

SPARTAN STORES INC
Form 10-Q
October 14, 2010

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

FORM 10-Q

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

For the quarterly period ended September 11, 2010.

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: 000-31127

SPARTAN STORES, INC.

(Exact Name of Registrant as Specified in Its Charter)

Michigan
(State or Other Jurisdiction
of Incorporation or Organization)

38-0593940
(I.R.S. Employer
Identification No.)

850 76th Street, S.W.
P.O. Box 8700
Grand Rapids, Michigan
(Address of Principal Executive Offices)

49518
(Zip Code)

(616) 878-2000

(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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

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| | | | |
|-------------------------|-----------------------|---------------------------|----------------------------------|
| Large accelerated filer | <input type="radio"/> | Accelerated filer | <input checked="" type="radio"/> |
| Non-accelerated filer | <input type="radio"/> | Smaller Reporting Company | <input type="radio"/> |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act)

Yes

No

As of October 11, 2010 the registrant had 22,627,275 outstanding shares of common stock, no par value.

FORWARD-LOOKING STATEMENTS

The matters discussed in this Quarterly Report on Form 10-Q, in our press releases and in our website-accessible conference calls with analysts and investor presentations include "forward-looking statements" about the plans, strategies, objectives, goals or expectations of Spartan Stores, Inc. (together with its subsidiaries, "Spartan Stores"). These forward-looking statements are identifiable by words or phrases indicating that Spartan Stores or management "expects," "anticipates," "plans," "believes," or "estimates," is "confident" that a particular occurrence or event "began," "will," "may," "could," "should" or "will likely" result or occur, or "appears" to have occurred, or will "continue" in the future, that the "outlook" or "trend" is toward a particular result or occurrence, that a development is an "opportunity," a "priority," a "strategy," or "initiative" or similarly stated expectations. Accounting estimates, such as those described under the heading "Critical Accounting Policies" in Part I, Item 2 of this Form 10-Q, are inherently forward-looking. Our asset impairment, restructuring cost provisions and fair value measurements are estimates and actual costs may be more or less than these estimates and differences may be material. You should not place undue reliance on these forward-looking statements, which speak only as of the date of the Quarterly Report, release, presentation, or statement.

In addition to other risks and uncertainties described in connection with the forward-looking statements contained in this Quarterly Report on Form 10-Q, Spartan Stores' Annual Report on Form 10-K for the year ended March 27, 2010 (in particular, you should refer to the discussion of "Risk Factors" in Item 1A of our Annual Report on Form 10-K) and other periodic reports filed with the Securities and Exchange Commission, there are many important factors that could cause actual results to differ materially. Our ability to maintain and improve our retail-store performance; assimilate acquired stores; maintain or grow sales; respond successfully to competitors or changing consumer behavior; maintain or increase gross margin; anticipate and successfully respond to openings of competitors; maintain and improve customer and supplier relationships; realize expected benefits of new relationships; realize growth opportunities; expand our customer base; reduce operating costs; generate cash; continue to meet the terms of our debt covenants; continue to pay dividends; and implement the other programs, initiatives, plans, priorities, strategies, objectives, goals or expectations described in this Quarterly Report, our other reports or presentations, our press releases and our public comments is not certain and will be affected by changes in economic conditions generally or in the markets and geographic areas that we serve, adverse effects of the changing food and distribution industries and other factors including, but not limited to, those discussed below.

Anticipated future sales are subject to competitive pressures from many sources. Our Distribution and Retail businesses compete with many distributors, supercenters, warehouse discount stores, supermarkets and other retail stores selling food and related products, pharmacies and product manufacturers. Future sales will be dependent on the number of retail stores that we own and operate, our ability to retain and add to the retail stores to whom we distribute, competitive pressures in the retail industry generally and our geographic markets specifically, our ability to implement effective new marketing and merchandising programs and unseasonable weather conditions. Competitive pressures in these and other business segments may result in unexpected reductions in sales volumes, product prices or service fees.

Our operating and administrative expenses, and as a result, our net earnings and cash flows, may be adversely affected by changes in costs associated with, among other factors: difficulties in the operation of our business segments; future business acquisitions; adverse effects on business relationships with independent retail grocery store customers; difficulties in the retention or hiring of employees; labor stoppages or disputes; business and asset divestitures; increased transportation or fuel costs; current or future lawsuits and administrative proceedings; and losses or financial difficulties of customers or suppliers. Our future costs for pension and postretirement benefit costs may be adversely affected by changes in actuarial assumptions and methods, investment return and the composition of the group of employees and retirees covered, changes in our business that result in a withdrawal liability under multi-employer plans, and the actions and contributions of other employers who participate in multi-employer plans to

which we contribute. Our future income tax expense, and as a result, our net earnings and cash flows, could be adversely affected by changes in tax laws and related interpretations. Our accounting estimates could change and the actual effects of changes in accounting principles could deviate from our estimates due to changes in facts, assumptions, or acceptable methods, and actual results may vary materially from our estimates. Our operating and administrative expenses, net earnings and cash flow could also be adversely affected by changes in our sales mix. Our ongoing cost reduction initiatives and changes in our marketing and merchandising programs may not be as successful as

anticipated. Acts of terrorism, war, natural disaster, fire, accident, severe weather, general economic conditions and unemployment, particularly in Michigan, government assistance programs, health care reform, or other circumstances beyond our control could have adverse effects on the availability of and our ability to operate our warehouses and other facilities, consumer buying behavior, fuel costs, shipping and transportation, product imports, product cost inflation or deflation and its impact on LIFO expense and other factors affecting our company and the grocery industry generally. A combination of the aforementioned factors coupled with a prolonged general economic recession could result in goodwill and other long-lived asset impairment charges.

Our future interest expense and income also may differ from current expectations, depending upon, among other factors: the amount of additional borrowings; changes in our borrowing agreements; changes in the interest rate environment; changes in accounting pronouncements; and changes in the amount of fees received or paid. The availability of our secured loan agreement depends on compliance with the terms of the loan agreement and financial stability of the banking community.

Our dividend policy does not commit the Board of Directors to declare future dividends. Each future dividend will be considered and declared by the Board of Directors in its discretion. The ability of the Board of Directors to continue to declare dividends will depend on a number of factors, including our future financial condition and profitability and compliance with the terms of our credit facilities.

This section is intended to provide meaningful cautionary statements. This should not be construed as a complete list of all economic, competitive, governmental, technological and other factors that could adversely affect our expected consolidated financial position, results of operations or liquidity. Additional risks and uncertainties not currently known to Spartan Stores or that Spartan Stores currently believes are immaterial also may impair its business, operations, liquidity, financial condition and prospects. We undertake no obligation to update or revise our forward-looking statements to reflect developments that occur or information obtained after the date of this Quarterly Report.

