INGLES MARKETS INC
Form 10-K
November 28, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON D.C. 20549

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended September 29, 2007

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ______ to ______.

Commission File Number 0-14706

INGLES MARKETS, INCORPORATED

(Exact name of registrant as specified in its charter)

North Carolina	**56-0846267**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
2913 U.S. Hwy. 70 West, Black Mountain, NC	**28711**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number including area code: (828) 669-2941

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Class A Common Stock, $0.05 par value	**The NASDAQ Stock Market**
Class B Common Stock, $0.05 par value	

Securities registered pursuant to Section 12(g) of the Act:

None

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES ¨ NO x .

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES ¨ NO x.

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 x NO ¨.

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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. (Check one): Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ¨ NO x.

As of March 31, 2007, the aggregate market value of voting stock held by non-affiliates of the registrant, based on the closing sales price of the Class A Common Stock on the Nasdaq Stock Market s National Market on March 30, 2007, was approximately $508.3 million. As of November 21, 2007, the registrant had 12,355,783 shares of Class A Common Stock outstanding and 12,156,476 shares of Class B Common Stock outstanding.

Certain information required in Part III hereof is incorporated by reference to the Proxy Statement for the registrant s 2008 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission pursuant to Regulation 14A no later than 120 days after the end of the fiscal year covered by this form.

This Annual Report (including the documents incorporated herein by reference) contains certain forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), in particular, the information appearing under the heading Management s Discussion and Analysis of Financial Condition and Results of Operations. The words estimate, expect, anticipate, in project, plan, forecast, foresee, likely, goal, target, believe, seek and similar expressions are intended to identify forward-looking While these forward-looking statements and the related assumptions are made in good faith and reflect the Company s current judgment regarding the direction of the Company s business, actual results will almost always vary, sometimes materially, from any estimates, predictions, projections, assumptions or other future performance suggested herein. Such statements are based upon a number of assumptions and estimates which are inherently subject to significant risks and uncertainties many of which are beyond the Company s control. Some of these assumptions inevitably will not materialize, and unanticipated events will occur which will affect the Company s results. Some important factors (but not necessarily all factors) that affect the Company s revenues, growth strategies, future profitability and operating results, or that otherwise could cause actual results to differ materially from those expressed in or implied by any forward-looking statement, include: business and economic conditions generally in the Company s operating area; the Company s ability to successfully implement its expansion and operating strategies and to manage rapid expansion; pricing pressures and other competitive factors; the Company s ability to reduce costs and achieve improvements in operating results; the availability and terms of financing; increases in labor and utility costs; success or failure in the ownership and development of real estate; changes in the laws and government regulations applicable to the Company; and changes in accounting policies, standards, guidelines or principles as may be adopted by regulatory agencies as well as the Financial Accounting Standards Board (FASB).

Consequently, actual events affecting the Company and the impact of such events on the Company s operations may vary significantly from those described in this report or contemplated or implied by statements in this report. The Company undertakes no obligation to publicly update or revise forward-looking statements to reflect events or circumstances after the date made or to reflect the occurrence of unanticipated events.

PART I

Item 1. *BUSINESS*

General

Ingles Markets, Incorporated (Ingles or the Company), a leading supermarket chain in the Southeast United States, operates 197 supermarkets in Georgia (73), North Carolina (65), South Carolina (36), Tennessee (20), Virginia (2) and Alabama (1).

The Company s strategy is to locate its supermarkets primarily in suburban areas, small towns and rural communities. The Company believes that it was the first supermarket in many of its target communities and was therefore able to secure favorable locations and a loyal customer base. The Company remodels, expands and relocates stores in these communities and builds stores in new locations to retain and grow its customer base with an enhanced one stop product offering while retaining a high level of customer service and convenience. Ingles supermarkets offer customers a wide variety of nationally advertised food products, including grocery, meat and dairy products, produce, frozen foods and other perishables. Non-food products include fuel centers, pharmacies, health and beauty care products and general merchandise. The Company also offers quality private label items.

The Company believes that customer service and convenience, modern stores and competitive prices on a broad selection of quality merchandise are essential to developing and retaining a loyal customer base. The Company s new and remodeled supermarkets provide an enhanced level of customer convenience in order to accommodate the lifestyle of today s shoppers. Design features of the Company s modern stores focus on selling high-growth, high-margin products including expanded perishable departments featuring organic and home meal replacement items, in-store pharmacies, on-premises fuel centers, and an expanded selection of food and non-food items to provide a one-stop shopping experience.

The Company has an ongoing renovation and expansion plan to add stores in its target markets and to modernize the appearance and layout of its existing stores. Over the past five fiscal years, the Company has spent approximately $382 million to modernize and remodel its existing stores, relocate older stores to larger, more convenient locations and construct new stores in order to maintain the quality shopping experience that its customers expect. Typically, new and expanded stores occupy at least 65,000 square feet. As part of the Company s renovation and expansion plan, the Company generally includes full-service pharmacies and gas stations at both new and expanded store properties and at selected existing store properties.

Substantially all of the Company s stores are located within 280 miles of its 780,000 square foot warehouse and distribution center, near Asheville, North Carolina, from which the Company distributes grocery, produce, meat and dairy products to all Ingles stores. The warehouse supplies the stores with approximately 53% of the goods the Company sells and the remaining 47% is purchased from third parties. The close proximity of the Company s purchasing and distribution operations to its stores facilitates the timely distribution of consistently high quality meat, produce and other perishable items.

To further ensure product quality, the Company also owns and operates a milk processing and packaging plant that supplies approximately 83% of the milk products sold by the Company s supermarkets as well as a variety of orange and other fruit juices and bottled water products. In addition, the milk processing and packaging plant sells approximately 69% of its products to other retailers, food service distributors and grocery warehouses in seventeen states, which provides the Company with an additional source of revenue. Beginning in fiscal year 2005, organic milk products were added to the Company s milk processing and packaging plant offerings for distribution to the Company s supermarkets and to outside parties.

Real estate ownership is an important component of the Company s operations. The Company owns and operates 71 shopping centers, 55 of which contain an Ingles supermarket, and owns 82 additional properties that contain a free-standing Ingles store. The Company also owns fourteen undeveloped sites suitable for a free-standing store. The majority of the land tracts that Ingles owns contain additional acreage which may either be sold or developed in the future. The Company s owned real estate is generally located in the same geographic region as its supermarkets.

Ownership of store and shopping center locations provides flexibility in remodeling or expanding store properties and adding on-site fuel centers, touch-free car washes and garden centers. Shopping center ownership provides tenant income and can enhance store traffic through the presence of additional products and services that complement grocery store operations. Appreciation in real estate values can provide capital resources through loan collateral or property sales. Ingles believes that real estate ownership allows it to decrease its occupancy costs, control the development and management of each property and benefit from value created by developing and operating free-standing supermarkets and shopping centers in smaller markets.

The Company was founded by Robert P. Ingle, the Company s Chief Executive Officer. As of September 29, 2007, Mr. Ingle owns or controls approximately 87% of the combined voting power and 48% of the total number of shares of the Company s outstanding Class A and Class B Common Stock (in each case including stock deemed to be beneficially owned by Mr. Ingle as one of the trustees of the Company s Investment/Profit Sharing Plan and Trust). The Company became a publicly traded company in September 1987. The Company s Class A Common Stock is traded on The Nasdaq Stock Market s Global Market under the symbol IMKTA.

The Company was incorporated in 1965 under the laws of the State of North Carolina. Its principal mailing address is P.O. Box 6676, Highway 70, Asheville, North Carolina 28816, and its telephone number is 828-669-2941. The Company s website is www.ingles-markets.com. Information on the Company s website is not a part of and is not incorporated by reference into this Annual Report on Form 10-K.

