

INGLES MARKETS INC
Form 10-Q/A
November 19, 2003

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

FORM 10-Q/A

Amendment No. 2

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

For the quarterly period ended June 28, 2003

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 0-14706.

INGLES MARKETS, INCORPORATED

(Exact name of registrant as specified in its charter)

North Carolina

56-0846267

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

P.O. Box 6676, Asheville NC

28816

(Address of principal executive offices)

(Zip Code)

(828) 669-2941

Registrant's telephone number, including area code

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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No .

As of August 1, 2003, the Registrant had 10,500,748 shares of Class A Common Stock, \$.05 par value per share, outstanding and 12,391,216 shares of Class B Common Stock, \$.05 par value per share, outstanding.

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INGLES MARKETS, INCORPORATED

INTRODUCTORY NOTE

Form 10-Q/A for the Three and Nine Months Ended June 28, 2003

This Amendment on Form 10-Q/A is being filed to restate certain amounts (see Note J, Critical Accounting Policies, and Managements Discussion and Analysis) and to revise disclosure and presentation of the Company's Consolidated Financial Statements for the three and nine-month periods ended June 28, 2003, in response to a routine periodic review of our filings by the staff of the U.S. Securities and Exchange Commission (the "SEC").

Our correspondence and discussions with the SEC, principally regarding the method of recognizing slotting fees and other vendor allowances in accordance with EITF 02-16, led us to revise our methodology for recognizing this consideration. Since we had previously filed the March 2003 and June 2003 Form 10-Q's, the option of recording the impact of EITF No. 02-16 as a cumulative effect of an accounting change was not available.

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Part I. Financial Information

Item 1. Financial Statements

INGLES MARKETS, INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS

| | June 28, 2003 (Unaudited) (Restated)* | September 28, 2002 (Note) |
|----------------------------|--|--|
| Current Assets: | | |
| Cash | \$ 71,370,360 | \$ 46,900,305 |
| Receivables | 31,297,637 | 34,822,934 |
| Inventories | 197,473,852 | 190,399,350 |
| Other | 5,831,855 | 5,706,754 |
| | <hr/> | <hr/> |
| Total Current Assets | 305,973,704 | 277,829,343 |
| Property and Equipment Net | 743,345,269 | 723,219,548 |
| Other Assets | 14,608,461 | 13,342,315 |
| | <hr/> | <hr/> |
| Total Assets | \$ 1,063,927,434 | \$ 1,014,391,206 |

Note: The balance sheet at September 28, 2002 has been derived from the audited financial statements at that date.

* Certain amounts have been restated in conjunction with the change in interpretation of EITF 02-16. See Note J for further details.

See notes to unaudited interim financial statements.

Table of Contents**INGLES MARKETS, INCORPORATED AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS (CONCLUDED)****LIABILITIES AND STOCKHOLDERS EQUITY**

| | June 28, 2003 (Unaudited) (Restated)* | September 28, 2002 (Note) |
|--|--|--|
| Current Liabilities: | | |
| Short-term loans and current portion of long-term debt | \$ 40,875,212 | \$ 47,307,046 |
| Accounts payable, accrued expenses and current portion of other long-term liabilities | 132,368,459 | 139,123,085 |
| | <u>173,243,671</u> | <u>186,430,131</u> |
| Total Current Liabilities | 173,243,671 | 186,430,131 |
| Deferred Income Taxes | 34,414,578 | 36,914,578 |
| Long-Term Debt | 616,661,926 | 549,324,487 |
| Other Long-Term Liabilities | 2,188,868 | 3,163,162 |
| | <u>826,509,043</u> | <u>775,832,358</u> |
| Total Liabilities | 826,509,043 | 775,832,358 |
| Stockholders Equity | | |
| Preferred stock, \$.05 par value; 10,000,000 shares authorized; no shares issued | | |
| Common stocks: | | |
| Class A, \$.05 par value; 150,000,000 shares authorized; 10,500,748 shares issued and outstanding June 28, 2003; 10,189,807 shares issued and outstanding September 28, 2002 | 525,037 | 509,490 |
| Class B, \$.05 par value; 100,000,000 shares authorized; 12,391,216 shares issued and outstanding June 28, 2003; 12,597,932 shares issued and outstanding September 28, 2002 | 619,561 | 629,897 |
| Paid-in capital in excess of par value | 101,164,536 | 100,148,857 |
| Retained earnings | 135,109,257 | 137,270,604 |
| | <u>237,418,391</u> | <u>238,558,848</u> |
| Total Stockholders Equity | 237,418,391 | 238,558,848 |
| Total Liabilities and Stockholders Equity | \$ 1,063,927,434 | \$ 1,014,391,206 |

Note: The balance sheet at September 28, 2002 has been derived from the audited financial statements at that date.

* Certain amounts have been restated in conjunction with the change in interpretation of EITF 02-16. See Note J for further details.

See notes to unaudited interim financial statements.

Table of Contents**INGLES MARKETS, INCORPORATED AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)**

| | THREE MONTHS ENDED | |
|---|--------------------|---------------------------------|
| | June 28, 2003 | June 29, 2002 (Restated)* |
| Net sales | \$ 503,630,936 | \$ 482,952,623 |
| Cost of goods sold | 372,659,527 | 353,780,308 |
| Gross profit | 130,971,409 | 129,172,315 |
| Operating and administrative expenses | 116,198,937 | 112,475,854 |
| Rental income, net | 2,029,832 | 2,342,073 |
| Income from operations | 16,802,304 | 19,038,534 |
| Other income, net | 1,606,103 | 386,695 |
| Income before interest and income taxes | 18,408,407 | 19,425,229 |
| Interest expense | 12,838,129 | 13,736,893 |
| Income before income taxes | 5,570,278 | 5,688,336 |
| Income taxes: | | |
| Current | 1,500,000 | 620,000 |
| Deferred | 500,000 | 1,500,000 |
| | 2,000,000 | 2,120,000 |
| Net income | \$ 3,570,278 | \$ 3,568,336 |
| Per share amounts: | | |
| Basic earnings per common share | \$.16 | \$.16 |
| Diluted earnings per common share | \$.16 | \$.16 |
| Cash dividends per common share: | | |
| Class A Common Stock | \$.165 | \$.165 |
| Class B Common Stock | \$.150 | \$.150 |

* Certain amounts have been reclassified for the provisions of FAS 145. See Note J for further details.

See notes to unaudited interim financial statements.

