SANFILIPPO JOHN B & SON INC
Form 10-Q
May 05, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark one)

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

For the quarterly period ended March 27, 2008

OR

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

Commission File Number 0-19681
JOHN B. SANFILIPPO & SON, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	36-2419677
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
1703 North Randall Road Elgin, Illinois	60123-7820
(Address of principal executive offices)	*(Zip code)*
(847) 289-1800	
(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, and (2) has been subject to such filing requirements for the past 90 days. þ Yes o 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. (Check one):

Large accelerated filer o Accelerated filer þ Non-accelerated filer o Smaller reporting company þ

(Do not check if a smaller reporting company)

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

As of May 5, 2008, 8,134,599 shares of the Registrant s Common Stock, $0.01 par value per share, including 117,900 treasury shares, and 2,597,426 shares of the Registrant s Class A Common Stock, $0.01 par value per share, were outstanding.

JOHN B. SANFILIPPO & SON, INC.
FORM 10-Q
FOR THE QUARTER ENDED MARCH 27, 2008
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PART I FINANCIAL INFORMATION
Item 1. Financial Statements
JOHN B. SANFILIPPO & SON, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(Dollars in thousands, except earnings per share)

	For the Quarter Ended		For the Thirty-nine Weeks Ended	
	March 27, 2008	March 29, 2007 (As revised)	March 27, 2008	March 29, 2007 (As revised)
Net sales	$ 106,716	$ 107,009	$ 416,514	$ 418,456
Cost of sales	93,878	100,954	368,539	387,108
Gross profit	12,838	6,055	47,975	31,348
Operating expenses:				
Selling expenses	7,835	8,131	26,332	30,202
Administrative expenses	4,511	3,956	14,177	11,917
Restructuring expenses	362		1,765	
Gain related to real estate sales				(3,047)
Total operating expenses	12,708	12,087	42,274	39,072
Income (loss) from operations	130	(6,032)	5,701	(7,724)
Other expense:				
Interest expense ($277, $281, $833 and $614 to related parties)	(2,662)	(2,861)	(8,039)	(6,315)
Debt extinguishment costs	(6,737)		(6,737)	
Rental and miscellaneous income (expense), net	(89)	(530)	(37)	(626)
Total other expense, net	(9,488)	(3,391)	(14,813)	(6,941)
Loss before income taxes	(9,358)	(9,423)	(9,112)	(14,665)
Income tax benefit	(608)	(3,299)	(490)	(5,231)
Net loss	(8,750)	(6,124)	(8,622)	(9,434)
Other comprehensive income, net of tax:				
Adjustment for prior service cost and actuarial gain amortization related to retirement plan	98		292	
Net comprehensive loss	$ (8,652)	$ (6,124)	$ (8,330)	$ (9,434)
Basic and diluted loss per common share	$ (0.82)	$ (0.58)	$ (0.81)	$ (0.89)

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

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JOHN B. SANFILIPPO & SON, INC.
CONSOLIDATED BALANCE SHEETS
(Unaudited)
(Dollars in thousands, except per share amounts)

	March 27, 2008	June 28, 2007 (As revised)	March 29, 2007 (As revised)
ASSETS			
CURRENT ASSETS:			
Cash	$ 1,988	$ 2,359	$ 2,187
Restricted cash	7,954		
Accounts receivable, less allowances of $3,167, $3,159 and $5,025	35,200	36,544	33,393
Inventories	141,661	134,159	168,237
Income taxes receivable	108	6,531	4,703
Deferred income taxes	1,499	2,140	2,499
Prepaid expenses and other current assets	1,432	1,150	1,123
Asset held for sale	5,569	5,569	5,569
TOTAL CURRENT ASSETS	195,411	188,452	217,711
PROPERTY, PLANT AND EQUIPMENT:			
Land	9,463	9,463	9,463
Buildings	98,962	97,113	77,733
Machinery and equipment	149,894	140,730	133,179
Furniture and leasehold improvements	6,239	6,191	6,113
Vehicles	745	2,880	2,880
Construction in progress	4,021	4,487	29,253
	269,324	260,864	258,621
Less: Accumulated depreciation	124,805	117,639	114,678
	144,519	143,225	143,943
Rental investment property, less accumulated depreciation of $2,435, $1,761 and $1,536	27,695	28,370	28,594
TOTAL PROPERTY, PLANT AND EQUIPMENT	172,214	171,595	172,537
Intangible asset minimum retirement plan liability			6,197
Cash surrender value of officers life insurance, unamortized debt issuance costs and other assets	8,645	6,141	6,254
Brand name, less accumulated amortization of $6,818, $6,498 and $6,392	1,102	1,422	1,528