Business

The Company operates three lines of business: retail grocery sales, shopping center rentals and a fluid dairy processing plant. Information about the Company s operations by lines of business (in millions) is as follows (for information regarding the Company s industry segments, see Note 11, Lines of Business to the Consolidated Financial Statements of this Annual Report on Form 10-K):

	Fiscal Year Ended September					
	2007		2006		2005	
Revenues from unaffiliated customers:						
Grocery sales	$ 2,729.0	95.3%	$ 2,501.1	95.3%	$ 2,164.8	94.6%
Shopping center rentals	12.3	0.4%	12.7	0.5%	13.4	0.6%
Fluid dairy	122.6	4.3%	111.2	4.2%	109.1	4.8%
	$ 2,863.9	100.0%	$ 2,625.0	100.0%	$ 2,287.3	100.0%
Income from operations:						
Grocery sales	$ 115.8	86.7%	$ 99.6	85.8%	$ 76.0	83.0%
Shopping center rentals	4.4	3.3%	5.0	4.3%	6.2	6.8%
Fluid dairy	13.3	10.0%	11.5	9.9%	9.3	10.2%
	133.5	100.0%	116.1	100.0%	91.5	100.0%
Other income (expense), net	3.0		1.8		2.3	
Interest expense	46.7		49.8		50.9	
Income before income taxes	$ 89.8		$ 68.1		$ 42.9	

Supermarket Operations

The Company s strategy is to locate its supermarkets primarily in suburban areas, small towns and rural communities. At September 29, 2007, the Company operated 191 supermarkets under the name Ingles, and six supermarkets under the name Sav-Mor with locations in western North Carolina, western South Carolina, northern Georgia, eastern Tennessee, southwestern Virginia and northeastern Alabama. The Sav-Mor, store concept accommodates smaller shopping areas and carries a limited line of dry groceries, fresh meat and produce, all of which are displayed in a modern, readily accessible environment. Sav-Mor stores are generally located in areas the Company has determined that demographics, target customer base and market potential could not support a full-service Ingles supermarket.

The following table sets forth certain information with respect to the Company s supermarket operations.

	Number of Supermarkets at Fiscal Year Ended September			Percentage of Total Net Sales for Fiscal Year Ended September		
	2007	2006	2005	2007	2006	2005
North Carolina	65	64	63	38%	38%	37%
South Carolina	36	35	35	19%	19%	17%
Georgia	73	75	76	34%	34%	35%

Tennessee	20	20	20	9%	9%	10%
Virginia	2	2	2			1%
Alabama	1	1	1			
	197	197	197	100%	100%	100%

The Company believes that today s supermarket customers are focused on convenience, quality and value in an attractive store environment. As a result, the Company s one-stop shopping experience combines a high level of customer service, convenience-oriented quality product offerings and low overall pricing. The Company s modern stores provide products and services such as home meal replacement items, delicatessens, bakeries, floral departments, video rental departments, greeting cards and broad selections of organic, beverage and health-related items. During fiscal 2000, Ingles opened its first company-owned, in-store pharmacy and its first fuel station, Ingles Gas Express. At September 29, 2007, the Company operated 51 pharmacies and 44 fuel stations. The Company plans to continue to incorporate these departments in substantially all future new and remodeled stores. The Company also plans to continue to add fuel stations to existing stores based on an assessment of store performance, competition and site availability. The Company caters to the needs of its customers by offering extended hours, self-service checkout and prepaid purchasing cards. The Company trains its employees to provide friendly service and to actively address the needs of customers. These employees reinforce the Company s distinctive service oriented image.

Selected statistics on the Company s supermarket operations are presented below:

	Fiscal Year Ended September				
	2007	**2006**	**2005**	**2004**	**2003**
Weighted Average Sales Per Store (000 s) (1)	$ 13,870	$ 12,701	$ 11,040	$ 10,302	$ 9,582
Total Square Feet at End of Year (000 s)	9,728	9,585	9,468	9,251	9,236
Average Total Square Feet per Store	49,382	48,657	48,058	47,198	46,648
Average Square Feet of Selling Space per Store (2)	34,567	34,060	33,641	33,039	32,654
Weighted Average Sales per Square Foot of Selling Space (1) (2)	405	375	331	313	296

(1) Weighted average sales per store include the effects of increases in square footage due to the opening of replacement stores and the expansion of stores through remodeling during the periods indicated, and includes gasoline sales.

(2) Selling space is estimated to be 70% of total store square footage.

Merchandising

The Company s merchandising strategy is designed to create a comprehensive and satisfying shopping experience that blends value and customer service with variety, quality and convenience. Management believes that this strategy fosters a loyal customer base by establishing a reputation for providing high quality products and a variety of specialty departments.

The Company s stores carry broad selections of quality meats, produce and other perishables. In response to current customer preferences, the Company s stores now carry a greater proportion of organic perishables. The Company s full-service meat and seafood departments are generally staffed at all times to assist customers and are designed so that customers can see Ingles butchers at work. The Company features only USDA Choice beef, where many of its competitors feature lower grade USDA Select. Many of the Company s stores offer fresh fruit cut on site by an associate available to assist customers. The Company emphasizes the freshness and quality of its produce, bakery and deli offerings by designing its departments with an open air market atmosphere. During fiscal year 2005, the Company s fluid dairy plant began producing certified organic milk for sale in the Company s supermarkets and to non-affiliated customers.

Management believes that supermarkets offering a broad array of products and time-saving services are perceived by customers as part of a solution to today s lifestyle demands. Accordingly, a principal component of the Company s merchandising strategy is to design stores that offer a one-stop shopping experience. To accommodate this strategy, substantially all of the Company s new and expanded stores cover at least 65,000 square feet. In the Company s current store designs, in-store bakeries and delicatessens, prepared foods sections and gourmet coffee services are conveniently located near seating areas. In addition, book stores with reading

areas and in-store pharmacies increase store traffic and enhance customer perception of a comprehensive and satisfying shopping experience. Most Ingles stores also offer domestic and imported wines and a wide selection of domestic, premium, and imported beers offered in walk-in coolers. The Company s floral departments offer balloons, flowers and plants. The Company s media departments feature new movie releases, reasonably priced computer software, snack items, and self-service photofinishing kiosks, all contained in an appealing display area decorated with a movie marquee and a monitor playing current videos. Customers can also purchase money orders, prepaid gift cards for use in Company stores and fuel stations, send/receive money wires from the customer service department or receive cash back at the check-out counter with a debit card. The Company offers both traditional and self-checkout registers.

A selection of prepared foods and home meal replacements are featured throughout Ingles deli departments and in the meat department to provide customers with easy meal alternatives that they can eat at home, at work or in a sit-down café that is conveniently located near the front of newer Ingles stores. Many stores offer daily selections of home meal replacement items, such as rotisserie chicken and pork, Italian foods, fried chicken, meat loaf and other entrees, sandwiches, pre-packaged salads, sushi and prepared fresh vegetables. The bakery offers an expanded selection of baked goods and self-service selections. Ingles bakes most of its items on site, including bread baked daily, cakes made to order in various sizes, donuts and other pastries. The deli offers a salad bar, an expanded offering of cheeses, olives, gourmet items and home meal replacement items. The Company also provides its customers with an expanded selection of frozen food items (including organics) to meet the increasing demands of its customers. Some of the Company s newer supermarkets contain a power aisle that includes specialty departments, such as a bakery, a delicatessen, a produce department, a gourmet coffee service and a separate check-out.

The Company operates fuel stations at 44 of its store locations. The Company believes fuel stations give customers a competitive fuel choice and increase store traffic by allowing customers to consolidate trips. Most new and expanded stores are designed to include a fuel station on the store property. The Company also adds fuel stations at existing stores based on its evaluation of local competition, the potential effect on overall store profitability and the availability of space on the existing property or an adjacent outparcel. The Company has begun locating laser car washes and garden centers adjacent to fuel stations at some locations. The Company s ownership of the majority of its store properties provides additional flexibility with respect to the addition and/or modification of these services.

Ingles intends to continue to increase sales of its proprietary brands, which typically carry higher margins than comparable branded products. The Company believes its current sales of proprietary brands represent a lower percentage of sales compared to many of its competitors. The Company currently carries four private label lines: Laura Lynn, its primary line named after the founder s daughter, Ingles Best, Bella Tavola and Harvest Farms. Ingles private labels cover a broad range of products throughout the store, such as milk, bread, organic products, soft drinks and canned goods. The Company promotes its private label brands through print and television advertising, by displaying comparison pricing with national brands on store shelf tags and by reflecting savings on customers cash register receipts. In addition to increasing margins, Ingles believes that private label sales help promote customer loyalty.

The Company seeks to maintain a reputation for providing friendly service, quality merchandise and customer value and for its commitment to community involvement. The Company employs various advertising and promotional strategies to reinforce the quality and value of its products. The Company promotes these attributes using all of the traditional advertising vehicles including radio, television, direct mail and newspapers. Ingles introduced its Ingles Advantage Savings and Reward Card (the Ingles Advantage Card) at the beginning of fiscal 2004. The Ingles Advantage Card program is designed to foster customer loyalty by providing information to better understand the Company s customers shopping patterns. The Ingles Advantage Card program facilitates marketing directly to different customer base segments via direct mail and Email offers specific to a particular segment. For fiscal year 2007, approximately 74% of total grocery sales were made to customers with the Ingles Advantage Card.