PART I
FINANCIAL INFORMATION

ITEM 1. Financial Statements

SPARTAN STORES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)
(Unaudited)

| <u>Assets</u> | September 11, 2010 | March 27, 2010 |
|--|-----------------------|-------------------|
| Current assets | | |
| Cash and cash equivalents | \$ 25,124 | \$ 9,170 |
| Accounts receivable, net | 54,848 | 54,529 |
| Inventories, net | 128,623 | 117,514 |
| Prepaid expenses and other current assets | 8,622 | 9,474 |
| Deferred taxes on income | 1,810 | 5,508 |
| | 219,027 | 196,195 |
| Other assets | | |
| Goodwill | 247,779 | 247,916 |
| Other, net | 60,773 | 61,409 |
| | 308,552 | 309,325 |
| Property and equipment, net | 246,391 | 247,961 |
| | \$ 773,970 | \$ 753,481 |
| <u>Liabilities and Shareholders' Equity</u> | | |
| Current liabilities | | |
| Accounts payable | \$ 131,933 | \$ 114,549 |
| Accrued payroll and benefits | 30,325 | 31,983 |
| Other accrued expenses | 17,866 | 20,838 |
| Current portion of restructuring costs | 7,211 | 8,877 |
| Current maturities of long-term debt and capital lease obligations | 4,167 | 4,209 |
| | 191,502 | 180,456 |
| Long-term liabilities | | |
| Deferred income taxes | 54,463 | 49,996 |
| Postretirement benefits | 22,843 | 21,060 |
| Other long-term liabilities | 19,738 | 19,937 |
| Restructuring costs | 25,873 | 27,061 |

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| | | |
|--|------------|------------|
| Long-term debt and capital lease obligations | 170,188 | 181,066 |
| | <hr/> | <hr/> |
| Total long-term liabilities | 293,105 | 299,120 |
| Commitments and contingencies (Note 6) | | |
| Shareholders' equity | | |
| Common stock, voting, no par value; 50,000 shares authorized; 22,626 and 22,450 shares outstanding | 159,182 | 158,225 |
| Preferred stock, no par value, 10,000 shares authorized; no shares outstanding | - | - |
| Accumulated other comprehensive loss | (13,437) | (12,973) |
| Retained earnings | 143,618 | 128,653 |
| | <hr/> | <hr/> |
| Total shareholders' equity | 289,363 | 273,905 |
| | <hr/> | <hr/> |
| Total liabilities and shareholders' equity | \$ 773,970 | \$ 753,481 |
| | <hr/> | <hr/> |

See accompanying notes to condensed consolidated financial statements.

SPARTAN STORES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS

(In thousands, except per share data)

(Unaudited)

| | 12 Weeks Ended | | 24 Weeks Ended | |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 11, 2010 | September 12, 2009 | September 11, 2010 | September 12, 2009 |
| Net sales | \$ 602,056 | \$ 610,222 | \$ 1,179,293 | \$ 1,206,249 |
| Cost of sales | 466,858 | 474,209 | 917,406 | 939,222 |
| Gross margin | 135,198 | 136,013 | 261,887 | 267,027 |
| Operating expenses | 113,109 | 114,974 | 226,451 | 230,897 |
| Operating earnings | 22,089 | 21,039 | 35,436 | 36,130 |
| Other income and expenses | | | | |
| Interest expense | 3,504 | 3,727 | 6,933 | 7,390 |
| Other, net | (4) | (30) | (54) | (53) |
| Total other income and expenses | 3,500 | 3,697 | 6,879 | 7,337 |
| Earnings before income taxes and discontinued operations | 18,589 | 17,342 | 28,557 | 28,793 |
| Income taxes | 7,244 | 6,845 | 11,137 | 11,452 |
| Earnings from continuing operations | 11,345 | 10,497 | 17,420 | 17,341 |
| (Loss) earnings from discontinued operations, net of taxes | (106) | (63) | (194) | (48) |
| Net earnings | \$ 11,239 | \$ 10,434 | \$ 17,226 | \$ 17,293 |
| Basic earnings per share: | | | | |
| Earnings from continuing operations | \$ 0.50 | \$ 0.47 | \$ 0.77 | \$ 0.78 |
| (Loss) earnings from discontinued operations | - | - | (0.01) | (0.01)* |
| Net earnings | \$ 0.50 | \$ 0.47 | \$ 0.76 | \$ 0.77 |
| Diluted earnings per share: | | | | |
| Earnings from continuing operations | \$ 0.50 | \$ 0.47 | \$ 0.77 | \$ 0.77 |
| (Loss) earnings from discontinued operations | - | (0.01)* | (0.01) | - |

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| | | | | |
|---|---------|---------|---------|---------|
| Net earnings | \$ 0.50 | \$ 0.46 | \$ 0.76 | \$ 0.77 |
| Weighted average shares outstanding: | | | | |
| Basic | 22,627 | 22,432 | 22,577 | 22,364 |
| Diluted | 22,692 | 22,496 | 22,650 | 22,435 |

**includes rounding*

See accompanying notes to condensed consolidated financial statements.

SPARTAN STORES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
(In thousands)
(Unaudited)

| | Shares Outstanding | Common Stock | Accumulated Other Comprehensive Loss | Retained Earnings | Total |
|--|-----------------------|-----------------|---|----------------------|------------|
| Balance - March 27, 2010 | 22,450 | \$ 158,225 | \$ (12,973) | \$ 128,653 | \$ 273,905 |
| Comprehensive income, net of tax: | | | | | |
| Net earnings | - | - | - | 17,226 | 17,226 |
| Change in fair value of interest rate swap, net of taxes of \$294 | - | - | (464) | - | (464) |
| Total comprehensive income | | | | | 16,762 |
| Dividends - \$.10 per share | - | - | - | (2,261) | (2,261) |
| Repurchase of equity component of convertible debt, net of tax | - | (388) | - | - | (388) |
| Stock-based employee compensation | - | 2,153 | - | - | 2,153 |
| Issuances of common stock and related tax benefits on stock option exercises | 23 | 208 | - | - | 208 |
| Issuances of restricted stock and related income tax | 216 | (78) | - | - | (78) |
| Cancellations of restricted stock | (63) | (938) | - | - | (938) |
| Balance - September 11, 2010 | 22,626 | \$ 159,182 | \$ (13,437) | \$ 143,618 | \$ 289,363 |

See accompanying notes to condensed consolidated financial statements.

SPARTAN STORES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

| | 24 Weeks Ended | |
|---|-----------------------|-----------------------|
| | September 11, 2010 | September 12, 2009 |
| Cash flows from operating activities | | |
| Net earnings | \$ 17,226 | \$ 17,293 |
| Loss from discontinued operations | 194 | 48 |
| | 17,420 | 17,341 |
| Earnings from continuing operations | 17,420 | 17,341 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Non-cash restructuring and asset impairment costs | 2,477 | 601 |
| Non-cash convertible debt interest | 1,594 | 1,591 |
| Depreciation and amortization | 15,950 | 16,232 |
| Postretirement benefits expense | 1,819 | 1,637 |
| Deferred taxes on income | 8,560 | 6,923 |
| Stock-based compensation expense | 2,145 | 2,406 |
| Excess tax benefit on stock compensation | (171) | (285) |
| Gain on repurchase of convertible notes | (69) | - |
| Other | 197 | 110 |
| Change in operating assets and liabilities: | | |
| Accounts receivable | (325) | (2,206) |
| Inventories | (11,109) | (29,117) |
| Prepaid expenses and other assets | (339) | 254 |
| Accounts payable | 18,245 | 34,617 |
| Accrued payroll and benefits | (2,470) | (7,819) |
| Postretirement benefits payments | (154) | (25) |
| Other accrued expenses and other liabilities | (8,311) | (1,392) |
| | 45,459 | 40,868 |
| Net cash provided by operating activities | 45,459 | 40,868 |
| Cash flows from investing activities | | |
| Purchases of property and equipment | (14,992) | (22,707) |
| Net proceeds from the sale of assets | 62 | 54 |
| Acquisitions | - | (1,405) |
| Other | (47) | 61 |
| | (14,977) | (23,997) |
| Net cash used in investing activities | (14,977) | (23,997) |
| Cash flows from financing activities | | |
| Proceeds from revolving credit facility | 125,473 | 215,021 |
| Payments on revolving credit facility | (125,310) | (227,423) |
| Repurchase of convertible notes | (10,724) | - |
| Repayment of other long-term borrowings | (2,364) | (1,863) |

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| | | |
|---|------------------|-----------------|
| Excess tax benefit on stock compensation | 171 | 285 |
| Proceeds from exercise of stock options | 151 | 28 |
| Dividends paid | (1,130) | (1,121) |
| | <hr/> | |
| Net cash used in financing activities | (13,733) | (15,073) |
| Cash flows from discontinued operations | | |
| Net cash used in operating activities | (795) | (1,571) |
| | <hr/> | |
| Net cash used in discontinued operations | (795) | (1,571) |
| | <hr/> | |
| Net increase in cash and cash equivalents | 15,954 | 227 |
| Cash and cash equivalents at beginning of period | 9,170 | 6,519 |
| | <hr/> | |
| Cash and cash equivalents at end of period | \$ 25,124 | \$ 6,746 |
| | <hr/> | |

See accompanying notes to condensed consolidated financial statements.

