GRISTEDES FOODS INC
Form 10-Q
August 27, 2004

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended May 30, 2004

|_| 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 1-7013

GRISTEDE'S FOODS, INC.
(Exact Name of Registrant as Specified in its Charter)

Delaware	13-1829183
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

823 Eleventh Avenue, New York, New York 10019
(Address of Principal Executive Offices)

(212) 956-5803
(Registrant's Telephone Number, Including Area Code)

N/A
(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

Yes |X| No |_|

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes |_| No |X|

At May 28, 2004, registrant had issued and outstanding 19,636,574 shares of common stock.

GRISTEDE'S FOODS, INC.

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Item 1
Financial Statements

GRISTEDE'S FOODS, INC.
CONSOLIDATED BALANCE SHEETS

ASSETS	(Unaudite May 30, 2004
CURRENT ASSETS:	
Cash	$ 787,
Accounts receivable - net of allowance for doubtful accounts of $607,774 at May 30, 2004 and $572,190 at November 30, 2003	9,993,
Inventories	47,050,
Prepaid expenses and other current assets	1,759,
Total current assets	59,590,
PROPERTY AND EQUIPMENT:	

Furniture, fixtures and equipment	22,079,
Capitalized equipment leases	37,377,
Leaseholds and leasehold improvements	65,899,
	125,356,
Less accumulated depreciation and amortization	60,624,
Net property and equipment	64,732,
Deposits and other assets	899,
Other assets	2,178,
TOTAL	$ 127,401,
LIABILITIES AND STOCKHOLDERS' EQUITY	
CURRENT LIABILITIES:	
Accounts payable, trade	$ 44,213,
Accrued payroll, vacation and withholdings	2,504,
Accrued expenses and other current liabilities	2,171,
Due to affiliates - trade	1,022,
Capitalized lease obligations - current portion	4,627,
Current portion of long term debt	1,461,
Total current liabilities	56,001,
Long-term debt - noncurrent portion	26,330,
Due to affiliates	26,177,
Capitalized lease obligations - noncurrent portion	10,997,
Deferred rent	6,485,
Total liabilities	125,991,
COMMITMENTS AND CONTINGENCIES	
STOCKHOLDERS' EQUITY:	
Preferred stock, $50 Par, -shares authorized 500,000; none issued	
Common stock, $0.02 par value - shares authorized 25,000,000; outstanding 19,636,574 shares at May 30, 2004 and November 30, 2003	392,
Additional paid-in capital	18,065,
Retained earnings/ (deficit)	(17,048,
Total stockholders' equity	1,409,
TOTAL	$ 127,401,

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

GRISTEDE'S FOODS, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE 26 WEEKS ENDED MAY 30, 2004 AND JUNE 1, 2003

	26 weeks ended May 30, 2004	13 weeks ended May 30, 2004
Sales	$ 134,995,099	$ 65,156,917
Cost of sales	79,165,696	38,596,504
Gross profit	55,829,403	26,560,413
Store operating, general and administrative expenses	46,098,579	22,458,083
Pre-store opening startup costs	33,533	33,533
Depreciation and amortization	4,766,554	2,387,947
Insurance proceeds	(80,005)	(80,005)
Non-store operating expenses:		
Administrative payroll and fringes	3,484,188	1,701,826
General office expense	1,403,990	641,172
Professional fees	283,635	178,942
Corporate expense	136,538	61,020
Total non-store operating expenses	5,308,351	2,582,960
Operating loss	(297,609)	(822,105)
Other income (expense):		
Other Income	129,172	129,172
Interest expense	(1,424,919)	(647,990)
Interest income	1,490	629
Total other income (expense) - net	(1,294,257)	(518,189)
Loss before income taxes	(1,591,866)	(1,340,294)
Provision for income taxes	--	--
Net loss	$ (1,591,866)	$ (1,340,294)
Net loss per share; basic and diluted	($ 0.08)	($ 0.07)
Weighted average number of shares and		

equivalents outstanding	19,636,574	19,636,574

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

GRISTEDE'S FOODS, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
FOR THE 52 WEEKS ENDED NOVEMBER 30, 2003
AND FOR THE 26 WEEKS ENDED MAY 30, 2004

	Common stock		Additional Paid-In	Retain earnin
	Shares	Amount	Capital	(defic
Balance at December 1, 2002	19,636,574	$392,732	14,136,674	$ (3,863
Capital contribution in connection of funding of company costs	--	--	3,728,628	
Net loss	--	--	--	(11,593
Balance at November 30, 2003	19,636,574	392,732	17,865,302	(15,456
Capital contribution in connection of funding of company costs	--	--	200,000	
Net loss	--	--	--	(1,591
Balance at May 30, 2004	19,636,574	$392,732	18,065,302	(17,048

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

GRISTEDE'S FOODS, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE 26 WEEKS ENDED MAY 30, 2004 AND JUNE 1, 2003