Table of Contents**INGLES MARKETS, INCORPORATED AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)**

| | NINE MONTHS ENDED | |
|---|---------------------------------|----------------------------------|
| | June 28, 2003 (Restated)* | June 29, 2002 (Restated)** |
| Net sales | \$ 1,488,130,084 | \$ 1,475,552,233 |
| Cost of goods sold | 1,099,771,475 | 1,085,869,119 |
| Gross profit | 388,358,609 | 389,683,114 |
| Operating and administrative expenses | 347,358,785 | 343,338,840 |
| Rental income, net | 6,530,093 | 7,098,511 |
| Income from operations | 47,529,917 | 53,442,785 |
| Other income, net | 3,955,068 | 3,544,124 |
| Income before interest and income taxes | 51,484,985 | 56,986,909 |
| Interest expense | 38,081,394 | 39,456,009 |
| Income before income taxes | 13,403,591 | 17,530,900 |
| Income taxes: | | |
| Current | 6,800,000 | 7,750,000 |
| Deferred | (1,962,000) | (1,200,000) |
| | 4,838,000 | 6,550,000 |
| Net income | \$ 8,565,591 | \$ 10,980,900 |
| Per share amounts | | |
| Basic earnings per common share | \$.37 | \$.49 |
| Diluted earnings per common share | \$.37 | \$.48 |
| Cash dividends per common share: | | |
| Class A Common Stock | \$.495 | \$.495 |
| Class B Common Stock | \$.450 | \$.450 |

* Certain amounts have been restated in conjunction with the change in interpretation of EITF 02-16. See Note J for further details.

** Certain amounts have been reclassified for the provisions of FAS 145. See Note J for further details.

See notes to unaudited interim financial statements.

Table of Contents**INGLES MARKETS, INCORPORATED AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY
(UNAUDITED)**

NINE MONTHS ENDED JUNE 28, 2003 AND JUNE 29, 2002

| | CLASS A COMMON STOCK | | CLASS B COMMON STOCK | | PAID-IN CAPITAL IN EXCESS OF PAR VALUE | RETAINED EARNINGS (Restated)* | TOTAL (Restated)* |
|-----------------------------------|-------------------------|-------------------|-------------------------|-------------------|---|-------------------------------------|-----------------------|
| | SHARES | AMOUNT | SHARES | AMOUNT | | | |
| Balance, September 29, 2001 | 10,005,107 | \$ 500,255 | 12,634,432 | \$ 631,722 | \$ 98,595,411 | \$ 136,772,824 | \$ 236,500,212 |
| Net income | | | | | | 10,980,900 | 10,980,900 |
| Cash dividends | | | | | | (10,664,265) | (10,664,265) |
| Exercise of stock options | 148,200 | 7,409 | | | 1,553,446 | | 1,560,855 |
| Common stock conversions | 26,200 | 1,311 | (26,200) | (1,311) | | | |
| Balance, June 29, 2002 | 10,179,507 | \$ 508,975 | 12,608,232 | \$ 630,411 | \$ 100,148,857 | \$ 137,089,459 | \$ 238,377,702 |
| Balance, September 28, 2002 | 10,189,807 | \$ 509,490 | 12,597,932 | \$ 629,897 | \$ 100,148,857 | \$ 137,270,604 | \$ 238,558,848 |
| Net income | | | | | | 8,565,591 | 8,565,591 |
| Cash dividends | | | | | | (10,726,938) | (10,726,938) |
| Exercise of stock options | 104,225 | 5,211 | | | 1,015,679 | | 1,020,890 |
| Common stock conversions | 206,716 | 10,336 | (206,716) | (10,336) | | | |
| Balance, June 28, 2003 | 10,500,748 | \$ 525,037 | 12,391,216 | \$ 619,561 | \$ 101,164,536 | \$ 135,109,257 | \$ 237,418,391 |

* Certain amounts have been restated in conjunction with the change in interpretation of EITF 02-16. See Note J for further details.

See notes to unaudited interim financial statements.

Table of Contents**INGLES MARKETS, INCORPORATED AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

| | NINE MONTHS ENDED | |
|---|---------------------------------|----------------------|
| | June 28, 2003 (Restated)* | June 29, 2002 |
| Cash Flows from Operating Activities: | | |
| Net income | \$ 8,565,591 | \$ 10,980,900 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization expense | 38,183,369 | 36,072,091 |
| Amortization of deferred gain on sale/leasebacks | (761,026) | (635,386) |
| Gains on disposals of property and equipment | (2,181,958) | (1,275,168) |
| Receipt of advance payments on purchases contracts | 530,546 | 2,756,871 |
| Recognition of advance payments on purchases contracts | (2,562,439) | (2,586,069) |
| Decrease in deferred income taxes | (1,962,000) | (1,200,000) |
| Decrease in receivables | 3,525,297 | 1,700,497 |
| (Increase) decrease in inventory | (7,074,502) | 810,739 |
| Increase in other assets | (1,796,335) | (324,726) |
| Decrease in accounts payable and accrued expenses | (5,451,671) | (9,307,227) |
| Net Cash Provided by Operating Activities | 29,014,872 | 36,992,522 |
| Cash Flows from Investing Activities: | | |
| Proceeds from sales of property and equipment | 3,433,386 | 7,031,083 |
| Capital expenditures | (58,119,635) | (26,227,924) |
| Net Cash Used by Investing Activities | (54,686,249) | (19,196,841) |
| Cash Flows from Financing Activities: | | |
| Proceeds from issuance of long-term debt and advances on lines of credit | 120,000,000 | 272,280,684 |
| Debt issuance costs | (1,058,125) | (9,695,258) |
| Principal payments on long-term debt | (59,094,395) | (216,263,126) |
| Proceeds from exercise of stock options | 1,020,890 | 1,560,855 |
| Dividends paid | (10,726,938) | (10,664,265) |
| Net Cash Provided by Financing Activities | 50,141,432 | 37,218,890 |
| Net Increase in Cash | 24,470,055 | 55,014,571 |
| Cash at beginning of period | 46,900,305 | 12,434,897 |
| Cash at End of Period | \$ 71,370,360 | \$ 67,449,468 |

* Certain amounts have been restated in conjunction with the change in interpretation of EITF 02-16. See Note J for further details.

See notes to unaudited interim financial statements.

Table of Contents**INGLES MARKETS, INCORPORATED AND SUBSIDIARIES****NOTES TO UNAUDITED INTERIM FINANCIAL STATEMENTS**

Nine Months Ended June 28, 2003 and June 29, 2002

A. BASIS OF PREPARATION

In the opinion of management, the accompanying unaudited interim financial statements contain all adjustments necessary to present fairly the Company's financial position as of June 28, 2003, and the results of operations, changes in stockholders' equity and cash flows for the three-month and nine-month periods ended June 28, 2003 and June 29, 2002. The adjustments made are of a normal recurring nature. Certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission for Form 10-Q. It is suggested that these unaudited interim financial statements be read in conjunction with the audited financial statements and the notes thereto included in the Annual Report on Form 10-K for the year ended September 28, 2002 filed by the Company under the Securities Exchange Act of 1934 on December 10, 2002.

The results of operations for the three-month and nine-month periods ended June 28, 2003 are not necessarily indicative of the results to be expected for the full fiscal year.