TOTAL ASSETS	$ 377,372	$ 367,610	$ 404,227

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

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JOHN B. SANFILIPPO & SON, INC.
CONSOLIDATED BALANCE SHEETS
(Unaudited)
(Dollars in thousands, except per share amounts)

	March 27, 2008	June 28, 2007 (As revised)	March 29, 2007 (As revised)
LIABILITIES & STOCKHOLDERS EQUITY			
CURRENT LIABILITIES:			
Revolving credit facility borrowings	$ 87,038	$ 73,281	$ 80,987
Current maturities of long-term debt, including related party debt of $212, $200 and $196	11,872	54,970	58,544
Accounts payable, including related party payables of $730, $361 and $1,279	26,089	21,264	31,174
Book overdraft	10,994	5,015	10,076
Accrued payroll and related benefits	8,256	6,018	5,318
Accrued workers compensation	6,610	6,686	6,052
Accrued restructuring	1,378		
Other accrued expenses	5,871	5,418	6,305
TOTAL CURRENT LIABILITIES	158,108	172,652	198,456
LONG-TERM LIABILITIES:			
Long-term debt, less current maturities, including related party debt of $13,699, $13,860 and $13,911	53,481	19,783	20,267
Retirement plan	8,914	9,060	8,644
Deferred income taxes	1,499	2,606	5,475
Other		179	310
TOTAL LONG-TERM LIABILITIES	63,894	31,628	34,696
COMMITMENTS AND CONTINGENCIES			
STOCKHOLDERS EQUITY:			
Class A Common Stock, convertible to Common Stock on a per share basis, cumulative voting rights of ten votes per share, $.01 par value; 10,000,000 shares authorized, 2,597,426 shares issued and outstanding	26	26	26
Common Stock, non-cumulative voting rights of one vote per share, $.01 par value; 17,000,000 shares authorized, 8,134,599, 8,123,349 and 8,121,349 shares issued and outstanding	81	81	81
Capital in excess of par value	100,705	100,335	100,219
Retained earnings	59,527	68,149	71,953
Accumulated other comprehensive loss	(3,765)	(4,057)	

Treasury stock, at cost; 117,900 shares of Common Stock	(1,204)	(1,204)	(1,204)
TOTAL STOCKHOLDERS EQUITY	155,370	163,330	171,075
TOTAL LIABILITIES & STOCKHOLDERS EQUITY	$ 377,372	$ 367,610	$ 404,227

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

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JOHN B. SANFILIPPO & SON, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(Dollars in thousands)

	For the Thirty-nine Weeks Ended	
	March 27, 2008	March 29, 2007 (As revised)
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (8,622)	$ (9,434)
Depreciation and amortization	11,856	9,970
Gain on disposition of properties	(79)	(3,108)
Deferred income tax benefit	(466)	(425)
Stock-based compensation expense	292	309
Change in current assets and current liabilities:		
Accounts receivable, net	1,344	2,088
Inventories	(7,502)	(3,847)
Prepaid expenses and other current assets	(282)	1,125
Accounts payable	4,825	6,189
Accrued expenses	3,993	(591)
Income taxes receivable	6,423	1,724
Other operating assets	(141)	(1,718)
Net cash provided by operating activities	11,641	2,282
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	(10,897)	(33,100)
Proceeds from disposition of properties	107	17,812
Increase in restricted cash	(7,954)	
Cash surrender value of officers life insurance	(202)	(285)
Net cash used in investing activities	(18,946)	(15,573)
CASH FLOWS FROM FINANCING ACTIVITIES		
Borrowings under revolving credit facilities	43,461	119,915
Repayments of revolving credit borrowings	(46,452)	(103,269)
Initial borrowing under new revolving credit facility	82,031	
Payment of amounts outstanding under prior revolving credit facility	(65,283)	
Principal payments on long-term debt	(54,607)	(10,020)
Issuance of long-term debt	45,000	
Debt issue costs	(3,273)	
Financing obligation with related parties		14,300
Increase (decrease) in book overdraft	5,979	(4,225)
Issuance of Common Stock under option plans	72	68
Minority interest distribution		(3,545)