	26 weeks ended May 30, 2004	26 weeks ended June 1, 2003

Cash flows from operating activities:		
Net loss	$(1,591,866)	$(2,297,245)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	4,766,554	4,759,168
Change in allowance for bad debts	35,584	35,168
Capital contribution in connection of funding of company costs	200,000	--
Changes in operating assets and liabilities:		
Accounts receivable	1,811,176	701,349
Inventories	(2,505,422)	(3,940,243)
Due to/from related parties - trade	647,808	(146,098)
Prepaid expenses and other current assets	1,886,238	1,065,330
Other assets	(337,749)	(505,192)
Accounts payable, trade	(391,153)	2,897,692
Accrued payroll, vacation and withholdings	(1,161,588)	(520,392)
Accrued expenses and other current liabilities	(1,254,774)	(208,419)
Current and other assets acquired via capital leases	--	700,000
Deferred rent	322,327	552,914
Net cash provided by operating activities	2,427,134	3,094,032
Cash flows from investing activities:		
Capital expenditures	(2,397,860)	(4,413,649)
Net cash used in investing activities	(2,397,860)	(4,413,649)
Cash flows from financing activities:		
Repayments of bank loan	(759,171)	(1,149,999)
Repayments of capitalized lease obligations	(3,345,291)	(2,543,739)
Advances from affiliates	4,169,408	5,106,493
Net cash provided by financing activities	64,946	1,412,755
Net increase in cash	94,220	93,138
Cash, begining of period	693,274	576,358
Cash, end of period	$ 787,494	$ 669,496
Supplemental disclosures of cash flow information:		
Cash paid for interest	$ 1,368,510	$ 1,734,300
Cash paid for taxes	$ 14,112	$ 23,590
Supplemental schedule of non cash financing activity:		
Assets acquired under capitalized lease obligations	$ 1,209,282	$ 2,640,659

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

GRISTEDE'S FOODS, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business -

The Company's corporate predecessor was originally incorporated in 1956 in New York under the name Designcraft Industries, Inc., and was engaged in the jewelry business until 1992, when the Company commenced its supermarket operations. The Company became a public company in 1968, listed its common stock on the American Stock Exchange in 1972, and reincorporated in Delaware in 1985. The Company changed its name to Sloan's Supermarkets, Inc. in September 1993 and to Gristede's Sloans, Inc. in November 1997. The Company changed its name to Gristede's Foods, Inc. in August 1999 to reflect its strategy of changing its "Sloan's" banner locations to "Gristede's" subsequent to a store remodeling.

On November 10, 1997, 29 supermarkets that were owned by John A. Catsimatidis, the Company's majority stockholder, Chairman of the Board and CEO (such 29 supermarkets hereinafter referred to as the "Food Group") were merged into the Company's existing 15 supermarkets (the "1997 merger"). The transaction was accounted for as an acquisition of the Company by the Food Group pursuant to Emerging Issues Task Force 90-13 as a result of the Food Group obtaining control of the Company after the transaction. The assets and liabilities of the Food Group were recorded at their historical cost. The Company's assets and liabilities were recorded at their fair value to the extent acquired. Consideration for the transaction was based on an aggregate of $36,000,000 in market value of the Company's common stock and the assumption of $4,000,000 of liabilities. 16,504,298 shares of common stock were issued on the date of the acquisition based on a market price of $2.18 per share.

During the period commencing the fourth quarter of fiscal 2002 through the second quarter of fiscal 2003, the Company opened a total of seven new stores (consisting of six supermarkets and one free standing pharmacy), and closed two stores. During fiscal 2003, the Company also commenced operating XpressGrocer.com, an on-line supermarket providing groceries, household items, fresh foods and other supermarket items in the borough of Manhattan, New York City. One store was closed in fiscal 2004.

The Company presently operates a total of 48 stores; 39 supermarkets and three free-standing pharmacies in Manhattan, New York, three supermarkets in Westchester County, New York, and one supermarket in each of Brooklyn, New York, Bronx County, New York and Long Island, New York. All of the supermarkets and pharmacies are leased and operated under the "Gristede's" banner.

The Company also owns City Produce Operating Corp., a company which operates a warehouse and distribution facility on leased premises in Bronx County, New York.

Basis of presentation - The unaudited consolidated financial statements included herein have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). In the opinion of management, the information furnished reflects all adjustments (consisting of normal recurring adjustments), which are necessary for a fair statement of the results of operations and financial position of the Company for the interim period. The interim figures are not necessarily indicative of the results to be expected for the fiscal year.

Principles of Consolidation - The consolidated financial statements include the

accounts of the Company and its wholly owned subsidiaries. All material intercompany accounts and transactions have been eliminated in consolidation.

Quarter End - The Company operates using the conventional retail 52/53-week fiscal year. The fiscal quarter ends on the Sunday closest to the end of the quarter. The Company's fiscal year ends on the Sunday closest to November 30.

