

TASTY BAKING CO  
Form 10-Q  
August 04, 2010

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

FORM 10-Q

(Mark One)

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

For the thirteen weeks ended June 26, 2010

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 1-5084

TASTY BAKING COMPANY  
(Exact name of Company as specified in its charter)

Pennsylvania 23-1145880  
(State of Incorporation) (IRS Employer  
Identification Number)

Navy Yard Corporate Center, Three Crescent Drive, Suite 200, Philadelphia, Pennsylvania 19112  
(Address of principal executive offices including Zip Code)

215-221-8500  
(Company's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES  NO

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

Edgar Filing: TASTY BAKING CO - Form 10-Q

YES  NO

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

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

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

YES  NO

There were 8,620,586 shares of Common Stock outstanding as of August 4, 2010.

---

TASTY BAKING COMPANY AND SUBSIDIARIES

INDEX

|                  |                                                                                                                                      |       |
|------------------|--------------------------------------------------------------------------------------------------------------------------------------|-------|
| <u>PART I.</u>   | <u>FINANCIAL INFORMATION</u>                                                                                                         |       |
| <u>Item 1.</u>   | <u>Financial Statements (Unaudited)</u>                                                                                              |       |
|                  | <u>Condensed Consolidated Statements of Operations</u><br><u>Thirteen and twenty-six weeks ended June 26, 2010 and June 27, 2009</u> | 3     |
|                  | <u>Condensed Consolidated Statements of Cash Flows</u><br><u>Twenty-six weeks ended June 26, 2010 and June 27, 2009</u>              | 4     |
|                  | <u>Condensed Consolidated Balance Sheets</u><br><u>As of June 26, 2010 and December 26, 2009</u>                                     | 5     |
|                  | <u>Notes to Condensed Consolidated Financial Statements</u>                                                                          | 6-17  |
| <u>Item 2.</u>   | <u>Management's Discussion and Analysis of Financial</u><br><u>Condition and Results of Operations</u>                               | 18-24 |
| <u>Item 3.</u>   | <u>Quantitative and Qualitative Disclosure About Market Risk</u>                                                                     | 24    |
| <u>Item 4.</u>   | <u>Controls and Procedures</u>                                                                                                       | 24-25 |
| <u>PART II.</u>  | <u>OTHER INFORMATION</u>                                                                                                             |       |
| <u>Item 6.</u>   | <u>Exhibits</u>                                                                                                                      | 26    |
| <u>Signature</u> |                                                                                                                                      | 27    |

## Part I. FINANCIAL INFORMATION

## Item 1. Financial Statements

TASTY BAKING COMPANY AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(Unaudited)  
(000's, except per share amounts)

|                                                      | For the Thirteen Weeks Ended |               | For the Twenty-six Weeks Ended |               |
|------------------------------------------------------|------------------------------|---------------|--------------------------------|---------------|
|                                                      | June 26, 2010                | June 27, 2009 | June 26, 2010                  | June 27, 2009 |
| Gross sales                                          | \$ 73,859                    | \$ 78,532     | \$ 146,145                     | \$ 155,461    |
| Less discounts and allowances                        | (30,332 )                    | (31,575 )     | (59,483 )                      | (62,341 )     |
| Net sales                                            | 43,527                       | 46,957        | 86,662                         | 93,120        |
| Costs and expenses:                                  |                              |               |                                |               |
| Cost of sales, exclusive of depreciation shown below | 32,237                       | 27,451        | 62,295                         | 57,372        |
| Depreciation                                         | 3,876                        | 3,320         | 8,581                          | 6,559         |
| Selling, general and administrative                  | 12,018                       | 12,376        | 24,932                         | 25,071        |
| Interest expense                                     | 1,579                        | 545           | 2,898                          | 1,150         |
| Other (income)/expense, net                          | (309 )                       | (175 )        | (72 )                          | (383 )        |
|                                                      | 49,401                       | 43,517        | 98,634                         | 89,769        |
| Income/(loss) before provision for income taxes      | (5,874 )                     | 3,440         | (11,972 )                      | 3,351         |
| Provision for income taxes                           | (2,540 )                     | 1,095         | (4,718 )                       | 1,077         |
| Net income/(loss)                                    | \$ (3,334 )                  | \$ 2,345      | \$ (7,254 )                    | \$ 2,274      |
| Average common shares outstanding:                   |                              |               |                                |               |
| Basic                                                | 8,151                        | 8,062         | 8,140                          | 8,060         |
| Diluted                                              | 8,151                        | 8,062         | 8,140                          | 8,060         |
| Per share of common stock:                           |                              |               |                                |               |
| Net income/(loss):                                   |                              |               |                                |               |
| Basic                                                | \$ (0.41 )                   | \$ 0.27       | \$ (0.90 )                     | \$ 0.27       |
| Diluted                                              | \$ (0.41 )                   | \$ 0.27       | \$ (0.90 )                     | \$ 0.27       |
| Cash dividend                                        | \$ 0.05                      | \$ 0.05       | \$ 0.10                        | \$ 0.10       |

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



TASTY BAKING COMPANY AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)  
(000's)

For the Twenty-six Weeks Ended  
June 26, 2010      June 27, 2009

|                                                                                   |             |              |
|-----------------------------------------------------------------------------------|-------------|--------------|
| Cash flows from (used for) operating activities                                   |             |              |
| Net income/(loss)                                                                 | \$ (7,254 ) | \$ 2,274     |
| Adjustments to reconcile net income to net cash provided by operating activities: |             |              |
| Depreciation                                                                      | 8,581       | 6,559        |
| Amortization                                                                      | 302         | 183          |
| Accretion of asset retirement obligation                                          | 206         | 195          |
| Gain on sale of property, plant and equipment                                     | (684 )      | (6 )         |
| Gain on sale of route                                                             | (21 )       | -            |
| Defined benefit pension expense                                                   | 159         | 626          |
| Pension contributions                                                             | (1,232 )    | (1,211 )     |
| (Increase) decrease in deferred taxes                                             | (4,976 )    | 1,407        |
| Prepaid rent                                                                      | 3,030       | -            |
| Increase in reserve for restructure                                               | 127         | -            |
| Share-based compensation                                                          | 877         | 641          |
| Postretirement benefit income                                                     | -           | (4,027 )     |
| Other                                                                             | (516 )      | 1,296        |
| Changes in assets and liabilities:                                                |             |              |
| Increase in receivables                                                           | (1,476 )    | (321 )       |
| Increase in inventories                                                           | (1,656 )    | (204 )       |
| (Increase) decrease in prepayments, deferred taxes and other                      | (917 )      | 520          |
| Increase (decrease) in accrued taxes                                              | 173         | (432 )       |
| Decrease in accounts payable, accrued payroll and other current liabilities       | (379 )      | (527 )       |
| Net cash from (used for) operating activities                                     | \$ (5,656 ) | \$ 6,973     |
| Cash flows from (used for) investing activities                                   |             |              |
| Independent sales distributor loan repayments                                     | 1,538       | 1,361        |
| Proceeds from sale of property, plant and equipment                               | 698         | 6            |
| Purchase of property, plant and equipment                                         | (9,231 )    | (29,654 )    |
| Loans to independent sales distributors                                           | (1,249 )    | (1,270 )     |
| Other                                                                             | 118         | (172 )       |
| Net cash used for investing activities                                            | \$ (8,126 ) | \$ (29,729 ) |
| Cash flows from (used for) financing activities                                   |             |              |
| Dividends paid                                                                    | (856 )      | (850 )       |
| Repurchase of treasury shares                                                     | (106 )      | -            |

Edgar Filing: TASTY BAKING CO - Form 10-Q

|                                              |           |           |
|----------------------------------------------|-----------|-----------|
| Payment on long-term debt                    | (1,166 )  | (9,889 )  |
| Increase in long-term debt                   | 14,045    | 33,162    |
| Net increase in cash overdraft               | 1,865     | 369       |
| Net cash from financing activities           | \$ 13,782 | \$ 22,792 |
| Net increase in cash and cash equivalents    | (0 )      | 36        |
| Cash and cash equivalents, beginning of year | 5         | 58        |
| Cash and cash equivalents, end of period     | \$ 5      | \$ 94     |

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

-4-

---

TASTY BAKING COMPANY AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(Unaudited)  
(000's)

|                                                                 | June 26, 2010 | December 26, 2009 |
|-----------------------------------------------------------------|---------------|-------------------|
| Assets                                                          |               |                   |
| Current assets:                                                 |               |                   |
| Cash and cash equivalents                                       | \$ 5          | \$ 5              |
| Receivables, less allowance of \$3,033 and \$3,063 respectively | 20,982        | 19,480            |
| Inventories                                                     | 8,422         | 6,767             |
| Deferred income taxes                                           | 3,389         | 3,389             |
| Prepayments and other                                           | 2,720         | 2,158             |
| Total current assets                                            | 35,518        | 31,799            |
| Property, plant and equipment:                                  |               |                   |
| Land                                                            | 1,433         | 1,433             |
| Buildings and improvements                                      | 68,559        | 66,724            |
| Machinery and equipment                                         | 122,432       | 151,327           |
| Construction in progress                                        | 11,908        | 43,367            |
|                                                                 | 204,332       | 262,851           |
| Less accumulated depreciation                                   | (79,623 )     | (141,199 )        |
|                                                                 | 124,709       | 121,652           |
| Other assets:                                                   |               |                   |
| Route territories                                               | 1,981         | 2,102             |
| Long-term receivables from independent sales distributors       | 9,027         | 9,286             |
| Long-term prepaid rent, net                                     | 4,495         | 7,452             |
| Deferred income taxes                                           | 20,437        | 16,085            |
| Miscellaneous                                                   | 1,021         | 1,094             |
|                                                                 | 36,961        | 36,019            |
| Total assets                                                    | \$ 197,188    | \$ 189,470        |
| Liabilities                                                     |               |                   |
| Current liabilities:                                            |               |                   |
| Accounts payable                                                | \$ 11,809     | \$ 8,824          |
| Accrued payroll and employee benefits                           | 5,050         | 6,457             |
| Cash overdraft                                                  | 7,790         | 5,924             |
| Current obligations under capital leases                        | 1,015         | 919               |
| Notes payable, banks and current portion of long-term debt      | 3,360         | 1,128             |
| Reserve for restructure                                         | 1,205         | 1,078             |
| Other current liabilities                                       | 8,133         | 7,535             |
| Total current liabilities                                       | 38,362        | 31,865            |
| Accrued pensions                                                | 22,159        | 25,257            |
| Asset retirement obligations                                    | 7,650         | 7,444             |
| Long-term debt                                                  | 98,580        | 88,147            |