Certain amounts for the three-month and nine-month periods ended June 29, 2002 have been reclassified for comparative purposes. See note J below.

B. ALLOWANCE FOR DOUBTFUL ACCOUNTS

Receivables are presented net of an allowance for doubtful accounts of \$606,954 and \$479,113 at June 28, 2003 and September 28, 2002, respectively.

C. ACCOUNTS PAYABLE, ACCRUED EXPENSES AND CURRENT PORTION OF OTHER LONG-TERM LIABILITIES

Accounts payable, accrued expenses and current portion of other long-term liabilities consist of the following:

| | June 28, 2003 | September 28, 2002 |
|--|--------------------------|-------------------------------|
| Accounts payable-trade | \$ 88,341,248 | \$ 82,651,435 |
| Property, payroll, and other taxes payable | 10,611,547 | 12,362,475 |
| Salaries, wages and bonuses payable | 11,475,102 | 11,985,095 |
| Self-insurance reserves | 7,092,488 | 6,565,623 |
| Interest | 2,493,115 | 9,569,420 |
| Other | 12,354,959 | 15,989,037 |
| | \$ 132,368,459 | \$ 139,123,085 |

Self-insurance reserves are established for workers' compensation and employee group medical and dental benefits based on claims filed and estimates of claims incurred but not reported. The Company is insured for covered costs in excess of \$350,000 per occurrence for workers' compensation and \$200,000 per covered person for medical care benefits for a policy year. Employee insurance expense, including workers' compensation and medical care benefits, net of employee contributions, totaled \$3.8 million and \$4.9 million for the three-month periods ended June 28, 2003 and June 29, 2002, respectively.

For the nine-month periods ended June 28, 2003 and June 29, 2002, employee insurance expense, net of employee contributions, totaled \$13.5 million and \$15.4 million, respectively.

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D. LONG-TERM DEBT

On May 29, 2003 the Company closed an offering of an additional \$100 million of the existing \$250 million 8-7/8% Senior Unsecured Subordinated Notes (the Notes). A portion of the proceeds was used to repay \$22.4 million of outstanding borrowings under existing lines of credit.

The Company has committed lines of credit totaling \$145 million, all of which is unused. \$120 million of the lines mature in October 2006 while the other \$25 million matures from September 2003 through October 2004. The maturity of the lines was renegotiated in connection with the issuance of the additional Notes.

E. DIVIDENDS

The Company paid cash dividends of \$.165 for each share of Class A Common Stock and \$.15 for each share of Class B Common Stock on April 9, 2003, January 15, 2003 and October 9, 2002 to stockholders of record on March 31, 2003, January 6, 2003 and October 1, 2002, respectively.

F. SUPPLEMENTARY CASH FLOW INFORMATION

Cash paid for interest and taxes is as follows:

| | Nine Months Ended | |
|--------------------------------------|-------------------|------------------|
| | June 28, 2003 | June 29, 2002 |
| Interest (net of amount capitalized) | \$ 45,157,699 | \$39,273,586 |
| Income taxes | \$ 8,923,854 | \$ 7,191,852 |

G. EARNINGS PER COMMON SHARE

The following tables set forth the computation of basic and diluted earnings per share for the three-month periods indicated:

| | Three Months Ended | |
|---|--------------------|------------------|
| | June 28, 2003 | June 29, 2002 |
| BASIC: | | |
| Net income | \$ 3,570,278 | \$ 3,568,336 |
| Weighted average number of common shares outstanding | 22,846,412 | 22,776,351 |
| Basic earnings per common share | \$.16 | \$.16 |
| DILUTED: | | |
| Net income | \$ 3,570,278 | \$ 3,568,336 |
| Weighted average number of common shares and common stock equivalent shares outstanding | 22,893,771 | 23,276,578 |
| Diluted earnings per common share item | \$.16 | \$.16 |

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The following table sets forth the computation of basic and diluted earnings per share for the nine-month periods indicated:

| | Nine Months Ended | |
|---|-------------------|------------------|
| | June 28, 2003 | June 29, 2002 |
| BASIC: | | |
| Net income | \$ 8,565,591 | \$ 10,980,900 |
| Weighted average number of common shares outstanding | 22,852,999 | 22,705,461 |
| Basic earnings per common share | \$.37 | \$.49 |
| DILUTED: | | |
| Net income | \$ 8,565,591 | \$ 10,980,900 |
| Weighted average number of common shares and common stock equivalent shares outstanding | 23,024,166 | 23,141,537 |
| Diluted earnings per common share | \$.37 | \$.48 |

H. LINES OF BUSINESS

The Company operates three lines of business: retail grocery sales, shopping center rentals, and a fluid dairy processing plant. All of the Company's operations are domestic. Information about the Company's operations by lines of business (in thousands) is as follows:

| | Three Months Ended | | Nine Months Ended | |
|---|--------------------|------------------|--------------------|--------------------|
| | June 28, 2003 | June 29, 2002 | June 28, 2003 | June 29, 2002 |
| Revenues from unaffiliated customers: | | | | |
| Grocery sales | \$479,871 | \$459,857 | \$1,418,498 | \$1,406,196 |
| Shopping center rentals | 3,679 | 3,963 | 11,588 | 11,847 |
| Fluid dairy | 23,760 | 23,095 | 69,632 | 69,356 |
| Total revenues from unaffiliated customers | \$507,310 | \$486,915 | \$1,499,718 | \$1,487,399 |
| Income from operations: | | | | |
| Grocery sales | \$ 12,248 | \$ 13,577 | \$ 32,992 | \$ 37,568 |
| Shopping center rentals | 2,030 | 2,342 | 6,530 | 7,099 |
| Fluid dairy | 2,524 | 3,119 | 8,008 | 8,776 |
| Total income from operations | \$ 16,802 | \$ 19,038 | \$ 47,530 | \$ 53,443 |

| June 28, 2003 | September 28, 2002 |
|------------------|-----------------------|
|------------------|-----------------------|

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| Assets: | | |
|-------------------------|-------------------|-------------------|
| Grocery sales | \$ 914,778 | \$ 860,583 |
| Shopping center rentals | 121,783 | 124,965 |
| Fluid dairy | 27,366 | 28,843 |
| | <u> </u> | <u> </u> |
| Total assets | \$1,063,927 | \$1,014,391 |
| | <u> </u> | <u> </u> |

Revenue from shopping center rentals is reported on the rental income, net line of the statements of income. The other revenues comprise the net sales reported.

For the three months ended June 28, 2003 and June 29, 2002, respectively, the fluid dairy segment had \$10.5 and \$11.0 million in sales to the grocery sales segment. The fluid dairy segment had \$33.2 and \$33.3 million in sales to the grocery sales segment in the nine-month periods ended June 28, 2003 and June 29, 2002, respectively. These sales have been eliminated in consolidation and are excluded from the amounts in the table above.