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Inventory - Inventories are valued principally at the lower of cost or market with cost determined under the retail first in, first out (FIFO) method.

Property and Equipment and Depreciation - Property and equipment is stated at cost. Depreciation of furniture, fixtures and equipment is computed by the straight-line method over the estimated useful lives of the assets.

Leases and Amortization - The Company charges the cost of noncancelable operating lease payments and beneficial leaseholds to operations on a straight-line basis over the lives of the leases.

Provision for income taxes - Income taxes reflect Federal and State alternative minimum tax only, as all regular income taxes have been offset by utilization of the Company's net operating loss carry forward.

Income (loss) per share - Per share data are based on the weighted average number of shares of common stock and equivalents outstanding during each quarter. Income (loss) per share is computed by the treasury stock method; basic and diluted income per share are the same.

The Company's Annual Report on Form 10-K for the 52 week period ended November 30, 2003, contains information which should be read in conjunction herewith.

2. RELATED PARTY TRANSACTIONS

The Company leases the following locations from an affiliate, Red Apple Real Estate, Inc., a company wholly owned by John A. Catsimatidis, the majority stockholder of the Company: a portion of its warehouse and distribution facility comprising 25,000 square feet, its office facilities and all or a portion of ten store locations. During the 13 weeks and the 26 weeks ended May 30, 2004, amounts payable by the Company to Red Apple Real Estate, Inc. for rent and real estate taxes under such leases totaled $937,952 and $1,914,559 respectively. The leases are triple net whereby the tenant pays all real estate taxes, insurance and maintenance.

Certain of the Company's supermarkets have entered into capital and operating leases with an affiliate, Red Apple Lease Corporation, a corporation wholly owned by John A. Catsimatidis. These leases are primarily for store operating equipment. Obligations under these leases at May 30, 2004 were $2,307,383. These leases require that monthly payments of $76,790 be made to Red Apple Lease Corporation through March 2007.

Certain of the Company's supermarkets have entered into capital leases with an affiliate, United Acquisition Leasing Corp., a company wholly owned by John A. Catsimatidis. These leases are primarily for store equipment. Obligations under these leases at May 30, 2004 were $4,113,874. These leases require that monthly payments of $113,482 be made to United Acquisition Leasing Corp. with various expirations through May 31, 2008.

Amounts due to affiliates, primarily United Acquisition Corp., a corporation indirectly wholly owned by John A. Catsimatidis represent liabilities in

connection with the 1997 merger and additional advances made to the Company by United Acquisition Corp. since the 1997 merger. These affiliates have agreed not to demand payment of these liabilities in the next year. Accordingly, the liability has been classified as noncurrent. As part of post-closing adjustments in connection with the 1997 merger, approximately $3,600,000 that is due from certain of the Company's affiliates has been offset against the amounts due to United Acquisition Corp. The net amount due to affiliates at May 30, 2004 was $26,177,666 of which $23,500,000 was subordinated to the Company's banks. The liability presently does not bear interest. However, the Company's credit agreement with its banks permits the Company to pay interest on such subordinated debt provided the Company has a positive net income. The liability has no stated maturity date.

In October 2002, the Company and Gristede's NY, LLC, an affiliate of the Company, acquired the fixtures, leasehold improvements and store leases of three stores from the Great Atlantic & Pacific Tea Company for a total purchase price of $5,500,000. The affiliate has leased the acquired assets to the Company. Such stores had been closed for more than six months prior to the transaction. Obligations under these capital leases at May 30, 2004 were $4,162,265 and require monthly payments of $79,156 through February 2008 and a balloon payment of $1,629,156 at such time.

In addition, in connection with the foregoing, Gristede's NY, LLC, received a term loan of $5,000,000 from a bank, which loan is guaranteed by Gristede's Foods NY, Inc. (a wholly-owned subsidiary of Namdor, Inc.), and the Company's subsidiaries Namdor Inc. and City Produce Operating Corp., and secured by a pledge of all of the capital stock of Gristede's Foods NY, Inc. The loan had a balance of $4,172,122 at May 30, 2004.

On February 6, 1998, the Company agreed to purchase substantially all of the assets and assumed certain of the liabilities of a supermarket located at 1644 York Avenue, New York City, that was owned by a corporation controlled by John Catsimatidis. On March 1, 2000 the Company and the affiliate determined to restructure the transaction by rescinding the purchase effective as of February 6, 1998, and entered into an operating agreement which gives the Company full control of th.e supermarket and the right to operate the supermarket for the account of the Company. The operating agreement presently terminates on December 1, 2004, but the term shall be extended for additional one year periods unless either party gives notice of termination not later than 90 days prior to the end of the then current term of the agreement. Under the operating agreement, the Company shall pay to the affiliate $1.00 per annum, plus such other consideration as may be approved by the Company's directors (excluding John Catsimatidis). Pursuant to the operating agreement the Company or any designee of the Company, also has the option until December 31, 2005 to purchase the supermarket for $2,778,000, which price is the fair market price of the supermarket established on October 11, 1999 by the Company's directors (excluding John Catsimatidis).