Edgar Filing: TASTY BAKING CO - Form 10-Q

|                                                                                                                                                      |             |             |
|------------------------------------------------------------------------------------------------------------------------------------------------------|-------------|-------------|
| Long-term obligations under capital leases, less current portion                                                                                     | 1,505       | 1,387       |
| Other non-current liabilities                                                                                                                        | 7,970       | 7,586       |
| Total liabilities                                                                                                                                    | \$ 176,226  | \$ 161,686  |
| Shareholders' equity                                                                                                                                 |             |             |
| Accumulated other comprehensive loss                                                                                                                 | \$ (5,411 ) | \$ (6,348 ) |
| Capital in excess of par value of stock                                                                                                              | 27,596      | 28,016      |
| Common stock, par value \$0.50 per share and entitled to one vote per share: Authorized 30,000 shares, issued 9,116 shares, outstanding 8,621 shares | 4,558       | 4,558       |
| Retained earnings                                                                                                                                    | 3,450       | 11,560      |
| Treasury stock, at cost                                                                                                                              | (9,231 )    | (10,002 )   |
| Total shareholders' equity                                                                                                                           | \$ 20,962   | \$ 27,784   |
| Total liabilities and shareholders' equity                                                                                                           | \$ 197,188  | \$ 189,470  |

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

Notes to Condensed Consolidated Financial Statements

All disclosures are pre-tax, unless otherwise noted.

1. Summary of Significant Accounting Policies

---

Nature of the Business

Tasty Baking Company (the “Company”) is a leading producer of sweet baked goods and one of the nation’s oldest and largest independent baking companies, in operation since 1914. It has two manufacturing facilities, one in Philadelphia, Pennsylvania, and a second facility in Oxford, Pennsylvania. The Company completed the relocation of its bakery operations from its Hunting Park, Philadelphia facility to the facility at the Philadelphia Navy Yard in the second quarter of 2010.

Fiscal Year

The Company and its subsidiaries operate on a 52-53 week fiscal year, ending on the last Saturday of December. Fiscal year 2010 is a 52-week year. Fiscal year 2009 was a 52-week year.

Basis of Consolidation

The condensed consolidated financial statements include the accounts of the Company and its subsidiaries. All intercompany accounts and transactions have been eliminated.

The condensed consolidated financial statements included herein have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States of America (“GAAP”) have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments, consisting of only normal recurring items, which are necessary for a fair statement of the results of operations for the periods shown. The results of operations for such periods are not necessarily indicative of the results expected for the full year or for any future period.

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with GAAP requires management to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an ongoing basis, the Company evaluates its estimates, including those related to customer sales, discounts and allowances, long-lived asset impairment, indefinite-lived asset impairment, pension plan assumptions, workers’ compensation expense and income taxes. Actual results may differ from these estimates.

Concentration of Credit

The Company encounters, in the normal course of business, exposure to concentrations of credit risk with respect to trade receivables. Ongoing credit evaluations of customers’ financial conditions are performed and, generally, no collateral is required. The Company maintains reserves for potential credit losses and such losses have not exceeded management’s expectations.

Revenue Recognition

Revenue is recognized when title and risk of loss pass, which is upon receipt of goods by the independent sales distributors, retailers or third party distributors. For route sales, the Company sells to independent sales distributors who, in turn, sell to retailers. Revenue for sales to independent sales distributors is recognized upon receipt of the product by the distributor. For sales made directly to a customer or a third party distributor, revenue is recognized

upon receipt of the products by the retailer or third party distributor.

#### Sale of Routes

Sales distribution routes are primarily owned by independent sales distributors that purchase the exclusive right to sell and distribute Tastykake® products in defined geographic areas. When the Company sells routes to independent sales distributors, it recognizes a gain or loss on the sale. Routes sold by the Company are either existing routes that the Company has previously purchased from an independent sales distributor or newly established routes in new areas. Any gain or loss recorded by the Company is based on the difference between the sales price and the carrying value of the route. Any potential impairment of net carrying value is reserved as identified. The Company recognizes gains or losses on sales of routes when all material services or conditions related to the sale have been substantially performed or satisfied by the Company. In most cases, the Company will finance a portion of the purchase price with interest bearing notes, which are required to be repaid in full. Interest rates on the notes are based on Treasury or LIBOR yields plus a spread. The Company has no obligation to later repurchase a route but may choose to do so to facilitate a change in route ownership.

Sales distribution routes owned by the Company are considered to have an indefinite life and are reviewed for impairment at least annually or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Any potential impairment is recognized when the fair value of the route is less than the net carrying value. As of June 26, 2010 and December 26, 2009, the net carrying value of sales distribution routes owned by the Company was \$2.0 million and \$2.1 million, respectively.

#### Cash and Cash Equivalents

The Company considers investments with an original maturity of three months or less on its acquisition date to be cash equivalents. Cash overdrafts are recorded within current liabilities. Cash flows associated with cash overdrafts are classified as financing activities.

#### Inventory Valuation

Inventories, which include material, labor and manufacturing overhead, are stated at the lower of cost or market, cost being determined using the first-in, first-out ("FIFO") method. Inventory balances for raw materials, work in progress and finished goods are regularly analyzed and provisions for excess and obsolete inventory are recorded, as necessary, based on the forecast of product demand and production requirements.

#### Property and Depreciation

Property, plant and equipment are carried at cost. Depreciation is computed by the straight-line method over the following estimated useful lives of the assets, except where a shorter useful life was necessitated by the Company's relocation of its Hunting Park, Philadelphia manufacturing facility.

| Asset Category                    | Estimated Useful Life |
|-----------------------------------|-----------------------|
| Buildings and improvements        | 26-39 years           |
| Machinery and equipment           | 7-15 years            |
| Vehicles                          | 5-10 years            |
| Capitalized hardware and software | 5 years               |
| Construction in progress          | Not applicable        |

Spare parts are capitalized as part of machinery and equipment and are expensed as utilized or capitalized as part of the relevant fixed asset. Spare parts are valued using a moving average method and are reviewed for potential obsolescence on a regular basis. Reserves are established for all spare parts that are no longer usable and have no fair market value. In connection with the sale of the Hunting Park manufacturing facility, during the second quarter of 2010, the Company disposed of \$1.3 million of excess and obsolete spare parts, for which the Company had previously provided a full reserve. As of June 26, 2010 and December 26, 2009, the Company had reserves for excess and obsolete spare parts of \$0.1 million and \$1.5 million, respectively.

Costs of major additions, replacements and betterments are capitalized, while maintenance and repairs, which do not improve or extend the life of the respective assets, are expensed as incurred. For significant projects, the Company capitalizes interest and labor costs associated with the construction and installation of plant and equipment and significant information technology development projects.

Long-lived assets are reviewed for impairment at least annually or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. In instances where the carrying amount may not be recoverable, the review for potential impairment utilizes estimates and assumptions of future cash flows directly

related to the asset. For assets where there is no plan for future use, the review for impairment includes estimates and assumptions of the fair value of the asset, which is based on the best information available. These assets are recorded at the lower of their book value or fair value.

The Company has a conditional asset retirement obligation related to asbestos in its Hunting Park, Philadelphia facility. This liability has accreted to the full value of the obligation while the capitalized asset retirement cost is depreciated over the remaining useful life of the Hunting Park, Philadelphia facility. During the thirteen and twenty-six weeks ended June 26, 2010 the Company recorded \$0.1 million and \$0.2 million in interest associated with the asset retirement obligation, respectively.

-7-

---

Also, during the thirteen and twenty-six weeks ended June 27, 2009, the Company recorded \$0.1 million and \$0.2 million in interest associated with the asset retirement obligation, respectively. As of June 26, 2010 and December 26, 2009, the asset retirement obligation totaled \$7.7 million and \$7.5 million, respectively.

#### Grants

The Company receives grants from various government agencies for employee training purposes. Expenses for the training are recognized in the condensed consolidated Statements of Operations at the time the training takes place. When the proper approvals are given and funds are received from the government agencies, the Company records an offset to the training expense already recognized.

In 2007, in connection with the decision to relocate its Philadelphia manufacturing operations, the Company received a \$0.6 million grant from the Department of Community and Economic Development of the Commonwealth of Pennsylvania (“DCED”). The opportunity grant has certain spending, job retention and nondiscrimination conditions with which the Company must comply. The Company accounted for this grant under the deferred income approach and will amortize the deferred income over the same period as the useful life of the asset acquired with the grant. The asset acquired with the grant was placed into service in the first quarter of 2010, and likewise the amortization of the grant also commenced in the first quarter of 2010.

Additionally, in conjunction with The Reinvestment Funds, Allegheny West Foundation and the DCED, the Company participates in Project Fresh Start (the “Project”). The Project is an entrepreneurial development program that provides an opportunity for qualified minority entrepreneurs to purchase independent sales distribution routes. The source of grant monies for this program is the DCED. The grants are used by minority applicants to partially fund their purchase of an independent sales distribution route.

Because the Project’s grant funds merely pass through the Company in its role as an intermediary, the Company records an offsetting asset and liability for the total amount of grants as they relate to the Project. There is no impact to the condensed consolidated Statements of Operations related to the establishment of, or subsequent change to, the asset and liability amounts.

#### Marketing Costs

The Company expenses marketing costs, which include advertising and consumer promotions, as incurred or over the period in which future benefits are expected to be received. Marketing costs are included as a part of selling, general and administrative expense. Total marketing costs, including direct marketing and marketing overhead costs, totaled \$0.9 million and \$1.8 million, for the thirteen and twenty-six weeks ended June 26, 2010, respectively. Total marketing costs, including direct marketing and marketing overhead costs, totaled \$1.0 million and \$1.9 million, for the thirteen and twenty-six weeks ended June 27, 2009, respectively.