SPARTAN STORES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1**Basis of Presentation and Significant Accounting Policies**

The accompanying unaudited Condensed Consolidated Financial Statements include the accounts of Spartan Stores, Inc. and its subsidiaries ("Spartan Stores"). All significant intercompany accounts and transactions have been eliminated.

In the opinion of management, the accompanying condensed consolidated financial statements, taken as a whole, contain all adjustments, which are of a normal recurring nature, necessary to present fairly the financial position of Spartan Stores as of September 11, 2010 and the results of its operations and cash flows for the interim periods presented. Interim results are not necessarily indicative of results for a full year.

Note 2**Restructuring and Asset Impairment Costs**

The following table provides the activity of restructuring costs for the 24 weeks ended September 11, 2010. Restructuring costs recorded in the Consolidated Balance Sheets are included in "Current portion of restructuring costs" in Current liabilities and "Restructuring costs" in Long-term liabilities based on when the obligations are expected to be paid.

(In thousands)

| | | |
|-------------------------------------|----|---------|
| Balance at March 27, 2010 | \$ | 35,938 |
| Charges | | 2,615 |
| Payments, net of interest accretion | | (5,469) |
| | | <hr/> |
| Balance at September 11, 2010 | \$ | 33,084 |
| | | <hr/> |

Included in the liability are lease obligations recorded at the present value of future minimum lease payments, calculated using a risk-free interest rate, and related ancillary costs from the date of closure to the end of the remaining lease term, net of estimated sublease income.

Note 3**Fair Value Measurements**

Financial instruments include cash and cash equivalents, accounts and notes receivable, accounts payable and long-term debt. The carrying amounts of cash and cash equivalents, accounts and notes receivable, and accounts payable approximate fair value because of the short-term nature of these financial instruments. At September 11, 2010 and March 27, 2010 the estimated fair value and the book value of our debt instruments were as follows:

(In thousands)

| | <u>September 11, 2010</u> | <u>March 27, 2010</u> |
|--|-------------------------------|---------------------------|
| | | |

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Book value of debt instruments:

| | | | | |
|--|----|---------|----|---------|
| Current maturities of long-term debt and capital lease obligations | \$ | 4,167 | \$ | 4,209 |
| Long-term debt and capital lease obligations | | 170,188 | | 181,066 |
| Equity component of convertible debt | | 14,497 | | 18,038 |
| | | <hr/> | | <hr/> |
| Total book value of debt instruments | | 188,852 | | 203,313 |
| Fair value of debt instruments | | 173,159 | | 185,118 |
| | | <hr/> | | <hr/> |
| Excess of book value over fair value | \$ | 15,693 | \$ | 18,195 |
| | | <hr/> | | <hr/> |

The estimated fair value of debt is based on market quotes for instruments with similar terms and remaining maturities.

ASC 820 prioritizes the inputs to valuation techniques used to measure fair value into the following hierarchy:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3: Unobservable inputs for the asset or liability, reflecting the reporting entity's own assumptions about the assumptions that market participants would use in pricing.

At September 11, 2010 and March 27, 2010, the fair value of the interest rate swap liability was approximately \$1.4 million and \$0.7 million, respectively, and is included in other long-term liabilities in the accompanying consolidated balance sheets. The fair value measurements are classified within Level 2 of the hierarchy as significant observable market inputs are readily available as the basis of the fair value measurements.

Note 4

Derivative Instruments

Spartan Stores has limited involvement with derivative financial instruments and uses them only to manage well-defined interest rate risk exposure when appropriate, based on market conditions. Spartan Stores' objective in managing exposure to changes in interest rates is to reduce fluctuations in earnings and cash flows, and consequently, from time to time Spartan Stores uses interest rate swap agreements to manage this risk. Spartan Stores does not use financial instruments or derivatives for any trading or other speculative purposes.

On January 2, 2009, Spartan Stores entered into an interest rate swap agreement. The interest rate swap has been designated as a cash flow hedge of interest payments on \$45.0 million of borrowings under Spartan Stores' senior secured revolving credit facility by effectively converting a portion of the variable rate debt to a fixed rate basis. Under the terms of the agreement, Spartan Stores has agreed to pay the counterparty a fixed interest rate of 3.33% and the counterparty has agreed to pay Spartan Stores a floating interest rate based upon the 1-month LIBOR plus 1.25% (1.51% at September 11, 2010) on a notional amount of \$45 million. The interest rate swap agreement expires concurrently with the senior secured revolving credit facility on December 24, 2012.

For derivative instruments that are designated and qualify as cash flow hedges, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income and reclassified into earnings in the same period during which the hedged transaction affects earnings. Gains and losses on the derivative representing hedge ineffectiveness are recognized in current earnings.

The following table provides a summary of the fair value and balance sheet classification of the derivative financial instrument designated as an interest rate cash flow hedge:

| Balance Sheet Classification | September 11, 2010 | March 27, 2010 |
|------------------------------|-----------------------|-------------------|
| Other long-term liabilities | \$ 1,411 | \$ 653 |

The following table provides a summary of the financial statement effect of the derivative financial instrument designated as an interest rate cash flow hedge for the quarter and year-to-date period ended September 11, 2010:

| | <u>Location in Consolidated Financial Statements</u> | <u>12 Weeks Ended September 11, 2010</u> | <u>24 Weeks Ended September 11, 2010</u> |
|---|--|--|--|
| Loss, net of taxes, recognized in other comprehensive income | Other comprehensive income | \$ 138 | \$ 464 |
| Pre-tax loss reclassified from accumulated other comprehensive loss | Interest expense | 87 | 294 |

Note 5

Commitments and Contingencies

Various lawsuits and claims, arising in the ordinary course of business, are pending or have been asserted against Spartan Stores. While the ultimate effect of such actions cannot be predicted with certainty, management believes that their outcome will not result in a material adverse effect on the consolidated financial position, operating results or liquidity of Spartan Stores.

Note 6

Associate Retirement Plans

The following table provides the components of net periodic pension and postretirement benefit costs for the second quarter and year-to-date periods ended September 11, 2010 and September 12, 2009:

(In thousands)

| | <u>12 Weeks Ended</u> | | <u>Pension Benefits</u> | | <u>SERP Benefits</u> | | <u>Postretirement Benefits</u> | |
|------------------------------------|-----------------------|-------------------|-------------------------|-------------------|----------------------|-------------------|--------------------------------|-------------------|
| | Sept. 11, 2010 | Sept. 12, 2009 | Sept. 11, 2010 | Sept. 12, 2009 | Sept. 11, 2010 | Sept. 12, 2009 | Sept. 11, 2010 | Sept. 12, 2009 |
| Service cost | \$ 807 | \$ 681 | \$ 14 | \$ 19 | \$ 45 | \$ 30 | | |
| Interest cost | 723 | 832 | 12 | 13 | 97 | 102 | | |
| Expected return on plan assets | (998) | (940) | - | - | - | - | | |
| Amortization of prior service cost | (147) | (147) | - | - | (12) | (12) | | |
| Recognized actuarial net loss | 345 | 152 | 10 | 10 | 28 | 5 | | |
| Net periodic benefit cost | <u>\$ 730</u> | <u>\$ 578</u> | <u>\$ 36</u> | <u>\$ 42</u> | <u>\$ 158</u> | <u>\$ 125</u> | | |

(In thousands)

| | <u>24 Weeks Ended</u> | | <u>Pension Benefits</u> | | <u>SERP Benefits</u> | | <u>Postretirement Benefits</u> | |
|---------------|-----------------------|-------------------|-------------------------|-------------------|----------------------|-------------------|--------------------------------|-------------------|
| | Sept. 11, 2010 | Sept. 12, 2009 | Sept. 11, 2010 | Sept. 12, 2009 | Sept. 11, 2010 | Sept. 12, 2009 | Sept. 11, 2010 | Sept. 12, 2009 |
| Service cost | \$ 1,613 | \$ 1,361 | \$ 28 | \$ 38 | \$ 89 | \$ 61 | | |
| Interest cost | 1,446 | 1,664 | 24 | 26 | 194 | 203 | | |

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| | | | | | | |
|------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Expected return on plan assets | (1,996) | (1,879) | | | | |
| Amortization of prior service cost | (294) | (294) | | | (25) | (24) |
| Recognized actuarial net loss | 691 | 304 | 19 | 20 | 57 | 9 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Net periodic benefit cost | \$ 1,460 | \$ 1,156 | \$ 71 | \$ 84 | \$ 315 | \$ 249 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |

No payments are required to be made in fiscal 2011 to meet the minimum pension funding requirements until the accumulated funding standard carryover balance of approximately \$2.2 million is fully utilized. As of September 11, 2010, no contributions have been made.