Table of Contents**I. ACCOUNTING FOR STOCK-BASED COMPENSATION**

In December 2002, the FASB issued Statement No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure* (FAS 148). FAS 148 amends FASB Statement No. 123, *Accounting for Stock-Based Compensation* (FAS123), to provide alternative methods of transition to the fair value method of accounting for stock-based employee compensation.

In addition, FAS 148 amends the disclosure provisions of FAS 123 to require disclosure of the effects of an entity's accounting policy with respect to stock-based employee compensation on reported net income and earnings per share in annual and interim financial statements. FAS 148 does not amend FAS 123 to require companies to account for their employee stock-based awards using the fair value method. However, the disclosure provisions are required for all companies with stock-based employee compensation, regardless of whether they utilize the fair value method of accounting described in FAS 123 or the intrinsic value method described in Accounting Principals Board Opinion No. 25 (APB Opinion No. 25), *Accounting for Stock Issued to Employees*. FAS 148 is effective for fiscal years ending after December 15, 2002 and early application is permitted. Interim pro forma disclosures are required for interim periods beginning after December 15, 2002. The Company adopted FAS 148 beginning with the March 29, 2003 quarter.

The Company reports the value of stock-based employee compensation under the provisions of FAS 123. FAS 123 establishes financial accounting and reporting standards for stock-based compensation plans. As permitted by FAS 123, the Company elected to account for stock-based compensation awards in accordance with APB Opinion No. 25. In accordance with FAS 123, the fair value of each option grant was determined using the Black-Scholes option-pricing model.

Had compensation cost for the Company's plans been determined based on the fair value at the grant date for such awards consistent with the provisions of FAS 123, the Company's earnings and earnings per share, basic and diluted, would have been reduced to the pro forma amounts indicated below:

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|------------------|-------------------|------------------|
| | June 28, 2003 | June 29, 2002 | June 28, 2003 | June 29, 2002 |
| BASIC | | | | |
| Net income | \$3,570,278 | \$3,568,336 | \$8,565,591 | \$10,980,900 |
| Net income, pro forma | \$3,433,074 | \$3,535,392 | \$8,060,135 | \$10,234,728 |
| Basic earnings per common share | \$.16 | \$.16 | \$.37 | \$.49 |
| Basic earnings per common share, pro forma | \$.15 | \$.15 | \$.35 | \$.45 |
| DILUTED | | | | |
| Diluted earnings | \$3,570,278 | \$3,568,336 | \$8,565,591 | \$10,980,900 |
| Diluted earnings, pro forma | \$3,433,074 | \$3,535,392 | \$8,060,135 | \$10,234,728 |
| Diluted earnings per common share | \$.16 | \$.16 | \$.37 | \$.48 |
| Diluted earnings per common share, pro forma | \$.15 | \$.14 | \$.35 | \$.44 |

No compensation expense has been recognized under APB Opinion No. 25 in the three and nine month periods ended June 28, 2003 and June 29, 2002. The pro forma impact of these options is not likely to be representative of the effects on reported net income for future years.

J. NEW ACCOUNTING PRONOUNCEMENTS

In April 2002, the FASB issued Statement No. 145, *Modifications to Reporting of Extinguishments of Debt and Accounting for Certain Capital Lease Modifications and Technical Corrections* (FAS 145). FAS 145 requires gains and losses on extinguishments of debt to be classified as income or loss from continuing operations rather than as extraordinary items as previously required under FASB Statement No. 4. Extraordinary treatment is required for certain extinguishments as provided in APB Opinion No. 30. FAS 145 also amends FASB Statement No. 13 to require certain modifications to capital leases be treated as sale-leaseback transactions and modifies the accounting for sub-leases when the original lessee remains a secondary obligor (or guarantor). In the December 2002 quarter,

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the Company adopted FAS 145. Costs of \$0.7 million incurred with the early retirement of \$170.0 million in debt have been reclassified in the June 2002 nine-month period from an extraordinary item to interest expense. The reclassification has no effect on total basic or diluted earnings per share but eliminates the need to classify a \$0.02 per share loss in the June 2002 nine-month period as an extraordinary item.

EITF (Emerging Issues Task Force) Issue No. 02-16, Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor, became effective as to the Company on December 29, 2002. This issue addresses the appropriate accounting for consideration received from a vendor. Due to system constraints and the nature of certain allowances, it is sometimes not practicable to apply allowances to the item cost of inventory. As a result of this new guidance and these constraints, the Company has adopted a new policy for recognizing vendor allowances, including slotting fees. The Company recognizes these allowances as a reduction to inventory and ultimately to cost of goods sold when the related products are sold, for transactions executed subsequent to December 29, 2002. Under the Company's previous accounting policy for vendor allowances including slotting fees, these credits were recognized as a reduction to cost of goods sold as soon as the amount was contractually established and collection was probable. In connection with the implementation of this new accounting policy, the Company applied the provisions of EITF No. 02-16 prospectively which resulted in deferring recognition of \$2.6 million of allowances, before a tax benefit of approximately \$1.0 million, in the second quarter of 2003. There is no additional impact recorded in the third quarter of 2003. This charge was recorded in the Company's Condensed Consolidated Statement of Income using the prospective method and reflects an adjustment of the Company's inventory balance.

In January 2003, the FASB released Interpretation No. 46, Consolidation of Variable Interest Entities (FIN 46). FIN 46 requires that all primary beneficiaries of Variable Interest Entities (VIE) consolidate that entity. FIN 46 is effective immediately for VIEs created or acquired after January 31, 2003. It applies in the first fiscal year or interim period beginning after June 15, 2003, to variable interest entities in which an enterprise holds a VIE it acquired before February 1, 2003. The Company has determined that it has not created or modified any relationships or contracts since February 1, 2003 that could result in potential VIEs. The Company is in the process of identifying any relationships that existed prior to February 1, 2003 that could potentially be classified as a VIE. The impact on the Company's financial statements is not known at this time.

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

Overview

Ingles, a leading supermarket chain in the Southeast, operates 199 supermarkets in Georgia (83), North Carolina (60), South Carolina (32), Tennessee (21), Virginia (2) and Alabama (1). The Company locates its supermarkets primarily in suburban areas, small towns and rural communities. Ingles' supermarkets offer customers a wide variety of nationally advertised food products, including grocery, meat and dairy products, produce, frozen foods and other perishables and non-food products, including health and beauty care products and general merchandise, as well as quality private label items. In addition, the Company focuses on selling high-growth, high-margin products to its customers through the development of book sections, media centers, floral departments, bakery departments and prepared foods including delicatessen sections. The Company recently began adding fuel centers and pharmacies at select store locations. As of June 28, 2003, the Company operated 23 in-store pharmacies and 16 fuel centers.