#### Computer Software Costs

The Company capitalizes certain costs, such as software coding, installation and testing that are incurred to purchase or create and implement internal use computer software. The majority of the Company’s capitalized software relates to the implementation of enterprise resource planning and handheld computer systems. The Company’s unamortized capitalized computer software costs totaled \$4.8 million and \$5.0 million as of June 26, 2010 and December 26, 2009, respectively. The Company recognized \$0.4 million and \$0.9 million of amortization expense related to its capitalized computer software costs for the thirteen and twenty-six weeks ended June 26, 2010, respectively. The Company recognized \$0.6 million and \$1.2 million of amortization expense related to its capitalized computer software costs for the thirteen and twenty-six weeks ended June 27, 2009, respectively.

#### Freight, Shipping and Handling Costs

Outbound freight, shipping and handling costs are included as a part of selling, general and administrative expense. Total outbound freight, shipping and handling costs totaled \$2.9 million and \$5.8 million, for the thirteen weeks and twenty-six weeks ended June 26, 2010 and \$2.8 million and \$5.6 million, for thirteen and twenty-six weeks ended June 27, 2009, respectively. Inbound freight, shipping and handling costs are capitalized with inventory and expensed with cost of sales.

#### Pension Plan

The Company's funding policy for the pension plan is to contribute amounts deductible for federal income tax purposes plus such additional amounts, if any, as the Company's actuarial consultants advise to be appropriate. In 1987 the Company elected to immediately recognize all gains and losses in excess of the pension corridor, which is equal to the greater of ten percent of the projected pension benefit obligation or ten percent of the market-related value of plan assets.

The Company accrues normal periodic pension expense or income during the year based upon certain assumptions and estimates. These estimates and assumptions include discount rate, rate of return on plan assets, compensation increases, mortality and employee turnover. In addition, the rate of return on plan assets is directly related to changes in the equity and credit markets, which can be very volatile. The use of the above estimates and assumptions, market volatility and the Company's election to immediately recognize all gains and losses in excess of its pension corridor in the current year may cause the Company to experience significant changes in its pension expense or income from year to year. Expense or income that falls outside the corridor is recognized only in the fourth quarter of each year.

#### Accounting for Derivative Instruments

The Company has entered into variable-to-fixed rate interest rate swap contracts to fix the interest rates on a portion of its variable interest rate debt. These contracts are accounted for as cash flow hedges. Accordingly, these derivatives are marked to market and the resulting gains or losses are recorded in other comprehensive income as an offset to the related hedged asset or liability. The actual interest expense incurred, inclusive of the effect of the hedge in the current period, is recorded in the condensed consolidated Statements of Operations.

#### Treasury Stock

Treasury stock is stated at cost. Cost is determined by the FIFO method.

#### Accounting for Income Taxes

The Company accounts for income taxes under the asset and liability method. Deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates in effect when the differences are expected to be recovered or settled.

#### Net Income (Loss) Per Common Share

Net income (loss) per common share is presented as basic and diluted earnings per share. Net income (loss) per common share – basic represents the earnings for the period available to each share of common stock outstanding during the reporting period. Net income (loss) per common share – diluted represents the amount of earnings for the period available to each share of common stock outstanding during the reporting period and to each share that would have been outstanding assuming the issuance of common shares for all dilutive potential common shares outstanding during the reporting period. For the thirteen and twenty-six weeks ended June 26, 2010 options to purchase common stock totaling 306,125 and 310,125 shares, respectively, were not included in the calculation of net income (loss) per common share – diluted since the exercise price per share exceeded the actual price per share during the periods presented. For the thirteen and twenty-six weeks ended June 27, 2009 options to purchase common stock totaling 317,075 and 317,200 shares, respectively, were not included in the calculation of net income (loss) per common share – diluted since the exercise price per share exceeded the actual price per share during the periods presented.

|                                                     | Thirteen Weeks Ended |        |               |        | Twenty-six Weeks Ended |        |               |        |
|-----------------------------------------------------|----------------------|--------|---------------|--------|------------------------|--------|---------------|--------|
|                                                     | June 26, 2010        |        | June 27, 2009 |        | June 26, 2010          |        | June 27, 2009 |        |
|                                                     | Income               | Shares | Income        | Shares | Income                 | Shares | Income        | Shares |
|                                                     | (Loss)               |        | (Loss)        |        | (Loss)                 |        | (Loss)        |        |
| Net income (loss)                                   | \$ (3,334)           |        | \$ 2,345      |        | \$ (7,254)             |        | \$ 2,274      |        |
| Less:                                               |                      |        |               |        |                        |        |               |        |
| Income attributable to participating securities     | (19 )                |        | (145 )        |        | (36 )                  |        | (128 )        |        |
| Net income (loss) available for common shareholders | \$ (3,353)           |        | \$ 2,200      |        | \$ (7,290)             |        | \$ 2,146      |        |



|                                              |         |       |      |       |         |       |      |       |
|----------------------------------------------|---------|-------|------|-------|---------|-------|------|-------|
| Net income (loss) per common share - basic   | (0.41 ) | 8,151 | 0.27 | 8,062 | (0.90 ) | 8,140 | 0.27 | 8,060 |
| Net income (loss) per common share - diluted | (0.41 ) | 8,151 | 0.27 | 8,062 | (0.90 ) | 8,140 | 0.27 | 8,060 |

The Company has determined that the calculation of net income (loss) per common share – basic includes all securities that are also required by the calculation of net income (loss) per common share – diluted, and therefore are the same for the respective periods presented.

#### Share-based Compensation

Share-based compensation expense recognized during the current period is based on the value of the portion of share-based payment awards that is ultimately expected to vest. The total value of compensation expense for restricted stock is based on the closing market price of Tasty Baking Company shares on the date of grant. Forfeitures are required to be estimated at the time of grant in order to estimate the amount of share-based awards that will ultimately vest. The forfeiture rate is based on the Company's historical forfeiture experience. The Company calculated its historical pool of windfall tax benefits.

## Recent Accounting Statements

In April 2010, the FASB issued ASU 2010-17, Revenue Recognition – Milestone Method (Topic 605): Milestone Method of Revenue Recognition (“ASU 2010-17”). ASU 2010-17 provides guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition for research or development transactions. ASU 2010-17 is effective on a prospective basis for milestones achieved in fiscal years, and interim periods within those years, beginning on or after June 15, 2010, with early adoption permitted. The Company does not expect the adoption of this guidance to have an impact on its condensed consolidated financial statements.

## 2. New Facilities

---

In May 2007, the Company announced that as part of its comprehensive operational review of strategic manufacturing alternatives, it entered into an agreement to relocate its Hunting Park, Philadelphia operations to the Philadelphia Navy Yard. The term of the bakery lease provides for a 26-year lease term, with renewal options for two additional 10 year terms, for a 345,500 square foot bakery, warehouse and distribution center located on approximately 25 acres. Construction of the new bakery, warehouse and distribution center is complete and the Company has commenced production of all of its product lines at the facility in the Philadelphia Navy Yard. The term of the bakery lease commenced in October 2009, and provides for no rent payments in the first year of occupancy. Rental payments increase from \$3.5 million in the second year of occupancy to \$7.2 million in the final year of the lease. The Company also entered into a 16-year agreement for \$9.5 million in financing at a fixed rate of 8.54% to be used for leasehold improvements. This agreement provides for no payments in the first year of occupancy and then requires monthly payments totaling \$1.2 million annually over the remainder of the term. The Company accounts for both agreements as a single unit of account and as an operating lease and recognizes rental expense associated with this operating lease on a straight-line basis over 26 years.

During April 2009, the Company relocated its corporate headquarters to 36,000 square feet of leased office space in the Philadelphia Navy Yard. The office lease term, which commenced in April 2009, will end at the same time as the new bakery lease. The office lease provides for no rent payments during the first six months of occupancy. Annual rental payments increase from approximately \$0.9 million after the first six months of occupancy to approximately \$1.6 million in the final year of the lease. The Company recognizes rental expense associated with the operating lease on a straight-line basis over the term of the agreement.

In connection with these agreements, the Company provided a \$1.1 million letter of credit, which increased to \$8.1 million in the beginning of 2009. The outstanding amount of the letter of credit will be reduced starting in 2026 and will be eliminated by the end of the lease term. As of June 26, 2010 and December 26, 2009, the outstanding letter of credit under this arrangement totaled \$8.1 million.

In connection with these agreements and the related construction of the new facilities, the Company provided an additional \$0.5 million letter of credit. There were no outstanding amounts as of December 26, 2009 and this letter of credit was eliminated in June 2010.

In addition to the facility leases, the Company purchased high-tech, modern baking equipment. The equipment is designed to increase product development flexibility and efficiency, while maintaining existing taste and quality standards. The investment for this project, in addition to any costs associated with the agreements described above, is projected to be approximately \$78.0 million through 2010. In September 2007, the Company closed on a multi-bank credit facility and low-interest development loans provided in part by the Commonwealth of Pennsylvania and the Philadelphia Industrial Development Corporation (“PIDC”) to finance this investment and refinance the Company’s existing revolving credit facilities, as well as to provide for financial flexibility in running the ongoing operations and

working capital needs.

The Company has evaluated the long-lived assets utilized in its Philadelphia operations and has determined that neither the assets remaining at its Hunting Park facility nor the assets at its Navy Yard facility have suffered impairment.

-10-

---

### 3. Restructure

---

As part of the relocation of its Hunting Park, Philadelphia operations, the Company eliminated approximately 215 positions. While the Company achieved much of this result through normal attrition and the reduction of contract labor, the Company incurred obligations related to postemployment benefits associated with restructuring. Amounts associated with the initial recognition of the restructuring liability and subsequent changes to the estimated liability are recorded in other (income) expense, net in the condensed consolidated Statements of Operations. The Company expects the majority of payments to be made in connection with the restructuring program to be paid in 2010.

As of June 26, 2010, the Company had not incurred any material obligations related to one-time termination benefits, contract termination costs or other associated costs.

The following table provides a roll forward of the estimated future obligations related to postemployment benefits associated with the relocation of the Company's Philadelphia operations from December 26, 2009 to June 26, 2010 (in thousands):

|                                        |         |
|----------------------------------------|---------|
| Restructure reserve, December 26, 2009 | \$1,078 |
| Additions                              | 1,094   |
| Payments                               | (967 )  |
| Restructure reserve, June 26, 2010     | \$1,205 |

During the second quarter of 2010, the Company recognized an additional liability totaling \$0.6 million associated with an increase in the estimated postemployment costs incurred with the restructuring of its Philadelphia operations and a realignment of its corporate workforce, partially offset by a \$0.1 million decrease in the reserve resulting from the reversal of the Company's 2009 bonus accrual. During the first quarter of 2010, the Company recognized an additional liability totaling \$0.5 million related to the estimated postemployment costs incurred with the restructuring of its sales organization.

