WILD OATS MARKETS INC
Form 10-Q/A
August 14, 2001

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q/A

AMENDMENT NO. 1

(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR SECTION 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2001

OR

( ) TRANSITION REPORT PURSUANT TO SECTION 13 OR SECTION 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM __________ TO __________

Commission file number

0-21577

WILD OATS MARKETS, INC.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	84-1100630 (I.R.S. Employer Identification Number)

3375 Mitchell Lane
Boulder, Colorado 80301-2244
(Address of principal executive offices, including zip code)
(303) 440-5220
(Registrant's telephone number, including area code)

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

Yes (X) No ( )

As of May 10, 2001, there were 24,625,352 shares outstanding of the Registrant's Common Stock (par value $0.001 per share).

This Form 10-Q/A is filed to correct certain clerical errors and to supplement certain information previously provided.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

WILD OATS MARKETS, INC.

Consolidated Balance Sheets

(in thousands, except share data)

	March 31, 2001 (Unaudited)	December 30, 2000
Assets		
Current assets:		
Cash and cash equivalents	$ 12,937	$ 12,457
Inventories	56,278	55,258
Accounts receivable (less allowance for doubtful accounts of $457 and $355, respectively)	4,196	3,936
Income tax receivable	6,179	9,973
Prepaid expenses and other current assets	1,683	2,004
Deferred income taxes	3,733	1,989
Total current assets	85,006	85,617
Property and equipment, net	176,880	168,535
Intangible assets, net	114,137	114,461
Deposits and other assets	2,320	3,791
Long-term investment	228	228
	$ 378,571	$ 372,632
	=======	=======
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 59,945	$ 56,556

Accrued liabilities	39,867	37,434
Current portion of debt and capital leases	123,687	124,215
Total current liabilities	223,499	218,205
Long-term debt and capital leases	331	353
Deferred income taxes	1,382	989
Other long-term obligations	2,623	1,521
	227,835	221,068
Stockholders' equity:		
Preferred stock, $0.001 par value; 5,000,000 shares authorized; no shares issued and outstanding		
Common stock, $0.001 par value; 60,000,000 shares authorized; 24,625,227 and 23,147,103 shares issued and outstanding	25	23
Additional paid-in capital	159,626	149,764
Note receivable, related party	(9,274)	
Retained earnings	1,519	1,635
Accumulated other comprehensive income	(1,160)	142
Total stockholders' equity	150,736	151,564
	$ 378,571	$ 372,632
	=======	=======

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

WILD OATS MARKETS, INC.

Consolidated Statements of Operations

(in thousands, except per-share data) (unaudited)

	Three Months Ended	
	March 31, 2001	April 1, 2000
Sales	$ 219,499	$ 211,241
Cost of goods sold and occupancy costs	153,090	144,717
Gross profit	66,409	66,524
Operating expenses:		
Direct store expenses	51,616	46,546
Selling, general and administrative expenses	11,083	7,845
Pre-opening expenses	1,430	1,354
Income from operations	2,280	10,779
Interest expense, net	2,466	1,782
Income (loss) before income taxes	(186)	8,997
Income tax expense (benefit)	(68)	3,663
Net income (loss)	$ (118)	$ 5,334
	======	=======
Net income (loss) per common share:		
Basic	$ (0.00)	$ 0.23
Diluted	$ (0.00)	$ 0.23
Average common shares outstanding	23,587	23,000
Dilutive effect of stock options	____	464
Average common shares outstanding, assuming dilution	23,587	23,464
	=======	========

The accompanying notes are an integral part of the consolidated financial statements

WILD OATS MARKETS, INC.

Consolidated Statements of Comprehensive Income (Loss)

(in thousands) (unaudited)

	Three Months Ended	
	March 31, 2001	April 1, 2000
Net income (loss)	$ (118)	$ 5,334
Other comprehensive income (loss):		
Foreign currency translation adjustments arising during the period	(264)	(172)
Cumulative effect of change in accounting principle (see Note 3), net of tax of $352	(586)	
Recognition of hedge results to interest expense during the period, net of tax of $38	64	
Change in market value of cash flow hedge during the period, net of tax of $308	- (516)	
Other comprehensive loss	(1,302)	- (172)
Comprehensive income (loss)	$ (1,420)	$ 5,162
	======	=======

The accompanying notes are an integral part of the consolidated financial statements

WILD OATS MARKETS, INC.

