LEE SARA CORP
Form 10-Q
May 12, 2003
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 29, 2003

OR

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

Commission file number 1-3344

Sara Lee Corporation

(Exact name of registrant as specified in its charter)

Maryland	36-2089049
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

Three First National Plaza, Suite 4600, Chicago, Illinois 60602-4260

(Address of principal executive offices)

(Zip Code)

(312) 726-2600

(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 ¨

On March 29, 2003, the Registrant had 777,143,917 outstanding shares of common stock $.01 par value, which is the Registrant s only class of common stock.

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PART I

SARA LEE CORPORATION AND SUBSIDIARIES

Preface

The consolidated financial statements for the thirteen and thirty-nine weeks ended March 29, 2003 and March 30, 2002 and the balance sheet as of March 29, 2003 included herein have not been audited by independent public accountants, but in the opinion of Sara Lee Corporation (the Corporation), all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position at March 29, 2003 and the results of operations and the cash flows for the periods presented herein have been made. The condensed consolidated balance sheet as of June 29, 2002 and the consolidated statements of common stockholders equity for the period June 30, 2001 to June 29, 2002 have been derived from the Corporation s audited financial statements included in our annual report on Form 10-K for the year ended June 29, 2002. The results of operations for the thirteen and thirty-nine weeks ended March 29, 2003 are not necessarily indicative of the operating results to be expected for the full fiscal year.

The consolidated financial statements included herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Although the Corporation believes the disclosures made are adequate to make the information presented not misleading, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such regulations. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Corporation s Form 10-K for the year ended June 29, 2002 and other financial information filed with the Securities and Exchange Commission.

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SARA LEE CORPORATION AND SUBSIDIARIES

Condensed Consolidated Balance Sheets at March 29, 2003 and June 29, 2002

(In millions)

	(Unaudited) March 29, 2003	June 29, 2002
ASSETS		
Cash and equivalents	$ 257	$ 298
Trade accounts receivable, less allowances	1,806	1,831
Inventories:		
Finished goods	1,757	1,619
Work in process	378	411
Materials and supplies	505	479
	2,640	2,509
Other current assets	327	341
Assets held for sale		7
Total current assets	5,030	4,986
Other non-current assets	242	192
Property, net	3,230	3,155
Trademarks and other identifiable intangibles, net	2,092	2,106
Goodwill	3,340	3,314
	$ 13,934	$ 13,753
LIABILITIES AND STOCKHOLDERS EQUITY		
Notes payable	$ 471	$ 468
Accounts payable	1,142	1,321
Accrued liabilities	2,851	2,953
Current maturities of long-term debt	1,136	721
Total current liabilities	5,600	5,463
Long-term debt	3,999	4,326
Deferred income taxes	530	534
Other non-current liabilities	1,129	1,038
Minority interests in subsidiaries	379	632
ESOP convertible preferred stock	221	226
Unearned deferred compensation	(205)	(208)
Common stockholders equity	2,281	1,742
	$ 13,934	$ 13,753

See accompanying Notes to Consolidated Financial Statements.

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SARA LEE CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income

For the Thirteen and Thirty-Nine Weeks Ended March 29, 2003 and March 30, 2002

(In millions, except per share data)

Unaudited

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	March 29, 2003	March 30, 2002	March 29, 2003	March 30, 2002
Net sales	$ 4,350	$ 4,200	$ 13,660	$ 13,133
Cost of sales	2,604	2,576	8,230	8,184
Cost of sales product line exit costs		(3)		(7)
Selling, general and administrative expenses	1,370	1,271	4,170	3,849
(Income from) charges for exit activities and business dispositions	(1)	(2)	(13)	190
Interest expense	70	70	205	224
Interest income	(21)	(19)	(58)	(62)
	4,022	3,893	12,534	12,378
Income before income taxes	328	307	1,126	755
Income taxes	59	50	201	96
Net income	269	257	925	659
Preferred stock dividends, net of tax	3	3	8	8
Income available for common stockholders	$ 266	$ 254	$ 917	$ 651
Net income per common share				
Basic	$ 0.34	$ 0.32	$ 1.17	$ 0.83
Diluted	$ 0.33	$ 0.31	$ 1.13	$ 0.80
Average shares outstanding				
Basic	781	786	782	784
Diluted	813	819	814	818
Cash dividends per common share	$ 0.155	$ 0.150	$ 0.460	$ 0.445

See accompanying Notes to Consolidated Financial Statements.