Purchasing and Distribution

The Company supplies approximately 53% of its supermarkets inventory requirements from its modern 780,000 square foot warehouse and distribution center from which the Company distributes groceries, produce, meat and dairy products to all Ingles stores. The Company believes that its warehouse and distribution facility contains sufficient capacity for the continued expansion of its store base for the foreseeable future. During fiscal 2007, the Company purchased 46 acres of land adjacent to its distribution facility for possible future expansion. This expansion could result in the construction of warehousing space for frozen foods, health, beauty, and cosmetic items as well as provide additional capacity for current warehoused items.

The Company s centrally managed purchasing and distribution operations provide several advantages, including the ability to negotiate and reduce the cost of merchandise, decrease overhead costs and better manage its inventory at both the warehouse and store level. From time to time, the Company engages in advance purchasing on high-turnover inventory items to take advantage of special prices offered by manufacturers for limited periods. The Company s ability to take advantage of advance purchasing is limited by several factors including carrying costs and warehouse space.

Approximately 11% of the Company s other inventory requirements, primarily frozen food and slower moving items that the Company prefers not to stock, are purchased from Merchant Distributors, Inc. (MDI), a wholesale grocery distributor with which the Company has had a continuing relationship since its inception. Purchases from MDI were approximately $241 million in fiscal 2007, $229 million in fiscal 2006 and $214 million in fiscal 2005. Additionally, MDI purchases product from Milkco, Inc., the Company s fluid dairy subsidiary, and these purchases totaled approximately $40 million in fiscal 2007, $37 million in fiscal 2006 and $35 million in fiscal 2005. The Company purchases items from MDI based on cost plus a handling charge. MDI owned approximately 2% of the Company s Class A Common Stock and approximately 1% of the Company s Class B Common Stock at September 29, 2007, which equals 1.3% of the total voting power. The Company believes that alternative sources of supply are readily available from other third parties.

The remaining 36% of the Company s inventory requirements, primarily beverages, gasoline, bread and snack foods, are supplied directly to Ingles supermarkets by local distributors and manufacturers.

Goods from the warehouse and distribution facility and the milk processing and packaging plant are distributed to the Company s stores by a fleet of 108 tractors and 433 trailers that the Company operates and maintains, including tractors and trailers that the Company leases. The Company invests on an ongoing basis in the maintenance, upgrade and replacement of its tractor and trailer fleet. The Company also operates truck servicing and fuel storage facilities at its warehouse and distribution center. The Company reduces its overall distribution costs by capitalizing on back-haul opportunities (contracting to transport merchandise on trucks that would otherwise be empty).

Store Development, Expansion and Remodeling

The Company believes that the appearance and design of its stores are integral components of its customers shopping experience and aims to develop one of the most modern supermarket chains in the industry. The ongoing modernization of the Company s store base involves (i) the construction of new stores of continuously updated designs, (ii) the replacement or complete remodeling and expansion of existing stores and (iii) minor remodels of existing stores. The Company s goal is to maintain clean, well-lit stores with attractive architectural features that enhance the image of its stores as catering to the changing lifestyle needs of quality-conscious consumers who demand an increasingly diverse product offering.

The Company is focused primarily on developing owned stores rather than leased stores. Management believes that owning stores rather than leasing them provides the Company with lower all-in occupancy costs and the flexibility over the long-term to expand its stores further, if needed. The construction of new stores is closely monitored and controlled by the Company. The Company hires independent contractors to construct its supermarkets from its continuously updated designs.

The Company renovates and remodels stores in order to increase customer traffic and sales, respond to existing customer demand, compete effectively against new stores opened by competitors and support its quality image merchandising strategy. The Company decides to complete a major remodel of an existing store based on its evaluation of the competitive landscape of the local marketplace. A major remodel and expansion provides the quality of facilities and product offerings identical to that of a new store, capitalizing upon the existing customer base. The Company retains the existing customer base by keeping the store in operation during the entire remodeling process. The Company may elect to relocate, rather than remodel, certain stores where relocation provides a more convenient location for its customers and is more economical.

The Company completes minor remodels in existing stores that management believes provide ample size and facilities to support the local customer base but require merchandising and operational improvements. In a minor remodel, the Company will also make cosmetic changes to give the store a new look and feel. Minor remodels generally include repainting, remodeling and upgrading of the lighting throughout the store. Additionally, the Company refurbishes existing equipment and adds selected new equipment in the remodeling process. As part of a minor remodel, the Company remerchandises the store including the broadening of product and service offerings.

When the Company remodels, expands or relocates an existing store, it uses that opportunity to retrain the employees of that store and reemphasize customer service.

The following table sets forth, for the periods indicated, the Company s new store development and store remodeling activities and the effect this program has had on the average size of its stores.

	2007	**2006**	**2005**	**2004**	**2003**
Number of Stores:					
Opened (1)	2	1	4	2	4
Closed (1)	2	1	3	4	4
Major remodels and replacements	5	3	2	3	4
Minor remodels	0	0	0	2	3
Stores open at end of period	197	197	197	196	198
Size of Stores:					
Less than 30,000 sq. ft.	16	16	15	16	16
30,000 up to 41,999 sq. ft.	46	48	52	53	55
42,000 up to 51,999 sq. ft.	31	31	31	32	34
At least 52,000 sq. ft.	104	102	99	95	93
Average store size (sq. ft.)	49,382	48,657	48,058	47,198	46,648

(1) Excludes new stores opened to replace existing stores.

The Company has historically expanded its store base by acquiring or leasing supermarket sites and constructing stores to its specifications. From time to time, however, the Company may consider the acquisition of existing supermarkets as such opportunities become available.

The Company s ability to open new stores is subject to many factors, including the acquisition of satisfactory sites and the successful negotiation of new leases, and may be limited by zoning and other governmental regulation. In addition, the Company s expansion, remodeling and replacement plans are continually reviewed and are subject to change. See the Liquidity and Capital Resources section included in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations regarding the Company s capital expenditures.

Competition

The supermarket industry is highly competitive and characterized by narrow profit margins. The degree of competition the Company s stores encounter varies by location, primarily based on the size of the community the store is located in and its proximity to other communities. The Company s principal competitors are, in alphabetical order, Bi-Lo, LLC., Food City (K-VA-T Food Stores, Inc.), Food Lion (Delhaize America, Inc.), The Kroger Co., Publix Super Markets, Inc., Target Corporation, and Wal-Mart Stores, Inc. Increasingly over the last few years, competition for consumers food dollars has intensified due to the addition of, or increase in, food sections by many types of retailers such as specialty grocers, drug and convenience stores, national general merchandisers and discount retailers, membership clubs, warehouse stores and super centers. Also, the consumer trend of eating out has made restaurants another significant competitor for food dollars.

Supermarket chains generally compete on the basis of location, quality of products, service, price, convenience, product variety and store condition.

The Company believes its competitive advantages include convenient locations, the quality of service it provides its customers, competitive pricing, product variety and quality and a pleasant shopping environment, which is enhanced by its ongoing modernization program.

The Company s strategy is to place its supermarkets in suburban areas, small towns and rural communities. Because the Company has operated in many of its markets longer than many of its competitors, it has been able to place its stores in prime locations. Furthermore, unlike many of its competitors, the Company owns property on which a majority of its stores are located, allowing it the flexibility to expand the store when needed.

By concentrating its operations within a relatively small geographic region, the Company is also positioned to more carefully monitor its markets, and the needs of its customers within those markets. The Company s senior executives live and work in the Company s operating region, thereby allowing management to quickly identify changes in needs and customer preference. Because of the Company s size, store managers have direct access to corporate management and are able to receive quick decisions regarding requested changes in operations. The Company can then move quickly to make adjustments in its business in response to changes in the market and customer needs. The Ingles Advantage Card provides information to better understand the Company s customers shopping patterns in various demographic categories and to develop targeted marketing programs based on this information.

The Company supports its quality image by carrying high quality perishable items. One major quality advantage of the Company is that it offers its customers only USDA Choice beef cut by butchers located in the stores. Many of Ingles competitors feature lower grade USDA Select beef and do not have butchers located in their stores. The Company has expanded its offering of certified organic products to include organic dairy, perishable and frozen items. The Company also carries a wide variety of produce, quality private label brands plus a variety of popular national and regional brands.

The Company s large national and international competitors primary advantages are related to their size. These larger organizations may have an advantage through stronger buying power and more significant capital resources. Certain competitors, such as super centers, may be able to operate with smaller margins in the food sections of their stores by relying on their higher margins on the general merchandise sections of their stores to compensate.

The Company s management monitors competitive activity and regularly reviews and periodically adjusts the Company s marketing and business strategies as management deems appropriate in light of existing conditions in the Company s region. The Company s ability to remain competitive

in its changing markets will depend in part on its ability to pursue its expansion and renovation programs and its response to remodeling and new store openings by its competitors.

