

# SECURITIES AND EXCHANGE COMMISSION

## FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

Filing Date: **1994-05-13** | Period of Report: **1994-03-31**  
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### FILER

#### **MORNINGSTAR GROUP INC**

CIK: **832768** | IRS No.: **752217488** | State of Incorporation: **DE** | Fiscal Year End: **1231**  
Type: **10-Q** | Act: **34** | File No.: **000-19934** | Film No.: **94527853**  
SIC: **2020** Dairy products

Mailing Address  
5956 SHERRY LN STE 1100  
DALLAS TX 75225

Business Address  
5956 SHERRY LN STE 1100  
DALLAS TX 75225  
2143604700

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 March 31, 1994

or

( ) Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the transition period from to

Commission file number 0-19075

THE MORNINGSTAR GROUP INC.

(Exact name of registrant as specified in its charter)

&lt;TABLE&gt;

<S>	DELAWARE (State or other jurisdiction of incorporation)	<C>	75-2217488 (I.R.S. Employer Identification No.)
	5956 SHERRY LANE, SUITE 1100 DALLAS, TEXAS (Address of principal executive offices)		75225-6522 (Zip Code)

&lt;/TABLE&gt;

Registrant's telephone number, including area code: (214) 360-4777

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 April 30, 1994, the number of shares outstanding of each class of common stock was:

Common Stock, \$.01 par value: 14,378,112 shares

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PART I  
FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS.

## THE MORNINGSTAR GROUP INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS  
(Dollars in thousands)

<TABLE>  
<CAPTION>

December 31, 1993	March 31, 1994
----------------------	-------------------

<u>ASSETS</u>	(Unaudited)
<S>	<C>
CURRENT ASSETS:	
Cash . . . . .	\$ 3,340      \$ 3,429
Receivables, net of allowance for doubtful accounts of \$974 and \$1,102 . .	26,762      27,226
Inventories . . . . .	11,527      11,549
Prepays and deposits . . . . .	9,519      5,991
Net assets of discontinued operations - current . . . . .	5,571      5,927
	-----
Total current assets . . . . .	56,719      54,122
PROPERTY, PLANT AND EQUIPMENT:	
Land . . . . .	6,062      6,062
Buildings . . . . .	16,463      17,710
Machinery and equipment . . . . .	29,334      30,252
	-----
Gross property, plant and equipment . . . . .	51,859      54,024
Less: Accumulated depreciation . . . . .	(9,749)      (10,758)
	-----
Net property, plant and equipment . . . . .	42,110      43,266
INTANGIBLE AND OTHER ASSETS:	
Identifiable intangible assets . . . . .	3,177      3,011
Goodwill . . . . .	71,829      71,021
Deferred financing costs . . . . .	2,705      2,587
Net assets of discontinued operations - noncurrent . . . . .	33,822      32,579
Other assets . . . . .	1,772      2,228
	-----
Total intangible and other assets . . . . .	113,305      111,426
	-----
TOTAL ASSETS . . . . .	\$ 212,134      \$ 208,814
	=====

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

THE MORNINGSTAR GROUP INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS  
(Dollars in thousands)

<TABLE>  
<CAPTION>

<S>	December 31, 1993	March 31, 1994
<C>	<C>	<C>
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
CURRENT LIABILITIES:		
Accounts payable . . . . .	\$ 17,850	\$ 19,006
Accrued liabilities . . . . .	17,663	18,108
Current portion of long-term debt . . . . .	14,750	15,000

Total current liabilities . . . . .	50,263	52,114
LONG-TERM DEBT (net of current maturities) . . . . .	105,425	97,608
OTHER LONG-TERM LIABILITIES . . . . .	1,913	1,744
STOCKHOLDERS' EQUITY AND RETAINED DEFICIT:		
Common stock, \$.01 par value, 50,000,000 shares authorized; 14,287,212 in 1993 and 14,376,312 in 1994 issued and outstanding . . . . .	143	144
Additional paid-in capital . . . . .	69,541	69,764
Retained deficit . . . . .	(15,151)	(12,560)
Total stockholders' equity and retained deficit . . . . .	54,533	57,348
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY . . . . .	\$ 212,134	\$ 208,814

</TABLE>

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

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THE MORNINGSTAR GROUP INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited, dollars in thousands, except per share amounts)