Consolidated Statements of Cash Flows

(in thousands) (unaudited)

	Three Months Ended	
	March 31, 2001	April 1, 2000
Cash Flows from Operating Activities		
Net income (loss)	$ (118)	$ 5,334
Adjustments to reconcile net income (loss) to net cash from operating activities:		
Depreciation and amortization	6,772	7,045
Loss on disposal of property and equipment	7	
Deferred tax benefit	(723)	(37)
Other	17	
Change in assets and liabilities (net of acquisitions):		
Inventories	(1,097)	(1,940)
Receivables and other assets	3,569	(566)
Accounts payable	3,426	2,361
Accrued liabilities	1,434	2,039
Net cash provided by operating activities	13,287	14,236
Cash Flows from Investing Activities		
Capital expenditures	(12,301)	(18,085)
Payment for purchase of acquired entities, net of cash acquired		(3,100)
Proceeds from sale of property and equipment	162	
Long-term investment		(38)
Net cash used in investing activities	(12,139)	(21,223)

Cash Flows from Financing Activities		
Net borrowings (repayments) under line-of-credit agreement	(2,486)	(1,589)
Proceeds from notes payable and long-term debt	2,000	
Repayments on notes payable, long-term debt & capital leases	(63)	(244)
Proceeds from issuance of common stock, net	13	217
Net cash used in financing activities	(536)	(1,616)
Effect of exchange rate changes on cash	(132)	7
Net increase (decrease) in cash and cash equivalents	480	(8,596)
Cash and cash equivalents at beginning of period	12,457	21,877
Cash and cash equivalents at end of period	12,937	$ 13,281
Non-Cash Investing and Financing Activities		
Stock issued in exchange for note receivable	$ 9,274	
Stock received in exchange for services		$ 750

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

WILD OATS MARKETS, INC.

Notes to Consolidated Financial Statements

(unaudited)

1. Nature of Operations and Basis of Presentation

Wild Oats Markets, Inc. ("Wild Oats" or the "Company"), headquartered in Boulder, Colorado, owns and operates natural foods supermarkets in the United States and Canada. The Company also operates bakeries, commissary kitchens, and warehouses that supply the retail stores. The Company's operations are concentrated in one market segment, grocery stores, and are geographically concentrated in the western and central parts of the United States of America.

The consolidated balance sheet as of March 31, 2001, the consolidated statements of operations and comprehensive income for the three months ended March 31, 2001 and April 1, 2000, as well as the consolidated statements of cash flows for the three months ended March 31, 2001 and April 1, 2000 have been prepared without an audit. In the opinion of management, all adjustments, consisting only of normal, recurring adjustments necessary for a fair presentation thereof, have been made.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. These consolidated financial statements should be read in conjunction with financial statements and notes thereto included in the Company's 2000 Annual Report on Form 10-K. The results of operations for interim periods presented are not necessarily indicative of the operating results for the full year.

Certain prior period information has been reclassified to conform to the current presentation.

2. Going Concern Matters

These consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The terms of the Company's credit facility require, among other things, compliance with certain financial ratios, including a funded debt (i.e., debt/EBITDA) ratio and a fixed charge coverage ratio, on a quarterly basis. As a result of restructuring and asset impairment charges incurred during fiscal 2000, the Company was not in compliance with the fixed charge coverage ratio and minimum net income covenants under its credit facility as of and for the quarter ended December 30, 2000, and as a result, its lenders have issued a notice of default, although no acceleration of outstanding debt has been requested. All borrowings outstanding under the credit facility at March 31, 2001 are considered to be due on demand and accordingly are classified as a current liability at March 31, 2001. The Company currently does not have sufficient funds to pay all outstanding indebtedness. These factors raise substantial doubt about the Company's ability to continue as a going concern. The Company currently is negotiating an amendment of its credit facility that may include the payment of an amendment fee, an increase in interest rates, a security interest in assets and additional covenants relating to capital expenditures and new leases. In conjunction with the Company's negotiations to amend its credit facility and obtain less restrictive covenants and other terms and conditions therein, the Company also proposes to raise approximately $30.0 million or more in equity financings to be used to provide additional liquidity, though such equity financing is not a requirement of amending the credit facility. If the Company's lenders accept the amendments currently proposed by the Company, then the Company's borrowing capacity would be limited to $125 million, the maturity date of the credit facility would continue to be August 1, 2003, the interest rate would be increased periodically, the lending group would receive a security interest in the Company's assets, and all existing events of default would be waived as of the amendment date.

A breach of any of the terms and conditions of the amended credit facility agreement could result in acceleration of the Company's indebtedness, in which case the debt would become immediately due and payable. Although no assurances can be given, management expects that it would be in compliance throughout the term of the amended credit facility with respect to the financial and other covenants, including those regarding funded debt ratio, fixed charge coverage ratio, minimum year-to-date net income, tangible net worth, capital expenditure limits, and new lease limits. Management believes that cash generated from operations will be sufficient to satisfy the Company's currently budgeted capital expenditure and debt service requirements through fiscal 2001 and that no additional funding will be necessary.

3. New Accounting Standard for Derivatives and Hedging Activities

In accordance with the Company's interest rate risk-management strategy and as required by the terms of the Company's credit facility, the Company has entered into a swap agreement to hedge the interest rate on $47.5 million of its borrowings. The swap agreement locks in an average LIBOR rate of 6.7% and expires in August 2003. The fair value of the swap at March 31, 2001 was ($1.7 million), which has been recorded in the accompanying balance sheet.

The Company adopted Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133) on December 31, 2000. In accordance with the transition provisions of FAS 133, as of December 31, 2000 the Company recorded a net-of-tax cumulative loss adjustment to other comprehensive income totaling $586,000 which relates to the fair value of the previously described cash flow hedging relationship. Based upon current interest rates, approximately $793,000 of the interest rate hedging loss currently in other comprehensive income is expected to flow through interest expense during the next twelve months.