In May 2000, another affiliate and the Company entered into a similar operating agreement for a store owned by the affiliate. As consideration, the affiliate receives the nominal amount of $1 per annum, plus such other consideration as may be approved by the Company's directors (excluding John Catsimatidis). The operating agreement presently terminates on May 10, 2005, but the term shall be extended for additional one year periods unless either party gives notice of termination not later than 90 days prior to the end of the then current term of the agreement. Pursuant to the operating agreement, the Company, or any designee of the Company, also has the option until December 31, 2005 to purchase the supermarket for the fair market price of the supermarket as established by the

Company's directors (excluding John Catsimatidis) using a valuation criterion similar to that issued for valuing the store at 1644 York Avenue, New York City. It is management's opinion that the fair market value of this store was approximately $3 million as of May, 2000.

The affiliates' intention in entering into these two operating agreements where the Company enjoys full benefits of ownership for the nominal consideration of $1 per annum per store was to effect post closing adjustments in connection with the Food Group acquisition. If the option to purchase the supermarkets is exercised, the excess of the purchase price over the net book value of the assets will be reflected as a charge to equity.

The Company uses the services of an affiliate Red Apple Medical, a corporation wholly-owned by John Catsimatidis, as an agent for self-insurance purposes. All employee medical claims are submitted to a third party administrator who processes claims to be remitted through a controlled account. Such amounts are reimbursed by the Company to the agent. No fees have been paid to this entity for fiscal year 2004 to date.

3. IMPACT OF NORTHEAST BLACKOUT OF AUGUST 14-15, 2003

The Company suffered significant losses of perishable inventory during the "Northeast blackout" of August 14-15, 2003. To a lesser extent, there were also property repair and damage losses, and related expenses. The Company's inventory is insured for its retail selling price, and property is insured for its new replacement cost. The Company has filed claims for these losses and related expenses with its insurance carriers and expects to recover at least approximately $5.8 million. The minimum claim for associated inventory costs and related expenses is approximately $4 million, resulting in a minimum expected net insurance gain of approximately $1.9 million, which is in lieu of filing separately for business

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interruption insurance and other expenses related to stocking, restocking and other costs associated with the "blackout". Machinery and other property are insured for their replacement cost. The insurance gain was recorded in the third quarter ended August 31, 2003, without separately accounting for the costs that go against such gain. The insurance carriers have acknowledged that the Company's losses are covered under its policy and have advanced the Company $3 million against its insured claim, including $2 million received subsequent to the quarter ended May 30, 2004. The Company is expecting final settlement of its claim during fiscal 2004.

4. RECENT ACCOUNTING PRONOUNCEMENTS

On January 17, 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"). FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after March 15, 2004.

In December 2003, the FASB issued a revision to Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No.

51"(FIN 46R or the "Interpretation"). FIN 46R clarifies the application of ARB No. 51, "Consolidated Financial Statements," to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. FIN 46R requires the consolidation of these entities, known as variable interest entities ("VIEs"), by the primary beneficiary of the entity. The primary beneficiary is the entity, if any, that will absorb a majority of the entity's expected losses, receives a majority of the entity's expected residual returns, or both

Among other changes, the revisions of FIN 46R: (1) clarified some requirements of the original FIN 46, which had been issued in January 2003, (2) eased some implementation problems, and (3) added new scope exceptions. FIN 46R deferred the effective date of the Interpretation for public companies, to the end of the first reporting period ending after March 15, 2004, except that all public companies must at a minimum apply the provisions of the Interpretation to entities that were previously considered "special-purpose entities" under the FASB literature prior to the issuance of FIN 46R by the end of the first reporting period ending after December 15, 2003. The adoption of FIN 46R did not have a material effect on the Company's financial position, cash flows or results of operations.

In November 2003, the EITF reached a consensus on EITF No. 03-10, "Application of Issue No. 02-16 by Resellers to Sales Incentives Offered to Consumers by Manufacturers." EITF No. 03-10 addresses the accounting for manufacturer sales incentives offered directly to consumers, including manufacturer coupons. The consensus applies to new arrangements, including modifications to existing arrangements, entered into in fiscal periods beginning after November 25, 2003. The adoption of EITF No. 03-10 did not have any effect on the Company's financial statements, as reimbursements received from manufacturers for sales incentives are shown as a reduction in cost of sales.

5. ACCOUNTING FOR STOCK-BASED COMPENSATION

The Company complies with Statement of Financial Accounting Standards No. 123 "Accounting for Stock-Based Compensation" ("SFAS No. 123"). This statement defines a fair value based method whereby compensation cost is measured at the grant date based on the fair value of the award and is recognized over the service period, which is usually the vesting period. Under SFAS No. 123, companies are encouraged, but are not required, to adopt the fair value method of accounting for employee stock-based transactions. The Company accounts for such transactions under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, but discloses pro forma net income (loss) as if the Company had applied the SFAS No. 123 method of accounting.