Tax benefit of stock options exercised		6		22
Net cash provided by financing activities		6,934		13,246
NET DECREASE IN CASH		(371)		(45)
Cash, beginning of period		2,359		2,232
Cash, end of period	$	1,988	$	2,187
SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:				
Capital lease obligations incurred		207		1,117

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

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JOHN B. SANFILIPPO & SON, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(Dollars in thousands, except where noted and per share data)

Note 1 Management s Plans to Continue as a Going Concern

The ability of John B. Sanfilippo & Son, Inc. (the Company) to continue as a going concern is dependent on the ability of the Company to return to levels of profitability and to achieve the necessary cash flows to meet the restrictive covenants associated with the new financing arrangements in the near term. The Company secured new financing during the third quarter of fiscal 2008 comprised of a revolving credit facility and a mortgage term loan. The new revolving credit facility contains one restrictive financial covenant, which the Company currently believes will be attainable, however compliance is dependent upon maintaining a $15.0 million level of excess availability under the revolving credit facility and achieving a certain fixed charge coverage ratio if the $15.0 million level of excess availability is not met. The ability of the Company to meet the restrictive covenants under the new revolving credit facility could be adversely affected if the Company s profitability and cash flows do not improve as a result of its restructuring activities and consolidation of facilities. The mortgage term loan is collateralized by certain real property and fixtures and is subject to a minimum net worth requirement of $110.0 million. The new financing arrangements should provide the Company with increased flexibility to accomplish its objectives and improve future financial performance.

The extent of the Company s losses in fiscal 2006 and 2007, the non-compliance with restrictive covenants under the previous primary financing facilities and uncertainty surrounding future profitability and cash flows with respect to the Company s ability to meet the restrictive covenants associated with the new financing arrangements in the near term raise substantial doubt with respect to the Company s ability to continue as a going concern. In order for the Company to continue as a going concern, it must be able to achieve the expected future profitability and cash flows, and the excess availability levels that are in accordance with the restrictive covenants contained in the Company s new financing arrangements for at least a twelve month period. The significant losses incurred for fiscal 2006 and the first half of fiscal 2007 were caused in large part by the decline in the market price for almonds after the 2005 crop was procured. Sales of the 2005 almond crop were completed in November 2006 (the second quarter of fiscal 2007). Almond profit margins returned to normal historical levels in December 2006. The Company no longer purchases almonds directly from growers and discontinued its almond handling operation conducted at its Gustine, California facility during the third quarter of fiscal 2007. The Company decided to discontinue its almond handling operation in order to reduce the commodity risk that had such a significant negative financial impact in fiscal 2006 and to eliminate the significant labor costs associated with processing almonds purchased directly from growers that could not be recovered completely when the almonds were sold. While the decline in the market price of the 2005 crop almonds negatively affected the Company s profitability through the first half of fiscal 2007, the loss incurred during the last half of fiscal 2007 was due primarily to insufficient sales volume and expenses related to the Company s relocation of its Chicago area operations to its new facility in Elgin, Illinois.