Ingles also operates two other lines of business, fluid dairy processing and shopping center rentals. The fluid dairy processing segment sells approximately 32% of its products to the retail grocery segment and approximately 68% of its products to third parties. Real estate ownership (including the shopping center rental segment) is an important component of the Company's operations, providing both operational and economic benefit.

Critical Accounting Policies

Critical accounting policies are those accounting policies that management believes are important to the portrayal of Ingles' financial condition and results of operations, and require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain.

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Self-Insurance

The Company is self-insured for workers' compensation and group medical and dental benefits. Risks and uncertainties are associated with self-insurance; however, the Company has limited its exposure by maintaining excess liability coverages. Self-insurance reserves are established based on claims filed and estimates of claims incurred but not reported. The estimates are based on data provided by the respective claims administrators. The majority of the Company's properties are self-insured for casualty losses and business interruption; however, liability coverage is maintained.

Asset Impairments

Beginning in fiscal 2003, the Company accounts for the impairment of long-lived assets in accordance with Statement of Financial Accounting Standards No. 144. For assets to be held and used, the Company tests for impairment using undiscounted cash flows and calculates the amount of impairment using discounted cash flows. For assets held for sale, impairment is recognized based on the excess of remaining book value over expected recovery value. The recovery value is the fair value as determined by independent quotes or expected sales prices developed by internal specialists. Estimates of future cash flows and expected sales prices are judgments based upon the Company's experience and knowledge of local operations and cash flows that are projected for several years into the future. These estimates can fluctuate significantly due to changes in real estate market conditions, the economic environment, capital spending decisions and inflation.

Closed Store Accrual

For properties to be closed that are under long-term lease agreements, the present value of any remaining liability under the lease, discounted using risk-free rates and net of expected sublease recovery, is recognized as a liability and expensed. If the real estate and leasing markets change, sublease recovery could vary significantly from the recoveries originally assumed, resulting in a material change in the Company's recorded liability.

Vendor Allowances

The Company receives funds for a variety of merchandising activities from the many vendors whose products the Company buys for resale in its stores. These incentives and allowances include volume or purchase based incentives, advertising allowances, slotting fees, and promotional discounts. The purpose of these incentives and allowances is generally to help defray the costs incurred by the Company for stocking, advertising, promoting and selling the vendor's products. Whenever possible, vendor discounts and allowances that relate to our buying and merchandising activities are recorded as a component of item cost inventory and recognized in merchandise costs when the item is sold. Due to system constraints and the nature of certain allowances, it is sometimes not practicable to apply allowances to the item cost of inventory. In those instances, the allowances are applied as a reduction of merchandise costs using a rational and systematic methodology, which results in the recognition of these incentives when the initial purchase of the related merchandise is sold. Amounts that represent a reimbursement of specific identifiable incremental costs, such as advertising, are recorded as a reduction to the related expense in the period that the related expense is incurred.

Results of Operations

Ingles operates on a 52 or 53-week fiscal year ending on the last Saturday in September. There are 13 and 39 weeks of operations included in the unaudited condensed consolidated statements of income for the three and nine-month periods ended June 28, 2003 and June 29, 2002. Comparable store sales are defined as sales by grocery stores in operation for the entire duration of the previous and current fiscal years. Replacement stores and major and minor remodels are included in the comparable store sales calculation. For the three and nine-month periods ended June 28, 2003 and June 29, 2002 comparable store sales includes 195 stores.

A replacement store is a new store that is opened to replace an existing nearby store that is closed. A major remodel entails substantial remodeling of an existing store and may include additional retail square footage. A minor remodel includes repainting, remodeling and updating the lighting and equipment throughout an existing store.

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The following table sets forth, for the periods indicated, selected financial information as a percentage of net sales. For information regarding the various segments of the business, see Note H Lines of Business to the Unaudited Consolidated Financial Statements.

| | Three Months Ended | | Nine Months Ended | |
|---|--------------------|------------------|-------------------|------------------|
| | June 28, 2003 | June 29, 2002 | June 28, 2003 | June 29, 2002 |
| Net sales | 100.0% | 100.0% | 100.0% | 100.0% |
| Gross profit | 26.0% | 26.7% | 26.1% | 26.4% |
| Operating and administrative expenses | 23.0% | 23.3% | 23.3% | 23.3% |
| Rental income, net | 0.4% | 0.5% | 0.4% | 0.5% |
| Other income, net | 0.3% | 0.1% | 0.3% | 0.2% |
| Income before interest and income taxes | 3.7% | 4.0% | 3.5% | 3.8% |
| Interest expense | 2.6% | 2.8% | 2.6% | 2.6% |
| Income before income taxes | 1.1% | 1.2% | 0.9% | 1.2% |
| Income taxes | 0.4% | 0.5% | 0.3% | 0.5% |
| Net income | 0.7% | 0.7% | 0.6% | 0.7% |

Three Months Ended June 28, 2003 Compared to the Three Months Ended June 29, 2002

Net Sales. Sales comparisons for the three-month period were affected by the timing of the Easter holiday. In fiscal 2002, Easter fell on the day following the end of the second quarter, therefore Easter related sales were included in the second quarter of fiscal 2002. Easter related sales are included in the third quarter of fiscal 2003.

Net sales for the June 2003 quarter increased 4.3% to \$503.6 million from \$483.0 million for the same quarter last year. Comparable store sales for the same period increased \$12.8 million or 2.8%. Excluding the effect of Easter sales, comparable store sales increased \$8.5 million or 2.0% for the June 2003 quarter compared to the June 2002 quarter. Aggressive promotional activity during the third quarter of 2003 was a primary contributing factor to the sales increase. Ingles operated 199 stores at the end of the June 2003 quarter and 201 stores at the end of the June 2002 quarter.

Gross Profit. Gross profit for the three-month period ended June 28, 2003, increased 1.4% to \$131.0 million, or 26.0% of sales, compared to \$129.2 million, or 26.7% of sales, for the three-month period ended June 29, 2002. Although gross profit dollars increased, gross profit as a percentage of sales decreased primarily due to the cost of the aggressive promotional activity during the quarter. The majority of the decrease as a percentage of sales was in the grocery department.

Operating and Administrative Expenses. Operating and administrative expenses increased 3.3% to \$116.2 million for the three months ended June 28, 2003, from \$112.5 million for the three months ended June 29, 2002. As a percentage of sales, operating and administrative expenses decreased to 23.1% for the June 2003 three-month period compared to 23.3% for the June 2002 three-month period.

A breakdown of the major increases (decreases) in operating and administrative expenses, expressed as a percentage of sales, is as follows:

| | |
|-------------------------------|--------|
| Salaries and wages | 0.1% |
| Rent expense | 0.1% |
| Depreciation and amortization | 0.1% |
| Bank charges | 0.1% |
| Repairs and maintenance | (0.1)% |
| Insurance | (0.2)% |

Salaries and wages increased as a percentage of sales, due to the addition of labor hours at the store level to enhance customer service as part of the Company's initiative to drive sales.

