

LANCASTER COLONY CORP

Form 10-Q

November 07, 2007

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

**Form 10-Q**

(Mark One)

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

**For the quarterly period ended September 30, 2007**

**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 000-04065**

**Lancaster Colony Corporation**

*(Exact name of registrant as specified in its charter)*

**Ohio**

*(State or other jurisdiction of  
incorporation or organization)*

**13-1955943**

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

**37 West Broad Street  
Columbus, Ohio**

*(Address of principal executive offices)*

**43215**

*(Zip Code)*

**614-224-7141**

*(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 a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large Accelerated filer  Accelerated filer  Non-accelerated filer

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

Yes  No

As of October 31, 2007, there were approximately 29,890,000 shares of Common Stock, without par value per share, outstanding.

**LANCASTER COLONY CORPORATION AND SUBSIDIARIES**

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**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Consolidated Financial Statements**

**LANCASTER COLONY CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
**(UNAUDITED)**

<u>(Amounts in thousands, except share data)</u>	<b>September 30 2007</b>	<b>June 30 2007</b>
<b>ASSETS</b>		
<b>Current Assets:</b>		
Cash and equivalents	\$ 14,505	\$ 8,318
Receivables (less allowance for doubtful accounts, September \$1,002 and June \$916)	114,610	92,635
Inventories:		
Raw materials	39,544	40,358
Finished goods and work in process	113,677	109,359
Total inventories	153,221	149,717
Deferred income taxes and other current assets	25,456	28,241
Total current assets	307,792	278,911
<b>Property, Plant and Equipment:</b>		
Land, buildings and improvements	163,387	162,276
Machinery and equipment	354,503	350,357
Total cost	517,890	512,633
Less accumulated depreciation	308,882	304,202
Property, plant and equipment net	209,008	208,431
<b>Other Assets:</b>		
Goodwill	89,590	89,590
Other intangible assets net	12,803	13,111
Other noncurrent assets	8,733	8,454
<b>Total</b>	<b>\$ 627,926</b>	<b>\$ 598,497</b>

**LIABILITIES AND SHAREHOLDERS EQUITY****Current Liabilities:**

Short-term bank loans	\$ 87,500	\$ 42,500
Accounts payable	47,175	48,423
Accrued liabilities	50,863	50,867

Total current liabilities	<b>185,538</b>	141,790
<b>Other Noncurrent Liabilities</b>	<b>14,847</b>	10,702
<b>Deferred Income Taxes</b>	<b>158</b>	1,696
<b>Shareholders' Equity:</b>		
Preferred stock authorized 3,050,000 shares; outstanding none		
Common stock authorized 75,000,000 shares; outstanding		
September 30, 2007 30,175,682 shares; June 30, 2007 30,748,390 shares	<b>81,708</b>	81,665
Retained earnings	<b>943,606</b>	937,376
Accumulated other comprehensive loss	<b>(5,121)</b>	(5,167)
Common stock in treasury, at cost	<b>(592,810)</b>	(569,565)
Total shareholders' equity	<b>427,383</b>	444,309
<b>Total</b>	<b>\$ 627,926</b>	\$ 598,497

See accompanying notes to consolidated financial statements.

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**LANCASTER COLONY CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME**  
**(UNAUDITED)**