On the date that the Company entered into the derivative contract, it designated the derivative as a hedge of the variability of cash flows that are to be received or paid in connection with a recognized asset or liability (a "cash flow" hedge). The Company does not enter into derivative contracts for trading or non-hedging purposes. Currently, the Company's swap agreement is designated as a cash flow hedge and is recognized in the balance sheet at its fair value. Changes in the fair value of the Company's cash flow hedge, to the extent that the hedge is highly effective, are recorded in other comprehensive income, until earnings are affected by the variability of cash flows of the hedged transaction through interest expense. Any hedge ineffectiveness (which represents the amount by which the changes in the fair value of the derivative exceed the variability in the cash flows being hedged) is recorded in current-period earnings.

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives that are designated as fair value, cash flow, or foreign currency hedges to (1) specific assets and liabilities on the balance sheet or (2) specific firm commitments or forecasted transactions. The Company also formally assesses (both at the hedge's inception and on an ongoing basis) whether the derivatives that are used in hedging transactions have been highly effective in offsetting changes in the cash flows of hedged items and whether those derivatives may be expected to remain highly effective in future periods. When it is determined that a derivative is not (or has ceased to be) highly effective as a hedge, the Company discontinues hedge accounting prospectively, as discussed below.

The Company discontinues hedge accounting prospectively when (1) it determines that the derivative is no longer effective in offsetting changes in the fair value or cash flows of a hedged item (including hedged items such as firm commitments or forecasted transactions); (2) the derivative expires or is sold, terminated, or exercised; (3) it is no longer probable that the forecasted transaction will occur; (4) a hedged firm commitment no longer meets the definition of a firm commitment; or (5) management determines that designating the derivative as a hedging instrument is no longer appropriate.

When hedge accounting is discontinued due to the Company's determination that the derivative no longer qualifies as an effective fair value hedge, the Company will continue to carry the derivative on the balance sheet at its fair value but cease to adjust the hedged asset or liability for changes in fair value. When hedge accounting is discontinued because the hedged item no longer meets the definition of a firm commitment, the Company will continue to carry the derivative on the balance sheet at its fair value, removing from the balance sheet any asset or liability that was recorded to recognize the firm commitment and recording it as a gain or loss in current period earnings. When the Company discontinues hedge accounting because it is no longer probable that the forecasted transaction will occur in the originally expected period, the gain or loss on the derivative remains in accumulated other comprehensive income and is reclassified into earnings when the forecasted transaction affects earnings. However, if it is probable that a forecasted transaction will not occur by the end of the originally specified time period or within an additional two-month period of time thereafter, the gains and losses that were accumulated in other comprehensive income will be recognized immediately in earnings. In all situations in which hedge accounting is discontinued and the derivative remains outstanding the Company will carry the derivative at its fair value on the balance sheet, recognizing changes in the fair value in current-period earnings.

4. Earnings Per Share

Earnings per share are calculated in accordance with the provisions of FAS No. 128, *Earnings Per Share.* FAS No. 128 requires the Company to report both basic earnings per share, which is based on the weighted-average number of common shares outstanding, and diluted earnings per share, which is based on the weighted-average number of common shares outstanding and all dilutive potential common shares outstanding, except where the effect of their inclusion would be antidilutive (i.e., in a loss period). Antidilutive stock options of 3,115,422 and 436,434 for the three months ended March 31, 2001 and April 1, 2000, respectively, were not included in the earnings per share calculations.

5. Restructuring and Asset Impairment Charges

During the first quarter of fiscal 2001, one natural foods store was closed in Denver, Colorado as part of the fiscal 2000 restructuring plans. With regard to the current status of the Company's fiscal 2000 restructuring plans, as of March 31, 2001, eight of the stores identified in fiscal 2000 for closure or sale remained to be closed or sold with all but one of the closures or sales to be completed by the end of fiscal 2001; the remaining store is expected to be closed or sold during the first quarter of fiscal 2002.

During the second quarter of fiscal 2000, the Company's management made certain decisions relating to the strategic repositioning of the Company's operations which resulted in a restructuring and asset impairment charge of $20.6 million. These decisions included the closure of three natural foods stores during the second quarter of fiscal 2000 ($4.7 million); the planned sale or closure of seven stores during the remainder of fiscal 2000 ($9.9 million); exit costs of previously closed or abandoned sites ($5.6 million); and the discontinuance of e-commerce activities ($400,000). The $5.6 million charge related to changes in estimates for previously closed or abandoned sites. The significant components of the $5.6 million charge were (a) $3.6 million of additional lease-related liabilities, and (b) $2.0 million of fixed asset impairments for 15 previously closed stores. Components of the restructuring and asset impairment charge consist of impairment of fixed ($8.9 million) and intangible assets ($6.4 million); and noncancelable lease obligations and lease related liabilities ($5.3 million). Substantially all of the restructuring charges are non-cash expenses.