Both rent expense and depreciation and amortization expense increased due to four new stores opened during the year, three of which are leased and one of which is owned as well as two major remodel/expansions that were completed during the year.

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Bank charges, as a percentage of sales, rose due to both increased usage of debit and credit cards and increased transaction fees.

Repairs and maintenance, as a percentage of sales, decreased primarily due to changes made in the refrigeration maintenance program and the addition of a field employee to oversee maintenance contractors at the store level. The charges made in the refrigeration maintenance program include a major vendor change and closer scrutiny and negotiation of charges made by maintenance contractors. We have hired a new field employee who has been charged with overseeing maintenance contractors at the store level. This employee has been successful in eliminating unnecessary charges and in reducing rates of needed maintenance.

The decline in insurance expense was due primarily to increased loss control efforts by the risk management department and store operations and to changes made to the self-insured group insurance plan in both April 2003 and April 2002. Loss control efforts from the risk management department and store operations include safety training, quick reporting of accidents and swifter disposition of general liability and workers compensation claims. Also, charges made directly to stores per accident have made the stores more proactive in preventing accidents. Changes made to the self-insured group plan in April 2002 and April 2003 include the addition of higher co-pays, larger deductibles and larger employee contributions. All these changes have resulted in a decline in insurance expense.

Rental Income, Net. Rental income, net decreased \$0.3 million to \$2.0 million for the June 2003 quarter from \$2.3 million for the June 2002 quarter. The decrease is due primarily to the loss of K-Mart as a tenant in one location and the relocation of several drug store tenants to free-standing sites.

Income from Operations. Income from operations decreased 11.8% to \$16.8 million or 3.3% of sales in the June 2003 quarter compared to \$19.0 million, or 3.9% of sales in the June 2002 quarter. The decrease is principally attributable to the increase in operating and administrative expense and the decline in net rental income, somewhat offset by increased gross profit.

Other Income, Net. Other income, net increased \$1.2 million to \$1.6 million for the three-month period ended June 28, 2003 from \$0.4 million for the three-month period ended June 29, 2002. The increase is principally due to the inclusion in the June 2003 quarter of a gain of \$0.9 million from a payment received due to a state condemnation for the construction of a highway on land adjacent to a former store location. Other income, net for the June 2002 three-month period was partially offset by a charge of \$0.4 million for the write off of leasehold improvements due to a termination of a lease on a closed store.

Income Before Interest & Income Taxes. Income before interest and income taxes decreased \$1.0 million to \$18.4 million, during the June 2003 quarter compared to \$19.4 million during the June 2002 quarter. Income before interest and income taxes, as a percentage of sales, was 3.7% and 4.0% for the June 2003 quarter and the June 2002 quarter, respectively.

Interest Expense. Interest expense decreased \$0.9 million for the June 2003 quarter compared to the June 2002 quarter due to a reduction in debt from June 2002, prior to the issuance on May 29, 2003 of an additional \$100 million of the existing 8-7/8% Senior Unsecured Subordinated Notes, due December 2011. A portion of the proceeds from the additional Notes was used to reduce outstanding borrowings of \$22.4 million under existing lines of credit.

Income Taxes. Income tax expense as a percentage of pre-tax income decreased to 35.9% in the June 2003 quarter compared to 37.3% in the June 2002 quarter, due primarily to reduced state income taxes.

Net Income. Net income remained stable at \$3.6 million, or \$.16 per basic and diluted share, for both the three-month period ended June 28, 2003 and the three-month period ended June 29, 2002. Net income, as a percentage of sales, was 0.7% for both the June 2003 and June 2002 three-month periods.

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Net Sales. Net sales for the nine months ended June 28, 2003 increased 0.9% to \$1.488 billion, compared to \$1.476 billion for the nine months ended June 29, 2002. Comparable store sales increased \$5.6 million or 0.4% for such period. Declines in comparable store sales in the previous two quarters, were more than offset with comparable store sales increases in the June 2003 quarter.

Gross Profit. Gross profit for the nine months ended June 28, 2003 decreased 0.3% to \$388.4 million, compared to \$389.7 million, for the nine months ended June 29, 2002. As a percentage of sales, gross profit decreased slightly to 26.1% for the nine months ended June 28, 2003 from 26.4% for the nine months ended June 29, 2002. The Company had previously recognized certain vendor allowances, principally slotting fees as soon as the amount was contractually established and collection was probable. Under EITF 02-16, the Company has changed its policy to including these allowances as a reduction in inventory value. Adoption of this policy in the June 2003 nine-month period resulted in a one time non-cash charge to cost of goods sold of \$2.6 million, or 1.0% of the 0.3 % decrease in gross profit.

Operating and Administrative Expenses. Operating and administrative expenses increased 1.2% to \$347.4 million for the nine months ended June 28, 2003, from \$343.3 million for the nine months ended June 29, 2002. Operating and administrative expenses, as a percentage of sales, were 23.3% for both the June 2003 nine-month period and the June 2002 nine-month period.

A breakdown of the major increases (decreases) in operating and administrative expenses, expressed as a percentage of sales, is as follows:

| | |
|-------------------------------|--------|
| Rent expense | 0.1% |
| Depreciation and amortization | 0.1% |
| Insurance | (0.1)% |

As discussed in the three-month comparison, rent expense and depreciation and amortization expense increased due to new store construction and major remodel/expansions of existing stores. Insurance expense decreased due to the factors discussed in the three-month comparison above.

Rental Income, Net. Rental income, net decreased \$0.6 million to \$6.5 million in the June 2003 nine-month period from \$7.1 million in the June 2002 comparable period. Gross rental income decreased \$0.3 million, while shopping center expenses (primarily depreciation) increased \$0.3 million.

Income from Operations. Income from operations decreased 11.1% to \$47.5 million or 3.2% of sales in the June 2003 nine-month period compared to \$53.4 million, or 3.6% of sales in the June 2002 nine-month period.

Other Income, Net. Other income, net increased \$0.4 million for the June 2003 nine-month period over the comparable period in fiscal 2002. The June 2003 nine-month period included a gain of \$1.1 million from the sale of a shopping center in which the company no longer operated a store and the \$0.9 million gain from the proceeds of a state condemnation for highway construction on land adjacent to a former Ingles store. The June 2002 nine-month period included \$1.8 million in gains from the sale of three tracts of land, partially offset by the write-off of leasehold improvements of \$0.4 million on a lease termination for a closed store.

Interest Expense. Interest expense decreased \$1.4 million to \$38.1 million for the nine months ended June 28, 2003 from \$39.5 million for the nine months ended June 29, 2002, due primarily to the decrease in debt prior to the issuance of the additional Notes on May 29, 2003.