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Pro forma information, assuming the Company had accounted for its employee stock options granted under the fair value method prescribed by SFAS No. 123, as amended by Financial Accounting Standards Board Statement No. 148, "Accounting for Stock Based Compensation - Transition and Disclosure, an Amendment of FASB Statement No. 123" is presented below. The fair value of each option grant is estimated on the date of each grant using the Black-Scholes option-pricing model. There were no stock options granted in the 13 weeks ended May 30, 2004 and June 1, 2003, respectively. The fair value generated by the Black-Scholes model may not be indicative of the future benefit, if any, that may be received by the option holder.

	26 Weeks Ended ($000s)		13 Weeks
	5/30/04	6/1/03	5/30/04
Net loss:	$ (1,592)	$ (2,297)	$ (1,340
Less: stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	--	3	--
Pro forma net loss	$ (1,592)	$ (2,300)	$ (1,340
Loss per share:			
Basic, as reported	$ (.08)	$ (0.12)	$ (.07
Basic, pro forma	$ (.08)	$ (0.12)	$ (.07
Diluted, as reported	$ (.08)	$ (0.12)	$ (.07
Diluted, pro forma	$ (.08)	$ (0.12)	$ (.07

This pro forma information may not be representative of the amounts to expected in future years as the fair value method of accounting prescribed by SFAS No. 123 has not been applied to options granted prior to fiscal 1996.

6. Going Private Transaction

On April 13, 2004, the Company announced that it had received a letter from John Catsimatidis, the holder with certain of his affiliates, of in excess of 90% of the outstanding shares of common stock of the Company, stating his intention to cash out the public stockholders of the Company, at $0.87 per share, via a short form merger pursuant to Section 253 of the General Corporation Law of the State of Delaware.

On April 14, 2003, the Board of Directors of the Company (John Catsimatidis abstaining), at a telephonic meeting, appointed a special committee of independent directors to (i) evaluate the offer, and (ii) determine its fairness from a financial point of view to the public shareholders of the Company.

The special committee has engaged a financial advisor to evaluate the fairness of the offer and to deliver an opinion to the special committee as to the fairness, from a financial point of view to the Company's public shareholders, of the consideration to be received in connection with the proposed merger. The financial advisor has completed its review and is in the process of finalizing its evaluation and opinion.

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GRISTEDE'S FOODS, INC. AND SUBSIDIARIES

PART I

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-looking information:

This report and documents incorporated by reference contain both historical and "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as

"anticipates", "believes", "expects", "intends", "future", and similar expressions identify forward-looking statements. Any such "forward-looking" statements in this report reflect the Company's current views with respect to future events and financial performance, and are subject to a variety of factors that could cause the actual results or performance to differ materially from historical results or from the anticipated results or performance expressed or implied by such forward-looking statements. Because of such factors, there can be no assurance that the actual results or developments anticipated by the Company will be realized or, even if substantially realized, that they will have the anticipated results. The risks and uncertainties that may affect the Company's business include, but are not limited to: economic conditions, governmental regulations, technological advances, pricing and competition, acceptance by the marketplace of new products, retention of key personnel, the sufficiency of financial resources to sustain and expand the Company's operations, and other factors described in this report and in prior filings with the Securities and Exchange Commission. Readers should not place undue reliance on such forward-looking statements, which speak only as of the date hereof, and should be aware that except as may be otherwise legally required of the Company, the Company undertakes no obligation to publicly revise any such forward-looking statements to reflect events or circumstances that may arise after the date hereof. A more detailed description of some of the risk factors is set forth in the Company`s Annual Report on Form 10-K, dated November 30, 2003.

Critical Accounting Policies

Financial Reporting Release No. 60, which was recently released by the Securities and Exchange Commission, requires all companies to include a discussion of critical accounting policies or methods used in the preparation of financial statements. Note 1 of the Notes to the Consolidated Financial Statements includes a summary of the significant accounting policies and methods used in the preparation of our consolidated financial statements. The following is a brief discussion of the more significant accounting policies and methods used by the Company.

General

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. The most significant estimates and assumptions relate to the adequacy of allowances for doubtful accounts, fixed assets and other intangibles, inventories, realization of deferred income taxes and the recoverability of internally developed software costs. Actual amounts could differ significantly from these estimates.

Accounts Receivable

We continuously monitor collections and payments from our customers, third party and vendor receivables and maintain a provision for estimated credit losses based upon our historical experience and any specific collection issues that we have identified. While such credit losses have historically been within our expectations and the provisions established, we cannot guarantee that we will continue to experience the same credit loss rates that we have in the past.