	<b>Three Months Ended</b>	
	<b>September 30</b>	
<u>(Amounts in thousands, except per share data)</u>	<b>2007</b>	<b>2006</b>
<b>Net Sales</b>	<b>\$ 285,570</b>	<b>\$ 262,064</b>
<b>Cost of Sales</b>	<b>236,399</b>	<b>217,415</b>
<b>Gross Margin</b>	<b>49,171</b>	<b>44,649</b>
<b>Selling, General and Administrative Expenses</b>	<b>23,940</b>	<b>22,203</b>
<b>Restructuring and Impairment Charge</b>	<b>136</b>	
<b>Operating Income</b>	<b>25,095</b>	<b>22,446</b>
<b>Other Income (Expense):</b>		
Interest expense	<b>(958)</b>	
Interest income and other net	<b>162</b>	<b>362</b>
<b>Income from Continuing Operations Before Income Taxes</b>	<b>24,299</b>	<b>22,808</b>
<b>Taxes Based on Income</b>	<b>8,729</b>	<b>8,318</b>
<b>Income from Continuing Operations</b>	<b>15,570</b>	<b>14,490</b>
<b>Loss from Discontinued Operations, Net of Tax</b>		<b>(709)</b>
<b>Net Income</b>	<b>\$ 15,570</b>	<b>\$ 13,781</b>
<b>Income Per Common Share from Continuing Operations:</b>		
Basic and Diluted	<b>\$ .51</b>	<b>\$ .45</b>
<b>Loss Per Common Share from Discontinued Operations:</b>		
Basic and Diluted	<b>\$</b>	<b>\$ (.02)</b>
<b>Net Income Per Common Share:</b>		
Basic and Diluted	<b>\$ .51</b>	<b>\$ .43</b>

<b>Cash Dividends Per Common Share</b>	\$	<b>.27</b>	\$	.26
<b>Weighted Average Common Shares Outstanding:</b>				
Basic		<b>30,412</b>		31,919
Diluted		<b>30,420</b>		31,936

See accompanying notes to consolidated financial statements.

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**LANCASTER COLONY CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(UNAUDITED)**

<b><u>(Amounts in thousands)</u></b>	<b>Three Months Ended September 30</b>	
	<b>2007</b>	<b>2006</b>
<b>Cash Flows From Operating Activities:</b>		
Net income	\$ 15,570	\$ 13,781
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss from discontinued operations		709
Depreciation and amortization	7,810	6,982
Deferred income taxes and other noncash changes	(1,324)	(357)
Restructuring and impairment charge	(56)	
Gain on sale of property	(42)	(25)
Pension plan activity	(171)	(53)
Changes in operating assets and liabilities:		
Receivables	(21,974)	(15,720)
Inventories	(3,521)	(5,900)
Other current assets	3,001	(2,378)
Accounts payable and accrued liabilities	3,330	10,605
Net cash provided by operating activities from continuing operations	<b>2,623</b>	7,644
<b>Cash Flows From Investing Activities:</b>		
Payments on property additions	(8,258)	(9,977)
Proceeds from sale of property	41	34
Proceeds from short-term investment sales, calls and maturities		35,765
Other net	(865)	(184)
Net cash (used in) provided by investing activities from continuing operations	<b>(9,082)</b>	25,638
<b>Cash Flows From Financing Activities:</b>		
Net change in short-term borrowings	45,000	
Purchase of treasury stock	(23,245)	(17,529)
Payment of dividends	(8,165)	(8,276)
Proceeds from the exercise of stock options		2,266
Decrease in cash overdraft balance	(948)	(2,201)
Net cash provided by (used in) financing activities from continuing operations	<b>12,642</b>	(25,740)
<b>Cash Flows From Discontinued Operations:</b>		
Net cash used in operating activities from discontinued operations		(1,613)
Net cash used in investing activities from discontinued operations		(222)



Net cash used in discontinued operations		(1,835)
Effect of exchange rate changes on cash	4	(7)
Net change in cash and equivalents	6,187	5,700
Cash and equivalents at beginning of year	8,318	6,050
Cash and equivalents at end of period	\$ 14,505	\$ 11,750

**Supplemental Disclosure Of Operating Cash Flows:**

Cash paid during the period for income taxes	\$ 1,014	\$ 1,260
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See accompanying notes to consolidated financial statements.

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**LANCASTER COLONY CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Tabular amounts in thousands, except share and per share data)**

**Note 1 Summary of Significant Accounting Policies**

***Basis of Presentation***

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In our opinion, the interim consolidated financial statements reflect all adjustments necessary for a fair presentation of the results of operations and financial position for such periods. All such adjustments reflected in the interim consolidated financial statements are considered to be of a normal recurring nature. The results of operations for any interim period are not necessarily indicative of results for the full year. Accordingly, these financial statements should be read in conjunction with the financial statements and notes thereto contained in our Annual Report on Form 10-K for the year ended June 30, 2007. The prior-year results reflect the classification of the sold Automotive operations as discontinued operations. Unless otherwise noted, the term year and references to a particular year pertain to our fiscal year, which begins on July 1 and ends on June 30; for example, 2008 refers to fiscal 2008, which is the period from July 1, 2007 to June 30, 2008.