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SARA LEE CORPORATION AND SUBSIDIARIES

Consolidated Statements of Common Stockholders Equity

For the Period June 30, 2001 to March 29, 2003

(In millions, except per share data)

	TOTAL	COMMON STOCK	CAPITAL SURPLUS	RETAINED EARNINGS	UNEARNED STOCK	ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)	COMPREHENSIVE INCOME
Balances at June 30, 2001	$ 1,122	$ 8	$	$ 2,635	$	$ (1,521)	
Net income	659			659			$ 659
Translation adjustments, net of tax	6					6	6
Net unrealized gain on qualifying cash flow hedges	(5)					(5)	(5)
Comprehensive income							$ 660
Cash dividends							
Common ($0.445 per share)	(349)			(349)			
ESOP convertible preferred ($4.08 per share)	(13)			(13)			
Stock issuances (cancelations)							
Stock option and benefit plans	75		75				
Business acquisitions	(1)		(1)				
Restricted stock	5		5				
Tax benefit related to stock-based compensation	5		5				
Reacquired shares repurchases	(85)		(85)				
Acquisition of Earthgrains ESOP			30		(30)		
Earthgrains stock option conversion	26		26				
ESOP tax benefit, redemptions and other	21		11	5	5		
Balances at March 30, 2002	1,466	8	66	2,937	(25)	(1,520)	
Net income	351			351			$ 351
Translation adjustments, net of tax	110					110	110
Minimum pension liability, net of tax	(56)					(56)	(56)
Net unrealized loss on qualifying cash flow hedges, net of tax	(4)					(4)	(4)

Comprehensive income							$ 401
Cash dividends							
Common ($0.15 per share)	(118)			(118)			
ESOP convertible preferred ($1.36 per share)	(4)			(4)			
Stock issuances (cancelations)							
Stock option and benefit plans	34		34				
Business acquisitions	1		1				
Restricted stock							
Tax benefit related to stock-based compensation	8		8				
Reacquired shares repurchases	(53)		(53)				
ESOP tax benefit, redemptions and other	7		3	2	2		
Balances at June 29, 2002	1,742	8	59	3,168	(23)	(1,470)	
Net income	925			925			$ 925
Translation adjustments, net of tax	132					132	132
Net unrealized gain on qualifying cash flow hedges, net of tax	13					13	13
Comprehensive income							$ 1,070
Cash dividends							
Common ($0.46 per share)	(359)			(359)			
ESOP convertible preferred ($4.08 per share)	(12)			(12)			
Stock issuances (cancelations)							
Stock option and benefit plans	86		86				
Restricted stock	13		13				
Tax benefit related to stock-based compensation	6		6				
Reacquired shares repurchases	(283)		(172)	(111)			
ESOP tax benefit, redemptions and other	18		8	3	7		
Balances at March 29, 2002	$ 2,281	$ 8	$	$ 3,614	$ (16)	$ (1,325)	

Interim period balances are unaudited.

See accompanying Notes to Consolidated Financial Statements.

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SARA LEE CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows

For the Thirty-Nine Weeks Ended March 29, 2003 and March 30, 2002

(In millions)

Unaudited

	Thirty-Nine Weeks Ended	
	March 29, 2003	March 30, 2002
OPERATING ACTIVITIES		
Net income	$ 925	$ 659
Adjustments for non-cash charges included in net income:		
Depreciation	384	350
Amortization of intangibles	96	73
Increase (decrease) in deferred income taxes	74	(28)
Other	53	10
(Income) charges for exit activities and business dispositions	(12)	111
Changes in current assets and liabilities, excluding businesses acquired and sold	(257)	(245)
Net cash from operating activities	1,263	930
INVESTMENT ACTIVITIES		
Purchases of property and equipment	(476)	(394)
Acquisitions of businesses and investments	(10)	(1,922)
Dispositions of businesses and investments		23
Sales of assets	53	85
Other	(2)	(26)
Net cash used in investment activities	(435)	(2,234)
FINANCING ACTIVITIES		
Issuances of common stock	86	75
Purchases of common stock	(283)	(85)
Redemption of preferred stock	(250)	
Borrowings of long-term debt	751	1,355
Repayments of long-term debt	(810)	(476)
Short-term (repayments) borrowings, net	1	908
Payments of dividends	(372)	(362)
Net cash (used in) from financing activities	(877)	1,415
Effect of changes in foreign exchange rates on cash	8	2