### 4. Inventories

---

Inventories are classified as follows (in thousands):

|                            | June 26, 2010 | December 26, 2009 |
|----------------------------|---------------|-------------------|
| Finished goods             | \$3,328       | \$1,939           |
| Work in progress           | 65            | 116               |
| Raw materials and supplies | 5,029         | 4,712             |
|                            | \$8,422       | \$6,767           |

There were no reserves for obsolete and slow-moving inventories as of June 26, 2010. The inventory balance has been reduced by reserves for obsolete and slow-moving inventories of \$42 thousand as of December 26, 2009.

5. Credit Facilities

---

In September 2007, the Company entered into a 5 year, \$100.0 million secured credit facility with 4 banks (the “Bank Credit Facility”), consisting of a \$55.0 million fixed asset line of credit, a \$35.0 million working capital revolver and a \$10.0 million low-interest loan from the agent bank with the Commonwealth of Pennsylvania. The Bank Credit Facility is secured by a blanket lien on the Company’s assets and contains various non-financial and financial covenants, which were amended, among other items, effective June 25, 2010 to provide for additional flexibility in the operations of the business and to avoid an instance of non-compliance with respect to the maximum operating leverage ratio. The Bank Credit facility, as amended, includes a fixed charge coverage covenant, a maximum operating leverage covenant, a minimum liquidity ratio covenant, a minimum Unadjusted EBITDA covenant, and in certain instances, restrictions on the payments of dividends. For purposes of the Company’s operating leverage ratio, which is the ratio of debt to Bank EBITDA, Bank EBITDA is defined as consolidated net income excluding option proceeds and extraordinary gains and losses, plus income tax expense, interest expense, depreciation and amortization, non-cash pension charges subject to certain limitations and any other allowable non-cash gains to or non-cash charges against net income (including a non-cash charge against net income in connection with stock-based compensation), less any non-cash pension gains, in each case to the extent deducted in determining net income. For purposes of this definition of Bank EBITDA, transition costs, restructure charges and any other allowable gains or losses that result from the execution of the strategic manufacturing initiative at the Philadelphia Navy Yard project are excluded. For purpose of the minimum Unadjusted EBITDA covenant, Unadjusted EBITDA is defined as operating profit plus depreciation and amortization.

Interest rates for the fixed asset line of credit and working capital revolver are indexed to LIBOR and include a spread above that index ranging from 125 to 450 basis points. This spread above LIBOR is currently at 450 basis points and is expected to range between 400 and 450 basis points through the first quarter of 2012. The fixed asset line of credit and the working capital revolver include commitment fees ranging from 20 to 50 basis points based upon the Company's ratio of debt to Bank EBITDA. The \$10.0 million low-interest loan bears interest at a fixed rate of 5.5% per annum. As of June 26, 2010 and December 26, 2009, the outstanding balances under the Bank Credit Facility were \$80.0 million and \$67.3 million, respectively.

In September 2007, the Company entered into a 10 year, \$12.0 million secured credit agreement with the PIDC Local Development Corporation ("PIDC Credit Facility"). This credit facility bears interest at a blended fixed rate of 4.5% per annum, participates in the blanket lien on the Company's assets and contains customary representations and warranties as well as customary affirmative and negative covenants essentially similar to those in the Bank Credit Facility, as amended. As of June 26, 2010 and December 26, 2009, the outstanding balance under the PIDC Credit Facility was \$12.0 million.

In September 2007, the Company entered into a 10 year, \$5.0 million Machinery and Equipment Loan Fund secured loan with the Commonwealth of Pennsylvania ("MELF Loan 1"). This loan bears interest at a fixed rate of 5.0% per annum and contains customary representations and warranties as well as customary affirmative and negative covenants similar to those in the Bank Credit Facility, as amended. In September 2008, the Company entered into a second 10 year, \$5.0 million Machinery and Equipment Loan Fund secured loan with the Commonwealth of Pennsylvania ("MELF Loan 2"). The terms and conditions of MELF Loan 2 are substantially the same as MELF Loan 1. As of June 26, 2010 and December 26, 2009, the aggregate outstanding balance under the MELF Loan 1 and MELF Loan 2 was \$10.0 million.

As of June 26, 2010, the Company was in compliance with the various nonfinancial and financial covenants associated with the Bank Credit Facility, the PIDC Credit Facility, the MELF Loan 1 and the MELF Loan 2.

In September 2007, the Company entered into an agreement which governs the shared collateral positions under the Bank Credit Facility, the PIDC Credit Facility, the MELF Loan 1 and the MELF Loan 2 (the "Intercreditor Agreement"), and establishes the priorities and procedures that each lender has in enforcing the terms and conditions of each of their respective agreements. The Intercreditor Agreement permits the group of banks and their agent bank in the Bank Credit Facility to have the initial responsibility to enforce the terms and conditions of the various credit agreements, subject to certain specific limitations, and allows such bank group to negotiate amendments and waivers on behalf of all lenders, subject to the approval of each lender.

The Company has used and expects to continue to utilize proceeds from the Bank Credit Facility, the PIDC Credit Facility, the MELF Loan 1 and the MELF Loan 2 to finance the Company's move of its corporate headquarters and manufacturing and distribution facilities to new facilities at the Philadelphia Navy Yard, along with working capital needs.

## 6. Derivative Instruments

---

In order to hedge a portion of the Company's exposure to changes in interest rates on debt incurred under its Bank Credit Facility, the Company enters into variable-to-fixed interest rate swap contracts to fix the interest rates on a portion of its variable interest rate debt. These contracts are accounted for as cash flow hedges. Accordingly, these derivatives are marked to market and the resulting gains or losses are recorded in other comprehensive income as an offset to the related hedged asset or liability. The actual interest expense incurred, inclusive of the effect of the hedge in the current period, is recorded in the condensed consolidated Statements of Operations.

In January 2008, the Company entered into an \$8.5 million notional value interest rate swap contract that increased to \$35.0 million in April 2010 with a fixed LIBOR rate of 3.835% that expires on September 5, 2012. As of June 26, 2010, the notional value of the swap was \$35.0 million. The LIBOR rates were subject to an additional credit spread ranging from 125 to 325 basis points and were equal to 325 basis points as of June 26, 2010. The cumulative change in the fair market value of the derivative instrument is reflected as a liability totaling \$2.4 million and \$2.1 million as of June 26, 2010 and December 26, 2009, respectively.

-12-

---

In May 2008, the Company entered into an \$8.0 million notional value interest rate swap with a fixed LIBOR rate of 2.97% that expires on May 1, 2011. The LIBOR rates were subject to an additional credit spread ranging from 125 to 325 basis points and were equal to 325 basis points as of June 26, 2010. The Company records an asset or a liability for the cumulative change in the fair market value of the derivative instrument, and as of June 26, 2010 and December 26, 2009, the Company recorded a liability of \$0.2 million and \$0.3 million, respectively.

As part of the construction of its new manufacturing facility, the Company entered into firm commitments to acquire machinery and equipment denominated in a foreign currency. In order to hedge the exposure resulting from changes in foreign currency rates, the Company entered into foreign currency forward contracts denominated in Australian Dollars (“AUD”). These contracts were accounted for as foreign currency fair value hedges. Accordingly, the changes in fair value of both the firm commitments and the derivative instruments were recorded in the condensed consolidated Statements of Operations, with the corresponding asset and liability recorded on the balance sheets.

As of June 26, 2010, all of the Company’s foreign currency forward contracts have been settled. As of December 26, 2009, the notional principle of outstanding foreign currency forward contracts designated as hedges was 1.4 million AUD (\$1.2 million USD), respectively.

The following table provides the location and amounts of gains and losses associated with the Company’s derivative instruments (in thousands):

|                                                                                                          | Income<br>Statement<br>Location | Thirteen Weeks Ended |                  | Twenty-six Weeks Ended |                  |
|----------------------------------------------------------------------------------------------------------|---------------------------------|----------------------|------------------|------------------------|------------------|
|                                                                                                          |                                 | June 26,<br>2010     | June 27,<br>2009 | June 26,<br>2010       | June 27,<br>2009 |
| <b>Cash Flow Hedges</b>                                                                                  |                                 |                      |                  |                        |                  |
| <b>Interest Rate Swaps</b>                                                                               |                                 |                      |                  |                        |                  |
| Net gain (loss) recognized in<br>accumulated<br>other comprehensive income                               |                                 | \$ (95 )             | \$ 367           | \$ (263 )              | \$ 210           |
| Net gain (loss) reclassified from<br>accumulated<br>other comprehensive income to<br>interest<br>expense | Interest<br>expense             | (366 )               | (108 )           | (675 )                 | (206 )           |
| <b>Fair Value Hedges</b>                                                                                 |                                 |                      |                  |                        |                  |
| <b>Foreign currency forward<br/>contracts</b>                                                            |                                 |                      |                  |                        |                  |
| Net gain (loss) recognized in<br>other income, net                                                       | Other income,<br>net            | -                    | 142              | 7                      | 603              |

Amounts are reclassified from accumulated other comprehensive income to interest expense for the interest rate swaps on the scheduled maturity dates defined by the agreements.

Foreign currency fair value hedges are entered into against foreign currency fluctuations of firm commitments. Amounts recognized in other (income) expense, net associated with these fair value hedges are fully offset by foreign currency fluctuations of the firm commitments also recognized in other (income) expense, net.



Edgar Filing: TASTY BAKING CO - Form 10-Q

Derivative instruments are reflected in the condensed consolidated Balance Sheets as follows (in thousands):

|                                | Balance Sheet Location        | June 26,<br>2010 | December 26,<br>2009 |
|--------------------------------|-------------------------------|------------------|----------------------|
| Hedging derivative instruments |                               |                  |                      |
| Interest rate swaps            | Other non-current liabilities | \$ (2,427 )      | \$ (2,342 )          |
| Interest rate swaps            | Other current liabilities     | (179 )           | -                    |
| Foreign currency hedges        | Prepayments and other         | -                | 133                  |

Counterparties to the foreign currency forward contracts and interest rate swaps are primarily major banking institutions with credit ratings of investment grade or better and no collateral is required. There are no significant risk concentrations. The Company believes the risk of incurring losses on derivative contracts related to credit risk is remote.

