lower margins and by costs incurred at northern California foodservice related to re-racking the facility and restructuring the operation.

Operating and Administrative Expenses. Operating and administrative expenses for the second quarter of 2001 were \$56.5 million, up \$4.3 million, or 8.3%, over the second quarter of 2000. These expenses, as a percentage of

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sales, increased from 11.8% in the second quarter of 2000 to 12.2% in the second quarter of 2001. Expenses increased due to restructuring costs incurred in northern California foodservice operations, increased utility costs and marketing expense increases. These increases were partially offset by a \$1.0 million retroactive medical insurance and other benefit charge recorded in the prior year's second quarter.

Interest expense, net. Interest expense, net decreased from \$3.2 million recorded in second quarter 2000 to \$2.8 million in the second quarter of 2001 due to rate reductions as a result of the Company's improved financial ratios and declining market rates.

Comparison of Twenty-Four Weeks Ended June 17, 2001 with Twenty-Four Weeks Ended June 18, 2000.

Sales. Sales in the first half of 2001 were \$887.8 million, up 5.4% from the comparable 2000 period.

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Store sales increased 6.0%, from \$651.5 million to \$690.5 million in the first half of 2001. Comparable store sales increased 5.1% in the first half of 2001 over the prior year period. Average comparable transaction size also increased 2.1% to \$38.33 in the first half of 2001.

Foodservice distribution sales increased 3.4%, from \$190.8 in the first half of 2000 to \$197.3 million in the first half of 2001. Florida foodservice sales increased 15.6% but northern California foodservice sales declined 10.1% in part as a result of the restructuring program now in progress.

Gross Margin. Gross margin improved 8.7% from \$114.4 million in the first half of 2000 to \$124.3 million in the 2001 twenty-four-week period. As a percentage of sales, gross margin increased from 13.6% of sales for the first half of 2000 to 14.0% in the comparable 2001 period. The primary factors in the improvement of gross margin rates were lower purchase costs due to the new national procurement program and expanded corporate brands, better store assortment mix and reduced distribution costs due to the improved efficiency at the new Commerce distribution center and cost reductions at Florida foodservice. These improvements were partially offset by costs incurred at northern California foodservice related to the restructuring.

Operating and Administrative Expenses. Operating and administrative expenses for the first half of 2001 were \$110.4 million, or 12.4% of sales, compared with \$102.2 million, or 12.1% of sales, in the first half of 2000. The expense increase was primarily driven by increased store marketing expense, increased utility costs and northern California foodservice operation restructuring costs. The increase was partially offset by the \$2.2 million consulting fees incurred related to improving procurement programs and \$1.0 million of retroactive medical insurance and other benefit charges recorded in the first half of 2000. No similar consulting fees or retroactive medical insurance and other benefit charges were recorded in the first half of 2001.

Interest Expense, net. Interest expense, net decreased from \$6.5 million, or 0.8% of sales, in the first half of 2000 to \$5.9 million, or 0.7% of sales, in the comparable 2001 period. This decrease was primarily a result of lower interest rates and lower average debt outstanding.

Financial Condition

Cash and cash equivalents were \$25.0 million at June 17, 2001, compared to \$23.3 million at December 31, 2000. Operating activities provided cash of \$8.0

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million for the twenty-four weeks ended June 17, 2001. For the first half of 2001, net proceeds from financing activities were \$15.0 million and investments in fixed asset and other additions were \$21.3 million.

During the twenty-four weeks ended June 17, 2001, inventories decreased by \$1.3 million and the related accounts payable decreased by \$6.8 million. Trade notes and accounts receivable increased \$3.9 million primarily due to the increased sales at Florida foodservice operation. Other changes in operating assets and liabilities generally reflect the timing of receipts and disbursements.

Stockholders' equity increased by \$5.6 million to \$270.5 million at June 17, 2001 as a result of the \$5.3 million net income for the first half of 2001 plus \$1.5 million of stock options

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exercised, issuance of restricted stock and other stock agreements and \$1.2 million decrease in accumulated OCI. The decrease in accumulated OCI includes \$0.3 million, net of tax cumulative effect of accounting change as a result of adoption of SFAS 133, \$0.8 million, net of tax reduction in fair values of interest rate collar agreements for the first half of 2001 and \$0.1 million translation adjustment.

Liquidity and Capital Resources

Historically, the Company's primary source of liquidity has been cash flows from operations. In addition, the Company has availability under bank facilities. Net cash provided by operating activities was \$8.0 million in the first half of 2001. At June 17, 2001, the Company had cash of \$25.0 million, compared to \$23.3 million at December 31, 2000. The Company had \$130.6 million of debt, excluding capital leases, at June 17, 2001, compared to \$115.7 million at December 31, 2000, and stockholders' equity of \$270.5 million at June 17, 2001.

The Company had \$219.0 million committed under its Senior Secured Credit Facilities ("Credit Facilities") at June 17, 2001 and December 31, 2000. At June 17, 2001, the Company's borrowings under these facilities totaled \$189.1 million, compared with \$171.6 million at December 31, 2000. At June 17, 2001, the Company had available \$29.9 million of unused credit under these facilities.

As of the end of second quarter 2001, the Company was in compliance with all financial covenants contained in its loan agreements, as amended.

The Credit Facilities expire in November of 2001. The Company is currently restructuring and extending these facilities. Given the Company's significantly improved financial position and excellent relationship with its lending group, the Company expects a successful restructuring process.

The Company expects to be able to fund future acquisitions and other cash requirements by a combination of available cash, cash from operations, lease financing and other borrowings and proceeds from the issuance of equity securities. The Company believes that its sources of funds are adequate to provide for working capital, other capital expenditures, and debt service requirements for the foreseeable future.