Seasonality

Sales in the grocery segment of the Company s business are subject to a slight seasonal variance due to holiday related sales and due to sales in areas where seasonal homes are located. Sales are traditionally higher in the Company s first fiscal quarter due to the inclusion of sales related to Thanksgiving and Christmas. The Company s second fiscal quarter traditionally has the lowest sales of the year, unless Easter falls in that quarter. In the third and fourth quarters, sales are affected by the return of customers to seasonal homes in the Company s market area. The fluid dairy segment of the Company s business has slight seasonal variation to the extent of its sales into the grocery industry. The Company s real estate segment is not subject to seasonal variations.

Employees and Labor Relations

At September 29, 2007, the Company had approximately 17,000 employees, of which 91% were supermarket personnel. Approximately 56% of these employees work on a part-time basis. None of the employees are represented by a labor union. Management considers employee relations to be good. The Company values its employees and believes that employee loyalty and enthusiasm are key elements of its operating performance.

Trademarks and Licenses

The Company employs various trademarks and service marks in its business, the most important of which are its own Laura Lynn private label trademark, The Ingles Advantage service mark, and the Ingles service mark. These service marks and the trademark are federally registered in the United States pursuant to applicable intellectual property laws and are the property of Ingles. In addition, the Company uses the Sealtest, Pet, Biltmore and Light N Lively trademarks pursuant to agreements entered into in connection with its milk, fruit juice and spring water processing and packaging operations. The Company believes it has all material licenses and permits necessary to conduct its business.

The current expiration dates for significant trade and service marks are as follows: Ingles December 9, 2015; Laura Lynn March 13, 2014; and The Ingles Advantage August 30, 2015. Each registration may be renewed for an additional ten-year term prior to its expiration. The Company intends to file all renewals timely. Each of the Company s trademark license agreements has a one year term which, with respect to one license, is automatically renewed annually, unless the owner of the trademark provides notice of termination prior to the then expiration date and, with respect to the other licenses, are renewed periodically by letter from the licensor. The Company currently has eight pending applications for additional trademarks or service marks.

Environmental Matters

Under applicable environmental laws, the Company may be responsible for remediation of environmental conditions and may be subject to associated liabilities relating to its stores and other buildings and the land on which such stores and other buildings are situated (including responsibility and liability related to its operation of its gas stations and the storage of gasoline in underground storage tanks), regardless of whether the Company leases or owns the stores, other buildings or land in question and regardless of whether such environmental conditions were created by the Company or by a prior owner or tenant. The Company s liabilities may also include costs and judgments resulting from lawsuits brought by private litigants. The presence of contamination from hazardous or toxic substances, or the failure to properly remediate such contaminated property, may adversely affect the Company s ability to sell or rent such real property or to borrow using such real property as collateral. Although the Company typically conducts a limited environmental review prior to acquiring or leasing new stores, other buildings or raw land, there can be no assurance that environmental conditions relating to prior, existing or future stores, other buildings or the real properties

on which such stores or other buildings are situated will not have a material adverse effect on the Company s business, financial condition and results of operations.

Federal, state and local governments could enact laws or regulations concerning environmental matters that affect the Company s operations or facilities or increase the cost of producing or distributing the Company s products. The Company believes that it currently conducts its operations, and in the past has conducted its operations, in substantial compliance with applicable environmental laws. The Company, however, cannot predict the environmental liabilities that may result from legislation or regulations adopted in the future, the effect of which could be retroactive. Nor can the Company predict how existing or future laws and regulations will be administered or interpreted or what environmental conditions may be found to exist at its facilities or at other properties where the Company or its predecessors have arranged for the disposal of hazardous substances. The enactment of more stringent laws or regulations or stricter interpretation of existing laws and regulations could require expenditures by the Company, some of which could have a material adverse effect on its business, financial condition and results of operations.

Government Regulation

The Company is subject to regulation by a variety of governmental agencies, including, but not limited to, the U.S. Food and Drug Administration, the U.S. Department of Agriculture, the Occupational Health and Safety Administration and other federal, state and local agencies. The Company s stores are also subject to local laws regarding zoning, land use and the sale of alcoholic beverages. The Company believes that its locations are in material compliance with such laws and regulations.

Item 1A. ***RISK FACTORS***

The Company s expansion and renovation plans may not be successful which may adversely affect its business and financial condition due to the capital expenditures and management resources required to carry out its plans.

The Company has spent, and intends to continue to spend, significant capital and management resources on the development and implementation of its expansion and renovation plans. These plans, if implemented, may not be successful and may not improve operating results and may have an adverse effect on cash flow due to the significant amount of capital invested.

The Company s new, relocated and remodeled stores may initially operate at a loss, depending on factors such as prevailing competition, development cost, and its market position in the surrounding community. The level of sales and profit margins in the Company s existing stores may not be duplicated in its new stores which could have an adverse affect on the Company s business and financial condition.

The Company s warehouse and distribution center, as well as all of its stores, are concentrated in the Southeastern United States, which makes the Company vulnerable to economic downturns, natural disasters and other adverse conditions or other catastrophic events in this region.

The Company operates in the Southeastern United States, with a strong concentration in Georgia, North Carolina, South Carolina and Tennessee. The Company s headquarters, warehouse and distribution center are located in North Carolina and all of its stores are located in the Southeast region. As a result, the Company s business is more susceptible to regional factors than the operations of more geographically diversified competitors. These factors include, among others, changes in the economy, weather conditions, demographics and population.

The Company s principal stockholder, Robert P. Ingle, has the ability to elect a majority of the Company s directors, appoint new members of management and approve many actions requiring shareholder approval.

Mr. Ingle s share ownership represents approximately 87% of the combined voting power of all classes of the Company s capital stock. As a result, Mr. Ingle has the power to elect a majority of the Company s directors and approve any action requiring the approval of the holders of the Company s Class A Common Stock and Class B Common Stock, including adopting certain amendments to the Company s charter and approving

mergers or sales of substantially all of the Company s assets. Currently, three of the Company s nine directors are members of the Ingle family. Circumstances may occur in which the interests of Mr. Ingle could be in conflict with the interests of other holders of the Company s Class A Common Stock and Class B Common Stock.

Various aspects of the Company s business are subject to federal, state and local laws and regulations. The Company s compliance with these regulations may require additional capital expenditures and could adversely affect the Company s ability to conduct its business as planned.

The Company is subject to federal, state and local laws and regulations relating to zoning, land use, work place safety, public health, community right-to-know, beer and wine sales, pharmaceutical sales and gasoline station operations. A number of states and local jurisdictions regulate the licensing of supermarkets, including beer and wine license grants. In addition, under certain local regulations, the Company is prohibited from selling beer and wine in certain stores. The Company s ownership and development of real estate and operation of gas stations may subject it to liability under state and federal environmental laws. Employers are also subject to law governing their relationship with employees, including minimum wage requirements, overtime, working conditions, disabled access and work permit requirements. Compliance with, or changes in, these laws could reduce the revenue and profitability of the Company s supermarkets and could otherwise adversely affect its business, financial condition or results of operations. A number of federal, state and local laws exist which impose burdens or restrictions on owners with respect to access by disabled persons. Compliance with these laws may result in modifications to Company properties, or prevent certain further renovations, with respect to access by disabled persons.

The Company is affected by certain operating costs which could increase or fluctuate considerably.

The Company depends on qualified employees to operate its stores and may be affected by future tight labor markets. Moreover, all of the Company s stores are located in the Southeastern United States which has recently experienced lower average unemployment rates than other parts of the country making it more difficult for the Company to attract and retain qualified employees. A shortage of qualified employees could require the Company to enhance its wage and benefit package in order to better compete for and retain qualified employees, and the Company may not be able to recover these increased labor costs through price increases charged to customers, which could significantly increase its operating costs.

Fluctuating fuel costs adversely affect the Company s operating costs in that the Company requires fuel for its fleet of tractors and trailers which distribute goods from the Company s distribution facility and for its fluid dairy operations. In addition, operations at the Company s stores are sensitive to rising utility fuel costs due to the amount of electricity and gas required to operate the stores and the influence of petroleum costs on plastic bags and wraps. Finally, interchange fees charged to the Company for accepting debit and credit cards have increased substantially and may continue to increase as more customer transactions are settled with debit and credit cards.

The Company s industry is highly competitive. If the Company is unable to compete effectively, its financial condition and results of operations could be materially affected.

The supermarket industry is and will remain highly competitive and is expected to be characterized by industry consolidation, continued competition from supercenters, and the development of smaller, more specialized stores. Furthermore, some of the Company s competitors have greater financial resources and could use these financial resources to take measures, such as altering product mix or reducing prices, which could adversely affect the Company s competitive position.