(Decrease) increase in cash and equivalents	(41)	113
Cash and equivalents at beginning of year	298	548
Cash and equivalents at end of quarter	$ 257	$ 661
COMPONENTS OF CHANGES IN CURRENT ASSETS AND LIABILITIES:		
Decrease in trade accounts receivable	$ 113	$ 2
(Increase) decrease in inventories	(45)	221
Decrease in other current assets	37	31
(Decrease) in accounts payable	(232)	(493)
(Decrease) in accrued liabilities	(130)	(6)
Changes in current assets and liabilities	$ (257)	$ (245)

See accompanying Notes to Consolidated Financial Statements.

SARA LEE CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

1. Net Income Per Share

Net income per share basic is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Net income per share diluted reflects the potential dilution that could occur if options or other contracts to issue common stock were exercised or converted into common stock. For both the thirteen and thirty-nine week periods ended March 29, 2003, options to purchase 54.0 million shares of the Corporation s common stock had exercise prices which were greater than the average market price of those shares during the respective reporting periods. For both the thirteen and thirty-nine week periods ended March 30, 2002, options to purchase 42.7 million shares of the Corporation s common stock had exercise prices which were greater than the average market price of those shares during the respective reporting periods.

The following is a reconciliation of net income to net income per share basic and diluted for the thirteen and thirty-nine weeks ended March 29, 2003 and March 30, 2002:

Computation of Net Income per Common Share

(In millions, except per share data)

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	March 29, 2003	March 30, 2002	March 29, 2003	March 30, 2002
Net income	$ 269	$ 257	$ 925	$ 659
Less dividends on preferred stock, net of tax benefit	(3)	(3)	(8)	(8)
Income available to common stockholders basic	266	254	917	651
Adjustment for assumed conversion of ESOP shares	3	3	7	7
Income available to common stockholders diluted	$ 269	$ 257	$ 924	$ 658
Average shares outstanding basic	781	786	782	784
Dilutive effect of stock option and award plans	8	8	8	9
Dilutive effect of ESOP plan	24	25	24	25
Average shares outstanding diluted	813	819	814	818

Net Income Per Common Share Basic	$ 0.34	$ 0.32	$ 1.17	$ 0.83
Net Income Per Common Share Diluted	$ 0.33	$ 0.31	$ 1.13	$ 0.80

2. Stock-Based Compensation

In December 2002, the FASB issued Statement No. 148 that permits additional transition methods for entities that adopt the fair-value based method of accounting for stock-based employee compensation. For those companies that do not elect to change their method of accounting for stock-based employee compensation, Statement No. 148 requires increased disclosure of the pro forma impact of applying the fair value method to the reported operating results. The increased disclosure requirements apply to company s interim and annual financial statements beginning this quarter and are presented below. At the present time, the Corporation does not intend to transition to the use of a fair-value method of accounting for stock-based compensation.

Employee stock options are accounted for under the provisions of Accounting Principles Board (APB) No. 25, Accounting for Stock Issued to Employees . APB No. 25 requires the use of the intrinsic value method, which measures compensation cost as the excess, if any, of the quoted market price of the stock at grant over the amount an employee must pay to acquire the stock. The Corporation provides below the pro-forma disclosures of net earnings and earnings per share as if the fair-value based method of accounting had been applied as required by SFAS No. 123, Accounting for Stock-Based Compensation . The pro forma impact of utilizing the fair value method to account for stock-based employee compensation, on an annual basis, is presented in the Corporation s annual report to shareholders.