During the fourth quarter of fiscal 2000, the Company expanded its strategic repositioning and, as a part of such expansion, decided to close or sell twelve under performing stores. This decision resulted in an additional restructuring and asset impairment charge of $21.4 million. This restructuring charge consists primarily of costs associated with the abandonment of fixed ($13.7 million) and intangible assets ($1.6 million) and noncancelable lease obligations and lease related liabilities ($6.1 million). Substantially all of the restructuring charges are non-cash expenses.

The assets written off as part of the second and fourth quarter 2000 charges consist of the following:

Goodwill impairment	$ 8,041,000
Leasehold interest impairment	2,537,000
Fixed asset impairment	20,030,000
Total	$ 30,608,000
	========

The following table summarizes the accruals related to the Company's restructuring activities during the first quarter of fiscal 2001:

(in thousands)	
Balance, December 30, 2000	$ 9,879
Cash paid	(1,655)
Stock options issued for lease settlement	(43)
Balance, March 31, 2001	$ 8,181
	=====

The Company paid cash of $1,655,000 during the first quarter of fiscal 2001 for lease-related liabilities of previously closed stores or abandoned properties.

In the Company's previous first quarter 2001 financial statements, the accrued liability for restructuring was presented as $12,450,000, which included $4,269,000 for fixed assets impairment reserves for stores held for sale or closure as of March 31, 2001. These impairment reserves have been reclassified from this restructuring liability to offset the appropriate fixed assets captions, resulting in a $4,269,000 reduction to both the fixed assets and restructuring liability captions in these amended first quarter 2001 financial statements.

6. Related Party Transaction

During the first quarter of fiscal 2001, the Company borrowed $2.0 million from Elizabeth C. Cook and Michael C. Gilliland, directors of the Company. The loan has no maturity date, bears interest at 9.0%, and is classified as a current liability.

7. Change in Management

Effective March 19, 2001, Michael Gilliland resigned as the Company's Chief Executive Officer. Mr. Gilliland was replaced by Perry D. Odak as the Company's Chief Executive Officer and President. Mr. Odak entered into an employment agreement, dated March 6, 2001 with the Company (the "Employment Agreement") for a term of five (5) years. Pursuant to the Employment Agreement, Mr. Odak will receive a base salary of $500,000 per annum, together with a minimum first year bonus of $250,000. Such bonus will be reviewed annually by the Company's Compensation Committee. Mr. Odak will have the right to receive a supplemental bonus if the fair market value of the stock, as measured by the closing price on NASDAQ for the preceding 120 consecutive trading days shall equal at least $30 per share or a change of control occurs and the fair market value of the stock is at least $20 per share. The amount of this supplemental bonus will be $9.2 million plus any interest that would accrue thereon at a rate of 7.5% per annum. In addition, pursuant to the Employment Agreement, Mr. Odak has the right to purchase from the Company a number of shares of the Company's Common Stock equal to five percent (5%) of the number of shares of Common Stock outstanding upon the date of purchase. On March 6, 2001, Mr. Odak agreed to purchase 1,332,649 shares of Common Stock for $6.969 per share for an aggregate purchase price of $9.3 million. Payment of $0.01 per share was made on the purchase date, the balance being paid by delivery of a full recourse, five-year promissory note from Mr. Odak to the Company, which has been reflected in shareholder equity as "note receivable, related party".

If the Company issues additional shares of Common Stock such that Mr. Odak's share of Common Stock represents less than five percent (5%) Mr. Odak has the right to purchase such additional shares of Common Stock sufficient to maintain his interest at five percent (5%) of the outstanding Common Stock, provided that Mr. Odak will not acquire more than 300,000 shares in the aggregate.

The Employment Agreement may be terminated at any time by the Company for cause, as defined. If terminated for cause, the Company shall have no further obligation or liability to Mr. Odak, other than payment of the base amount earned and unpaid at the date of termination and payments or reimbursement of business expenses accrued prior to the date of termination. All other options terminate. The Company also may terminate the Employment Agreement other than for cause, in which event the Company has the continuing obligation to pay Mr. Odak his base salary for nine months following termination. If such termination occurs during the last 51 months of the five year term of the Employment Agreement, the Company will have the obligation to pay Mr. Odak his base salary for 36 months following termination. Additionally, the Company will continue to contribute, for the period during which the base salary is continued, the cost of Mr. Odak's participation (including his family) in the Company's group medical and hospitalization insurance plans and group life insurance plan, provided that if Mr. Odak is not entitled to such coverage, the Company will reimburse Mr. Odak for the cost of obtaining such coverage.

In event of Mr. Odak's death, the Company will pay to his designated beneficiary any earned and unpaid base salary and reimbursement of business expenses accrued prior to the date of death. In the event that Mr. Odak becomes disabled to the extent that he is unable to perform substantially all of his duties and responsibilities for 90 days, the Company may terminate him.

Mr. Odak may terminate his employment with the Company for good reason, as defined. A termination by Mr. Odak for good reason and in the absence of circumstances that would entitled the Company to terminate Mr. Odak for cause will be treated as a termination by the Company other than for cause and Mr. Odak will retain the same benefits provided for thereunder.