Inventories

We value our inventory at the lower of cost or market with cost determined under the retail method. We regularly review inventory quantities on hand and record a provision for excess and obsolete inventory where appropriate based primarily on our historical shrink and spoilage rates.

Intangibles and Other Long-Lived Assets

Property, plant and equipment, intangible and certain other long-lived assets are amortized over their useful lives. Useful lives are based on management's estimates of the period that the assets will generate revenue. Intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

Accrued Self-Insurance

Insurance expense for employee-related health care benefits are estimated using historical experience.

RESULTS OF OPERATIONS

The following table sets forth, as a percentage of sales, components of our Results of Operations:

	26 weeks ended 5/30/04	26 weeks ended 6/1/03	13 weeks ended 5/30/04
Sales	100.0	100.0	100.0
Cost of sales	58.6	60.1	59.2
Gross profit	41.4	39.9	40.8
Store operating, general and administrative expenses	34.1	33.2	34.5
Pre-store opening startup costs	0.0	0.3	0.1
Depreciation and amortization	3.5	3.3	3.7
Insurance and grant proceeds	-0.1	-0.3	-0.1
Non-store operating expense	3.9	3.9	4.0
Operating loss	-0.2	-0.5	-1.3
Other income (expense)	-1.0	-1.1	-0.8
Loss from operations before income taxes	-1.2	-1.6	-2.1
Provisions for income taxes	--	--	--
Net loss	-1.2	-1.6	-2.1

Percentage of individual line items (as a percent of sales) have been rounded to the nearest tenth of a percent, and therefore, the totals may not add to 100%.

Sales were $134,995,099 and $65,156,917 for the 26 weeks and for the 13 weeks ended May 30, 2004, respectively, as compared to sales of $145,586,712 and $70,991,953 for the 26 weeks and for the 13 weeks ended June 1, 2003, respectively. Same store sales declined 7.2% and 7.4% for the 26 weeks and 13 weeks ended May 30, 2004, compared to the 26 weeks and 13 weeks ended June 1, 2003. The decline in sales for the 2004 periods primarily resulted from a reduction in promotional pricing at the Company's recently opened seven new stores, and promotional pricing by an e-commerce supermarket competitor. Same store sales are calculated using stores that were open for business both in the current period and in the same period last year.

Gross profit was $55,829,403 or 41.4% and $26,560,413 or 40.8% of sales for the 26 weeks and 13 weeks ended May 30, 2004, respectively, as compared to $58,094,385 or 39.9% of sales and $28,944,048 or 40.8% of sales for the 26 weeks and 13 weeks ended June 1, 2003, respectively. The increase in gross profit percentage during the 26 week period ended May 30, 2004 was due to the ability of the Company to increase and maintain gross margins on the sale of its products, and reduced promotional pricing on the recently opened new stores.

Store operating, general and administrative expenses were $46,098,579 or 34.1% of sales and $22,458,083 or 34.5% of sales for the 26 weeks and 13 weeks ended May 30, 2004, respectively, as compared to $48,386,141 or 33.2% of sales and $24,065,494 or 33.9% of sales for the 26 weeks and 13 weeks ended June 1, 2003, respectively. Store operating, general and administrative expenses increased as a percentage of sales during the 2004 periods mainly due to occupancy costs of the newly opened stores, and higher real estate taxes.

Pre-store opening startup costs were $33,533 for the 26 weeks and 13 weeks ended May 30, 2004, respectively, as compared to $495,633 and $260,626 for the 26 weeks and 13 weeks ended June 1, 2003, respectively. There were no store remodelings or new stores opened during the 2004 periods versus 2 new store openings in each of the first two fiscal quarters of 2003. New stores have higher pre-store openings costs than remodeled stores.

Non-store operating expenses were $5,308,351 or 3.9% and $2,582,960 or 4.0% of sales for the 26 weeks and 13 weeks ended May 30, 2004, respectively, as compared to $5,642,601 or 3.9% of sales, and $2,884,867 or 4.1% of sales for the 26 weeks and 13 weeks ended June 1, 2003, respectively. Administrative payroll and fringes were 2.6% of sales for both the 26 weeks and 13 weeks ended May 30, 2004, respectively, as compared to 2.8% of sales and 2.9% of sales for the corresponding 2003 periods respectively. General office expenses were 1.0% of sales for both the 26 weeks and 13 weeks ended May 30, 2004, respectively, as compared to 0.8% for both the corresponding 2003 periods. Professional fees were 0.2% and 0.3% of sales for the 26 weeks and 13 weeks ended May 30, 2004, respectively, as compared to 0.2% for both the corresponding 2003 periods. Corporate expenses were 0.1% of sales for both the 2004 and 2003 periods.

Depreciation and amortization expense was $4,766,554 or 3.5% of sales and $2,387,947 or 4.0% of sales for the 26 weeks and 13 weeks ended May 30, 2004, respectively, as compared to $4,759,168 or 3.3% of sales and $2,379,142 or 3.4% of sales for the corresponding 2003 periods respectively. The increase in the 2004 periods was primarily a result of capital expenditures incurred in connection with recent new store openings and store renovations.