Note 7**Taxes on Income**

There were no material changes to the amount of unrecognized tax benefits during the second quarter of fiscal 2011. Spartan Stores expects that an immaterial amount of the unrecognized tax benefits will be settled prior to September 10, 2011.

The effective income tax rate differs from the statutory Federal income tax rate primarily due to state income taxes.

Note 8**Stock-Based Compensation**

Spartan Stores has two shareholder-approved stock incentive plans that provide for the granting of incentive stock options, non-qualified stock options, stock appreciation rights, restricted stock, restricted stock units, stock awards, and other stock-based awards to directors, officers and other key associates.

Spartan Stores accounts for stock-based compensation awards in accordance with the provisions of ASC Topic 718 which requires that share-based payment transactions be accounted for using a fair value method and the related compensation cost recognized in the consolidated financial statements over the period that an employee is required to provide services in exchange for the award. Spartan Stores recognized stock-based compensation expense (net of tax) of \$0.6 million (\$0.03 per diluted share) and \$0.7 million (\$0.03 per diluted share) in the second quarter of fiscal 2011 and 2010, respectively, as a component of Operating expenses in the Consolidated Statements of Earnings. Stock-based compensation expense (net of tax) was \$1.3 million (\$0.06 per diluted share) and \$1.4 million (\$0.06 per diluted share) for the year-to-date period ended September 11, 2010 and September 12, 2009, respectively.

The following table summarizes activity in the share-based compensation plans for the year-to-date ended September 11, 2010:

| | Shares Under Options | Weighted Average Exercise Price | Restricted Stock Awards | Weighted Average Grant-Date Fair Value |
|---|----------------------------|---------------------------------------|-------------------------------|---|
| Outstanding at March 27, 2010 | 831,849 | \$ 17.39 | 618,722 | \$ 18.28 |
| Granted | - | - | 211,938 | 15.39 |
| Exercised/Vested | (19,065) | 7.66 | (202,735) | 17.42 |
| Cancelled/Forfeited | - | - | (3,222) | 16.73 |
| | <hr/> | <hr/> | <hr/> | <hr/> |
| Outstanding at September 11, 2010 | 812,784 | \$ 17.62 | 624,703 | \$ 17.37 |
| | <hr/> | <hr/> | <hr/> | <hr/> |
| Vested and expected to vest in the future at September 11, 2010 | 800,544 | \$ 17.60 | | |
| | <hr/> | <hr/> | | |
| Exercisable at September 11, 2010 | 524,757 | \$ 16.81 | | |
| | <hr/> | <hr/> | | |

There were no stock options granted during the first or second quarter of fiscal 2011. The weighted average grant-date fair value of stock options granted during the second quarter ended September 12, 2009 was \$5.50. The weighted average grant-date fair value of stock options granted during the year-to-date period ended September 12, 2009 was \$5.24. The fair value of each stock option grant is estimated on the date of grant using the Black-Scholes option-pricing model. The following weighted average assumptions were used to estimate the fair value of stock options at the date of grant using the Black-Scholes option-pricing model:

24 Weeks Ended

Sept. 12, 2009

| | |
|-------------------------|-------------|
| Dividend yield | 1.43% |
| Expected volatility | 41.50-42.3% |
| Risk-free interest rate | 2.28-2.92% |
| Expected life of option | 6.25 years |

Due to certain events that are considered unusual and/or infrequent in nature, and that resulted in significant business changes during the limited historical exercise period, management does not believe that Spartan Stores' historical exercise data will provide a reasonable basis upon which to estimate the expected term of stock options. Therefore, the expected term of stock options granted is determined using the "simplified" method as described in SEC Staff Accounting Bulletins that uses the following formula: ((vesting term + original contract term)/2).

As of September 11, 2010, total unrecognized compensation cost related to nonvested share-based awards granted under our stock incentive plans was \$1.2 million for stock options and \$9.2 million for restricted stock. The remaining compensation costs not yet recognized are expected to be recognized over a weighted average period of 1.8 years for stock options and 3.2 years for restricted stock.

**Note 9
Discontinued Operations**

Results of the discontinued operations are excluded from the accompanying notes to the consolidated financial statements for all periods presented, unless otherwise noted.

The following table details the results of discontinued operations reported on the Consolidated Statements of Earnings:

(In thousands)

12 Weeks Ended

| | September 11, 2010 | September 12, 2009 |
|---|-----------------------|-----------------------|
| Loss from discontinued operations (net of taxes of (\$68) and (\$47)) | \$ (106) | \$ (63) |

(In thousands)

24 Weeks Ended

| | September 11, 2010 | September 12, 2009 |
|--|-----------------------|-----------------------|
| Loss from discontinued operations (net of taxes of (\$124) and (\$37)) | \$ (194) | \$ (48) |

Note 10
Supplemental Cash Flow Information

Non-cash financing activities include the issuance of restricted stock/units to employees and directors of \$3.3 million and \$4.6 million for the year-to-date periods ended September 11, 2010 and September 12, 2009, respectively. Non-cash investing activities include capital expenditures included in current liabilities of \$0.9 million and \$0.4 million for the year-to-date periods ended September 11, 2010 and September 12, 2009, respectively.

Note 11
Operating Segment Information

The following tables set forth information about Spartan Stores by operating segment:

(In thousands)

| | <u>Distribution</u> | <u>Retail</u> | <u>Total</u> |
|--|---------------------|---------------|--------------|
| 12 Weeks Ended September 11, 2010 | | | |
| Net sales | \$ 248,604 | \$ 353,452 | \$ 602,056 |
| Inter-segment sales | 158,336 | - | 158,336 |
| Depreciation and amortization | 1,943 | 6,128 | 8,071 |
| Operating earnings | 10,723 | 11,366 | 22,089 |
| Capital expenditures | 2,645 | 6,031 | 8,676 |
| 12 Weeks Ended September 12, 2009 | | | |
| Net sales | \$ 250,027 | \$ 360,195 | \$ 610,222 |
| Inter-segment sales | 165,476 | - | 165,476 |
| Depreciation and amortization | 2,050 | 6,088 | 8,138 |
| Operating earnings | 10,612 | 10,427 | 21,039 |
| Capital expenditures | 1,250 | 10,875 | 12,125 |
| 24 Weeks Ended September 11, 2010 | | | |
| Net sales | \$ 493,879 | \$ 685,414 | \$ 1,179,293 |
| Inter-segment sales | 307,468 | - | 307,468 |
| Depreciation and amortization | 3,814 | 12,092 | 15,906 |
| Operating earnings | 18,708 | 16,728 | 35,436 |
| Capital expenditures | 4,430 | 10,562 | 14,992 |
| 24 Weeks Ended September 12, 2009 | | | |
| Net sales | \$ 503,394 | \$ 702,855 | \$ 1,206,249 |
| Inter-segment sales | 327,046 | - | 327,046 |
| Depreciation and amortization | 4,204 | 11,946 | 16,150 |
| Operating earnings | 18,377 | 17,753 | 36,130 |
| Capital expenditures | 4,111 | 18,596 | 22,707 |