***Property, Plant and Equipment***

Property, plant and equipment are stated at cost. Purchases of property, plant and equipment included in accounts payable at September 30, 2007 and 2006 were approximately \$1.2 million. These purchases, less the preceding June 30 balances, have been excluded from the property additions in the Consolidated Statements of Cash Flows.

***Significant Accounting Policies***

There were no changes to our Significant Accounting Policies from those disclosed in our Annual Report on Form 10-K for the year ended June 30, 2007.

**Note 2 Impact of Recently Issued Accounting Standards**

In February 2007, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities ( SFAS 159 ). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value in order to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This pronouncement is effective as of the beginning of our 2009 fiscal year. We are currently evaluating the impact, if any, that SFAS 159 will have on our financial position or results of operations.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements ( SFAS 157 ). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. This pronouncement is effective as of the beginning of our 2009 fiscal year. We are currently evaluating the impact that SFAS 157 will have on our financial position or results of operations.

We adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes ( FIN 48 ) on July 1, 2007. See further discussion in Note 9.

**Note 3 Goodwill and Other Intangible Assets**

Goodwill attributable to the Specialty Foods segment was approximately \$89.6 million at September 30, 2007 and June 30, 2007.

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**LANCASTER COLONY CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Tabular amounts in thousands, except share and per share data)**

The following table summarizes our identifiable other intangible assets by segment as of September 30, 2007 and June 30, 2007:

	<b>September 30 2007</b>	<b>June 30 2007</b>
<b>Specialty Foods</b>		
Trademarks (40-year life)		
Gross carrying value	\$ 370	\$ 370
Accumulated amortization	(151)	(149)
Net Carrying Value	\$ 219	\$ 221
Customer Relationships (12-15-year life)		
Gross carrying value	\$ 13,020	\$ 13,020
Accumulated amortization	(1,479)	(1,233)
Net Carrying Value	\$ 11,541	\$ 11,787
Non-compete Agreements (5-8-year life)		
Gross carrying value	\$ 1,540	\$ 1,540
Accumulated amortization	(585)	(531)
Net Carrying Value	\$ 955	\$ 1,009
<b>Glassware and Candles Customer Lists (12-year life)</b>		
Gross carrying value	\$ 250	\$ 250
Accumulated amortization	(162)	(156)
Net Carrying Value	\$ 88	\$ 94
Total Net Carrying Value	\$ 12,803	\$ 13,111

Amortization expense relating to these assets was approximately \$0.3 million and \$0.1 million for the three months ended September 30, 2007 and 2006. Total annual amortization expense is estimated to be approximately \$1.2 million for each of the next three years, \$1.1 million for the fourth year and \$0.9 million for the fifth year.

**Note 4 Short-Term Borrowings**

At September 30, 2007, we had an unsecured revolving credit facility under which we could borrow up to \$100 million. The facility was to expire in February 2008, but was replaced with a new facility in October, as discussed further below. At September 30, 2007, we were in compliance with all applicable provisions and covenants, and we had \$77.5 million outstanding under the facility with a weighted average interest rate of 5.78%. We also had \$10.0 million outstanding under a separate discretionary line. The interest rate of this borrowing was 5.39%. We paid approximately \$0.9 million of interest for the three months ended September 30, 2007.

On October 5, 2007, we entered into a new unsecured revolving credit facility, which replaced the existing credit facility described above. Under the new facility, we may borrow up to a maximum of \$160 million at any one time, with potential to expand the total credit availability to \$260 million based on consent of the issuing bank and certain other conditions. The facility expires on October 5, 2012, and all outstanding amounts are due and payable on that day. The facility contains certain restrictive covenants, including limitations on indebtedness, asset sales and acquisitions, and financial covenants relating to interest coverage and leverage. Loans may be used for general corporate purposes.