Interest expense was $1,424,919 or 1.1% of sales and $647,990 or 1.0% of sales for the 26 weeks and 13 weeks ended May 30, 2004, respectively, as compared to $1,610,435 and $767,786, in both cases 1.1% of sales for the corresponding 2003

periods respectively. The primary reason for the lower interest expense in the 2004 periods was owing to lower average levels of bank debt and capitalized leases.

As a result of the items reviewed above, the net loss was ($1,591,866) and ($1,340,294) for the 26 weeks and 13 weeks ended May 30, 2004, respectively, as compared to a net loss of ($2,297,245) and ($912,756) for the 26 weeks and 13 weeks ended June 1, 2003, respectively.

Owing to a reduction in promotional pricing at the Company's recently opened stores (seven stores were opened during the period commencing the 4th quarter of fiscal 2002 through the 2nd quarter of fiscal 2003), such stores had a smaller aggregate negative impact on earnings and EBITDA for the six months (26 weeks) ended May 30, 2004. Newly opened

stores negatively impact earnings and EBITDA in their initial start-up phase through a combination of higher labor costs, promotional pricing reductions of gross margins, and higher advertising, depreciation, interest and rent expense.

The Company uses the term "EBITDA" to mean net income before income taxes, interest expense, depreciation, amortization, and changes in deferred rent and other non-cash charges. EBITDA is a term not defined under United States generally accepted accounting principles. The Company's management considers EBITDA to be an important measure in evaluating the Company's financial performance and uses this measure in managing its ongoing operations. The Company's method of computation of EBITDA may or may not be comparable to other similarly titled measures used by other companies. (See reconciliation of EBITDA to net income in the table set forth below).

During the six months (26 weeks) ended May 30, 2004, the aggregate negative EBITDA impact of the recently opened seven new stores was approximately $700,000. The comparable aggregate negative EBITDA impact of these seven new stores for the entire fiscal year 2003 was approximately $3,600,000.

For the 26 weeks ended May 30, 2004, the Company's EBITDA was $4,921,934, representing a 6.4% increase over EBITDA of $4,625,272 for the comparable period last year.

Reconciliation of EBITDA to net loss:

	26 weeks ended May 30, 2004	26 weeks ended June 1, 2003
Net (loss)	($1,591,866)	($2,297,245)
Interest expense	1,424,919	1,610,435
Income tax expense	0	0
Depreciation, amortization & changes in deferred rent	5,088,881	5,312,082
EBITDA	$ 4,921,934	$ 4,625,272

Liquidity and Capital Resources

Liquidity:

The consolidated financial statements of the Company indicate that at May 30, 2004, current assets exceeded current liabilities by $3,589,509 and stockholders' equity was $1,409,384.

As further discussed in footnote 3 to the Notes to Consolidated Financial Statements herein ("Impact of Northeast Blackout of August 14-15, 2003), the Company has filed claims for losses incurred during the "blackout" and expects to recover at least approximately $5.8 million, against which claim it has already received $3 million. Pending final settlement of its insurance claim, United Acquisition Corp. ("UAC") , a corporation indirectly owned by John Catsimatidis, the majority shareholder, agreed to provide the Company with a $5 million liquidity credit facility available during fiscal 2004. As of May 30, 2004, UAC had advanced approximately $ 3.25 million to the Company under this credit facility. The credit facility has no stated maturity date and does not presently bear interest.

Management believes that cash flows generated from operations, supplemented by financing from its bank facility, third party leasing companies and/or additional financing from the Company's majority shareholder, will be sufficient to pay the Company's debts as they may come due, provide for its capital expenditure program and meet its other cash requirements.

Debt and Debt Service:

In May, 2004, the Company's credit agreement with a group of banks was amended and increased to a total $27,500,000 facility, and certain covenants were amended. The amendment was effective as of February 28, 2004. The revolving line of credit was increased from $17,000,000 to $19,500,000, and its maturity extended from March 31, 2005 to March 31, 2007. The term loan in the aggregate principal amount of $8,000,000 had its maturity extended from December 3, 2006 to March 1, 2007, and its amortization amended as follows: (i) monthly payments of $97,500 due June 1, 2004 - September 1, 2004, (ii) $5,000,000 due October 1, 2004, and (iii) monthly payments of $90,000 due November 1, 2004 - March 1, 2007. Additionally, if the Company receives final proceeds from its insurance claim related to the August 14, 2003 Northeast "blackout" prior to October 1, 2004, 50% of such proceeds must be applied to reduce the October 1, 2004 scheduled term loan amortization, and the remaining 50% must be applied to reduce outstandings under the revolving line of credit.