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| | September 11, 2010 | March 27, 2010 |
|-------------------------|-----------------------|-------------------|
| Total assets | | |
| Distribution | \$ 262,542 | \$ 237,480 |
| Retail | 505,934 | 510,486 |
| Discontinued operations | 5,494 | 5,515 |
| Total | \$ 773,970 | \$ 753,481 |

The following table presents sales by type of similar product and services:

| (Dollars in thousands) | 12 Weeks Ended | | | | 24 Weeks Ended | | | |
|--------------------------------|-----------------------|-------------|-----------------------|-------------|-----------------------|-------------|-----------------------|-------------|
| | September 11, 2010 | | September 12, 2009 | | September 11, 2010 | | September 12, 2009 | |
| Non-perishables ⁽¹⁾ | \$ 308,392 | 51% | \$ 325,863 | 53% | \$ 602,927 | 51% | \$ 643,572 | 54% |
| Perishables ⁽²⁾ | 219,213 | 36 | 218,681 | 36 | 430,944 | 36 | 434,289 | 36 |
| Pharmacy | 47,151 | 8 | 43,994 | 7 | 91,235 | 8 | 88,169 | 7 |
| Fuel | 27,300 | 5 | 21,684 | 4 | 54,187 | 5 | 40,219 | 3 |
| Consolidated net sales | \$ 602,056 | 100% | \$ 610,222 | 100% | \$ 1,179,293 | 100% | \$ 1,206,249 | 100% |

⁽¹⁾ Consists primarily of general merchandise, grocery, beverages, snacks and frozen foods.

⁽²⁾ Consists primarily of produce, dairy, meat, bakery, deli, floral and seafood.

Note 12

Convertible Note Repurchase

During the first quarter of fiscal 2011 the Company repurchased \$12.3 million in principal amount of its outstanding convertible senior notes for approximately \$10.7 million and recognized a resultant gain of \$0.1 million. No additional repurchases were made in the second quarter.

Note 13

Company-Owned Life Insurance

During the first quarter of fiscal 2011 the Company purchased variable universal life insurance policies on certain key associates. The company-owned policy was purchased for \$0.8 million and has a cash surrender value of \$0.8 million, which is recorded on the balance sheet in Other Assets. These company-owned policies have an aggregate amount of life insurance coverage of approximately \$15 million.

Note 14

Subsequent Events

During the third quarter of fiscal 2011 the Company's retirement plans were modified and the changes were communicated to all Spartan associates. Effective January 1, 2011, the Cash Balance Pension Plan will be frozen and no additional service credits will be added to each Associate's account, however, interest credits will continue to accrue. Effective the same date, Company matching contributions to the Savings Plus 401k Plan will be reinstated at a

rate of 50% of pay deferral contributions up to 6% of each Associate's compensation. Additionally, a discretionary annual profit sharing contribution may be added to each qualified Associate's 401k Plan.

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
Executive Overview

Spartan Stores is a leading regional grocery distributor and grocery retailer, operating principally in Michigan and Indiana.

We operate two reportable business segments: Distribution and Retail. Our Distribution segment provides a full line of grocery, general merchandise, health and beauty care, frozen and perishable items to approximately 370 independently owned grocery stores and our 97 corporate owned stores. Our Retail segment operates 97 retail supermarkets in Michigan under the banners *Glen's Markets*, *Family Fare Supermarkets*, *D&W Fresh Markets*, *Felpausch Food Centers* and *VG's Food and Pharmacy* and 24 fuel centers/convenience stores, adjacent to our supermarket locations, under the banners *Glen's Quick Stop*, *Family Fare Quick Stop*, *D&W Fresh Markets Quick Stop*, *Felpausch Quick Stop* and *VG's Quick Stop*. Our retail supermarkets have a "neighborhood market" focus to distinguish them from supercenters and limited assortment stores.

Our sales and operating performance vary with seasonality. Our first and fourth quarters are typically our lowest sales quarters and therefore operating results are generally lower during these two quarters. Additionally, these two quarters can be affected by the timing of the Easter holiday, which results in a strong sales week. Many northern Michigan stores are dependent on tourism, which is affected by the economic environment and seasonal weather patterns, including, but not limited to, the amount and timing of snowfall during the winter months and the range of temperature during the summer months. All quarters are 12 weeks, except for our third quarter, which is 16 weeks and includes the Thanksgiving and Christmas holidays.

At the beginning of the fourth quarter of fiscal 2010, we began implementing the conclusions of a comprehensive, multi-year supply chain optimization study. This was another important step in our ongoing strategy of maintaining a low cost grocery distribution operation. We reached an agreement with the Teamsters Local 337 to transition our Plymouth, Michigan dry grocery distribution operation to our Grand Rapids, Michigan facility. The transition was substantially complete at the end of the fourth quarter of fiscal 2010. During the past several years, we have prudently invested capital to upgrade our distribution system technology, expand our produce ripening operations, upgrade our entire fleet of trucks, and complete a major warehouse re-racking project at our Grand Rapids grocery distribution center that significantly increased warehouse capacity and improved space utilization. In addition to improved customer service through a centralized Grand Rapids facility, this decision, along with our other cost reduction initiatives is intended to create better alignment between the current level of business activity and our cost structure. In conjunction with the warehouse optimization, we implemented another administrative cost reduction initiative by eliminating certain positions. As a result of the closing of the warehouse facility and elimination of certain administrative positions, we incurred charges of \$4.2 million for severance, asset impairment and other related one-time costs in the fourth quarter of fiscal 2010. In addition, in the first and second quarters of fiscal 2011 the Company incurred additional charges related to its warehouse consolidation initiative. These charges consisted of warehouse closing expenses for lease payments and other related expenses, which were offset by a LIFO credit due to reduced inventory levels resulting in a year-to-date net \$0.4 million after tax benefit.

We launched four retail programs intended to enhance the value delivered to customers in fiscal 2010 that we will continue to refine in fiscal 2011. We implemented a customer loyalty card program in our *Glen's Markets* banner late in the first quarter of fiscal 2010. This program is beginning to provide us with more sophisticated information to better understand our customers' purchasing behavior, which we are using to improve the effectiveness of our promotions, marketing and merchandising programs. We also expect the program will help solidify our long-term customer loyalty, improve our sales growth opportunities and further strengthen our market position. We continue to enhance the program to improve our consumer offers and will roll out the program to another retail store banner during the last half of the fiscal year. Our award-winning Michigan's Best initiative, which clearly identifies and

promotes 2,400 products grown, made or processed in Michigan was launched in 2nd quarter of 2010 and was expanded to 3,000 products early in the second quarter of 2011. As part of our emphasis on consumer health and wellness, we began a major nutrition guide program in our *D&W Fresh Markets* and *Family Fare Supermarkets* retail stores early in the third quarter of fiscal 2010. The nutrition guide program offers shelf tags

which provide consumers a simplistic identification of six key product attributes. The tags are color coded, and health and nutrition attributes are identified using FDA guidelines to assist consumers in making more informed choices in the foods they buy. We also implemented our first continuous customer satisfaction monitoring system in the 2nd quarter of fiscal 2010. This program allows randomly selected customers to rate individual stores on multiple dimensions of shopping satisfaction and helps us refine our offers to enhance customer satisfaction.

Data suggests that the Michigan economy appears to have stabilized, giving us somewhat more confidence than this time last year, however, the consumer remains cautious and the competitive environment is still challenging. We have made many enhancements to our business operations during the past several years that have allowed us to sustain profitability in a slower growth economic climate, and we expect to realize additional benefits from these changes when the economy returns to a more normal growth rate.