8. Employee Stock Purchase Plan

The Board suspended participation in the Employee Stock Purchase Plan effective January 29, 2001, when the available pool of shares was substantially exhausted. The Company is seeking shareholder approval at its annual meeting in May 2001 to increase the pool of stock by 500,000 shares.

Item 2. Management's Discussion And Analysis Of Financial Condition And Results Of Operations

This report on Form 10-Q contains certain forward-looking statements regarding our future results of operations and performance. Important factors that could cause differences in results of operations include, but are not limited to, the Company's ability to negotiate a suitable amendment to its outstanding line of credit facility; the timing and success of the current comprehensive review of the Company's business operations and strategic plan; the successful transition of operating authority to our new Chief Executive Officer, Perry D. Odak; the timing and execution of new store openings, relocations, remodels, sales and closures; the timing and impact of promotional and advertising campaigns;

the impact of competition; changes in product supply or suppliers; changes in management information needs; changes in customer needs and expectations; governmental and regulatory actions; general industry or business trends or events; changes in economic or business conditions in general or affecting the natural foods industry in particular; and competition for and the availability of sites for new stores and potential acquisition candidates. See *"Management's Discussion and Analysis of Financial Condition and Results of Operations - Cautionary Statement Regarding Forward-Looking Statements."*

Overview

Store openings, closings, sales, remodels, relocations and acquisitions

. In the first quarter of fiscal 2001, we opened four new stores in Cleveland, Ohio; Irvine, California; Westport, Connecticut; and Omaha, Nebraska; and we closed one store in Denver, Colorado that was previously identified for closure as part of the restructuring charges taken in the second quarter of fiscal 2000. We plan to open one new store in the remainder of fiscal 2001. To date in fiscal 2001, we have closed or sold 14 of the 22 stores identified for closure or sale as part of the restructuring and asset impairment charges taken by the Company in the second and fourth quarters of fiscal 2000. We expect to close or sell seven of the remaining identified stores in fiscal 2001, and one in the first quarter of fiscal 2002.

Our ability to open additional stores in fiscal 2001 and beyond may depend upon our ability to successfully negotiate an amendment to our existing credit facility. As of March 31, 2001, we were in non-monetary default as a result of the violation of certain financial covenants contained in our credit facility, although our lenders have not accelerated repayment on our outstanding debt. All borrowings outstanding under the credit facility at March 31, 2001 are considered to be due on demand and accordingly are classified as a current liability at March 31, 2001. We are currently negotiating an amendment to the credit facility that, if agreed upon, will waive the outstanding defaults in exchange for limitations on our execution of new leases and capital expenditures, as well as other financial covenants, possibly including increased interest rates, a security interest in our assets and an amendment fee. See *"Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources"* and *Consolidated Financial Statements - Footnote 2.*

As has been our past practice, we will continue to evaluate the profitability, strategic positioning, impact of potential competition on and sales growth potential of all of our stores on an ongoing basis. We may, from time to time, make decisions regarding closures, disposals, relocations or remodels in accordance with such evaluations. As a result of such evaluations in the first quarter of fiscal 2001, we closed one operating grocery store that was previously identified for closure as part of our strategic repositioning.

Restructuring and asset impairment charges. As a result of the March 2001 transition in our Chief Executive Officer and a new management philosophy, the Company is currently conducting an extensive review of all components of its business, including its previously announced strategic repositioning initiatives, as well as current marketing, purchasing, merchandising, and new store programs. This comprehensive review is intended to aggressively reexamine all aspects of our business for opportunities to improve, strengthen, streamline and reposition our business operations. The outcomes of this review may result in significant changes to the Company's current business strategy and may have a negative impact on the Company's financial projections for the remainder of fiscal 2001. In conducting this review of its business, the Company has potentially identified additional non-cash restructuring and asset impairment charges of approximately $38 million to $45 million after tax, which we anticipate will be recorded in the second quarter. A portion of the anticipated restructuring and asset impairment charges relate to severance costs for a reduction in the Company's general and administrative workforce resulting from the comprehensive review being conducted. The future savings from salaries and benefits attributed to the reduction in the general and administrative workforce will be reinvested to improve store operations, marketing programs and technology systems. Also as part of this comprehensive review of its business, the Company has decided to postpone any further new store openings planned for fiscal 2001, with the exception of one Henry's Marketplace

® store planned to open in the fourth quarter. The sites previously planned for opening in fiscal 2001 will be rescheduled to open in 2002. The Company also continues to reevaluate certain locations that it had previously identified for sale or closure.

Results of Operations.

Our results of operations have been and will continue to be affected by, among other things, the number, timing and mix of store openings, acquisitions, relocations or closings. New stores build their sales volumes and refine their merchandise selection gradually and, as a result, generally have lower gross margins and higher operating expenses as a percentage of sales than more mature stores. We anticipate that the new stores opened in fiscal 2001 will experience operating losses for the first six to 12 months of operation, in accordance with historical trends. Further, acquired stores, while generally profitable as of the acquisition date, generate lower gross margins and store contribution margins than our company average due to their substantially lower volume purchasing discounts and the integration of the acquired stores into our operating systems. Over time, we expect that the gross margin and store contribution margin of acquired stores approach our company average.