Costs of \$0.7 million associated with the early retirement of debt incurred during the June 2002 nine-month period have been reclassified in the June 2002 nine-month period from an extraordinary item to interest expense in compliance with FASB Statement No. 145.

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Income Taxes. Income tax expense as a percentage of pre-tax income decreased to 36.1% in the June 2003 nine-month period compared to 37.4% in the June 2002 nine-month period due primarily to a reduction in state income tax expense.

Net Income. Net income for the June 2003 nine-month period was \$8.6 million, or 0.6% of sales, compared to \$11.0 million, or 0.7% of sales, for the June 2002 nine-month period. Basic earnings per common share were \$.37 and \$.49 for the June 2003 and June 2002 nine-month period, respectively. Diluted earnings per common share were \$.37 for the June 2003 nine-month period compared to \$.48 for the June 2002 nine-month period. The one time charge from adoption of EITF 02-16 resulted in a reduction of net income of \$1.6 million, or \$.07 per diluted share.

Liquidity and Capital Resources

Capital Expenditures

The Company believes that a key to its ability to continue to develop a loyal customer base is providing conveniently located, clean and modern stores which provide customers with good service and a broad selection of competitively priced products. As such, the Company has invested and will continue to invest significant amounts of capital toward the modernization of its store base. The Company's modernization program includes the opening of new stores, the completion of major remodels and expansion of selected existing stores, the relocation of selected existing stores to larger, more convenient locations and the completion of minor remodeling of its remaining existing stores.

Capital expenditures totaled \$58.1 million for the nine-month period ended June 28, 2003, including the opening of four new stores, the completion of two major remodel/expansions and three minor remodels and the purchase of one shopping center in which the Company was a tenant. Capital expenditures also included the costs of upgrading and replacing store equipment, technology investments, the purchase of future store sites, capital expenditures related to the Company's distribution operation and its milk processing plant, and expenditures for stores to open later in fiscal 2003 and in fiscal 2004.

Total capital expenditure plans for fiscal 2003 are projected to be approximately \$70 million. For the balance of fiscal 2003, the Company plans to replace one existing store and complete one major remodel/expansion. Expenditures will also include investments in stores expected to open in fiscal 2004 as well as technology improvements, upgrading and replacing existing store equipment and warehouse and transportation equipment and improvements to the Company's milk processing plant.

While capital expenditures for the fiscal year are expected to be of a level consistent with the Company's past practice, management expects that the number of projects pursued during each fiscal year will decline in the future to some degree, possibly stabilizing at a smaller number of projects per year. This decline in number is a result of an increase in the average size of each company store. The dollar value of such projects should remain stable or continue to increase.

The Company does not generally enter into commitments for capital expenditures other than on a store-by-store basis at the time it begins construction on a new store or begins a major or minor remodeling project. The Company generally engages in major remodeling and new store development on not more than three or four locations at a time. Therefore, the dollar amounts of any commitments for capital expenditures are generally immaterial to the Company's financial position and when compared to aggregate capital expenditures in each fiscal year. The vast majority of the Company's capital expenditures each fiscal year is discretionary. The Company makes expenditure decisions from time to time based on available financing and other market conditions.

Liquidity

The Company had net cash from operations of \$29.0 million in the June 2003 nine-month period compared to \$37.0 million in the June 2002 period. The primary factors contributing to the fluctuation were increases in inventory and decreases in accounts payable and accrued expenses, partially offset by a decrease in receivables. Although trade accounts payable increased in conjunction with the increase in inventory, interest payable decreased due to two semi-annual payments of interest on the Notes in the June 2003 nine-month period.

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Cash used by investing activities totaled \$54.7 million comprised primarily of \$58.1 million of capital expenditures during the period, partially offset by \$3.4 million of proceeds from the sale of assets. The Company has generally funded its capital expenditures with cash provided from operations and borrowings under lines of credit. The lines of credit are later refinanced with secured long-term debt. During the June 2003 nine-month period, the Company's financing activities provided \$50.1 million in cash. Proceeds from long-term debt totaled \$120.0 million, comprised of \$100.0 million from the issuance of additional Notes and \$20.0 net advances under long-term lines of credit, while repayments of long-term debt were \$59.1 million. Dividends paid totaled \$10.7 million.

At June 28, 2003, the Company had lines of credit with five banks totaling \$145.0 million, all of which was unused. Of the \$145.0 million of committed lines of credit, \$120.0 million matures in October 2006 and \$25.0 million matures between September 2003 and November 2004. The lines provide the Company with various interest rate options generally at rates less than prime. The Company is not required to maintain compensating balances in connection with these lines of credit. The Company was in compliance with all financial covenants related to these lines of credit at June 28, 2003.

The Company's principal sources of liquidity are expected to be cash flow from operations, borrowings under its lines of credit and long-term financing. As of June 28, 2003, the Company had unencumbered real property and equipment with a net depreciated value of approximately \$323.6 million. The Company believes, based on its current results of operations and financial condition, that its financial resources, including existing bank lines of credit, short- and long-term financing expected to be available to it and internally generated funds, will be sufficient to meet planned capital expenditures and working capital requirements for the foreseeable future, including any debt service requirements of additional borrowings. However, there can be no assurance that any such sources of financing will be available to the Company on acceptable terms, or at all.

The supermarket business is a highly competitive business with numerous competitors. There is increasing competition for food business from non-traditional retailers such as discount stores, drug stores, club stores and super centers, as well as from restaurants as families eat out more often. The Company currently expects moderate sales growth to continue in the upcoming fiscal year as stores that are new or expanded mature and promotional efforts to drive sales are successful. It also currently expects sales of higher margin products to continue to increase due to the expansion of the perishable departments in stores that are new or remodeled.

However, it is possible that, in the future, the Company's results of operations and financial condition will be different from that described in this report or from that currently expected by the Company based on a number of intangible factors. These factors may include, among others, increased competition, changing regional and national economic conditions, adverse climatic conditions affecting food production and delivery and changing demographics as well as the additional factors discussed below under "Forward Looking Statements". It is also possible, for such reasons, that the results of operations from the new, expanded, remodeled and/or replacement stores will not meet or exceed the results of operations from existing stores that are described in this report.

Quarterly Cash Dividends

Since December 27, 1993, the Company has paid regular quarterly cash dividends of \$.165 (sixteen and one-half cents) per share on its Class A Common Stock and \$.15 (fifteen cents) per share on its Class B Common Stock for an annual rate of \$.66 and \$.60 per share, respectively.