Results of Operations

The following table sets forth items from our Consolidated Statements of Earnings as a percentage of net sales and the year-to-year percentage change in dollar amounts:

(Unaudited)

| | Percentage of Net Sales | | | | Percentage Change | |
|--|-------------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| | 12 Weeks Ended | | 24 Weeks Ended | | 12 Weeks Ended | 24 Weeks Ended |
| | Sept. 11, 2010 | Sept. 12, 2009 | Sept. 11, 2010 | Sept. 12, 2009 | Sept. 11, 2010 | Sept. 11, 2010 |
| Net sales | 100.0 | 100.0 | 100.0 | 100.0 | (1.3) | (2.2) |
| Gross margin | 22.5 | 22.3 | 22.2 | 22.1 | (0.6) | (1.9) |
| Selling, general and administrative expenses | 18.8 | 18.8** | 19.0 | 19.1 | (1.8) | (2.9) |
| Restructuring and asset impairments costs | - | - | 0.2 | - | * | * |
| Operating earnings | 3.7 | 3.4 | 3.0 | 3.0 | 5.0 | (1.9) |
| Other income and expenses | 0.6 | 0.6 | 0.6 | 0.6 | (5.3) | (6.2) |
| Earnings before income taxes and discontinued operations | 3.1 | 2.8 | 2.4 | 2.4 | 7.2 | (0.8) |
| Income taxes | 1.2 | 1.1 | 0.9 | 1.0 | 5.8 | (2.8) |
| Earnings from continuing operations | 1.9 | 1.7 | 1.5 | 1.4 | 8.1 | 0.5 |
| (Loss) earnings from discontinued operations, net of taxes | (0.0) | (0.0) | (0.0) | (0.0) | * | * |
| Net earnings | 1.9 | 1.7 | 1.5 | 1.4 | 7.7 | (0.4) |

* Percentage change is not meaningful

** Difference due to rounding

Net Sales - Net sales for the quarter ended September 11, 2010 ("second quarter") decreased \$8.1 million, or

1.3%, from \$610.2 million in the quarter ended September 12, 2009 ("prior year second quarter") to \$602.1 million. Net sales for the year-to-date period ended September 11, 2010 ("current year-to-date") decreased \$26.9 million, or 2.2%, from \$1,206.2 million in the prior year-to-date period ended September 12, 2009 ("prior year-to-date") to \$1,179.3 million.

Net sales for the second quarter in our Retail segment decreased \$6.7 million, or 1.9%, from \$360.2 million in the prior year second quarter to \$353.5 million. Net sales for the year-to-date period decreased \$17.5 million, or 2.5%, from \$702.9 million in the prior year-to-date period to \$685.4 million. The second quarter decrease was primarily due to a comparable store sales decrease of 4.7% and \$5.8 million of lost sales from closed/sold stores, partially offset by an increase in fuel center sales of \$6.1 million and sales of \$8.7 million related to new/replacement

stores. The year-to-date decrease was primarily due to a comparable store sales decrease of 5.4% and \$12.2 million of lost sales from closed/sold stores, partially offset by an increase in fuel center sales of \$15.2 million and sales of \$14.7 million related to new/replacement stores.

The majority of the comparable store sales decrease was a result of cautious consumer spending due to Michigan's current economic state and competitive activity. We define a retail store as comparable when it is in operation for 14 periods (a period equals four weeks), and we include remodeled, expanded and relocated stores in comparable stores.

Net sales of \$248.6 million for the second quarter in our Distribution segment were comparable to net sales of \$250.0 million in the prior year second quarter. Net sales for the current year-to-date period decreased \$9.5 million, or 1.9%, from \$503.4 million in the prior year-to-date period to \$493.9 million. The year-to-date decrease was due to a comparable sales decrease of 0.6% to existing independent customers and a decrease in equipment sales of \$1.2 million.

During the remainder of the fiscal year, we expect retail comparable store sales (excluding fuel centers) to improve relative to the second quarter results, with a modest improvement in the third quarter. Distribution sales for the third quarter are expected to approximate the year-ago levels.

Gross Margin - Gross margin represents sales less cost of sales, which include purchase costs and promotional allowances. Vendor allowances that relate to our buying and merchandising activities consist primarily of promotional allowances, which are generally allowances on purchased quantities and, to a lesser extent, slotting allowances, which are billed to vendors for our merchandising costs, such as setting up warehouse infrastructure. Vendor allowances associated with product cost are recognized as a reduction in cost of sales when the product is sold. Lump sum payments received for multi-year contracts are amortized over the life of the contracts based on contractual terms.

Gross margin for the second quarter decreased \$0.8 million, or 0.6%, from \$136.0 million in the prior year second quarter to \$135.2 million. As a percent of net sales, gross margin for the second quarter increased to 22.5% from 22.3%. The increase was due to improved retail margins and a \$1.5 million pretax LIFO inventory valuation credit from the lower inventory levels related to the Company's warehouse consolidation initiative, partially offset by a higher mix of distribution and fuel center sales and lower procurement related gains. Gross margin for the year-to-date period decreased \$5.1 million, or 1.9%, from \$267.0 million in the prior year-to-date period to \$261.9 million. As a percent of net sales, gross margin for the year-to-date period increased to 22.2% from 22.1%. This increase was due to improved retail margins and a \$3.5 million pretax LIFO inventory valuation credit from the lower inventory levels related to the Company's warehouse consolidation initiative, partially offset by a higher mix of distribution and fuel center sales and lower procurement related gains.

Operating Expenses - Operating expenses consist primarily of salaries and wages, employee benefits, warehousing costs, store occupancy costs, utilities, equipment rental, depreciation, restructuring and asset impairment costs and other administrative costs.

Operating expenses for the second quarter decreased \$1.9 million, or 1.6%, from \$115.0 million in the prior year second quarter to \$113.1 million. As a percent of net sales, operating expenses were 18.8% for both the second quarter of fiscal 2011 and fiscal 2010. The second-quarter operating expenses included a pretax restructuring charge and loss on the sale of assets totaling \$0.3 million. The restructuring charge totaled \$0.2 million and related to the warehouse consolidation project. Operating expenses for the year-to-date period decreased \$4.4 million, or 1.9%, from \$230.9 million in the prior year-to-date period to \$226.5 million. As a percent of net sales, operating expenses were 19.2% for the current year-to-date period compared to 19.1% in the prior year-to-date period. Excluding the previously mentioned restructuring charge, year-to-date operating expenses decreased to 19.0% of sales due to continued store productivity improvements, cost containment initiatives and distribution operating efficiency

improvements, despite higher debit/credit card expenses, utility and employee benefit costs.

The net decrease in second quarter operating expenses was primarily due to the following:

- Decreased compensation and benefits of \$1.7 million due to reductions in store labor.
- Decreased warehousing expenses of \$0.8 million primarily due to our warehouse consolidation efforts.
- Increased restructuring costs of \$0.2 million related to the Plymouth facility.
- Increases in various other general expenses including incentive bonus, transportation fuel and charge card fees.

The net decrease in year-to-date operating expenses was primarily due to the following:

- Decreased compensation and benefits of \$4.1 million due to reductions in store labor.
- Decreased warehousing expenses of \$1.5 million primarily due to our warehouse consolidation efforts.
- Decreased supplies of \$1.3 million.
- Increased restructuring costs of \$2.2 million including a charge for the Plymouth facility of \$1.9 million, severance costs of \$0.5 million, warehouse closing costs of \$0.3 million and an asset impairment charge of \$0.1 million related to one store. In the prior year-to-date asset impairment and restructuring costs of \$0.6 million were incurred related to one store.
- Increases in various other general expenses including incentive bonus, transportation fuel and charge card fees.

Interest Expense - Interest expense decreased \$0.2 million, or 6.4%, from \$3.7 million in the prior year second quarter to \$3.5 million. The decrease in interest expense was due primarily to lower net borrowings. For fiscal year 2011, we expect interest expense to be reduced by \$0.7 million as a result of these convertible note repurchases.