The Company also faces increasing competition from restaurants and fast food chains due to the increasing proportion of household food expenditures for food prepared outside the home. In addition, certain of the Company s stores also compete with local video stores, florists, book stores, pharmacies and gas stations.

The Company has, and expects to continue to have, a significant amount of debt.

At September 29, 2007 the Company had total debt of $543.3 million. A significant potion of the Company s cash flow is used to service indebtedness. At September 29, 2007 debt totaling $173.3 million was secured by real estate and equipment owned by the Company. This could limit the Company s ability to dispose of mortgaged property without payment of the associated debt.

The Company expects to incur additional debt to support its growth and expansion plans. There can be no assurances that sources of financing will be available to the Company on acceptable terms or that new and expanded stores will generate sufficient cash flow to service any additional debt.

Disruptions in the efficient distribution of food products to the Company s warehouse and stores may adversely affect the Company s business.

The Company s business could be adversely affected by disruptions in the efficient distribution of food products to the Company s warehouse and to our stores. Such disruptions could be caused by, among other things, adverse weather conditions, food contamination recalls and civil unrest in foreign countries in which our suppliers do business.

Item 1B. ***UNRESOLVED STAFF COMMENTS***

None.

Item 2. ***PROPERTIES***

Owned Properties

The Company owns and operates 71 shopping centers, 55 of which contain an Ingles supermarket, and owns 82 additional properties that contain a free-standing Ingles store. The Company also owns fourteen undeveloped sites which are suitable for a free-standing store or shopping center development. Ingles owns numerous outparcels and other acreage located adjacent to the shopping centers and supermarkets it owns. Real estate owned by the Company is generally located in the same geographic regions as its supermarkets.

In order to maximize the utility of the Company s real estate portfolio, the Company regularly purchases and sells real estate. During fiscal 2007, the Company spent $41.3 million for the purchase of land. During fiscal 2007, the Company sold a shopping center in which it no longer operated a store, generating net proceeds of approximately $13.4 million and a pre-tax gain of approximately $7.9 million.

The shopping centers owned by the Company contain an aggregate of 5.7 million square feet of leasable space, of which 2.7 million square feet is used by the Company s supermarkets. The remainder of the leasable space in these shopping centers is leased or held for lease by the Company

to third party tenants. Third party tenant occupancy rates have been decreasing in many of the Company s shopping centers as the Company intends to expand and upgrade existing supermarkets into former tenant space. In addition, a number of drug store and retailer tenants have relocated to stand alone spaces. Finally, the Company intends to maximize supermarket sales by limiting space leased to companies that offer competing products. A breakdown by size of the shopping centers operated by the Company is as follows:

Size	**Number**
Less than 50,000 square feet	20
50,000 100,000 square feet	30
More than 100,000 square feet	21
Total	71

The Company owns an 810,000 square foot facility, which is strategically located between Interstate 40 and Highway 70 near Asheville, North Carolina, as well as the 73 acres of land on which it is situated. The facility includes the Company s headquarters and its 780,000 square foot warehouse and distribution center. The property also includes truck servicing and fuel storage facilities. The Company also owns a 139,000 square foot warehouse on 21 acres of land approximately one mile from its main warehouse and distribution center that is used to store seasonal and overflow items. The Company has also purchased a 46 acre site adjacent to its warehouse and distribution facility for possible future expansion.

The Company s milk processing and packaging subsidiary, Milkco, Inc., owns an 116,000 square foot manufacturing and storage facility in Asheville, North Carolina. In addition to the plant, the 19.7 acre property includes truck cleaning and fuel storage facilities.

Certain long-term debt of the Company is secured by the owned properties. See Note 6 to the Consolidated Financial Statements of this report on Form 10-K for further details.

Leased Properties

The Company operates supermarkets at 60 locations leased from various unaffiliated third parties. The Company also leases 15 supermarket facilities in which it is not currently operating, nine of which are subleased to third parties and the remainder are held for lease by the Company. Certain of the leases give the Company the right of first refusal to purchase the entire shopping center in which the supermarkets are located. The majority of these leases require the Company to pay property taxes, utilities, insurance, repairs and certain other expenses incidental to occupation of the premises. In addition to base rent, most leases contain provisions that require the Company to pay additional percentage rent (ranging from 0.75% to 1.5%) if sales exceed a specified amount.

Rental rates generally range from $1.67 to $8.18 per square foot. During fiscal years 2007, 2006 and 2005, the Company paid a total of $15.5 million, $16.5 million and $17.4 million, respectively, in supermarket rent, exclusive of property taxes, utilities, insurance, repairs and other expenses. The following table summarizes lease expiration dates as of September 29, 2007, with respect to the initial and any renewal option terms of leased supermarkets:

Year of Expiration (Including Renewal Terms)	**Number of Leases Expiring**
2006 2021	7
2021 2040	10
2041 or after	58

Management believes that the long-term rent stability provided by these leases is a valuable asset of the Company.

Item 3. ***LEGAL PROCEEDINGS***

Various legal proceedings and claims arising in the ordinary course of business are pending against the Company. In the opinion of management, the ultimate liability, if any, from all pending legal proceedings and claims would not materially affect the Company s financial position or the results of its operations.

Item 4. ***SUBMISSION OF MATTERS TO VOTE OF SECURITY HOLDERS***

No matters were submitted to a vote of the Company s security holders during the fourth quarter of the fiscal year covered by this report.

PART II

Item 5. ***MARKET FOR REGISTRANT S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS***

Market Information

The Company has two classes of Common Stock: Class A and Class B. Class A Common Stock is traded on The Nasdaq Stock Market s Global Market under the symbol IMKTA. There is no public market for the Company s Class B Common Stock. However, under the terms of the Company s Articles of Incorporation, any holder of Class B Common Stock may convert any portion or all of the holder s shares of Class B Common Stock into an equal number of shares of Class A Common Stock at any time.

As of November 21, 2007, there were approximately 698 holders of record of the Company s Class A Common Stock and 165 holders of record of the Company s Class B Common Stock. The following table sets forth the reported high and low closing sales price for the Class A Common Stock during the periods indicated as reported by NASDAQ. The quotations reflect actual inter-dealer prices without retail mark-up, mark-down or commission and may not necessarily represent actual transactions.

2007 Fiscal Year	**High**	**Low**
First Quarter (ended December 30, 2006)	$ 30.22	$ 25.64
Second Quarter (ended March 31, 2007)	$ 42.59	$ 30.84
Third Quarter (ended June 30, 2007)	$ 41.65	$ 32.95
Fourth Quarter (ended September 29, 2007)	$ 35.68	$ 25.24
2006 Fiscal Year	**High**	**Low**
First Quarter (ended December 24, 2005)	$ 17.30	$ 15.01
Second Quarter (ended March 25, 2006)	$ 17.44	$ 15.23
Third Quarter (ended June 24, 2006)	$ 18.55	$ 16.30
Fourth Quarter (ended September 30, 2006)	$ 27.07	$ 16.59

On November 21, 2007, the closing sales price of the Company s Class A Common Stock on The Nasdaq Stock Market s Global Market was $21.07 per share.

Dividends

The Company has paid cash dividends on its Common Stock in each of the past twenty-six fiscal years, except for the 1984 fiscal year when the Company paid a 3% stock dividend. During both fiscal 2007 and fiscal 2006 the Company paid annual dividends totaling $0.66 per share of Class A Common Stock and $0.60 per share of Class B Common Stock, paid in quarterly installments of $0.165 and $0.15 per share, respectively. The Company s last dividend payment was made on October 25, 2007 to common stockholders of record on October 15, 2007.

The Company expects to continue paying regular cash dividends on a quarterly basis. However, the Board of Directors periodically reconsiders the declaration of dividends. The Company pays these dividends at the discretion of the Board of Directors. The continuation of these payments, the amount of such dividends, and the form in which the dividends are paid (cash or stock) depends upon the results of operations, the financial condition of the Company and other factors which the Board of Directors deems relevant. The payment of dividends is also subject to

restrictions contained in certain financing arrangements. (See Note 6, Long-Term Debt and Short-Term Loans to the Consolidated Financial Statements of this Annual Report on Form 10-K.)

Equity Compensation Plan Information

The Company had a nonqualified stock option plan pursuant to which an aggregate of 8,000,000 shares of the Company s Class A Common Stock were reserved for issuance to the Company s officers and other key employees until January 1, 2007. Accordingly, as of September 29, 2007, no shares of the Company s Class A Common Stock were available for future issuance under the plan and all remaining unexercised options had expired.

The Company does not have any equity compensation plans not approved by its stockholders.