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	March 29, 2003	March 30, 2002	March 29, 2003	March 30, 2002
	(In millions)			
Reported net income	$ 269	$ 257	$ 925	$ 659
Plus Stock-based employee compensation included in reported net income, net of related tax effects	7	6	17	18
Less Total stock-based employee compensation expense determined under the fair-value method for all awards, net of related tax effects	(15)	(20)	(42)	(60)
Pro forma net income	$ 261	$ 243	$ 900	$ 617
Earnings per share:				
Basic as reported	$ 0.34	$ 0.32	$ 1.17	$ 0.83
Basic pro forma	$ 0.33	$ 0.31	$ 1.14	$ 0.78
Diluted as reported	$ 0.33	$ 0.31	$ 1.13	$ 0.80
Diluted pro forma	$ 0.32	$ 0.30	$ 1.11	$ 0.76

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3. Exit Activities and Business Dispositions

The reported results for the quarter and for the first nine months of fiscal 2003 reflect amounts recognized from various programs involving the exit of defined business activities and the disposition of certain businesses. The first of these programs is referred to as business reshaping and the second as bakery restructuring. The net pretax amounts recognized as a result of these programs in the income statement captions labeled (Income from) charges for exit activities and business dispositions and Cost of sales product line exit costs are summarized as follows:

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	March 29, 2003	March 30, 2002	March 29, 2003	March 30, 2002
	(in millions)			
Business reshaping:				
Exit activities	$	$ (5)	$ (30)	$ 177
Business dispositions	(1)		(5)	6
Bakery restructuring			22	
Total	$ (1)	$ (5)	$ (13)	$ 183
Amount recognized on Cost of sales product line exit costs	$	$ (3)	$	$ (7)
Amount recognized on (Income from) charges for exit activities and business dispositions	(1)	(2)	(13)	190
Total	$ (1)	$ (5)	$ (13)	$ 183

A more complete description of the actions taken under both of these programs is presented in the following section of this note:

Reshaping Program

In May 2000, a program to reshape the business activities of the Corporation was announced. In connection with this program, the Corporation s management approved a series of actions to exit certain defined business activities and dispose of a number of businesses. Each of these actions was to be completed within a 12-month period. Management approved these plans beginning in the second quarter of fiscal 2001, with the final series of actions approved during the second quarter of fiscal 2002. The actions approved in the reshaping program have essentially been completed. A discussion of the adjustments made during the third quarter of fiscal 2003 to the costs previously accrued for these plans, and the actions taken since the initiation of the Reshaping program, is as follows:

Fiscal 2003 Recognition of Exit Activities and Business Dispositions

During the third quarter of fiscal 2003, adjustments were made to previously accrued costs for certain exit activities and business dispositions. The net adjustment recognized in the quarter increased pretax income and net income by $1 million. There was no measurable effect on diluted earnings per share. The total pretax adjustment is reflected on the (Income from) charges for exit activities and business dispositions line of the Consolidated Statement of Income and includes a $2 million credit for employee termination benefits, a $1 million charge for the disposal of property and equipment and a $1 million charge for moving expenses related to employees affected by the Reshaping program. These adjustments resulted from settling obligations associated with the exit activities completed under the Reshaping program. Also included in the net adjustment is a $1 million credit associated with the disposition of a business, which resulted from the receipt of certain

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contingent sales proceeds. The effect of these adjustments has been recognized in the tables included within this note.

Including the effects of the third quarter, the cumulative adjustments made for the Reshaping program thus far during fiscal 2003 increased pretax income, net income and diluted earnings per share by $35 million, $26 million and $.03, respectively. The total pretax adjustment is reflected on the (Income from) charges for exit activities and business dispositions line of the Consolidated Statement of Income and consists of a $18 million credit for employee termination benefits, a $9 million credit for losses on the disposal of property and equipment, a $4 million credit for non-cancelable lease and other third party obligations, a $1 million charge for moving expenses and a $5 million credit on the loss previously recognized on the disposition of certain businesses. These adjustments increased the operating companies income of the Corporation s business segments as follows: Intimates and Underwear $24 million; Sara Lee Meats $7 million; and Sara Lee Bakery $4 million.

Status of Exit Plans and Business Dispositions

Combining the amounts recognized in fiscal 2001, fiscal 2002 and the first three quarters of fiscal 2003, the Corporation s ongoing Reshaping program has reduced pretax earnings and net income by $689 million and $575 million, respectively. Of the $689 million pretax charge, $3 million is for actions taken at the Corporate headquarters and $686 million is related to the following business segments: Intimates and Underwear $467 million; Sara Lee Bakery $105 million; Sara Lee Meats $96 million; Beverage $15 million; and Household Products $3 million. The components of the $689 million pretax charge are as follows:

Business Dispositions

$341 million of the charge represents the cost recognized in connection with the disposition of 18 businesses. As of March 29, 2003, the disposition of 17 of these businesses had been completed. The final business to be disposed is a small bakery operation in China that has been closed. The Corporation is currently in discussions to sell the company to its joint venture partner and expects to complete this transaction before the end of fiscal 2003. The carrying value of the net assets of this business is less than $1 million.