**Note 5 Pension Benefits**

We and certain of our operating subsidiaries provide multiple defined benefit pension plans. Benefits under the plans are primarily based on negotiated rates and years of service and cover the union workers at such locations. We contribute to these plans at least the minimum amount required by regulation or contract. We recognize the cost of plan benefits as the employees render service.

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**LANCASTER COLONY CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Tabular amounts in thousands, except share and per share data)**

The following table discloses net periodic benefit cost for our pension plans:

	<b>Three Months Ended September 30</b>	
	<b>2007</b>	<b>2006</b>
<b>Components of net periodic benefit cost</b>		
Service cost	\$ 39	\$ 127
Interest cost	647	632
Expected return on plan assets	(805)	(748)
Amortization of unrecognized net loss	43	65
Amortization of prior service cost	26	61
Amortization of unrecognized net obligation existing at transition	1	1
Net periodic (benefit) cost	\$ (49)	\$ 138

The above-noted net periodic benefit cost for the three months ended September 30, 2006 included approximately \$0.1 million of costs that are presented in discontinued operations because those costs related to the discontinued businesses.

We anticipate that significant disbursements will largely be made before the second quarter ends related to the early withdrawal of accumulated benefits (i.e., lump sum payouts) from a defined benefit plan associated with a disposed automotive operation sold in June 2007. As a result, we expect a significant pension settlement charge to be recorded in the second quarter. While currently available information is not sufficient to allow for a reasonable estimation of the noncash charge, the associated unrecognized losses deferred in accordance with accounting guidance exceeded \$3 million at September 30, 2007. The actual amount of the settlement loss will be based upon current pension assumptions (e.g., discount rate) at the time of remeasurement.

For the three months ended September 30, 2007, we made approximately \$0.1 million in contributions to our pension plans. We expect to make approximately \$0.7 million more in contributions to our pension plans during the remainder of 2008, except as may be modified as a result of the settlement activity noted above.

**Note 6 Postretirement Benefits**

We and certain of our operating subsidiaries provide multiple postretirement medical and life insurance benefit plans. We recognize the cost of benefits as the employees render service. Postretirement benefits are funded as incurred.

The following table discloses net periodic benefit cost for our postretirement plans:

	<b>Three Months Ended September 30</b>	
	<b>2007</b>	<b>2006</b>
<b>Components of net periodic benefit cost</b>		
Service cost	\$ 6	\$ 33
Interest cost	58	106
Amortization of unrecognized net loss	--	32
Amortization of prior service asset	(1)	(2)
Net periodic benefit cost	\$ 63	\$ 169

The above-noted net periodic benefit cost for the three months ended September 30, 2006 included approximately \$0.1 million of costs that are presented in discontinued operations because those benefit costs related to the discontinued businesses.

For the three months ended September 30, 2007, we made approximately \$0.1 million in contributions to our postretirement medical and life insurance benefit plans. We expect to make approximately \$0.2 million

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**LANCASTER COLONY CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
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more in contributions to our postretirement medical and life insurance benefit plans during the remainder of 2008.

**Note 7 Stock-Based Compensation**

As approved by our shareholders in November 1995, the terms of the 1995 Key Employee Stock Option Plan ( the 1995 Plan ) reserved 3,000,000 common shares for issuance to qualified key employees. All options granted under the 1995 Plan were exercisable at prices not less than fair market value as of the date of grant. The 1995 Plan expired in August 2005, but there are still options outstanding that were issued under this plan. In general, options granted under the 1995 Plan vested immediately and had a maximum term of five years. Our policy is to issue shares upon option exercise from new shares that had been previously authorized.

Our shareholders approved the adoption of a new equity compensation plan, the Lancaster Colony Corporation 2005 Stock Plan ( the 2005 Plan ), at our 2005 Annual Meeting of Shareholders. This new plan reserved 2,000,000 common shares for issuance to our employees and directors, and all options that will be granted under the plan will be exercisable at prices not less than fair market value as of the date of the grant.