Stock Performance Graph

In accordance with the rules and regulations of the Securities and Exchange Commission, set forth below are a graph and accompanying tables comparing the cumulative total stockholder return on the Class A Common Stock to the cumulative total return of (i) the S&P 500 Comprehensive-Last Trading Day Index and (ii) a peer group of companies in the Company s line of business for the five-year period ended September 29, 2007. The peer group consists of the following companies: Royal Ahold N.V., Delhaize S.A., Pathmark Stores, Inc., The Kroger Co., Safeway Inc., Supervalu Inc., Whole Foods Market, Inc. and The Great Atlantic & Pacific Tea Company, Inc.

The graph and table assume that $100 was invested after the close of the market on September 28, 2002, and that dividends were reinvested quarterly. Returns of the companies included in the peer group reflected below have been weighted according to each company s stock market capitalization at the beginning of each section for which a return is presented.

INGLES MARKETS, INCORPORATED

COMPARATIVE RETURN TO STOCKHOLDERS

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*

AMONG INGLES MARKETS, INC., THE S & P 500 INDEX AND A PEER GROUP

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* $100 invested on 9/28/02 in stock or on 9/30/02 in index-including reinvestment of dividends. Index calculated on month-end basis.

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www.researchdatagroup.com/S&P.htm

INDEXED RETURNS OF INITIAL $100 INVESTMENT*

Company/Index	2003	2004	2005	2006	2007
Ingles Markets, Incorporated Class A Common Stock	$ 95.78	$ 126.56	$ 160.57	$ 294.22	$ 326.04
S&P 500 Comprehensive Last Trading Day Index	$ 124.40	$ 141.65	$ 159.01	$ 176.17	$ 205.13
Expanded Peer Group	$ 111.58	$ 107.51	$ 136.32	$ 163.97	$ 198.16

* Assumes $100 invested in the Class A Common Stock of Ingles Markets, Incorporated after the close of the market on September 28, 2002.

Item 6. ***SELECTED FINANCIAL DATA***

The selected financial data set forth below has been derived from the Company s consolidated financial statements. The information should be read in conjunction with the information set forth below in Item 7 under the heading Management s Discussion and Analysis of Results of Operations and Financial Condition and in the Company s Consolidated Financial Statements and Notes thereto included elsewhere herein.

	Selected Income Statement Data for the Year Ended September				
	2007	2006	2005	2004	2003
	(in thousands, except per share amounts)				
Net Sales	$ 2,851,593	$ 2,612,233	$ 2,273,941	$ 2,137,426	$ 1,991,093
Net Income	58,638	42,582	26,570	28,752	17,018
Diluted Earnings per Common Share					
Class A	$ 2.39	$ 1.74	$ 1.10	$ 1.22	$ 0.74
Class B	2.28	1.66	1.05	1.17	0.71
Cash Dividends per Common Share					
Class A	$ 0.66	$ 0.66	$ 0.66	$ 0.66	$ 0.66
Class B	0.60	0.60	0.60	0.60	0.60

	Selected Balance Sheet Data at September				
	2007	2006	2005	2004	2003
	(in thousands, except per share amounts)				
Current Assets	$ 305,593	$ 285,818	$ 304,457	$ 313,539	$ 320,271
Property and Equipment, net	839,732	771,628	744,162	738,219	739,023
Total Assets	1,155,272	1,074,974	1,066,005	1,063,687	1,075,450
Current Liabilities, including Current Portion of Long-Term Debt	250,468	218,861	200,876	188,741	187,659
Long-Term Liabilities, net of Current Portion (1)	518,484	528,767	557,035	572,843	611,532
Stockholders Equity	348,144	304,673	276,849	261,217	236,595

(1) Excludes long-term deferred income tax liability.

Item 7. ***MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS***

Overview

Ingles, a leading supermarket chain in the Southeast United States, operates 197 supermarkets in Georgia (73), North Carolina (65), South Carolina (36), Tennessee (20), Virginia (2) and Alabama (1). The Company locates its supermarkets primarily in suburban areas, small towns and rural communities. Ingles supermarkets offer customers a wide variety of nationally advertised food products, including grocery, meat and dairy products, produce, frozen foods and other perishables and non-food products, including health and beauty care products and general merchandise, as well as quality private label items. In addition, the Company focuses on selling high-growth, high-margin products to its customers through the development of book sections, media centers, floral departments, premium coffee kiosks, certified organic products, bakery departments and prepared foods including delicatessen sections. During fiscal 2000, the Company began adding fuel centers and pharmacies at select store locations. As of September 29, 2007, the Company operates 51 in-store pharmacies and 44 fuel centers.

Ingles also operates two other lines of business, fluid dairy processing and shopping center rentals. The fluid dairy processing segment sells approximately 31% of its products to the retail grocery segment and approximately 69% of its products to third parties. Real estate ownership (including the shopping center rental segment) is an important component of the Company s operations, providing both operational and economic benefit.

Critical Accounting Policies

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

Self-Insurance

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

Asset Impairments

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

decisions and inflation. The Company monitors the carrying value of long-lived assets for potential impairment each quarter based on whether any indicators of impairment have occurred.

Closed Store Accrual

For properties closed prior to December 31, 2002 that were under long-term lease agreements, the present value of any remaining liability under the lease, discounted using risk-free rates and net of expected sublease recovery, is recognized as a liability and expensed. For all store closures subsequent to the adoption of SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities, effective December 31, 2002, the liability is recognized and expensed based on the difference between the present value of any remaining liability under the lease and the present value of the estimated market rate at which the Company expects to be able to sublease the properties. The Company s estimates of market rates are based on its experience, knowledge and typical third-party advice or market data. If the real estate and leasing markets change, sublease recovery could vary significantly from the recoveries originally assumed, resulting in a material change in the Company s recorded liability. The closed store accrual is included in the line item Accrued expenses and current portion of other long-term liabilities on the Consolidated Balance Sheets.

Vendor Allowances

The Company receives funds for a variety of merchandising activities from the many vendors whose products the Company buys for resale in its stores. These incentives and allowances are primarily comprised of volume or purchase based incentives, advertising allowances, slotting fees, and promotional discounts. The purpose of these incentives and allowances is generally to help defray the costs incurred by the Company for stocking, advertising, promoting and selling the vendor s products. These allowances generally relate to short term arrangements with vendors, often relating to a period of a month or less, and are negotiated on a purchase-by-purchase or transaction-by transaction basis. Whenever possible, vendor discounts and allowances that relate to buying and merchandising activities are recorded as a component of item cost in inventory and recognized in merchandise costs when the item is sold. Due to system constraints and the nature of certain allowances, it is sometimes not practicable to apply allowances to the item cost of inventory. In those instances, the allowances are applied as a reduction of merchandise costs using a rational and systematic methodology, which results in the recognition of these incentives when the inventory related to the vendor consideration received is sold. Vendor allowances applied as a reduction of merchandise costs totaled $91.6 million, $92.7 million, and $89.3 million for the fiscal years ended September 29, 2007, September 30, 2006 and September 24, 2005, respectively. Vendor advertising allowances that represent a reimbursement of specific identifiable incremental costs of advertising the vendor s specific products are recorded as a reduction to the related expense in the period that the related expense is incurred. Vendor advertising allowances recorded as a reduction of advertising expense totaled $10.4 million, $8.8 million, and $8.7 million for the fiscal years ended September 29, 2007, September 30, 2006 and September 24, 2005, respectively.

If vendor advertising allowances were substantially reduced or eliminated, the Company would likely consider other methods of advertising as well as the volume and frequency of the Company s product advertising, which could increase or decrease the Company s expenditures.

Similarly, the Company is not able to assess the impact of vendor advertising allowances on creating additional revenues, as such allowances do not directly generate revenue for the Company s stores.

Tax Contingencies

Despite the Company s belief that its tax positions are consistent with applicable tax laws, the Company believes that certain positions are likely to be challenged by taxing authorities. Settlement of any challenge can result in no change, a complete disallowance, or some partial adjustment reached through negotiations or litigation. Significant judgment is required in evaluating the Company s tax contingencies. The Company s contingencies are adjusted in light of changing facts and circumstances, such as the progress of its tax audits as well as evolving case law. Income tax expense includes the impact of contingency provisions and changes to contingencies that the Company considers appropriate. Unfavorable settlement of any particular issue would require use of cash. Favorable resolution would be recognized as a reduction to income tax

expense at the time of resolution.

During the fiscal year 2007, the Company settled a tax position under an initiative offered by one of the states in which the Company conducts its operations. As a result of this settlement, the Company reduced its reserve for contingent income tax liabilities by $3.2 million. This reduction is reflected as a reduction of income tax expense for the year ended September 29, 2007.