## 7. Fair Value Measurements

The Company discloses certain fair value measurements based on a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

- Level 1. Observable inputs such as quoted prices in active markets for identical assets or liabilities;
- Level 2. Inputs, other than quoted prices included within Level 1, that are observable either directly or indirectly; and
- Level 3. Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

The following table presents assets / (liabilities) measured at fair value on a recurring basis as of June 26, 2010 (in thousands):

| Description                       | Balance as of<br>June 26, 2010 | Fair Value Measurement at Reporting Date Using                                   |                                                           |                                                    |
|-----------------------------------|--------------------------------|----------------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|
|                                   |                                | Quoted<br>Prices in<br>Active<br>Markets<br>for Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| Financial instruments owned:      |                                |                                                                                  |                                                           |                                                    |
| Interest rate swaps               | \$ (2,606 )                    | \$ —                                                                             | \$ (2,606 )                                               | \$ —                                               |
| Total financial instruments owned | \$ (2,606 )                    | \$ —                                                                             | \$ (2,606 )                                               | \$ —                                               |

The following table presents assets / (liabilities) measured at fair value on a recurring basis at December 26, 2009 (in thousands):

| Description                       | Balance as of<br>December 26, 2009 | Fair Value Measurement at Reporting Date Using                                   |                                                           |                                                    |
|-----------------------------------|------------------------------------|----------------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|
|                                   |                                    | Quoted<br>Prices in<br>Active<br>Markets<br>for Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| Financial instruments owned:      |                                    |                                                                                  |                                                           |                                                    |
| Interest rate swaps               | \$ (2,342 )                        | \$ —                                                                             | \$ (2,342 )                                               | \$ —                                               |
| Foreign currency hedges           | 133                                | —                                                                                | 133                                                       | —                                                  |
| Total financial instruments owned | \$ (2,209 )                        | \$ —                                                                             | \$ (2,209 )                                               | \$ —                                               |

As of June 26, 2010 and December 26, 2009, the carrying values of cash and cash equivalents, accounts receivable, accounts payable and other current liabilities are representative of fair value due to the short-term nature of the instruments. The Company's carrying value of long-term debt approximates fair value.

The Company also has nonfinancial assets and liabilities that are measured at fair value on a nonrecurring basis. These include long-lived assets, asset retirement obligations and sales distribution routes owned by the

Company. These items are recognized at fair value when they are considered to be other than temporarily impaired. As of June 26, 2010, no material adjustments were made to assets and liabilities measured at fair value on a nonrecurring basis during fiscal 2010.

#### 8. Defined Benefit Retirement Plans

---

The Company maintains a partially funded noncontributory Defined Benefit (“DB”) Retirement Plan (the “DB Plan”) providing retirement benefits. Benefits under this DB Plan generally are based on the employees’ years of service and compensation during the years preceding retirement. In December 2004, the Company announced to its employees that it was amending the DB Plan to freeze benefit accruals effective March 26, 2005. The Company maintains a DB Supplemental Executive Retirement Plan (“SERP”) for key employees designated by the Board of Directors (the “Board”), however, there are no current employees earning benefits under this plan. The Company also maintains a frozen unfunded Retirement Plan for Directors (the “Director Plan”). The benefit amount is the annual cash retainer in the year of retirement, but not less than \$16 thousand for Directors serving on December 31, 1993.

Effective February 15, 2007, benefit accruals under the Directors’ Retirement Plan were frozen for current directors and future directors were precluded from participating in the plan. Participants are credited for service under the Director Retirement Plan after February 15, 2007 solely for vesting purposes. On February 15, 2007, the Board approved a Deferred Stock Unit Plan (the “DSU Plan”). The DSU Plan provides that for each fiscal quarter, the Company will credit DSUs to the director’s account equivalent in value to \$4 thousand on the last day of such quarter, provided that he or she is a director on the last day of such quarter. Directors will be entitled to be paid in shares upon termination of Board service provided the director has at least five years of continuous service on the Board. The shares may be paid out in a lump sum or at the director’s election, over a period of five years.

The components of the DB Plan, DB SERP, and DB Director Plan's costs are summarized as follows (in thousands):

|                                                | Thirteen Weeks Ended |               | Twenty-six Weeks Ended |               |
|------------------------------------------------|----------------------|---------------|------------------------|---------------|
|                                                | June 26, 2010        | June 27, 2009 | June 26, 2010          | June 27, 2009 |
| Service Cost                                   | \$ -                 | \$ -          | \$ -                   | \$ -          |
| Interest cost on projected benefit obligations | 1,157                | 1,272         | 2,313                  | 2,519         |
| Expected return on plan assets                 | (1,092 )             | (952 )        | (2,184 )               | (1,911 )      |
| Amortization of prior service cost             | -                    | (4 )          | -                      | (8 )          |
| Actuarial loss recognition                     | 15                   | 13            | 30                     | 26            |
| Net amount recorded in income                  | \$ 80                | \$ 329        | \$ 159                 | \$ 626        |

The Company made cash contributions totaling \$1.2 million to the frozen DB Plan for the twenty-six weeks ended June 26, 2010, in accordance with the Pension Protection Act of 2006. During 2010, the Company will make aggregate minimum required cash contributions to the DB Plan totaling \$3.0 million.

## 9. Defined Contribution Retirement Plans

The Company maintains the Tasty Baking Company 401(k) and Company Funded Retirement Plan (the "DC Retirement Plan") which has two separate benefits. The first benefit in the DC Retirement Plan is a funded Defined Contribution Retirement Plan (the "DC Plan"), which is offered in lieu of the benefits previously provided in the now frozen DB Plan. Under the DC Plan, the Company makes weekly cash contributions into individual accounts for all eligible employees. These contributions are based on employees' point values which are the sum of age and years of service as of January 1 each year. All employees receive contributions that range from 2.0% to 5.0% of covered compensation relative to their point totals. Employees at March 27, 2005 who had 20 years of service or 10 years of service and 60 points received an additional "grandfathered" contribution between 1.5% and 3.5% of salary. The "grandfathered" contribution percentage is paid weekly with the regular contribution until those covered employees retire or separate from the Company. These "grandfathered" contributions are being made to compensate older employees for the shorter earnings period that their accounts will have to appreciate in value relative to their normal retirement dates.

The second benefit in the DC Retirement Plan is a 401(k) Plan ("401(k) Plan"). Under the 401(k) Plan, all participants receive a discretionary Company match of their elective deferrals. Historically, the Company matching contribution has been 50% of their elective deferrals that do not exceed 4.0% of their covered compensation as defined in the 401(k) Plan.

The Company also maintains an unfunded defined contribution SERP ("DC SERP") for one eligible active employee. The total DC SERP liability as of June 26, 2010 and December 26, 2009, was \$1.8 million and \$1.7 million, respectively.

Components of deferred contribution retirement plan amounts charged to income are summarized as follows (in thousands):

|                              | Thirteen Weeks Ended |               | Twenty-six Weeks Ended |               |
|------------------------------|----------------------|---------------|------------------------|---------------|
|                              | June 26, 2010        | June 27, 2009 | June 26, 2010          | June 27, 2009 |
| DC Plan expense              | \$ 435               | \$ 431        | \$ 894                 | \$ 874        |
| DC SERP expense              | 45                   | 72            | 155                    | 144           |
| 401(k) matching contribution | 181                  | 178           | 359                    | 351           |

Edgar Filing: TASTY BAKING CO - Form 10-Q

Net defined contribution retirement plan  
amount

|                   |        |        |          |          |
|-------------------|--------|--------|----------|----------|
| charged to income | \$ 661 | \$ 681 | \$ 1,408 | \$ 1,369 |
|-------------------|--------|--------|----------|----------|

-15-

---

## 10. Postretirement Benefits Other than Pensions

---

With the implementation of Medicare Part D in January 2006, the Company stopped providing medical benefits for most of its post-65 retirees and began requiring incumbent retirees to pay age-based rates for life insurance benefits in excess of \$20 thousand. In December 2008, the Company made the decision to terminate its retiree medical benefit plan, which offered medical insurance to pre-65 retirees at a subsidized rate. The decision to terminate the plan was made prior to December 27, 2008 and the Company set the benefits' cessation date as December 1, 2009.

Life insurance for individuals retiring before January 1, 2006 was capped at \$20 thousand of coverage. Incumbent retirees who purchase coverage in excess of \$20 thousand and all new retirees after January 1, 2006 pay age based rates for their life insurance benefit for which the Company incurs no liability. In June 2009, the Company made a decision to cease providing life insurance benefits for its retirees and terminated the plan.

Components of net periodic postretirement benefit cost (benefit) are summarized as follows (in thousands):

|                                                 | Thirteen Weeks Ended |               | Twenty-six Weeks Ended |               |
|-------------------------------------------------|----------------------|---------------|------------------------|---------------|
|                                                 | June 26,<br>2010     | June 27, 2009 | June 26,<br>2010       | June 27, 2009 |
| Service Cost                                    | \$ -                 | \$ -          | \$ -                   | \$ -          |
| Interest cost                                   | -                    | 42            | -                      | 85            |
| Amortization of unrecognized prior service cost | -                    | (199 )        | -                      | (398 )        |
| Amortization of unrecognized gain               | -                    | -             | -                      | -             |
| Curtailment benefit                             | -                    | (3,717 )      | -                      | (3,717 )      |
| Total net postretirement benefit                | \$ -                 | \$ (3,874 )   | \$ -                   | \$ (4,030 )   |

There were no payments made in connection with the terminated other postretirement plans in 2010. Payments made in connection with the other postretirement plans totaled \$0.3 million for the twenty-six weeks ended June 27, 2009.

## 11. Income Taxes

---

The Company's effective tax rate was 43.2% and 31.8% for the thirteen weeks ended June 26, 2010 and June 27, 2009, respectively, and 39.4% and 32.1% for the twenty-six weeks ended June 26, 2010 and June 27, 2009. The Company's effective tax rate differs from the composite federal and state statutory tax rate due to certain expenses which are not deductible for income tax purposes and non-recurring discrete items.