On January 2, 2009, we entered into an interest rate swap agreement. The interest rate swap is considered to be a cash flow hedge of interest payments on \$45.0 million of borrowings under our senior secured revolving credit facility by effectively converting a portion of the variable rate debt to a fixed rate basis. Under the terms of the agreement, we have agreed to pay the counterparty a fixed interest rate of 3.33% and the counterparty has agreed to pay Spartan Stores a floating interest rate based upon the 1-month LIBOR plus 1.25% (1.51% at September 11, 2010) on a notional amount of \$45 million. The interest rate swap agreement expires concurrently with its senior secured revolving credit facility on December 24, 2012.

Income Taxes - The effective tax rate is 39.0% and 39.5% for the second quarter and prior year second quarter, respectively. The year-to-date effective tax rate is 39.0% and 39.8% for the current year and prior year, respectively. The difference from the statutory rate is primarily due to State of Michigan income taxes.

Discontinued Operations

Certain of our retail and grocery distribution operations have been recorded as discontinued operations. Results of the discontinued operations are excluded from the accompanying notes to the condensed consolidated financial statements for all periods presented, unless otherwise noted.

Liquidity and Capital Resources

The following table summarizes our consolidated statements of cash flows for the year-to-date and prior year-to-date periods:

(In thousands)

| | September 11, 2010 | September 12, 2009 |
|--|-----------------------|-----------------------|
| Net cash provided by operating activities | \$ 45,459 | \$ 40,868 |
| Net cash used in investing activities | (14,977) | (23,997) |
| Net cash used in financing activities | (13,733) | (15,073) |
| Net cash used in discontinued operations | (795) | (1,571) |
| Net increase in cash and cash equivalents | 15,954 | 227 |
| Cash and cash equivalents at beginning of year | 9,170 | 6,519 |
| Cash and cash equivalents at end of period | \$ 25,124 | \$ 6,746 |

Net cash provided by operating activities increased from the prior year-to-date period primarily due to a lower inventory investment resulting from the Plymouth consolidation and other inventory initiatives, partially offset by the timing of accounts payable payments.

Net cash used in investing activities decreased during the current year-to-date period primarily due to capital expenditures which decreased \$7.7 million to \$15.0 million. Of this amount our Retail and Distribution segments utilized 70.5% and 29.5%, respectively. Expenditures during the current fiscal year were primarily related to two new stores and four store remodels. Under the terms of our senior secured revolving credit facility, should our available borrowings fall below certain levels, our capital expenditures would be restricted each fiscal year. Our current available borrowings are approximately \$123.1 million above these limits as of September 11, 2010 and we do not expect to fall below the restricted levels. We expect capital and real estate development expenditures to range from \$33.0 million to \$35.0 million for fiscal 2011.

Net cash used in financing activities includes cash paid and received related to our long-term borrowings, dividends paid, tax benefits of stock compensation and proceeds from the issuance of common stock. Payments on long-term borrowings were \$2.2 million and \$14.3 million for the current year-to-date period and prior year-to-date period, respectively. Cash dividends of \$1.1 million were paid in each year-to-date period. Although we expect to continue to pay a quarterly cash dividend, adoption of a dividend policy does not commit the board of directors to declare future dividends. Each future dividend will be considered and declared by the board of directors at its discretion. Whether the board of directors continues to declare dividends depends on a number of factors, including our future financial condition and profitability and compliance with the terms of our credit facilities. Our current maturities of long-term debt and capital lease obligations at September 11, 2010 are \$4.2 million. Our ability to borrow additional funds is governed by the terms of our credit facilities.

Net cash used in discontinued operations includes the net cash flows of our discontinued operations and consists primarily of the payment of store asset impairment costs, insurance run-off claims and other liabilities offset by the proceeds from the sale of assets and sublease income.

Our principal sources of liquidity are cash flows generated from operations and our senior secured revolving credit facility. Interest on our convertible senior notes is payable on May 15 and November 15 of each year. The revolving credit facility matures December 2012, and is secured by substantially all of our assets. As of September 11, 2010, our senior secured revolving credit facility had outstanding borrowings of \$45.2 million and additional available borrowings of \$143.1 million, which exceeds the minimum excess availability levels, as defined in the credit agreement. We believe that cash generated from operating activities and available borrowings under the credit facility

will be sufficient to meet anticipated requirements for working capital, capital expenditures, dividend payments, and debt service obligations for the foreseeable future. However, there can be no assurance that Spartan Stores' business will continue to generate cash flow at or above current levels or that we will maintain our ability to borrow under our credit facility.

Our current ratio increased to 1.14:1.00 at September 11, 2010 from 1.09:1.00 at March 27, 2010 and our investment in working capital increased to \$27.5 million at September 11, 2010 from \$15.7 million at March 27, 2010. Our total net long-term debt (including current maturities and capital lease obligations net of cash and cash equivalents) to total capital ratio at September 11, 2010 was 0.34:1.00 versus 0.39:1.00 at March 27, 2010.

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Adjusted EBITDA is a non-GAAP financial measure that is defined under the terms of our credit facility as net earnings from continuing operations plus depreciation and amortization, and other non-cash charges including imputed interest, deferred (stock) compensation, LIFO expense and costs associated with the closing of operational locations, plus interest expense, the provision for income taxes and Michigan Single Business Tax to the extent deducted in the computation of net earnings.

Adjusted EBITDA is not a measure of performance under accounting principles generally accepted in the United States of America, and should not be considered as a substitute for net earnings, cash flows from operating activities and other income or cash flow statement data. The adjusted EBITDA information has been included as one measure of our operating performance and historical ability to service debt. We believe that investors find the information useful because it reflects the resources available for strategic investments including, for example, capital needs of the business, strategic acquisitions and debt service. Our definition of Adjusted EBITDA may not be identical to similarly titled measures reported by other companies.

Following is a reconciliation of net earnings to adjusted EBITDA for quarters ended September 11, 2010 and September 12, 2009.

| (In thousands) | Second Quarter | | Year-to-Date | |
|---|-------------------|-------------------|-------------------|-------------------|
| | Sept. 11, 2010 | Sept. 12, 2009 | Sept. 11, 2010 | Sept. 12, 2009 |
| Net earnings | \$ 11,239 | \$ 10,434 | \$ 17,226 | \$ 17,293 |
| Add: | | | | |
| Discontinued operations | 106 | 63 | 194 | 48 |
| Income taxes | 7,244 | 6,845 | 11,137 | 11,452 |
| Interest expense | 3,504 | 3,727 | 6,933 | 7,390 |
| Non-operating expense | (4) | (30) | (54) | (53) |
| Operating earnings | 22,089 | 21,039 | 35,436 | 36,130 |
| Add: | | | | |
| Depreciation and amortization | 8,071 | 8,138 | 15,906 | 16,150 |
| LIFO (income) expense | (1,400) | 9 | (3,208) | (81) |
| Restructuring and asset impairment costs | 183 | - | 2,765 | 601 |
| Non-cash stock compensation and other charges | 1,045 | 823 | 2,123 | 2,134 |
| Adjusted EBITDA | \$ 29,988 | \$ 30,009 | \$ 53,022 | \$ 54,934 |

Reconciliation of operating earnings to adjusted EBITDA by segment:

| | | | | |
|---|-----------|-----------|-----------|-----------|
| Retail: | | | | |
| Operating earnings | \$ 11,366 | \$ 10,427 | \$ 16,728 | \$ 17,753 |
| Add: | | | | |
| Depreciation and amortization | 6,128 | 6,088 | 12,092 | 11,946 |
| LIFO expense | 100 | 109 | 200 | 219 |
| Restructuring and asset impairment costs | 3 | - | 153 | 601 |
| Non-cash stock compensation and other charges | 56 | (110) | 126 | (142) |

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| | | | | |
|---|-----------|-----------|-----------|-----------|
| Adjusted EBITDA | \$ 17,653 | \$ 16,514 | \$ 29,299 | \$ 30,377 |
| <hr/> | | | | |
| Distribution: | | | | |
| Operating earnings | \$ 10,723 | \$ 10,612 | \$ 18,708 | \$ 18,377 |
| Add: | | | | |
| Depreciation and amortization | 1,943 | 2,050 | 3,814 | 4,204 |
| LIFO income | (1,500) | (100) | (3,408) | (300) |
| Restructuring and asset impairment costs | 180 | - | 2,612 | - |
| Non-cash stock compensation and other charges | 989 | 933 | 1,997 | 2,276 |
| Adjusted EBITDA | \$ 12,335 | \$ 13,495 | \$ 23,723 | \$ 24,557 |
| <hr/> | | | | |

For information on contractual obligations, see our Annual Report on Form 10-K for the fiscal year ended March 27, 2010. At September 11, 2010, there have been no material changes to our significant contractual obligations outside the ordinary course of business.