Results of Operations

Ingles operates on a 52- or 53-week fiscal year ending on the last Saturday in September. The consolidated statements of income for the fiscal years ended September 29, 2007, September 30, 2006 and September 24, 2005, included 52, 53 and 52 weeks of operations, respectively.

Comparable store sales are defined as sales by grocery stores in operation for the entire duration of the previous and current fiscal years. The Company has an ongoing renovation and expansion plan to modernize the appearance and layout of its existing stores. Over the past five fiscal years, the Company has spent approximately $382 million to modernize and remodel its existing stores, relocate older stores to larger, more convenient locations and to construct new stores in order to maintain the quality shopping experience that its customers expect. Sales from replacement stores, major remodels, minor remodels and the addition of fuel stations to existing stores are included in the comparable store sales calculation from the date of completion of the replacement, remodel or addition. A replacement store is a new store that is opened to replace an existing nearby store that is closed. A major remodel entails substantial remodeling of an existing store and may include additional retail square footage. A minor remodel includes repainting, remodeling and updating the lighting and equipment throughout an existing store. Gasoline sales from the addition of fuel stations to existing stores during the measurement period are included in comparable store sales. For the fiscal years ended September 29, 2007 and September 30, 2006 comparable store sales include 194 and 192 stores, respectively. Weighted average retail square footage added to comparable stores due to replacement and remodeled stores totaled approximately 215,000 and 139,000 for the fiscal years ended September 29, 2007 and September 30, 2006, respectively.

The following table sets forth, for the periods indicated, selected financial information as a percentage of net sales. For information regarding the various segments of the business, reference is made to Note 11 Lines of Business to the Consolidated Financial Statements.

	Fiscal Years Ended		
	2007	**2006**	**2005**
Net sales	100.0%	100.0%	100.0%
Gross profit	24.1	25.0	25.8
Operating and administrative expenses	19.8	20.6	22.0
Rental income, net	0.2	0.2	0.2
Gain (loss) on sale or disposal of assets	0.2	(0.2)	
Income from operations	4.7	4.4	4.0
Other income (expense), net	0.1	0.1	0.1
Interest expense	1.6	1.9	2.2
Income before income taxes	3.2	2.6	1.9
Income taxes	1.1	1.0	0.7
Net income	2.1	1.6	1.2

Fiscal Year Ended September 29, 2007 Compared to the Fiscal Year Ended September 30, 2006

The Company achieved record sales, gross profit and net income for the fiscal year ended September 29, 2007. The predominant factor was increased sales. The sales increase encompassed most of the Company s departments and included increases in comparable store sales, customer visits and average purchase per visit. Operating and administrative expense increases were controlled, resulting in improved cost leverage and additional operating income. A real estate sale and settlement of a state income tax position also contributed to higher net income.

Net Sales. Fiscal 2007 was the 43rd consecutive year Ingles achieved an increase in net sales. Net sales increased 9.2% to $2.852 billion for the fiscal year ended September 29, 2007 from $2.612 billion for the fiscal year ended September 30, 2006. Excluding gasoline sales, sales increased $161.5 million or 6.7% for the fiscal year ended September 29, 2007. Fiscal 2007 contained 52 weeks compared to 53 weeks in fiscal 2006. Adjusted for the difference in weeks, net sales increased 11.0%.

Grocery segment comparable store sales adjusted for the difference in weeks increased $268.7 million, or 11.0%, for the same period. Gasoline department sales increased due to a 39% increase in gallons sold, while the average sales price per gallon for fiscal 2007 was slightly lower than the comparable fiscal 2006 amount. Excluding gasoline sales and adjusting for the extra week in fiscal 2006, comparable store sales increased $187.8 million, or 8.4%, for the fiscal year ended September 29, 2007. During fiscal 2007, Ingles opened two new stores, closed two older stores and completed five remodeled or replacement stores. Retail square footage increased 1.5% to 9.7 million square feet at September 29, 2007, compared to 9.6 million square feet at September 30, 2006.

Changes in grocery segment sales for the fiscal year ended September 29, 2007 are summarized as follows (in thousands):

Total grocery sales for the fiscal year ended September 30, 2006	$ 2,501,003
Comparable store sales increase (including gasoline)	268,719
Impact of stores opened in fiscal 2006 and 2007	8,827
Impact of stores closed in fiscal 2006 and 2007	(7,064)
Other, including effect of 53rd week in fiscal 2006	(42,502)
Total grocery sales for the fiscal year ended September 29, 2007	$ 2,728,983

Net grocery segment sales increased in each of the Company s ten product categories except for video, with the largest increases in gasoline, pharmacy, deli and produce. In general, net sales increases were driven by effective promotions, service execution and expanded product selections. Fuel stations and pharmacies have been effective in giving customers a competitive choice and allowing them to consolidate shopping trips at Company supermarkets. Growth in the deli and produce departments reflect current customer preferences for greater selection in organic and meal replacement items, including rotisserie chicken and pork, cut fruit, made to order items and hot food offerings. The Ingles Advantage Savings and Rewards Card (the Ingles Advantage Card) also contributes to the increase in net sales and comparable store sales as approximately 74% of grocery segment sales are to holders of the Ingles Advantage Card. Information obtained from holders of the Ingles Advantage Card assists the Company in optimizing product offerings and promotions specific to customer shopping patterns.

Net sales to outside parties for the Company s milk processing subsidiary increased 10.2% to $122.6 million for fiscal year 2007 compared to $111.2 million for fiscal year 2006. Much of the sales increase was attributable to a 22% increase in the average cost of raw milk, representing approximately 35 cents per gallon. Raw milk cost increases are generally passed through to higher sales prices. Case volume sales increased by approximately 0.4% during fiscal 2007 compared to fiscal 2006.

The Company expects continued sales growth in the upcoming fiscal year. The magnitude of expected growth could vary significantly due to volatility in the retail price of gasoline, overall food price inflation and changes in the mix of products sold by the Company. The Company expects that the maturation of new and expanded stores that enhance one-stop shopping and convenience-oriented products will also drive sales growth.

Gross Profit. Gross profit for the fiscal year ended September 29, 2007, increased $34.0 million or 5.2% to $686.2 million, or 24.1% of sales, compared to $652.2 million, or 25.0% of sales, for the fiscal year ended September 30, 2006.

The increase in grocery segment gross profit dollars was primarily due to the higher sales volume. Grocery segment gross profit as a percentage of total sales was lower for fiscal 2007. Inflation for food, beverages and energy (including retail gasoline) increased to a greater extent than overall inflation during fiscal 2007. In many instances, the Company elected to absorb cost increases and accept lower margins in order to increase market share and keep prices as low as possible for its customers. Approximately 90% of the Company s grocery segment sales were at a lower gross margin in fiscal 2007 compared to fiscal 2006. In addition, the department with the highest percentage fiscal 2007 sales growth, gasoline, carries the lowest gross margin, putting further downward pressure on the Company s gross margin. Excluding gasoline sales, grocery segment gross profit as a percentage of sales was 26.7% for fiscal year 2007 compared to 27.0% for fiscal year 2006.

In addition to the direct product cost, the cost of goods sold line item for the grocery segment includes inbound freight charges. Grocery segment shipping, handling and other costs of the Company s distribution network are included in operating and administrative expenses. The milk processing segment is a manufacturing process. Therefore, costs of goods sold include direct product and production costs, inbound freight, purchasing and receiving costs, inspection costs, warehousing costs, internal transfer costs, and other costs of distribution.

The Company s gross margins may not be comparable to those of other retailers, since some retailers include all of the costs related to their distribution network in cost of goods sold, while others, like the Company, exclude a portion of the costs from gross profit, including these costs instead in a line item such as operating and administrative expenses.

Operating and Administrative Expenses. Operating and administrative expenses increased $27.4 million or 5.1% to $564.0 million for the year ended September 29, 2007, from $536.6 million for the year ended September 30, 2006. As a percentage of sales, operating and administrative expenses decreased to 19.8% for the fiscal year ended September 29, 2007, compared to 20.6% for the fiscal year ended September 30, 2006. A variety of factors contributed to the dollar increase.

A breakdown of the major increases (decreases) in operating and administrative expenses is as follows:

	(in millions)	**Increase (decrease) as a % of sales**
Salaries and wages	$ 17.3	(0.13)%
Equipment rent expense	$ (2.9)	(0.11)%
Bank charges	$ 2.5	0.04 %
Utility and fuel expense	$ 2.2	(0.05)%
Warehouse expense	$ 2.0	(0.04)%
Taxes and licenses	$ 1.7	(0.05)%
Store supplies	$ 1.5	(0.02)%

Salaries and wages increased in dollars due to the addition of labor hours required for the increased sales volume, but decreased as a percentage of sales due to increases in store traffic and average purchase and the allocation of management salaries over higher sales dollars.