The Company evaluates the net realizable value of its deferred tax assets, including tax loss carryforwards, each reporting period, considering all objective evidence. The Company's assessment that deferred tax assets will be realized is based on estimates of future taxable income generated from various sources including the expected efficiencies and savings of the Navy Yard facility and increased profitability due to cost reductions. If the current estimates of future taxable income are reduced or not realized, the assessment regarding the realization of deferred tax assets in certain jurisdictions could change.

## 12. Accumulated Other Comprehensive Income (Loss)

Total comprehensive income (loss), net of taxes, is comprised as follows (in thousands):

|                                                                                    | Thirteen Weeks Ended |               | Twenty-six Weeks Ended |               |
|------------------------------------------------------------------------------------|----------------------|---------------|------------------------|---------------|
|                                                                                    | June 26, 2010        | June 27, 2009 | June 26, 2010          | June 27, 2009 |
| Net income (loss)                                                                  | \$ (3,334 )          | \$ 2,345      | \$ (7,254 )            | \$ 2,274      |
| Other comprehensive income (loss)                                                  |                      |               |                        |               |
| Change in pension plan                                                             | 9                    | (500 )        | 1,065                  | (494 )        |
| Change in other postretirement benefits                                            | -                    | (749 )        | -                      | (1,001 )      |
| Change in unrealized loss on derivative instruments designated as cash flow hedges | (57 )                | 220           | (128 )                 | 145           |
| Total other comprehensive income (loss)                                            | (48 )                | (1,029 )      | 937                    | (1,350 )      |
| Total comprehensive income (loss)                                                  | \$ (3,382 )          | \$ 1,316      | \$ (6,317 )            | \$ 924        |

The following table summarizes the components of accumulated other comprehensive income (loss), net of tax (in thousands):

|                                                                          | June 26, 2010     | December 26,<br>2009 |
|--------------------------------------------------------------------------|-------------------|----------------------|
| Pension plan                                                             | \$(3,848 )        | \$(4,913 )           |
| Unrealized loss on derivative instruments designated as cash flow hedges | (1,563 )          | (1,435 )             |
| <b>Total accumulated other comprehensive loss</b>                        | <b>\$(5,411 )</b> | <b>\$(6,348 )</b>    |

### 13. Subsequent Events

---

On July 2, 2010, the Company entered into a First Addendum to Purchase and Sale Agreement (the "Addendum") with TKMG Associates, L.P. (the "Buyer") to amend the terms of the Purchase and Sale Agreement (the "Agreement") between the Company and Buyer pursuant to which the Company will sell to Buyer the Company's former (i) corporate office and distribution center located on Fox Street in Philadelphia, PA and (ii) bakery property located on Hunting Park Avenue in Philadelphia, PA. The Addendum extended the initial due diligence period through July 30, 2010 in consideration for \$25,000 of the initial deposit becoming non refundable. The Addendum also contains the parties' agreement that a required zoning change has been satisfied. On July 30, 2010, the due diligence period expired and the buyer deposited an additional \$0.5 million into a non-refundable escrow account. All other terms of the Agreement, including the date of Settlement, remain unchanged. The Company previously disclosed entering into the Agreement on a Form 8-K filed with the Securities and Exchange Commission on April 6, 2010.



Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation  
All disclosures are pre-tax, unless otherwise noted.

## Results of Operations

For the Thirteen Weeks ended June 26, 2010 and June 27, 2009

### Overview

Net loss for the second quarter of 2010 was \$3.3 million, or \$0.41 per fully-diluted share, as compared to net income of \$2.3 million, or \$0.27 per fully-diluted share, in the second quarter of 2009. Earnings for the second quarter of 2010 were negatively impacted by various production limitations in the quarter stemming from transition issues at the Philadelphia Navy Yard facility, as well as \$5.1 million in pre-tax operating costs associated with the transition of production, most of which are not expected to fully recur after the transition and optimization of the new facility is complete which is expected to be completed in the fourth quarter of 2010. Net loss for the second quarter of 2010 and 2009 also included \$1.4 million and \$1.3 million, respectively, of incremental pre-tax depreciation resulting from the change in estimated useful lives of certain assets at the Company's Philadelphia operations in the second quarter of fiscal 2007. The change in estimated useful lives resulted from the Company's move from its Hunting Park, Philadelphia manufacturing and distribution facilities.

### Sales

Gross sales in the second quarter of 2010 decreased \$4.7 million, or 6.0%, versus the comparable period in 2009. The reduction in gross sales was driven by a 4.9% decline in total volumes, primarily driven by lower sales to direct customers and third-party distributors, production limitations stemming from transition issues at the Philadelphia Navy Yard facility as well as moderately lower sales in the Company's route territories. Total net sales declined 7.3% in the second quarter of 2010 compared to the prior year period driven by the decline in volume as well as lower net sales realization resulting from higher promotional and product return costs.

### Cost of Sales

Total cost of sales, excluding depreciation, rose 17.4%, or \$4.8 million, on a unit volume decrease of 4.9% in the second quarter of 2010 as compared to the same period a year ago. The increase in cost of sales was driven by the impact of the \$5.1 million in transition related costs, \$4.6 million of which were classified as a component of cost of sales with the remainder classified as a component of selling, general and administrative costs. Also driving the increase was a \$1.6 million dollar increase in the cost of key ingredients and packaging as well as \$1.5 million in rental expense associated with the new manufacturing and distribution facility, \$1.4 million of which was non-cash. Partially offsetting these increases were lower fixed manufacturing costs and beneficial sales mix, as well as the impact on cost of sales from lower sales volumes. In addition, in the second quarter of 2009, the Company recorded a \$3.7 million benefit related to the termination of the Company's postretirement life insurance plan, \$2.2 million of which was recorded as an offset to cost of sales.

### Depreciation

Depreciation expense increased \$0.6 million to \$3.9 million in the second quarter of fiscal 2010 from \$3.3 million in the second quarter of fiscal 2009. Included in depreciation expense for the second quarter of fiscal 2010 and 2009 is approximately \$1.4 million and \$1.3 million, respectively, of depreciation related to changes in the useful lives of certain assets at the Company's Philadelphia operations which were not relocated to the new facility. The Company does not expect incremental depreciation resulting from the change in useful lives to continue after the second quarter of fiscal 2010.

### Gross Profit

Gross profit declined \$8.8 million in the second quarter of 2010 as compared to the second quarter of 2009. This decline was driven by the increase in cost of sales and a \$0.6 million increase in depreciation expense as compared to the same period last year, as well as the impact of lower sales volumes.

#### Selling, General and Administrative Expenses

Selling, general and administrative expense decreased 2.9%, or \$0.4 million, in the second quarter of 2010, versus the comparable period in 2009. The decline in selling, general and administrative costs was primarily due to favorability in incentive compensation costs, resulting from the \$1.1 million reversal of the Company's 2009 bonus accrual, as well as reductions in other employee related costs. Partially offsetting this was \$0.5 million in expenses related to the transition to the new production and distribution facility at the Navy Yard in the second quarter of 2010. In addition, in the second quarter of 2009, the Company recorded a \$3.7 million benefit related to the termination of the Company's postretirement life insurance plan, \$1.5 million of which was recorded as an offset to selling, general and administrative expenses.

#### Interest Expense

Interest expense increased by \$1.1 million to \$1.6 million in the second quarter of 2010 from \$0.5 million in the second quarter of 2009, due to increased borrowings related to expenditures for the Company's new manufacturing facility. The Company is exposed to market risk relative to its interest expense as certain of its notes payable and long-term debt have floating interest rates that vary with the conditions of the credit market.

#### Other (Income) Expense, Net

Other income, net, totaled \$0.3 million in the second quarter of 2010 compared to \$0.2 million in the second quarter of 2009. The increase in other income, net in the second quarter of 2010 is primarily driven by a gain on the sale of fixed assets and spare parts totaling \$0.7 million partially offset by a charge of \$0.6 million related to an increase in the estimated postemployment costs incurred in connection with the restructuring of the Company's Philadelphia operations and corporate workforce.

#### Taxes

The effective income tax rate for state and federal taxes was 43.2% and 31.8% for the thirteen weeks ended June 26, 2010 and June 27, 2009, respectively.

For the Twenty-six Weeks ended June 26, 2010 and June 27, 2009

#### Overview

Net loss for the twenty-six weeks ended June 26, 2010 was \$7.3 million, or \$0.90 per fully-diluted share, as compared to net income of \$2.3 million, or \$0.27 per fully-diluted share, for the twenty-six weeks ended June 27, 2009. Earnings for the first half of fiscal 2010 were negatively impacted by various production and distribution limitations stemming from a first quarter 2010 oven fire at the Hunting Park manufacturing facility, first quarter 2010 severe winter weather, and production transition issues at the Philadelphia Navy Yard facility, as well as \$8.0 million in pre-tax operating costs associated with the transition of production, most of which are not expected to fully recur after the transition and optimization of the new facility is complete. Net loss for the first half of fiscal 2010 and 2009 also included \$4.1 million and \$2.6 million, respectively, of incremental pre-tax depreciation resulting from the change in estimated useful lives of certain assets at the Company's Philadelphia operations in the second quarter of fiscal 2007. The change in estimated useful lives resulted from the Company's decision to move from its Hunting Park, Philadelphia manufacturing and distribution facilities.

#### Sales

Gross sales for the twenty-six weeks ended June 26, 2010 decreased \$9.3 million, or 6.0%, versus the comparable period in 2009. The reduction in gross sales was driven by a 5.2% decline in total volumes, driven by lower sales in all major channels of the Company's business. Impacting this decline were production and distribution limitations stemming from a first quarter 2010 oven fire at the Hunting Park manufacturing facility, first quarter 2010 severe winter weather conditions, and production and distribution transition issues at the Philadelphia Navy Yard facility. Total net sales declined 6.9% for the twenty-six weeks ended June 26, 2010 compared to the prior year period driven by the volume declines mentioned above as well as lower net sales realization from higher promotional costs and higher product return costs.

#### Cost of Sales

Total cost of sales, excluding depreciation, rose 8.6%, or \$4.9 million, on a unit volume decrease of 5.2% in the second quarter of 2010 as compared to the same period a year ago. The increase in cost of sales was driven by the impact of the transition related costs, \$7.0 million of which were classified as a component of cost of sales with the remainder classified as a component of selling, general and administrative costs. In addition, in the second quarter of 2009, the Company recorded a \$3.7 million benefit related to the termination of the Company's postretirement life insurance plan, \$2.2 million of which was recorded in cost of sales. This benefit did not recur in the second quarter of

2010. Also driving the increase was \$3.0 million in rental expense associated with the new manufacturing and distribution facility, \$2.9 million of which was non-cash as well as a \$1.3 million dollar increase in the cost of key ingredients and packaging for the twenty-six weeks ended June 26, 2010 as compared to the prior year period. Partially offsetting these increases were lower fixed manufacturing costs, beneficial sales mix, as well as the impact on cost of sales from lower sales volumes.