Other factors that could cause acquired stores to perform at lower than expected levels include, among other things, turnover of regional and store management, disruption of advertising, changes in product mix and delays in the integration of purchasing programs. The Company continues to experience integration difficulties with certain of the stores acquired or added to our store base in fiscal 1999, and as a result such stores are having a negative impact on our consolidated results of operations. We expect that these stores will take substantially longer to show gross margin and store contribution margin improvements.

We are actively upgrading, remodeling or relocating some of our older stores. We plan to complete the remodeling or remerchandizing of as many as 10 of our older stores in the first half of fiscal 2001. Remodels and relocations typically cause short-term disruption in sales volume and related increases in certain expenses as a percentage of sales, such as payroll. Remodels on average take between 90 and 120 days to complete. Certain remodels in fiscal 2000 took longer to complete, resulting in greater than projected sales disruptions. We cannot predict whether sales disruptions and the related impact on earnings may be greater in time or volume than projected in certain remodeled or relocated stores.

Store format and clustering strategy.

We operate two store formats: natural foods supermarkets and farmers' markets. The natural foods supermarket format, operated under the Wild Oats Community Market® and other tradenames, is generally 20,000 to 35,000 gross square feet, and the farmers' markets, operated under the Henry's Marketplace® and Sun Harvest Farms™ tradenames, are generally 15,000 to 25,000 gross square feet. Our profitability has been and will continue to be affected by the mix of natural foods supermarkets and farmers' market stores opened, acquired or relocated and whether stores are being opened in markets where we have an existing presence. As part of the current comprehensive review of the Company's business operations and strategic plan, we are evaluating our current natural foods store format and design, and may make significant changes in the future. We also plan to expand the Henry's Marketplace farmers' market-style store format as our second, parallel store format. We believe this format, which is primarily located in metropolitan San Diego, California and Texas, appeals to a more value-conscious customer.

In the past, we have pursued a strategy of clustering stores in each of our markets to increase overall sales, reduce operating costs and increase customer awareness. In prior years, when we opened a store in a market where we had an existing presence, our sales and operating results declined at certain of our existing stores in that market. However, over time, the affected stores generally achieved store contribution margins comparable to prior levels on the lower base of sales. Certain new stores opened in the past two years have caused a greater degree of cannibalization than previously expected, and at this time it does not appear that the store contribution margins at the older, affected stores in these regions will rebound to their prior levels. In certain existing markets the sales and operating results trends for other stores may continue to experience temporary declines related to the clustering of stores. We are currently reevaluating our clustering strategy in response to greater than expected sales cannibalization in certain existing markets where we opened new stores.

Comparable store sales results.

Sales of a store are deemed to be comparable commencing in the thirteenth full month of operations for new, relocated and acquired stores. A variety of factors affect our comparable store sales results, including, among others:

- the opening of stores by us or by our competitors in markets where we have existing stores
- the relative proportion of new or relocated stores to mature stores
- the timing of advertising and promotional events
- store remodels
- store closures
- our ability to effectively execute our operating plans
- changes in consumer preferences for natural foods products
- availability of produce and other seasonal merchandise
- general economic conditions.

Past increases in comparable store sales may not be indicative of future performance.

Our comparable store sales results have been negatively affected in the past by, among other factors, planned cannibalization, which is the loss of sales at an existing store when we open a new store nearby, resulting from the implementation of our store clustering strategy. See *"Management's Discussion and Analysis of Financial Condition and Results of Operations - Store format and clustering strategy."* Comparable store sales results in previous years were negatively affected by higher than expected cannibalization due to the openings of new or relocated stores in several of our existing markets. Certain stores, such as the Henry's Marketplace format stores, which depend heavily on produce sales, are more susceptible to sales fluctuations resulting from the availability and price of certain produce items. As a result of operational improvements in some recently acquired stores, new marketing programs in selected regions and store closures of certain weaker stores, comparable store sales results increased to 1% in the first quarter of fiscal 2001 from (3.5%) at the end of the fourth quarter of fiscal 2000. We expect comparable store sales results to be approximately 1% for the remainder of the year. There can be no assurance that comparable store sales for any particular period will not decrease in the future.

Pre-opening expenses.

Pre-opening expenses include labor, rent, utilities, supplies and certain other costs incurred prior to a store's opening. Pre-opening expenses have averaged approximately $250,000 to $350,000 per store historically, although the amount per store may vary depending on the store format and whether the store is the first to be opened in a market, or is part of a cluster of stores in that market.

Results of Operations

The following table sets forth for the periods indicated, certain selected income statement data expressed as a percentage of sales.

Three Months Ended	March 31, 2001	April 1, 2000
Sales	100.0%	100.0%
Cost of goods sold and occupancy costs	69.7	68.5
Gross margin	30.3	31.5
Direct store expenses	23.5	22.0
Selling, general and administrative expenses	5.1	3.7
Pre-opening expenses	0.7	0.7
Income from operations	1.0	5.1
Interest expense, net	1.1	0.9
Income (loss) before income taxes	(0.1)	4.2

Income tax expense (benefit)	(0.0)	1.7
Net income (loss)	(0.1)%	2.5%
	=====	====

Sales.