**Stock Options**

Under SFAS 123R, we calculate fair value of option grants using the Black-Scholes option-pricing model. Assumptions used in the model for the prior-year grants are described in our Annual Report on Form 10-K for the year ended June 30, 2007. Total compensation cost related to share-based payment arrangements for the three months ended September 30, 2007 and 2006 was less than \$0.1 million. These amounts were reflected in Selling, General and Administrative Expenses and have been allocated to each segment appropriately. No initial tax benefits are recorded for these compensation costs because they relate to incentive stock options that do not qualify for a tax deduction until, and only if, a disqualifying disposition occurs.

There were no stock option exercises during the three months ended September 30, 2007. During the three months ended September 30, 2006, we received approximately \$2.1 million in cash from the exercise of stock options. The aggregate intrinsic value of these options was approximately \$0.4 million. A related tax benefit of approximately \$0.1 million was recorded in the three months ended September 30, 2006. These tax benefits were included in the financing section of the Consolidated Statements of Cash Flows and resulted from incentive stock option disqualifying dispositions and exercises of non-qualified options. The benefits include less than \$0.1 million of gross windfall tax benefits for the three months ended September 30, 2006.

There were no grants of stock options in the three months ended September 30, 2007 and 2006.

The following summarizes the activity relating to stock options granted under the 1995 Plan mentioned above for the three months ended September 30, 2007:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Outstanding stock options vested and expected to vest at beginning of period	361,500	\$ 40.42		
Exercised				
Granted				
Forfeited	(3,650)	39.82		
Outstanding stock options vested and expected to vest at end of period	357,850	\$ 40.43	1.93	\$ 86
	350,063	\$ 40.40	1.92	\$ 86

Exercisable and vested stock options at end of  
period



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**LANCASTER COLONY CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Tabular amounts in thousands, except share and per share data)**

The following summarizes the status of, and changes to, unvested options during the three months ended September 30, 2007:

	<b>Number of Shares</b>	<b>Weighted Average Grant Date Fair Value</b>
Unvested stock options at beginning of period	<b>7,787</b>	<b>\$ 8.14</b>
Granted		--
Vested		--
Forfeited		--
Unvested stock options at end of period	<b>7,787</b>	<b>\$ 8.14</b>

At September 30, 2007, there was less than \$0.1 million of total unrecognized compensation cost related to unvested share-based compensation arrangements granted under the 1995 Plan. This cost is expected to be recognized over a weighted-average period of 0.7 years.

**Restricted Stock**

On November 20, 2006, we granted a total of 3,500 shares of restricted stock to our seven nonemployee directors under the terms of the 2005 Plan discussed above. The restricted stock had a grant date fair value of approximately \$0.1 million based on a per share closing stock price of \$42.70. This restricted stock vests over a one-year period, and all of these shares are expected to vest. Dividends earned on the stock are held in escrow and will be paid to the directors at the time the stock vests. Compensation expense related to the restricted stock award will be recognized over the requisite service period.

The following summarizes the activity related to restricted stock transactions for the three-month period ended September 30, 2007:

	<b>Number of Shares</b>	<b>Weighted Average Grant Date Fair Value</b>
Unvested restricted stock at beginning of period	<b>3,500</b>	<b>\$ 42.70</b>
Granted		--
Vested		--
Forfeited		--
Unvested restricted stock at end of period	<b>3,500</b>	<b>\$ 42.70</b>

Compensation expense of less than \$0.1 million was recorded for the three-month period ended September 30, 2007 in Selling, General and Administrative Expenses. A tax benefit of less than \$0.1 million was recorded for the three months ended September 30, 2007 related to this restricted stock.

At September 30, 2007, there is less than \$0.1 million of unrecognized compensation expense that will be recognized over a weighted average period of .1 years.

**Note 8 Restructuring and Impairment Charge**

In the third quarter of 2007, we announced our plan to close our industrial glass operation located in Lancaster, Ohio. The decision to close this operation resulted from continuing declines in sales volume and profitability. During 2007, we recorded a restructuring and impairment charge of approximately \$3.5 million (\$2.3 million after taxes) including \$1.4 million recorded in cost of sales for the write-down of inventories. Production at the m