<TABLE>  
<CAPTION>

	Three Months Ended March 31,	
	1993	1994
<S>	<C>	<C>
NET SALES . . . . .	\$ 56,576	\$ 70,739
Cost of goods sold . . . . .	41,899	54,480
Selling, distribution, and general and administrative . . . . .	11,931	12,526
OPERATING INCOME . . . . .	2,746	3,733
OTHER (INCOME) AND EXPENSE:		
Interest expense . . . . .	1,148	1,230
Amortization of deferred financing cost . . . . .	106	95
Other income, net . . . . .	(174)	(245)
INCOME BEFORE INCOME TAXES . . . . .	1,666	2,653
Provision for income taxes . . . . .	649	889
INCOME FROM CONTINUING OPERATIONS . . . . .	1,017	1,764
DISCONTINUED OPERATIONS		
Income from discontinued operations, net of applicable tax provision of \$442 and \$456 . . . . .	932	907
Loss on disposal, net of applicable tax benefit of \$41 . . . . .	-	(80)
INCOME FROM DISCONTINUED OPERATIONS . . . . .	932	827
NET INCOME . . . . .	\$ 1,949	\$ 2,591
EARNINGS PER COMMON SHARE:		
Earnings from continuing operations . . . . .	\$ 0.07	\$ 0.12
Earnings from discontinued operations . . . . .	0.06	0.05

Earnings per common share . . . . .	\$ 0.13	\$ 0.17
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING . . . . .	15,074,868	14,905,068

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

THE MORNINGSTAR GROUP INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited, dollars in thousands)

<TABLE>  
<CAPTION>

	Three Months Ended March 31,	
	1993	1994
<S>	<C>	<C>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from customers . . . . .	\$ 58,145	\$ 71,315
Interest received . . . . .	9	1
Income tax refund . . . . .	6	-
Cash paid to suppliers and employees . . . . .	(53,965)	(60,412)
Interest paid . . . . .	(1,357)	(1,566)
Income taxes paid . . . . .	(3)	(184)
NET CASH PROVIDED BY CONTINUING OPERATIONS . . . . .	2,835	9,154
NET CASH PROVIDED (USED) BY DISCONTINUED OPERATIONS . . . . .	1,806	(182)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Sale (acquisition) of subsidiaries:		
Working capital . . . . .	(3,352)	857
Property, plant and equipment . . . . .	(12,843)	1,179
Other assets . . . . .	(15,552)	(4)
Liabilities related to acquisition . . . . .	2,956	-
Net cash provided (used) by sale (acquisition) of subsidiary . . . . .	(28,791)	2,032
Capital expenditures . . . . .	(1,037)	(2,158)
Proceeds from sale of fixed assets . . . . .	19	10
Other . . . . .	(155)	(423)
Net cash used by continuing operations . . . . .	(29,964)	(539)
Discontinued operations:		
Capital and other expenditures . . . . .	(340)	(468)
Proceeds from sale of fixed assets . . . . .	95	2
Net cash used by discontinued operations . . . . .	(245)	(466)
NET CASH USED BY INVESTING ACTIVITIES . . . . .	(30,209)	(1,005)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuing common stock . . . . .	-	224
Proceeds from issuance of long-term debt . . . . .	35,000	-
Net payments under revolving credit facility . . . . .	(6,021)	(4,067)
Payments on long-term debt . . . . .	(2,667)	(3,500)
Dividends paid . . . . .	(535)	(535)
NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES . . . . .	25,777	(7,878)

NET INCREASE IN CASH . . . . .	209	89
CASH, BEGINNING OF PERIOD . . . . .	3,849	3,340
	-----	-----
CASH, END OF PERIOD . . . . .	\$ 4,058	\$ 3,429
	=====	=====

</TABLE>

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

THE MORNINGSTAR GROUP INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS  
RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATIONS  
(Unaudited, dollars in thousands)