The Company s financial performance has improved in fiscal 2008. The loss before income taxes was $9.1 million, including $6.7 million of debt extinguishment costs, for the first thirty-nine weeks of fiscal 2008 compared to $14.7 million for fiscal 2007. The loss before income taxes for the first thirty-nine weeks of fiscal 2008 also contains certain unusual or infrequent expenses in addition to the debt extinguishment costs, including:

- $7.0 million increase in unfavorable labor and efficiency variances over the first thirty-nine weeks of fiscal 2007, which was primarily related to the shut down and start up costs for production lines that were moved from the existing facilities and installed in the new Elgin facility. The increase was only $1.0 million for the third quarter of fiscal 2008 over the third quarter of fiscal 2007 as Elgin production is stabilizing;

- $2.5 million in estimated redundant manufacturing expenses as production activities occurred at the existing Chicago area facilities while the manufacturing spending in the new Elgin facility reflected increased production levels. Only $0.1 million of redundant manufacturing expenses were incurred during the third quarter of fiscal 2008 as only limited production occurred at the one remaining Chicago area facility, excluding

Elgin;

$2.3 million in external contractor charges that were related to the acceleration of the equipment move from the existing Chicago area facilities to the new Elgin facility. Only $0.3 million of the $2.3 million total was incurred during the third quarter of fiscal 2008;

$1.2 million in restructuring charges related to the discontinuance of the Company s store-door distribution system, $0.4 million in severance expenses, $0.3 million in inventory write-downs related to the

discontinuance of low volume sales items and $0.2 million in restructuring charges related to the exit of a leased facility before the termination date at a facility no longer utilized by the Company; and

$0.9 million in consulting fees related to the Company s profitability enhancement initiative, the implementation of a new sales analysis system and the design and implementation of a Sanfilippo Value Added Plan, which will reward plan participants in connection with year-over-year improvement in the Company s after-tax net operating financial performance in excess of the Company s annual cost of capital.

During the fourth quarter of fiscal 2007, the Company conducted an intensive review of walnut operations at its Gustine, California facility and created an action plan to reduce waste and loss in the shelling operation. This plan, which includes new equipment, is substantially completed. Management has developed and will continue to develop action plans at all facilities to reduce manufacturing expenses. Management also accelerated the move of equipment from its Chicago area facilities to the new Elgin facility. The Company has ceased operations at two of its three old Chicago area facilities. Activities at the lone remaining facility should be transferred to the Elgin facility by August 2008 versus the original schedule of the end of calendar 2008. While additional costs were incurred during the first thirty-nine weeks of fiscal 2008 in connection with the accelerated move, the acceleration is expected to generate net cost savings. The Company also expects to achieve operational efficiencies, once all production is integrated into the new facility.

Management further addressed the Company s ability to continue as a going concern by conducting profitability reviews of all items sold to customers. The Company engaged a profitability enhancement consultant (which was a requirement relating to the waivers received from the lenders under the Company s previous primary financing facilities for non-compliance with financial covenants for the third quarter of fiscal 2007) to assist in this process and in the Company s forecasting procedures. The result of this profitability review led to price increases for many items and the eventual discontinuance of approximately 1,200 other items, or approximately 30% of the number of items sold by the Company, during the third quarter of fiscal 2008. The Company believes that annual net sales could decrease by approximately $20.0 million as a result of the discontinuance of these items. Also, in the first two months of calendar 2008, the Company terminated approximately 80 employees, approximately 5% of its work force, pursuant to an initiative separate from the store-door discontinuance described below. These terminations were possible due to the Company s initiatives, such as consolidating all Chicago area activities at Elgin and discontinuing 1,200 items. The Company expects to save approximately $4.0 million in payroll and related benefits annually as a result of the work force reduction.

The Company terminated its store-door distribution system in January 2008 as a result of its determination that it is no longer profitable to ship products to customers through its store-door distribution system. In connection with the discontinuance of the store-door delivery system, the Company terminated nine employees. The Company has contacted its larger grocery customers who are receiving products through this mode of distribution and requested that products be shipped directly to their distribution centers. Based upon positive customer response, the Company believes that many of these customers will accept this change in distribution, and consequently, the Company anticipates that approximately 50% of the $2.5 million in sales made in calendar 2007 through its store-door distribution system will migrate to other distribution channels. However, there can be no assurances in this regard.