Equipment rent expense decreased due to the expiration of operating leases on equipment used in the Company s distribution facility and in its stores. Much of this equipment was purchased by the Company at the expiration of the lease term.

Bank charges rose primarily due to increased fees for processing debit and credit cards. The increase is a result of both increased usage of cards and increased transaction fees related to the usage.

Utility and fuel expenses increased due to increases in market energy prices.

Warehouse expenses increased due to additional labor costs needed to process increased volume of both incoming and outgoing product shipments.

Taxes and licenses increased due to higher payroll taxes associated with increased labor costs and increased property taxes and a number of the Company s store properties were revalued by taxing authorities in fiscal 2007.

Store supplies increased due to upgraded packaging used in perishables departments and the higher cost of plastic used in bags and wrapping materials.

Rental Income, Net. Rental income, net decreased $0.6 million to $4.4 million for the 2007 year from $5.0 million for the 2006 year. Gross rental income decreased $0.4 million, while shopping center expenses increased $0.2 million for the period. Third party tenant occupancy rates have been decreasing in many of the Company s shopping centers as the Company intends to expand and upgrade existing supermarkets into former tenant space. In addition, a number of drug store and retailer tenants have relocated to stand alone spaces. Finally, the Company intends to maximize supermarket sales by limiting space leased to companies that offer competing products.

Gain (Loss) From Sale or Disposal of Assets. Gain (loss) from sale or disposal of assets increased $11.3 million from a loss of $4.4 million in fiscal 2006 to a gain of $6.9 million in fiscal 2007. During fiscal year 2007 the Company sold a shopping center in which it no longer operated a store at a pre-tax gain of approximately $7.9 million. During fiscal year 2006 the Company realized a loss of approximately $4.5 million on shopping center and store assets that were demolished or otherwise taken out of service in conjunction with the Company s store relocation, closing and remodeling activities.

Other Income (Expense), Net. Other income (expense), net increased $1.3 million to a net other income of $3.0 million for the year ended September 29, 2007 from net other income of $1.7 million for the year ended September 30, 2006. Increased waste paper and packaging sales contributed to the increase in net other income during fiscal year 2007.

Interest Expense. Interest expense decreased $3.1 million for the year ended September 29, 2007 to $46.7 million from $49.8 million for the year ended September 30, 2006, due primarily to the repayment of $29.7 million of principal mortgage debt during fiscal year 2007. Line of credit borrowings increased by $16.6 million during fiscal year 2007, but these borrowings were generally at lower interest rates than principal mortgage debt that was repaid. Total debt at September 29, 2007 was $543.3 million compared to $556.3 million at September 30, 2006.

Income Taxes. Income tax expense as a percentage of pre-tax income decreased to 34.7% for the 2007 fiscal year compared to 37.5% for the 2006 fiscal year. During the fiscal year 2007 the Company settled a tax position under an initiative offered by one of the states in which the Company conducts its operations. As a result of this settlement, the Company reduced its reserve for contingent income tax liabilities by $3.2 million. This reduction is reflected as a reduction of income tax expense for the year ended September 29, 2007.

Net Income. Net income increased $16.0 million or 37.7% for the fiscal year ended September 29, 2007 to $58.6 million from $42.6 million for the fiscal year ended September 30, 2006. Fiscal 2007 net income is the highest in the Company s 43 year history. The increase in net income is attributed to increased sales, a decrease in expenses as a percentage of sales, real estate sold and lower income tax expense. Basic and diluted earnings per share for Class A Common Stock were $2.51 and $2.39 for the fiscal year ended September 29, 2007 compared to $1.82 and $1.74, respectively, for the fiscal year ended September 30, 2006. Basic and diluted earnings per share for Class B Common Stock were each $2.28 for the fiscal year ended September 29, 2007 compared to $1.66 of basic and diluted earnings per share for the fiscal year ended September 30, 2006.

Fiscal Year Ended September 30, 2006 Compared to the Fiscal Year Ended September 24, 2005

The Company achieved record sales, gross profit and net income for the fiscal year ended September 30, 2006. The predominant factor was increased sales. The sales increase encompassed most of the Company s departments and included increases in comparable store sales, customer visits and average purchase per visit. Operating and administrative expense increases were controlled, resulting in improved cost leverage and additional operating income.

Net Sales. Fiscal 2006 was the 42nd consecutive year Ingles achieved an increase in net sales. Net sales increased 14.9% to $2.612 billion for the fiscal year ended September 30, 2006 from $2.274 billion for the fiscal year ended September 24, 2005. Excluding gasoline sales, sales increased $231.5 million or 10.7% for the fiscal year ended September 30, 2006. Fiscal 2006 contained 53 weeks compared to 52 weeks in fiscal 2005. Adjusted for the difference in weeks, net sales increased 12.8%.

Grocery segment comparable store sales increased $252.7 million or 11.6% for the same period. Fuel price inflation of approximately 23.2% and a 66.6% increase in total gallons sold increased gasoline department sales. Excluding gasoline sales, comparable store sales increased $164.7 million or 7.9% for the fiscal year ended September 30, 2006. During fiscal 2006, Ingles opened one new store, closed one older store and completed three replacement stores. Retail square footage increased 1.2% to 9.6 million square feet at September 30, 2006 compared to 9.5 million square feet at September 24, 2005.

Changes in grocery segment sales for the fiscal year ended September 30, 2006 are summarized as follows (in thousands):

Total grocery sales for the fiscal year ended September 24, 2005	$ 2,164,834
Comparable store sales increase (including gasoline)	252,702
Impact of stores opened in fiscal 2005 and 2006	49,885
Impact of stores closed in fiscal 2005 and 2006	(9,385)
Other, including effect of 53rd week in fiscal 2006	42,967
Total grocery sales for the fiscal year ended September 30, 2006	$ 2,501,003

Net grocery segment sales increased by more than 10% in eight of the Company s ten product categories, with the largest increases in gasoline, pharmacy, deli and produce. In general, net sales increases were driven by effective promotions, service execution and a favorable competitive environment as a result of certain competitors closing stores in the Company s market area. Fuel stations and pharmacies have been effective in giving customers a competitive choice and allowing them to consolidate shopping trips at Company supermarkets. Ingles introduced The Ingles Advantage Card on the first day of the 2004 fiscal year. The increase in net sales and comparable store sales is partially attributable to the continued success of the Ingles Advantage Card program, as approximately 75% of grocery segment sales are to holders of the Ingles Advantage Card. Information obtained from holders of the Ingles Advantage Card assists the Company in optimizing product offerings and promotions specific to customer shopping patterns.

Net sales to outside parties for the Company s milk processing subsidiary increased 1.9% to $111.2 million for fiscal year 2006 compared to $109.1 million for fiscal year 2005. Decreases in the price of raw milk during fiscal 2006 were offset by increased case volume sales compared to fiscal 2005.

The Company expects slower sales growth in the upcoming fiscal year compared to the sales growth experienced in fiscal 2006. The Company anticipates increased competition in certain of its markets that could affect sales growth in the shorter-term. In addition, the per-gallon retail price of gasoline has decreased recently and could stay below the record high levels reached during fiscal 2006. While the Company anticipates growth in the number of gallons sold, the overall effect on gasoline sales in dollars could be mixed. The Company expects that the maturation of new and expanded stores that enhance one-stop shopping and convenience-oriented products will also drive sales growth.

Gross Profit. Gross profit for the fiscal year ended September 30, 2006, increased $66.5 million or 11.4% to $652.2 million, or 25.0% of sales, compared to $585.7 million, or 25.8% of sales, for the fiscal year ended September 24, 2005.

The increase in grocery segment gross profit dollars was primarily due to the higher sales volume. Grocery segment gross profit as a percentage of total sales was lower for fiscal 2006 primarily due to higher sales growth in the gasoline and pharmacy departments. These departments generally have lower gross margins. Excluding gasoline sales, grocery segment gross profit as a percentage of sales was 27.0% for both fiscal year 2006 and fiscal year 2005.

In addition to the direct product cost, the cost of goods sold line item for the grocery segment includes inbound freight charges. Grocery segment shipping, handling and other costs of the Company s distribution network are included in operating and administrative expenses. The milk processing segment is a manufacturing process. Therefore, costs of goods sold include direct product and production costs, inbound freight, purchasing and receiving costs, inspection costs, warehousing costs, internal transfer costs, and other costs of distribution.

The Company s gross margins may not be comparable to those of other retailers, since some retailers include all of the costs related to their distribution network in cost of goods sold and others, like the Company, exclude a portion of the costs from gross profit, including the costs instead in a line item such as operating and administrative expenses.