Exit of Defined Business Activities

$204 million of the cumulative charge is for the cost of severance and other employee benefits associated with the termination of 18,579 employees. The specific location of these employees is summarized in a table contained on page 12. All of these employees have been terminated and the remaining accrued liability is for severance benefits to be paid in future periods.

$54 million of the cumulative charge is for losses realized on the disposal of real estate and equipment at 17 owned facilities and the disposal of equipment at a number of leased facilities. The loss is primarily related to the exit of Intimates and Underwear manufacturing facilities in the United States, Mexico and Europe and 3 domestic meat processing plants. All of the owned facilities have been sold.

$61 million of the cumulative charge is related to certain contractual obligations that must be satisfied in connection with the exit activities approved by management. Of this amount, $52 million relates to non-cancelable lease payments on 35 leased facilities that have been exited. Of the $52 million charge, $39 million remains to be paid as of March 29, 2003, and represents the difference between the remaining non-cancelable lease obligation and the anticipated sublease income. Certain other contractual obligations account for the

remaining $9 million of the charge. These contractual obligations include amounts to terminate distribution and product licensing arrangements. Of the $9 million charge, $2 million remains to be paid as of March 29, 2003.

$19 million of the cumulative charge resulted from the decision to terminate product licensing agreements and exit related manufacturing operations. The $19 million charge was recorded in the Cost of sales product line exit costs line in the Consolidated Statement of Income and consisted of a $26 million charge in fiscal 2001 and a $7 million credit in fiscal 2002 from better than expected results on the disposition of inventory related to these licensing agreements. All of the inventory has been disposed. The loss recognized is the difference between the value of the inventory realized, based on the actual proceeds received, and the related carrying value.

$10 million of the cumulative charge relates to moving and other related expenses for employees affected by the Reshaping program. The Corporation recognized these expenses in the period the related service was rendered by third-party suppliers. Cash was expended to pay vendors in essentially the same period as the expense was recognized.

The following table summarizes the charges taken for the approved exit of business activities under the Reshaping program and the related status as of March 29, 2003:

	Exit Costs (Benefits) Recognized During			Writedown of Assets to Net Realizable Value	Cash Payments	Accrued Exit Costs as of March 29, 2003
	2003	2002	2001			
				(In millions)		
Employee termination and other benefits	$ (18)	$ 100	$ 122	$	$ (176)	$ 28
Expected losses on disposals of property and equipment and other related costs	(9)	26	37	(54)		
Other exit costs includes non-cancelable lease and other contractual obligations	(4)	40	25		(20)	41
Expected losses on disposal of inventories		(7)	26	(19)		
Moving and other related costs	1	6	3		(10)	
Total exit costs	$ (30)	$ 165	$ 213	$ (73)	$ (206)	$ 69

Of the $348 million cumulative charge, $275 million requires the use of cash and $73 million is a non-cash charge. Of the $275 million of cash costs, $206 million has previously been expended and $69 million of cash expenditures are to be made in the future. The Corporation expects to fund these future cash costs from internal sources.

The following table summarizes the employee terminations by location and business segment. All terminations were completed by the end of the second quarter of fiscal 2003.

	Sara Lee Meats	Sara Lee Bakery Group	Beverage	Household Products	Intimates and Underwear	Corporate	Total
United States	846	268			1,746	20	2,880
Canada					84		84
Puerto Rico, Mexico and Latin America	48				11,548		11,596
Europe	84	210	90		2,490		2,874
Asia and Africa		381		48	716		1,145
	978	859	90	48	16,584	20	18,579

Bakery Actions

During the second quarter of fiscal 2003, the Corporation s management approved a plan to reduce the cost structure of its Bakery business. This plan includes actions to sever 311 employees from the U.S. bakery business, exit leases and dispose of certain assets. The charge for these planned actions decreased pretax income, net income and diluted earnings per share for the year by $22 million, $14 million and $.02, respectively. The pretax charge of $22 million is reflected on the (Income from) charges for exit activities and business dispositions line of the