While the initiatives described above are expected to improve efficiencies and generate cost savings, the Company cannot endure further sales volume reductions if it is to return to historical levels of profitability and realize the benefits originally expected from the Company s new facility. The Company is actively developing plans, especially for its Fisher brand, with the intention of increasing sales and gross margin. As a result of these efforts, the Company secured additional private label business that generated over $25 million in sales during the first thirty-nine weeks of fiscal 2008. Other new business opportunities are being pursued across all of the Company s distribution channels.

Management believes that the implementation of the initiatives described above should enhance future operating performance; however, the discontinuance of the almond handling operation has contributed to a decrease in net sales and the efforts to reduce unprofitable items will likely lead to an additional decline in net sales, which could, among other things, negatively impact the Company s ability to benefit from the facility consolidation project.

In summary, management believes that the steps that it has taken and will take to improve operating performance should enhance its ability to return to historic levels of profitability.

If the Company is not able to achieve these objectives, the Company s financial condition will be adversely affected in a material way. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Note 2 Basis of Presentation

The Company was incorporated under the laws of the State of Delaware in 1979 as the successor by merger to an Illinois corporation that was incorporated in 1959. As used herein, unless the context otherwise indicates, the term

Company refers collectively to John B. Sanfilippo & Son, Inc. and JBSS Properties LLC, a wholly-owned subsidiary of John B. Sanfilippo & Son, Inc. The Company s fiscal year ends on the final Thursday of June each year, and typically consists of fifty-two weeks (four thirteen week quarters). References herein to fiscal 2008 are to the fiscal year ending June 26, 2008. References herein to fiscal 2007 are to the fiscal year ended June 28, 2007. References herein to the third quarter of fiscal 2008 are to the quarter ended March 27, 2008. References herein to the first thirty-nine weeks of fiscal 2008 are to the thirty-nine weeks ended March 27, 2008. References herein to the third quarter of fiscal 2007 are to the quarter ended March 29, 2007. References herein to the first thirty-nine weeks of fiscal 2007 are to the thirty-nine weeks ended March 29, 2007. The Company s Note Agreement and Prior Credit Facility, as defined in Note 11, are sometimes collectively referred to the Company s previous primary financing facilities and the Company s previous financing arrangements . The Company s New Credit Facility and Mortgage Facility, as defined in Note 11, are sometimes collectively referred to as the Company s new primary financing facilities and the Company s new financing arrangements .

In the opinion of the Company s management, the accompanying statements present fairly the consolidated statements of operations, consolidated balance sheets and consolidated statements of cash flows, and reflect all adjustments, consisting only of normal recurring adjustments which, in the opinion of management, are necessary for the fair presentation of the results of the interim periods. As is discussed in Note 14, results for prior periods have been revised, resulting in a $438 increase in retained earnings at the end of fiscal 2007. The Company secured new financing during the third quarter of fiscal 2008. The new financing facilities contain limited restrictive financial covenants, which the Company currently believes will be attainable. The new financing arrangements should provide the Company with increased flexibility to accomplish its objectives and improve financial performance. However, as discussed in Note 1, there is uncertainty regarding the Company s ability to continue as a going concern.

The interim results of operations are not necessarily indicative of the results to be expected for a full year. The balance sheet as of June 28, 2007 was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. It is suggested that these financial statements be read in conjunction with the financial statements and notes thereto included in the Company s 2007 Annual Report filed on Form 10-K for the year ended June 28, 2007.

Note 3 Accounts Receivable

Included in accounts receivable as of March 27, 2008, June 28, 2007 and March 29, 2007 are $3,031, $2,730 and $2,565, respectively, relating to workers compensation excess claim recovery.

Note 4 Inventories

Inventories are stated at the lower of cost (first in, first out) or market. Inventories consist of the following:

	March 27, 2008	June 28, 2007	March 29, 2007
Raw material and supplies	$ 81,803	$ 57,348	$ 87,282
Work-in-process and finished goods	59,858	76,811	80,955
Inventories	$ 141,661	$ 134,159	$ 168,237

Note 5 Income Taxes

The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), on June 29, 2007. There were no material effects associated with the implementation of FIN 48. As of June 29, 2007, unrecognized tax benefits and accrued interest and penalties were not material. The Company recognizes interest and penalties accrued related to unrecognized tax benefits in the income tax (benefit)/expense caption in the statement of operations. The Company files income tax returns with federal and state tax authorities within the United States of America. The Internal Revenue Service is currently auditing the Company s tax returns for fiscal 2003 and fiscal 2004. The Illinois Department of Revenue is currently auditing the Company s tax returns for fiscal 2003, fiscal 2004 and fiscal 2005. No other tax jurisdictions are material to the Company.