Indebtedness and Liabilities of Subsidiaries

On May 30, 2007, the Company sold \$110 million aggregate principal amount of 3.375% Convertible Senior Notes due 2027 (the "Notes"). The Notes are general unsecured obligations and rank equally in right of payment with all of the Company's other existing and future obligations that are unsecured and unsubordinated. Because the Notes are unsecured, they are structurally subordinated to our subsidiaries' existing and future indebtedness and other liabilities and any preferred equity issued by our subsidiaries. We rely in part on distributions and advances from our subsidiaries in order to meet our payment obligations under the notes and our other obligations. The Notes are not guaranteed by our subsidiaries. Many of our subsidiaries serve as guarantors with respect to our existing credit facility. Creditors of each of our subsidiaries, including trade creditors, and preferred equity holders, generally have priority with respect to the assets and earnings of the subsidiary over the claims of our creditors, including holders of the Notes. The Notes, therefore, are effectively subordinated to the claims of creditors, including trade creditors, judgment creditors and equity holders of our subsidiaries. In addition, our rights and the rights of our creditors, including the holders of the notes, to participate in the assets of a subsidiary during its liquidation or reorganization are effectively subordinated to all existing and future liabilities and preferred equity of that subsidiary. The Notes are effectively subordinated to our existing and future secured indebtedness to the extent of the assets securing such indebtedness and to existing and future indebtedness and other liabilities of our subsidiaries (including subsidiary guarantees of our senior credit facility).

The following table shows the indebtedness and other liabilities of our subsidiaries as of September 11, 2010:

Spartan Stores Subsidiaries Only (In thousands)

| | September 11, 2010 |
|--|-------------------------------|
| | |
| Current Liabilities | |
| Accounts payable | \$ 130,618 |
| Accrued payroll and benefits | 28,894 |
| Other accrued expenses | 16,282 |
| Current portion of restructuring costs | 7,211 |
| Current maturities of long-term debt and capital lease obligations | 4,167 |
| | |
| Total current liabilities | 187,172 |
| Long-term Liabilities | |
| Postretirement benefits | 21,825 |
| Other long-term liabilities | 16,772 |
| Restructuring costs | 25,873 |
| Long-term debt and capital lease obligations | 41,782 |
| | |
| Total long-term liabilities | 106,252 |

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| | |
|--|------------|
| Total Subsidiary Liabilities | 293,424 |
| Operating Leases | 139,947 |
| | <hr/> |
| Total Subsidiary Liabilities and Operating Leases | \$ 433,371 |
| | <hr/> |

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Ratio of Earnings to Fixed Charges

Our ratio of earnings to fixed charges was 4.00:1.00 and 3.70:1.00 for the second quarter and prior year second quarter, respectively, and 3.30:1.00 for both the year-to-date and prior year-to-date periods. For purposes of calculating the ratio of earnings to fixed charges, earnings consist of pretax earnings from continuing operations plus fixed charges (excluding capitalized interest). Fixed charges consist of interest costs, whether expensed or capitalized, the interest component of rental expense and amortization of debt issue costs, whether expensed or capitalized.

Off-Balance Sheet Arrangements

We had letters of credit totaling \$1.7 million outstanding and unused at September 11, 2010. The letters of credit are maintained primarily to support payment or deposit obligations. We pay a commission of approximately 2% on the face amount of the letters of credit.

Critical Accounting Policies

This discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts. On an ongoing basis, we evaluate our estimates, including those related to bad debts, inventories, intangible assets, assets held for sale, long-lived assets, income taxes, self-insurance reserves, restructuring and asset impairment costs, retirement benefits, stock-based compensation and contingencies and litigation. We base our estimates on historical experience and on various other assumptions and factors that we believe to be reasonable under the circumstances. Based on our ongoing review, we make adjustments we consider appropriate under the facts and circumstances. We have discussed the development, selection and disclosure of these estimates with the Audit Committee. The accompanying condensed consolidated financial statements are prepared using the same critical accounting policies discussed in our Annual Report on Form 10-K for the fiscal year ended March 27, 2010.

ITEM 3. Quantitative and Qualitative Disclosure About Market Risk

There have been no material changes in market risk of Spartan Stores from the information provided under Part II, Item 7A, "Quantitative and Qualitative Disclosure About Market Risk", of the Company's Annual Report on Form 10-K for the fiscal year ended March 27, 2010.

ITEM 4. Controls and Procedures

An evaluation of the effectiveness of the design and operation of Spartan Stores' disclosure controls and procedures (as currently defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) was performed as of September 11, 2010 (the "Evaluation Date"). This evaluation was performed under the supervision and with the participation of Spartan Stores' management, including its Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"). Spartan Stores' management, including the CEO and CFO, concluded that Spartan Stores' disclosure controls and procedures were effective as of the Evaluation Date to ensure that material information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the reports that we file or submit under the Securities and Exchange Act of 1934 is accumulated and communicated to management, including our principal executive and principal financial officers as appropriate to allow for timely decisions regarding required disclosure. During the last fiscal quarter there was no change in Spartan Stores' internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, Spartan Stores' internal control over financial reporting.

PART II
OTHER INFORMATION

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

The following table provides information regarding the Company's purchases of its own common stock during the third quarter. The Company has no public stock repurchase plans or programs. All transactions reported are with associates under stock compensation plans. These include: (1) shares of Spartan Stores, Inc. stock delivered in satisfaction of the exercise price and/or tax withholding obligations by holders of employee stock options who exercised options, and (2) shares submitted for cancellation to satisfy tax withholding obligations that occur upon the vesting of the restricted shares. The value of the shares delivered or withheld is determined by the applicable stock compensation plan.

Spartan Stores, Inc. Purchases of Equity Securities

| Period | Total Number of Shares Purchased | Average Price Paid per Share |
|---|--|------------------------------------|
| June 20 - July 17, 2010 | | |
| Employee Transactions | 56 | \$ 14.11 |
| July 18 - August 14, 2010 | | |
| Employee Transactions | 163 | \$ 13.51 |
| August 15 - September 11, 2010 | | |
| Employee Transactions | - | \$ - |
| Total for Second Quarter ended September 11, 2010 | 219 | \$ 13.66 |

ITEM 6.

Exhibits

The following documents are filed as exhibits to this Quarterly Report on Form 10-Q:

| <u>Exhibit Number</u> | <u>Document</u> |
|-----------------------|---|
| 3.1 | Amended and Restated Articles of Incorporation of Spartan Stores, Inc., as amended. |
| 3.2 | Bylaws of Spartan Stores, Inc., as amended. |
| 10.1 | Spartan Stores, Inc. Executive Cash Incentive Plan of 2010 as amended. Previously filed as an exhibit to Spartan Stores' Current Report on Form 8-K on August 12, 2010. Here incorporated by reference. |
| 10.2 | Form of Long-Term Executive Incentive Plan Award. Previously filed as an exhibit to Spartan Stores' Current Report on Form 8-K on August 12, 2010. Here incorporated by reference. |
| 31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

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