Sales for the three months ended March 31, 2001, increased 3.9% to $219.5 million from $211.2 million in the same period in fiscal 2000. The increase was primarily due to the opening of four new stores, as well as the inclusion of the 16 stores opened or acquired in fiscal 2000, offset by 20 stores closed in fiscal 2000. Comparable store sales increased to 1% for the first quarter of fiscal 2001 from (3.5%) at the end of the fourth quarter of fiscal 2000, as compared to (2%) for the same period in fiscal 2000 due to operational improvements in some recently acquired stores, new marketing programs in selected regions and store closures of certain weaker stores.

Gross Profit.

Gross profit for the three months ended March 31, 2001 of $66.4 million was relatively flat as compared to the same period in fiscal 2000, reflecting the growth from new store openings, offset by store closures. As a percentage of sales, gross profit decreased to 30.3% in the first quarter of fiscal 2001 from 31.5% in the same period in fiscal 2000 due primarily to operational weaknesses in certain new and acquired stores resulting from lower than expected sales in those stores, as well as a 30 basis point impact from increasing utilities costs.

Direct Store Expenses.

Direct store expenses for the three months ended March 31, 2001 increased 10.9% to $51.6 million from $46.5 million in the same period in fiscal 2000, and as a percentage of sales, increased to 23.5% in the first quarter of fiscal 2001 from 22.0% in the first quarter of fiscal 2000. The increases are primarily due to higher payroll costs as a percentage of sales in certain acquired and new stores, temporary payroll inefficiencies caused by extended remodels and increasing insurance costs.

Selling, General and Administrative Expenses.

Selling, general and administrative expenses for the three months ended March 31, 2001 increased 41.3% to $11.1 million from $7.8 million in the same period in fiscal 2000, and as a percentage of sales, increased to 5.1% in the first quarter of fiscal 2001 from 3.7% in the same period in fiscal 2000. The increases are primarily attributable to the severance costs associated with the transition in Chief Executive Officers and additions in the corporate and regional staff necessary to support the Company's growth.

Pre-Opening Expenses.

Pre-opening expenses for the three months ended March 31, 2001, remained constant at $1.4 million compared to the same period in fiscal 2000. As a percentage of sales, pre-opening expenses remained constant at 0.7% in the first quarter of fiscal 2001 compared to the same period in fiscal 2000, due to the opening of four new stores in the first quarter of fiscal 2001 as compared to four new stores and two relocations in the same period in fiscal 2000.

Interest Expense, Net.

Net interest expense for the three months ended March 31, 2001 increased to $2.5 million, from $1.8 million in the same period in fiscal 2000. As a percentage of sales, net interest expense increased to 1.1% from 0.9% in the first quarter of fiscal 2000. The increase is primarily attributable to the increased interest rate on our line of credit and an increase in the amount of borrowings. Interest expense may increase in the future as a result of an expected increase in the interest rate under our credit facility. See *"Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources"* below.

Liquidity and Capital Resources

Our primary sources of capital have been cash flow from operations, trade payables, bank indebtedness, and the sale of equity securities. Primary uses of cash have been the financing of new store development, new store openings, relocations, remodels and acquisitions.

Net cash provided by operating activities was $13.3 million during the first three months of fiscal 2001 as compared to $14.2 million during the same period in fiscal 2000. Cash from operating activities decreased during this period primarily due to a reduction in net income, offset by changes in working capital items. We have not required significant external financing to support inventory requirements at our existing and new stores because we have been able to rely on vendor financing for most of the inventory costs, and we anticipate that vendor financing will continue to be available for new store openings.

Net cash used in investing activities was $12.1 million during the first three months of fiscal 2001 as compared to $21.2 million during the same period in fiscal 2000. The decrease is due to a reduction in capital expenditures and acquisitions.

Net cash used in financing activities was $536,000 during the first three months of fiscal 2001 as compared to $1.6 million during the same period in fiscal 2000. The decrease reflects $2.5 million in debt payments, offset by our receipt of cash borrowed under a $2.0 million promissory note with a related party during the first three months of fiscal 2001.

In the third quarter of fiscal 2000, we renewed and increased our existing revolving credit facility to $157.5 million. The facility as increased and amended has two separate lines of credit, a revolving line for $111.2 million and the remainder in a term loan facility, each with a three-year term expiring August 1, 2003. The facility currently bears interest at the default rate, which is the prime rate plus 0.25%. The credit agreement includes certain financial and other covenants, as well as restrictions on payments of dividends. As of December 30, 2000, we were in violation of two financial covenants, and the lending group issued a notice of default, although it has not accelerated our repayment obligations. All borrowings outstanding under the credit facility at March 31, 2001 are considered to be due on demand and accordingly are classified as a current liability at March 31, 2001. As a result of the covenant violations, our borrowings under the credit facility have been limited to $125 million. We are currently negotiating an amendment to the credit facility to waive the defaults and modify certain of the covenants that may include an increase in our interest rate and certain limitations on the execution of new leases and capital expenditures, as well as other financial covenants and a security interest in certain of our assets. If we are unsuccessful in negotiating an amendment acceptable to our lenders, such lenders could accelerate repayment of existing borrowings. The Company currently does not have sufficient available funds to repay in the event of an acceleration of our debt. The Company is also proposing to raise up to approximately $30.0 million or more in equity financings to provide additional liquidity, though such equity financing is not a requirement of amending the credit facility. As of March 31, 2001, there were $77.6 million in borrowings outstanding under the revolving facility and $43.8 million in borrowings outstanding under the term loan. If we are successful in negotiating an amendment to our existing credit facility, we believe that cash generated from operations will be sufficient to meet our capital expenditure requirements in fiscal 2001.