The Company expects to continue paying regular cash dividends on a quarterly basis. However, the Board of Directors periodically reconsiders the declaration of dividends. The Company pays these dividends at the discretion of the Board of Directors and the continuation of these payments, the amount of such dividends, and the form in which the dividends are paid (cash or stock) depends upon the results of operations, the financial condition of the Company and other factors which the Board of Directors deems relevant. In addition, certain loan agreements containing provisions outlining minimum tangible net worth requirements restrict the ability of the Company to pay additional dividends to approximately \$29.0 million based on tangible net worth at June 28, 2003. Further, the Company is prevented from paying dividends at any time that it is in default under the indenture governing the Notes. In addition, the terms of the indenture may restrict the ability of the Company to pay additional dividends based on certain financial parameters.

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Impact of Inflation

Inflation in food prices during the first nine months of fiscal 2003 and in fiscal 2002 was slightly higher than the overall increase in the Consumer Price Index. One of the Company's significant costs is labor, which increases with inflation.

New Accounting Pronouncements

In April 2002, the FASB issued Statement No. 145, *Modifications to Reporting of Extinguishments of Debt and Accounting for Certain Capital Lease Modifications and Technical Corrections* (FAS 145). FAS 145 requires gains and losses on extinguishments of debt to be classified as income or loss from continuing operations rather than as extraordinary items as previously required under FASB Statement No. 4. Extraordinary treatment is required for certain extinguishments as provided in APB Opinion No. 30. FAS 145 also amends FASB Statement No. 13 to require certain modifications to capital leases be treated as sale-leaseback transactions and modifies the accounting for sub-leases when the original lessee remains a secondary obligor (or guarantor). In the December 2002 quarter, the Company adopted FAS 145. Costs of \$0.7 million incurred with the early retirement of \$170.0 million in debt have been reclassified in the June 2002 nine-month period from an extraordinary item to interest expense. The reclassification had no effect on total basic or diluted earnings per share but eliminates the need to classify a \$0.02 per share loss in the June 2002 nine-month period as an extraordinary item.

EITF (Emerging Issues Task Force) Issue No. 02-16, *Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor*, became effective as to the Company on December 29, 2002. This issue addresses the appropriate accounting for consideration received from a vendor. Due to system constraints and the nature of certain allowances, it is sometimes not practicable to apply allowances to the item cost of inventory. As a result of this new guidance and these constraints, the Company has adopted a new policy for recognizing vendor allowances, including slotting fees. The Company recognizes these allowances as a reduction to inventory and ultimately to cost of goods sold when the related products are sold, for transactions executed subsequent to December 29, 2002. Under the Company's previous accounting policy for vendor allowances including slotting fees, these credits were recognized as a reduction to cost of goods sold as soon as the amount was contractually established and collection was probable. In connection with the implementation of this new accounting policy, the Company applied the provisions of EITF No. 02-16 prospectively which resulted in deferring recognition of \$2.6 million of allowances, before a tax benefit of approximately \$1.0 million, in the second quarter of 2003. There is no additional impact recorded in the third quarter of 2003. This charge was recorded in the Company's Condensed Consolidated Statement of Income using the prospective method and reflects an adjustment of the Company's inventory balance.

In January 2003, the FASB released Interpretation No. 46, *Consolidation of Variable Interest Entities* (FIN 46). FIN 46 requires that all primary beneficiaries of Variable Interest Entities (VIE) consolidate that entity. FIN 46 is effective immediately for VIEs created or acquired after January 31, 2003. It applies in the first fiscal year or interim period beginning after June 15, 2003, to variable interest entities in which an enterprise holds a VIE it acquired before February 1, 2003. The Company has determined that it has not created or modified any relationships or contracts since February 1, 2003 that could result in potential VIEs. The Company is in the process of identifying any relationships that existed prior to February 1, 2003 that could potentially be classified as a VIE. The impact on the Company's financial statements is not known at this time.

Forward Looking Statements

This Quarterly Report contains certain forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934. The words *expect*, *anticipate*, *intend*, *plan*, *believe*, *seek* and similar expressions are intended to identify forward-looking statements. When forward-looking statements and the related assumptions are made in good faith and reflect our current judgment regarding the direction of our business, actual results will almost always vary, sometimes materially, from any estimates, predictions, projections, assumptions or other future performance suggested herein. Such statements are based upon a number of assumptions and estimates which are inherently subject to significant risks and uncertainties many of which are beyond our control. Some of these assumptions inevitably will not materialize, and unanticipated events will occur which will affect our results. Some important factors (but not necessarily all factors) that affect our revenues, growth strategies,

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future profitability and operating results, or that otherwise could cause actual results to differ materially from those expressed in or implied by any forward-looking statement, include business and economic conditions generally in the Company's operating area; the Company's ability to successfully implement its expansion and operating strategies and to manage rapid expansion; pricing pressures, the opening of competitors stores in the Company's markets and other competitive factors; the Company's ability to reduce costs and achieve improvements in operating results; the availability and terms of financing; increases in labor and utility costs; success or failure in the ownership and development of real estate; and changes in the laws and government regulations applicable to the Company.

Consequently, actual events affecting the Company and the impact of such events on the Company's operations may vary significantly from those described in this report or contemplated or implied by statements in this report.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

On December 11, 2001 the Company closed the offering of the Notes. On May 29, 2003, the Company closed an issuance of an additional \$100 million of the Notes. The Notes bear interest at a rate of 8 7/8%. The \$250 million of Notes issued in 2001 were issued at a discount to yield 9%. The \$100 million of Notes issued in 2003 were issued at a premium to yield 8.67%. There have been no material changes in the market interest rates subsequent to September 28, 2002.

Item 4. CONTROLS AND PROCEDURES

As of June 28, 2003, the end of the period covered by this report, an evaluation was performed under the supervision and with the participation of Ingles' management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of Ingles' disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act). Based on that evaluation, Ingles' management, including the Chief Executive Officer and Chief Financial Officer, concluded that, as of the end of the period covered by this report, Ingles' disclosure controls and procedures were effective at ensuring that required information will be disclosed on a timely basis in Ingles' reports filed under the Exchange Act. No significant changes in Ingles' internal control over financial reporting have occurred during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect, Ingles' internal control over financial reporting.

Part II. Other Information

Item 6. EXHIBITS AND REPORTS ON FORM 8-K

- (a) Exhibits.
 - 1) Exhibit 31.1 Rule 13a-14(a) Certification
 - 2) Exhibit 31.2 Rule 13a-14(a) Certification
 - 3) Exhibit 32.1 Certification Pursuant to 18 U.S.C. Section 1350
 - 4) Exhibit 32.2 Certification Pursuant to 18 U.S.C. Section 1350
- (b) Reports on Form 8-K. The Company filed a report on form 8-K on April 30, 2002 furnishing a press release announcing earnings for the second quarter of fiscal 2003.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Amendment No. 2 to Form 10-Q to be signed on its behalf by the undersigned thereunto duly authorized.

INGLES MARKETS, INCORPORATED

Date: November 19, 2003

/s/ Brenda S. Tudor

Brenda S. Tudor
Vice President Finance and
Chief Financial Officer