#### Depreciation

Depreciation expense increased \$2.0 million to \$8.6 million in the first half of fiscal 2010 from \$6.6 million in the first half of fiscal 2009. Included in depreciation expense for the first half of fiscal 2010 and 2009 is approximately \$4.1 million and \$2.6 million, respectively, of depreciation related to changes in the useful lives of certain assets at the Company's Philadelphia operations which were not relocated to the new facility. The Company does not expect incremental depreciation resulting from the change in useful lives to continue after the second quarter of 2010.

#### Gross Profit

Gross profit declined \$13.4 million for the twenty-six weeks ended June 26, 2010 versus the comparable period in 2009. This decline was driven by the various changes in cost of sales, as mentioned above, as well as lower sales volumes and \$2.0 million in higher depreciation expense compared to the same period last year.

#### Selling, General and Administrative Expenses

Selling, general and administrative expense for the twenty-six weeks ended June 26, 2010 decreased 0.6%, or \$0.1 million, versus the comparable period in 2009. This decrease was due to approximately \$1.8 million in lower compensation expense, resulting from the \$1.1 million reversal of the Company's 2009 bonus accrual, as well as \$0.9 million in reductions in selling and administrative expenses such as bad debt and pension expense. The above reductions were partially offset by a \$1.5 million benefit the Company recorded in the second quarter of 2009 related to the termination of the Company's postretirement life insurance plan that did not recur in the second quarter of 2010. Also, the Company incurred \$1.0 million in expenses related to the transition to the new production and distribution facility at the Navy Yard in the first half of fiscal 2010, primarily related to transportation and shipping activities.

#### Interest Expense

Interest expense increased by \$1.8 million to \$2.9 million for the twenty-six weeks ended June 26, 2010 from \$1.1 million for the comparable period in 2009, primarily due to increased borrowings related to expenditures for the Company's new manufacturing facility. The Company is exposed to market risk relative to its interest expense as certain of its notes payable and long-term debt have floating interest rates that vary with the conditions of the credit market.

#### Other (Income) Expense, Net

Other income, net, totaled \$0.1 million in the first half of fiscal 2010 compared to \$0.4 million in the first half of fiscal 2009. The decrease in other income, net in the first half of fiscal 2010 is primarily driven by a charge of \$1.1 million related to an increase in the estimated postemployment costs primarily incurred with the restructuring of the Company's Philadelphia operations partially offset by a gain on the sale of fixed assets and spare parts totaling \$0.7 million and miscellaneous income of \$0.5 million.

#### Taxes

The effective income tax rate for state and federal taxes was 39.4% and 32.1% for the twenty-six weeks ended June 26, 2010 and June 27, 2009, respectively.

#### Liquidity and Capital Resources

Current assets at June 26, 2010 were \$35.5 million compared to \$31.8 million at December 26, 2009, and current liabilities at June 26, 2010 were \$38.4 million compared to \$31.9 million at December 26, 2009. The increase in current assets was driven by an increase in accounts receivable of \$1.5 million and a \$0.6 million increase in prepayments, combined with a \$1.7 million increase in inventories resulting primarily from the timing of promotional activity as well as the process of commissioning new production lines. The \$6.5 million increase in current liabilities was due to an increase in notes payable of \$2.2 million and accounts payable of \$3.0 million resulting primarily from an increase in obligations related to the construction of the Company's new manufacturing and distribution facility.

During the twenty-six weeks ended June 26, 2010, the Company made payments of \$1.0 million on the long-term debt incurred in connection with the Company's new manufacturing and distribution facility and capital lease obligations related to computer and handheld equipment. In addition, during fiscal 2010 the Company is required, under the Pension Protection Act of 2006, to make cash contributions totaling \$3.0 million to its defined benefit pension plan. The Company has made cash contributions totaling \$1.2 million to the defined benefit pension plan during the twenty-six weeks ended June 26, 2010.

In May 2007, the Company announced that as part of its comprehensive operational review of strategic manufacturing alternatives, it entered into an agreement to relocate its Philadelphia operations to the Philadelphia Navy Yard. The term of the bakery lease provides for a 26-year lease term, with renewal options for two additional 10 year terms, for a 345,500 square foot bakery, warehouse and distribution center located on approximately 25 acres. Construction of the new bakery, warehouse and distribution center is complete and the Company has commenced production of all of its product lines at the facility in the Philadelphia Navy Yard. The term of the bakery lease commenced in October 2009, and provides for no rent payments in the first year of occupancy. Rental payments increase from \$3.5 million in the second year of occupancy to \$7.2 million in the final year of the lease. The Company also entered into a 16-year agreement for \$9.5 million in financing at a fixed rate of 8.54% to be used for leasehold improvements. This agreement provides for no payments in the first year of occupancy and then requires monthly payments totaling \$1.2 million annually over the remainder of the term. The Company accounts for both agreements as a single unit of account and as an operating lease and recognizes rental expense associated with this operating lease on a straight-line basis over 26 years.

During April 2009, the Company relocated its corporate headquarters to 36,000 square feet of leased office space in the Philadelphia Navy Yard. The office lease term, which commenced in April 2009, will end at the same time as the new bakery lease. The office lease provides for no rent payments during the first six months of occupancy. Annual rental payments increase from approximately \$0.9 million after the first six months of occupancy to approximately \$1.6 million in the final year of the lease. The Company recognizes rental expense associated with the operating lease on a straight-line basis over the term of the agreement.

In connection with these agreements, the Company provided a \$1.1 million letter of credit, which increased to \$8.1 million in the beginning of 2009. The outstanding amount of the letter of credit will be reduced starting in 2026 and will be eliminated by the end of the lease term. As of June 26, 2010 and December 26, 2009, the outstanding letter of credit under this arrangement totaled \$8.1 million.

In connection with these agreements and the related construction of the new facilities, the Company provided an additional \$0.5 million letter of credit. There were no outstanding amounts as of December 26, 2009 and this letter of credit was eliminated in June 2010.

In addition to the facility leases, the Company purchased high-tech, modern baking equipment. The equipment is designed to increase product development flexibility and efficiency, while maintaining existing taste and quality standards. The investment for this project, in addition to any costs associated with the agreements described above, is projected to be approximately \$78.0 million through 2010. The Company anticipates that this project, when completed and fully optimized, will generate approximately \$13.0 million to \$15.0 million in annual pre-tax savings, after taking into account the impact of the new leases, but before any debt service requirements resulting from the investment in the project. In September 2007, the Company closed on a multi-bank credit facility and low-interest development loans provided in part by the Commonwealth of Pennsylvania and the Philadelphia Industrial Development Corporation (“PIDC”) to finance this investment and refinance the Company’s existing revolving credit facilities, as well as to provide for financial flexibility in running the ongoing operations and working capital needs.

As of June 26, 2010 and December 26, 2009, the Company had a restructuring liability for postemployment obligations totaling \$1.2 million and \$1.1 million, respectively. The Company expects the restructuring liability to settle and likewise the majority of payments to be made in connection with the restructuring program to be paid in 2010.

As of June 26, 2010, the Company had not incurred any material obligations related to one-time termination benefits, contract termination costs or other associated costs.

Cash and Cash Equivalents

Historically, the Company has been able to generate sufficient amounts of cash from operations. Bank borrowings are used to supplement cash flow from operations during periods of cyclical shortages. The Company maintains a Bank Credit Facility, a PIDC Credit Facility, a MELF Loan 1 and a MELF Loan 2, as defined below, and utilizes certain capital and operating leases.

Cash overdrafts are recorded within current liabilities. Cash flows associated with cash overdrafts are classified as financing activities.



In September 2007, the Company entered into a 5 year, \$100.0 million secured credit facility with 4 banks (the “Bank Credit Facility”), consisting of a \$55.0 million fixed asset line of credit, a \$35.0 million working capital revolver and a \$10.0 million low-interest loan from the agent bank with the Commonwealth of Pennsylvania. The Bank Credit Facility is secured by a blanket lien on the Company’s assets and contains various non-financial and financial covenants, which were amended, among other items, effective June 25, 2010 to provide for additional flexibility in the operations of the business and to avoid an instance of non-compliance with respect to the maximum operating leverage ratio. The Bank Credit facility, as amended, includes a fixed charge coverage covenant, a maximum operating leverage ratio covenant, a minimum liquidity ratio covenant, a minimum Unadjusted EBITDA covenant, and in certain instances, restrictions on the payments of dividends. For purposes of the Company’s operating leverage ratio, which is the ratio of debt to Bank EBITDA, Bank EBITDA is defined as consolidated net income excluding option proceeds and extraordinary gains and losses, plus income tax expense, interest expense, depreciation and amortization, non-cash pension charges subject to certain limitations and any other allowable non-cash gains to or non-cash charges against net income (including a non-cash charge against net income in connection with stock-based compensation), less any non-cash pension gains, in each case to the extent deducted in determining net income. For purposes of this definition of Bank EBITDA, transition costs, restructure charges and any other allowable gains or losses that result from the execution of the strategic manufacturing initiative at the Philadelphia Navy Yard project are excluded. For purpose of the minimum Unadjusted EBITDA covenant, Unadjusted EBITDA is defined as operating profit plus depreciation and amortization.

Interest rates for the fixed asset line of credit and working capital revolver are indexed to LIBOR and include a spread above that index ranging from 125 to 450 basis points. This spread above LIBOR is currently at 450 basis points and is expected to range between 400 and 450 basis points through the first quarter of 2012. The fixed asset line of credit and the working capital revolver include commitment fees ranging from 20 to 50 basis points based upon the Company’s ratio of debt to Bank EBITDA. The \$10.0 million low-interest loan bears interest at a fixed rate of 5.5% per annum. As of June 26, 2010 and December 26, 2009, the outstanding balances under the Bank Credit Facility were \$80.0 million and \$67.3 million, respectively.