The Company maintains an interest rate risk-management strategy that uses derivative instruments to minimize significant, unanticipated earnings fluctuations that may arise from volatility in interest rates. The Company's specific goals are to (1) manage interest rate sensitivity by modifying the repricing or maturity characteristics of some of its debt and (2) lower (where possible) the cost of its borrowed funds. In accordance with the Company's interest rate risk-management strategy, the Company has entered into a swap agreement to hedge the interest rate on $47.5 million of its borrowings. The swap agreement locks in an average LIBOR rate of 6.7% and expires in August 2003.

We spent approximately $12.3 million during the first three months of fiscal 2001 for new store construction, development, remodels and other capital expenditures, exclusive of acquisitions, and anticipate that we will spend $10.0 million or more in the remainder of fiscal 2001 for new store construction, equipment, leasehold improvements, remodels and other capital expenditures and relocations of existing stores, exclusive of acquisitions. We expect that the capital expenditures originally planned for stores rescheduled to open in 2002 will be incurred commencing in the fourth quarter of 2001. That amount was originally estimated at $15.0 million to $20.0 million, but may be revised as part of our comprehensive review of the business operations and strategic plan. Our average capital expenditures to open a leased store, including leasehold improvements, equipment and fixtures, have ranged from approximately $2.0 million to $5.0 million historically, excluding inventory costs and initial operating losses. We anticipate that our average capital expenditures will be $2.5 million to $6.0 million in the future, partly because of increases in the size of new stores and partly because our new store prototype requires more expensive fixturing. Delays in opening new stores may result in increased capital expenditures and increased pre-opening costs for the site, as well as lower than planned sales for the Company. Although there can be no assurance that actual capital expenditures will not exceed anticipated levels, we believe that cash generated from operations will be sufficient to satisfy the Company's budgeted capital expenditure requirements through the remainder of fiscal 2001.

The cost of initial inventory for a new store is approximately $300,000 to $800,000 depending on the store format; however, we obtain vendor financing for most of this cost. Pre-opening costs currently are approximately $250,000 to $350,000 per store and are expensed as incurred. The amounts and timing of such pre-opening costs will depend upon the availability of new store sites and other factors, including the location of the store and whether it is in a new or existing market for us, the size of the store, and the required build-out at the site. Costs to acquire future stores, if any, are impossible to predict and could vary materially from the cost to open new stores. There can be no assurance that actual capital expenditures will not exceed anticipated levels. We believe that cash generated from operations will be sufficient to satisfy our budgeted cash requirements through fiscal 2001.

Cautionary Statement Regarding Forward-Looking Statements

This Report on Form 10-Q contains "forward-looking statements," within the meaning of the Private Securities Litigation Reform Act of 1995, that involve known and unknown risks. Such forward-looking statements include statements as to the Company's plans to open, acquire or relocate additional stores; the anticipated performance of such stores; the impact of competition; the sufficiency of funds to satisfy the Company's cash requirements through the remainder of fiscal 2001; our ability to negotiate an amendment to our credit facilities acceptable to our lenders; our expectations for comparable store sales; our plans for redesigning our natural foods store format; the impact of changes resulting from our current comprehensive review of the Company's business operations and strategic plan; levels of cannibalization; expected pre-opening expenses and capital expenditures; and other statements containing words such as "believes," "anticipates," "estimates," "expects," "may," "intends" and words of similar import or statements of management's opinion. These forward-looking statements and assumptions involve known and unknown risks, uncertainties and other factors that may cause the actual results, market performance or achievements of the Company to differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. Important factors that could cause differences in results of operations include, but are not limited to, the Company's ability to negotiate a suitable amendment to its outstanding line of credit facility; the timing and success of the current comprehensive review of the Company's business operations and strategic plan; the successful transition of operating authority to our new Chief Executive Officer, Perry Odak; the timing and execution of new store openings, relocations, remodels, sales and closures; the timing and impact of promotional and advertising campaigns; the impact of competition; changes in product supply or suppliers; changes in management information needs; changes in customer needs and expectations; governmental and regulatory actions; general industry or business trends or events; changes in economic or business conditions in general or affecting the natural foods industry in particular; and competition for and the availability of sites for new stores and potential acquisition candidates. The

Company undertakes no obligation to update any forward-looking statements in order to reflect events or circumstances that may arise after the date of this Report.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Boulder, County of Boulder, State of Colorado, on the 14th day of August, 2001.

Wild Oats Markets, Inc.

By /s/ Nancy Casey
Treasurer and Controller