Borrowings under our credit facility bear interest at a spread over either the prime rate of the bank acting as agent for the group of banks or a LIBOR rate, with the spread dependent on our leverage ratio, as defined in our credit facility. The average interest rate on amounts outstanding under our credit facility during the 13 weeks ended May 30, 2004 was 4.34% per annum.

Our credit facility contains covenants, representations and events of default typical of credit agreements, including financial covenants which require us to meet, among other things, a minimum tangible net worth and fixed charge coverage ratio, and which limit transactions with affiliates. Our credit facility is secured by equipment, inventories and accounts receivable.

The Company's majority shareholder, through affiliates, has contributed $26,177,666 through May 30, 2004, in the form of unsecured non-interest bearing loans, of which $23,500,000 is subordinated to the Company's banks. The liability presently does not bear interest. However, the Company's credit agreement with its banks permits the Company to pay interest on such

subordinated debt provided the Company has a positive net income.

Capital Expenditures:

Capital expenditures (including property acquired under capital leases) were $3.6 million for the 26 weeks ended May 30, 2004, as compared to $7.1 million for the 26 weeks ended June 1, 2003.

We have not incurred any material commitments for capital expenditures, although we anticipate spending approximately $4 - 5 million, inclusive of new capital leases, on store remodeling in fiscal 2004. Such amount is subject to adjustment based on the availability of funds.

Cash Flow:

Cash provided by operating activities amounted to $2.4 million for the 26 weeks ended May 30, 2004 as compared to $3.1 million for the 26 weeks ended June 1, 2003. The change in cash flow from operating activities was primarily due to the changes in inventories, receivables, and vendor trade payable. Net cash used for investing activities was $2.4 million in the 2004 period as compared to $4.4 million in the 2003 period, as there were no new stores opened in the 2004 period. Net cash provided by financing activities was $0.1 million for the 2004 period as compared to $1.4 million for the 2003 period, reflecting the additional proceeds provided by an affiliate, offset by repayments of bank loans and capital leases.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Market risk represents the risk of loss that may impact the consolidated financial position, results of operations or cash flow of the Company due to adverse changes in financing rates. The Company is exposed to market risk in the area of interest rates. This exposure is directly related to its term loan and borrowing activities under the working capital facility. The Company does not currently maintain any interest rate hedging arrangements due to the reasonable risk that near-term interest rates will not rise significantly. The Company is continuously evaluating this risk and will consider implementing interest rate hedging arrangements when deemed appropriate.

ITEM 4. CONTROLS AND PROCEDURES

(a) Based on an evaluation by management of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended) as of the end of the fiscal quarter ended May 30, 2004 (the "Evaluation Date"), each of John Catsimatidis, Chairman and Chief Executive Officer of the Company, Kishore Lall, Executive Vice President and Chief Financial Officer of the Company and Mark S. Kassner, Senior Vice President of Finance and Chief Accounting Officer of the Company, have concluded that the Company's disclosure controls and procedures were effective as of the Evaluation Date.

Notwithstanding the foregoing, a control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that it will detect or uncover failures within the Company to disclose material information otherwise required to be set forth in the Company's periodic reports.

(b) There have not been any significant changes in the Company's internal controls over financial reporting that occurred during the Company's fiscal quarter ended May 30, 2004 that has materially affected, or is reasonably likely

to materially affect, the Company's internal controls over financial reporting.

GRISTEDE'S FOODS INC. AND SUBSIDIARIES

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

None

Item 2. Change in Securities And Use of Proceeds and Issuer Purchase of Equity Securities

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits and Reports on Form 8-K

* Exhibit 10.14 Amended and Restated Loan Agreement dated as of May 5, 2004, between the Company and Citibank, N.A., Israel Discount Bank of New York, and Bank Leumi USA.

* Exhibit 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

* Exhibit 31.2 Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

* Exhibit 31.3 Certification of the Chief Accounting Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

* Exhibit 32.1 Certifications of Chief Executive Officer, Chief Financial Officer and Chief Accounting Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Exhibit 99.1 Press Release of Gristede's Foods, Inc., dated July 19, 2004, announcing delay in filing this Form 10-Q.

* Exhibit 99.2 Press Release of Gristede's Foods, Inc., dated August 18, 2004, announcing the appointment of new Senior Vice President of Finance and Chief Accounting Officer.

* Exhibit 99.3 Press Release of Gristede's Foods, Inc., dated August 27, 2004, reporting results of operations for the period ended May 30, 2004.

* Filed herewith

(a) Reports on Form 8-K

None

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.

Gristede's Foods, Inc.

By: /s/ John A. Catsimatidis
John A. Catsimatidis
Chairman of the Board and
Chief Executive Officer

Dated: August 27, 2004

By: /s/ Kishore Lall
Kishore Lall
Executive Vice President and
Chief Financial Officer

Dated: August 27, 2004

By: /s/ Mark S. Kassner
Mark S. Kassner
Senior Vice President of Finance and
Chief Accounting Officer

Dated: August 27, 2004