In September 2007, the Company entered into a 10 year, \$12.0 million secured credit agreement with the PIDC Local Development Corporation (“PIDC Credit Facility”). This credit facility bears interest at a blended fixed rate of 4.5% per annum, participates in the blanket lien on the Company’s assets and contains customary representations and warranties as well as customary affirmative and negative covenants essentially similar to those in the Bank Credit Facility, as amended. As of June 26, 2010 and December 26, 2009, the outstanding balances under the PIDC Credit Facility were \$12.0 million.

In September 2007, the Company entered into a 10 year, \$5.0 million Machinery and Equipment Loan Fund secured loan with the Commonwealth of Pennsylvania (“MELF Loan 1”). This loan bears interest at a fixed rate of 5.0% per annum and contains customary representations and warranties as well as customary affirmative and negative covenants similar to those in the Bank Credit Facility, as amended. In September 2008, the Company entered into a second 10 year, \$5.0 million Machinery and Equipment Loan Fund secured loan with the Commonwealth of Pennsylvania (“MELF Loan 2”). The terms and conditions of MELF Loan 2 are substantially the same as MELF Loan 1. As of June 26, 2010 and December 26, 2009, the aggregate outstanding balance under the MELF Loan 1 and MELF Loan 2 was \$10.0 million.

As of June 26, 2010, the Company was in compliance with the various nonfinancial and financial covenants associated with the Bank Credit Facility, the PIDC Credit Facility, the MELF Loan 1 and the MELF Loan 2.

Certain of our covenants become more restrictive over the term of the agreement. Our most restrictive covenants, maximum operating leverage ratio, defined as the ratio of debt to Bank EBITDA, and minimum Unadjusted EBITDA, have the following requirements for the next year as follows:

|                            | Maximum Operating<br>Leverage Ratio |
|----------------------------|-------------------------------------|
| Fiscal 2010 Second Quarter | 6.00 to 1.0                         |
| Fiscal 2010 Third Quarter  | 6.00 to 1.0                         |
| Fiscal 2010 Fourth Quarter | 5.50 to 1.0                         |
| Fiscal 2011 First Quarter  | 5.00 to 1.0                         |
| Fiscal 2011 Second Quarter | 4.75 to 1.0                         |

|                                     | Minimum Unadjusted<br>EBITDA |
|-------------------------------------|------------------------------|
| 6 months ended December 25,<br>2010 | \$ 3,000,000                 |
| 9 months ended March 26, 2011       | \$ 7,000,000                 |
| 12 months ended June 25, 2011       | \$12,000,000                 |

As of June 26, 2010 the maximum operating leverage ratio was approximately 5.9 to 1.0. As of December 26, 2009, the Company was in compliance with the various non-financial and financial covenants associated with the Bank Credit Facility, the PIDC Credit Facility, the MELF Loan 1, and the MELF Loan 2 and is currently projecting compliance with its debt covenants for June 2010 with expected compliance for the next four fiscal quarters.

In September 2007, the Company entered into an agreement which governs the shared collateral positions under the Bank Credit Facility, the PIDC Credit Facility, the MELF Loan 1 and the MELF Loan 2 (the “Intercreditor Agreement”), and establishes the priorities and procedures that each lender has in enforcing the terms and conditions of each of their respective agreements. The Intercreditor Agreement permits the group of banks and their agent bank in the Bank Credit Facility to have the initial responsibility to enforce the terms and conditions of the various credit agreements, subject to certain specific limitations, and allows such bank group to negotiate amendments and waivers on behalf of all lenders, subject to the approval of each lender.

The Company has used and expects to continue to utilize proceeds from the Bank Credit Facility, the PIDC Credit Facility, the MELF Loan 1 and the MELF Loan 2 to finance the Company’s move of its corporate and manufacturing and distribution facilities to new facilities at the Philadelphia Navy Yard, along with working capital needs.

Net cash used for operating activities for the twenty-six weeks ended June 26, 2010 was \$5.7 million, primarily attributed to the combined effect of the net loss for the quarter as well as the year over year changes in the Company’s inventories, accounts receivable and prepayments and other.

Net cash used for investing activities for the twenty-six weeks ended June 26, 2010 was \$8.1 million attributed to capital expenditures primarily related to investments in the Company’s new manufacturing and distribution facility.

Net cash from financing activities for the twenty-six weeks ended June 26, 2010 totaled \$13.8 million, driven by an increase in long-term debt primarily due to investments in the Company’s new manufacturing and distribution facility.

The Company currently anticipates that cash flow from operations, along with the continued availability under the Bank Credit Facility, as described above, will provide sufficient cash to meet the short-term and long-term operating, capital expenditure and financing requirements of the Company.

#### New Accounting Pronouncements

Refer to Note 1 of the Notes to condensed consolidated financial statements, included herein, for a discussion of new accounting pronouncements.

#### Critical Accounting Policies and Estimates

Management’s Discussion and Analysis of Financial Condition and Results of Operations is based on the condensed consolidated financial statements and accompanying notes that have been prepared in conformity with GAAP. The

preparation of such condensed consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Included in the Company's Annual Report on Form 10-K for fiscal 2009 ("2009 Form 10-K") are the significant accounting policies of the Company, which are described in Note 1 to the consolidated financial statements, and the critical accounting estimates, which are described in the Management's Discussion and Analysis of Financial Condition and Results of Operations in the 2009 Form 10-K. Information concerning the Company's implementation and impact of new accounting standards is included in Note 1 of the condensed consolidated financial statements included herein. Otherwise, there were no changes in the Company's critical accounting policies and estimates in the second quarter of 2010 which had a material impact on the Company's financial condition, change in financial condition, liquidity or results of operations.

## Forward-Looking Statements

Statements contained in this Quarterly Report on Form 10-Q, including but not limited to those under the heading "Management's Discussion and Analysis," contain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, and are subject to the safe harbor created by that Act. Such forward-looking statements are based upon assumptions by management, as of the date of this Report, including assumptions about risks and uncertainties faced by the Company. These forward-looking statements can be identified by the use of words such as "anticipate," "believe," "could," "estimate," "expect," "intend," "may," "plan," "predict," "project," "should," "would," "is likely to," or "is expected to" and other similar terms. They may include comments about relocating operations and the funding thereof, legal proceedings, competition within the baking industry, concentration of customers, commodity prices, consumer preferences, long-term receivables, inability to develop brand recognition in the Company's expanded markets, production and inventory concerns, employee productivity, availability of capital, fluctuation in interest rates, pension expense and related assumptions, changes in long-term corporate bond rates or asset returns that could affect the pension corridor expense or income, governmental regulations, protection of the Company's intellectual property and trade secrets and other statements contained herein that are not historical facts.

Because such forward-looking statements involve risks and uncertainties, various factors could cause actual results to differ materially from those expressed or implied by such forward-looking statements, including, but not limited to, changes in general economic or business conditions nationally and in the Company's primary markets, the availability of capital upon terms acceptable to the Company, the availability and pricing of raw materials, the level of demand for the Company's products, the outcome of legal proceedings to which the Company is or may become a party, the actions of competitors within the packaged food industry, changes in consumer tastes or eating habits, the success of business strategies implemented by the Company to meet future challenges, the costs to complete a new facility and relocate thereto, the rules of business interruption and an adverse impact of financial results while optimizing production of the new facility, the costs and availability of capital to fund improvements or new facilities and equipment, the retention of key employees, and the ability to develop and market in a timely and efficient manner new products which are accepted by consumers. If any of our assumptions prove incorrect or should unanticipated circumstances arise, our actual results could differ materially from those anticipated by such forward-looking statements. The differences could be caused by a number of factors or combination of factors, including, but not limited to, those factors described in the Company's 2009 Form 10-K, "Item 1A, Risk Factors." There can be no assurance that the new manufacturing facility described herein will be successful or that projected cost savings will be achieved. The Company undertakes no obligation to publicly revise or update such forward-looking statements, except as required by law. Readers are advised, however, to consult any further public disclosures by the Company (such as in the Company's filings with the SEC or in Company press releases) on related subjects.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not required for smaller reporting companies.

### Item 4. Controls and Procedures

#### (a) Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's reports filed or submitted pursuant to the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without

limitation, controls and procedures designed to ensure at a reasonable assurance level that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Management of the Company, including the Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of the Company's disclosure controls and procedures (as defined in the Exchange Act Rule 13a-15(e)) as of June 26, 2010. Based upon the evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of June 26, 2010.

(b) Changes in Internal Control over Financial Reporting

During the thirteen weeks ended June 26, 2010, there have been no changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

-25-

---

TASTY BAKING COMPANY AND SUBSIDIARIES

PART II. OTHER INFORMATION

Item 6. Exhibits

(a) Exhibits:

- Exhibit 10 (a)– Amended and Restated Tasty Baking Company 2006 Long Term Incentive Plan, effective as of May 7, 2010, is incorporated herein by reference to Exhibit 99.1 to Form 8-K report of Company, filed on or about May 13, 2010.
- Exhibit 10 (b)– Purchase and Sale Agreement between Tasty Baking Company and TKMG Associates, L.P., dated April 5, 2010, is incorporated herein by reference to Exhibit 10(b) to Form 10-Q report of Company for the 26 weeks ended March 27, 2010.
- Exhibit 10 (c)– First Addendum, dated July 2, 2010, to Purchase and Sale Agreement between Tasty Baking Company and TKMG Associates, L.P., dated April 5, 2010.
- Exhibit 10 (d)– Fifth Amendment, effective June 25, 2010, to Credit Agreement, dated as of September 6, 2007, among Tasty Baking Company and its subsidiaries, as Borrowers; Citizens Bank of Pennsylvania, as Administrative Agent, Collateral Agent, Swing Line Lender and Letter of Credit Issuer; and Bank of America, N.A., Sovereign Bank, and Manufacturers and Traders Trust Company, each as a Lender, is incorporated herein by reference to Exhibit 10.1 to Form 8-K report of Company, filed on or about August 2, 2010.
- Exhibit 31 (a)– Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- Exhibit 31 (b)– Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- Exhibit 32 – Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.



TASTY BAKING COMPANY AND SUBSIDIARIES

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

TASTY BAKING COMPANY  
(Company)

August 4, 2010  
(Date)

/s/ Paul D. Ridder  
PAUL D. RIDDER  
SENIOR VICE PRESIDENT  
AND  
CHIEF FINANCIAL OFFICER  
(Principal Financial and  
Accounting Officer)