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Item 3. Quantitative and Qualitative Disclosure About Market Risk

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The Company is exposed to market risks relating to fluctuations in interest rates and the exchange rate between the U.S. Dollar and Mexican Peso. The Company's objective of financial risk management is to minimize the negative impact of interest rate fluctuations on the Company's earnings and cash flows. The Company's exposure to foreign currency risk is limited. The Company does not hold or issue financial instruments for trading purposes, nor engage in other speculative or leveraged transactions. See Note 3 and Note 4 to the consolidated financial statements regarding the adoption of SFAS 133, as amended.

Interest Rate Risk

Interest rate risk is managed through the use of four interest rate collar agreements to hedge principal amounts of up to an aggregate of \$100 million. These agreements limit LIBOR fluctuations to interest rate ranges from 4.7% to 8.0% and expire during various periods from October 2002 to September 2004. These agreements are entered into with major financial institutions thereby minimizing risk of credit loss.

Foreign Currency Risk

The Company's exposure to foreign currency risk is limited to the Company's operations under Smart & Final Mexico and the equity earnings in its Mexico joint venture. The Company's other transactions are conducted in U.S. dollars and are not exposed to fluctuations in foreign currency. The Company does not hedge foreign currency and therefore is not exposed to such hedging risk.

Credit Risk

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

Forward-Looking Statements

From time to time Smart & Final may publish forward-looking statements about anticipated results. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. In order to comply with the terms of the safe harbor, the Company notes that such forward-looking statements are based upon internal estimates which are subject to change because they reflect preliminary information and management assumptions, and that a variety of factors could cause the Company's actual results and experience to differ materially from the anticipated results or other expectations expressed in the Company's forward-looking statements. The factors which could cause actual results or outcomes to differ from such expectation include the extent of the company's success in (i) changing market

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conditions (ii) unforeseen costs and expenses (iii) ability to attract new customers and retain existing customers (iv) gain or losses from sales along with the uncertainties of achieving planned sales (v) increases in interest rates of the Company's cost of borrowing and other factors, including unusually adverse weather conditions, described from time to time in the company's SEC filing and reports. This report includes "forward-looking statements" including, without limitation, statements as to the Company's liquidity and availability of capital resources.

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PART II - OTHER INFORMATION

Item 1. Legal Proceedings

Not applicable.

Item 2. Changes in Securities and Use of Proceeds

Not applicable.

Item 3. Defaults upon Senior Securities

Not applicable

Item 4. Submission of Matters to a Vote of Security Holders

The annual Meeting of Stockholders of the Company was held on May 23, 2001. At the meeting, stockholders (1) elected four directors of the Company; (2) approved an amendment to the Long-Term Equity Compensation Plan increasing by 1,130,000 the number of shares authorized for grant thereunder and extending the expiration date of that plan until December 31, 2010; and (3) ratified the selection of Arthur Andersen LLP, independent public accountants, as auditors for the Company for the year ending December 30, 2001.

The four directors elected at the meeting were Pierre B. Bouchut, David J. McLaughlin, Thomas G. Plaskett, and Etienne Snollaerts. The directors whose term of office as a director continued after the meeting are Christian P. Couvreur, Timm F. Crull, James S. Gold, Antoine Guichard, Joel-Andre Ornstein and Ross E. Roeder.

The votes cast for, against, or withheld, as well as the number of abstention and broker non-votes for each nominee for office as a director were as follows:

	VOTES				Broker Non-Votes
	For	Against	Withheld	Abstentions	
Pierre B. Bouchut	27,009,921	-	994,730	-	-
David J. McLaughlin	27,009,932	-	994,719	-	-
Thomas G. Plaskett	27,009,572	-	995,079	-	-
Etienne Snollaerts	27,009,621	-	995,030	-	-

The votes cast for, against, or withheld, as well as the number of abstentions and broker non-votes for approving the amendment to the Long-Term Equity Compensation Plan were as follows:

	VOTES				Broker Non-Votes
	For	Against	Withheld	Abstentions	

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Amendment to the Long-Term Equity Compensation Plan	24,433,012	1,226,688	-	15,476	2,329,475
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The votes cast for, against, or withheld, as well as the number of abstentions and broker non-votes for ratification of Arthur Andersen LLP, as auditors for the Company for the year ending December 30, 2001 were as follows:

	VOTES			Abstentions	Broker Non-Votes
	For	Against	Withheld		
Ratification of Arthur Andersen LLP as auditors for the Company for the year ending December 30, 2001	27,993,301	7,337	-	4,013	-

Item 5. Other Information

Not applicable.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

Exhibit Number	Description of Exhibit
10.53	Amendment dated May 11, 2001 to Employment Agreement between the Company and Ross E. Roeder dated May 11, 1999*
10.54	Amendment dated May 31, 2001 to Employment Agreement and Consulting Agreement between the Company and Martin A. Lynch dated April 1, 1997*

*Management contracts and compensatory plans, contracts and arrangements of the Company.

(b) Reports on Form 8-K

The Company filed a Current Report on Form 8-K, dated April 5, 2001, announcing the retirement of Martin A. Lynch, the Executive Vice President and Chief Financial Officer of the Company, effective at the end of May 2001 and the appointment of Richard N. Phegley as the new Chief Financial Officer.

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Signatures

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

SMART & FINAL INC.

By:

Date: July 26, 2001

/s/ RICHARD N. PHEGLEY

Richard N. Phegley
Senior Vice President,
Chief Financial Officer, and
Principal Accounting Officer of the Company

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