As of March 27, 2008, there have been no material changes to the amount of unrecognized tax benefits. The Company does not anticipate that total unrecognized tax benefits will significantly change in the future.

The Company recorded a tax benefit of $490, or 5.4% of loss before income taxes, for the thirty-nine weeks ended March 27, 2008 and $608, or 6.5% of loss before income taxes, for the quarter ended March 27, 2008. The Company has no ability to carry back losses to prior years, since losses were experienced for fiscal 2006 and fiscal 2007. The benefits for fiscal 2008 were limited to the extent that deferred tax liabilities exceeded deferred tax assets. To the extent future losses arise, no benefit may be recognized for the remaining quarter of fiscal 2008 since deferred tax liabilities equal deferred tax assets. As of March 27, 2008, the Company has a valuation allowance of approximately $5.3 million.

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Since the accuracy of the Company s forecasting procedures is identified as a material weakness in its control environment, the Company is unable to make a reliable estimate of its effective tax rate for the year. The actual tax rate for the year-to-date period represents the most appropriate estimate at this time. The quarterly income tax rate reflects the tax benefit associated with a portion of the first quarter loss that could previously not be recorded as a tax benefit as a result of recording an income tax provision based on year to date actual results.

Note 6 Earnings Per Common Share

Earnings per common share is calculated using the weighted average number of shares of Common Stock and Class A Common Stock outstanding during the period. The following table presents the reconciliation of the weighted average shares outstanding used in computing earnings per share:

	For the Quarter Ended		For the Thirty-nine Weeks Ended	
	March 27, 2008	March 29, 2007	March 27, 2008	March 29, 2007
Weighted average shares outstanding basic	10,614,125	10,594,944	10,608,988	10,593,981
Effect of dilutive securities:				
Stock options				
Weighted average shares outstanding diluted	10,614,125	10,594,944	10,608,988	10,593,981

476,940 stock options with a weighted average exercise price of $11.45 were excluded from the computation of diluted earnings per share for both the quarter and thirty-nine weeks ended March 27, 2008, due to the net loss for the quarterly and thirty-nine week periods. 359,690 stock options with a weighted average exercise price of $12.98 were excluded from the computation of diluted earnings per share for both the quarter and thirty-nine weeks ended March 29, 2007, due to the net loss for the quarterly and thirty-nine week periods.

Note 7 Stock-Based Compensation

At the Company s annual meeting of stockholders on October 28, 1998, the Company s stockholders approved a new stock option plan (the 1998 Equity Incentive Plan) under which non-qualified options and stock-based awards may be made. There are 700,000 shares of common stock authorized for issuance to certain key employees and outside directors (i.e., directors who are not employees of the Company or any of its subsidiaries). The exercise price of the options will be determined by the Board of Directors as set forth in the 1998 Equity Incentive Plan. The exercise price for the stock options must be at least the fair market value of the Common Stock on the date of grant, with the exception of non-qualified stock options, which can have an exercise price equal to at least 50% of the fair market value of the Common Stock on the date of grant. Except as set forth in the 1998 Equity Incentive Plan, options expire upon termination of employment or directorship. The options granted under the 1998 Equity Incentive Plan are exercisable 25% annually commencing on the first anniversary date of grant and become fully exercisable on the fourth anniversary date of grant. Through fiscal 2007 all of the options granted, except those granted to outside directors, were intended to qualify as incentive stock options within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended. Effective fiscal 2008, all option grants are non-qualified awards. On March 27, 2008, there were 24,500 options available for distribution under this plan. Option exercises are satisfied through the issuance of new shares of Common Stock.