<TABLE>  
<CAPTION>

	Three Months Ended March 31,	
	1993	1994
	-----	-----
	<C>	<C>
NET INCOME . . . . .	\$ 1,949	\$ 2,591
ADJUSTMENTS TO RECONCILE NET INCOME TO NET CASH FLOW FROM OPERATIONS:		
Discontinued operations net income . . . . .	(932)	(827)
Depreciation . . . . .	873	1,034
Amortization of intangibles . . . . .	1,126	618
(Gain) loss on fixed asset retirements . . . . .	11	(240)
Increase in deferred taxes . . . . .	924	972
Change in assets and liabilities, net of effects from acquisition and disposition of subsidiaries:		
Accounts receivable . . . . .	1,241	(464)
Inventories . . . . .	(269)	(22)
Prepays and other . . . . .	(1,293)	3,528
Accounts payable . . . . .	(921)	1,156
Accrued liabilities . . . . .	342	976
Long-term liabilities . . . . .	(216)	(168)
	-----	-----
NET CASH PROVIDED BY CONTINUING OPERATIONS . . . . .	\$ 2,835	\$ 9,154
	=====	=====
DISCONTINUED OPERATIONS:		
Discontinued operations net income . . . . .	\$ 932	\$ 827
Increase in working capital . . . . .	(18)	(1,800)
Depreciation and amortization . . . . .	892	791
	-----	-----
NET CASH PROVIDED (USED) BY DISCONTINUED OPERATIONS . . . . .	\$ 1,806	\$ (182)
	=====	=====

</TABLE>

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

THE MORNINGSTAR GROUP INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
March 31, 1994

(1) CONSOLIDATED FINANCIAL STATEMENTS

The consolidated financial statements as of March 31, 1994, and for the three months then ended have been prepared by The Morningstar Group Inc. (the "Company" or "Morningstar") without audit. In the opinion of management, all necessary adjustments (which include only normal recurring adjustments) to present fairly, in all material respects, the consolidated financial position, results of operations and changes in cash flows at March 31, 1994 and for the three months then ended, have been made. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted. These financial statements should be read in conjunction with the Company's 1993 financial statements contained in its most recent Annual Report on Form 10-K.

On April 13, 1994, Morningstar completed the divestiture of its Florida-based fluid milk operation Velda Farms Inc. ("Velda") to Engles Dairy Acquisition L.P. ("Purchaser") at an approximate selling price of \$48 million consisting of \$45 million of cash and \$3 million of 9% Series A Preferred Stock. The sale of Velda completes the Company's divestiture of its regional dairies. These operations have been treated as discontinued operations, and previously published financial statements have been restated to conform with this presentation.

On March 31, 1993, the Company acquired Favorite Foods Inc., ("Favorite") a subsidiary of Nestle USA, Inc., for approximately \$28 million plus expenses. Favorite, headquartered in Fullerton, California, is a processor of cultured and ultrapasteurized products. The Company amended its senior credit agreement to increase the term loan and borrowed funds thereunder to complete this purchase.

(2) INVENTORIES

Inventories are valued at the lower of cost or market. Cost is determined using the first-in, first-out method. Inventories are summarized as follows (in thousands):

<TABLE>  
<CAPTION>

	At December 31, 1993	At March 31, 1994
	-----	-----
<S>	<C>	<C>
Raw materials and supplies . . . . .	\$ 7,871	\$ 6,886
Finished goods . . . . .	3,656	4,663
	-----	-----
Total . . . . .	\$ 11,527	\$ 11,549
	=====	=====

</TABLE>

Finished goods inventories include the costs of materials, labor and plant overhead.

(3) DEBT

The Company's outstanding long-term debt and average interest rates in effect on March 31, 1994 were:

<TABLE>  
<CAPTION>

	Amount of Debt	Average Interest Rate
	(in thousands)	
<S>	<C>	<C>
Senior term loan . . . . .	\$ 97,000	5.667%
Revolving credit facility (a) . . . . .	12,608	5.684%
Industrial development revenue bonds . . . . .	3,000	2.950%
	-----	
Total . . . . .	112,608	
Less: Current maturities . . . . .	15,000	
	-----	
Long-term debt, net of current maturities . . . . .	\$ 97,608	
	=====	

</TABLE>

(a) As of March 31, 1994, \$12,608,000 was borrowed under the revolving credit facility and letters of credit totalling \$5,216,090 were issued. At March 31, 1994, the Company had \$12,175,910 in additional borrowing capacity under the terms of its revolving credit facility.

(4) PRO FORMA RESULTS

The following unaudited pro forma information is presented to illustrate the estimated effects of: (i) the acquisition of Favorite and (ii) the divestiture of Velda as if both transactions had occurred on January 1, 1993 (in thousands):

<TABLE>  
<CAPTION>

	Three Months Ended March 31,	
	1993	1994
	-----	-----
<S>	<C>	<C>
Pro forma net sales . . . . .	\$ 67,763	\$ 70,739
Pro forma income from continuing operations . . . . .	\$ 1,075	\$ 1,764
	=====	=====
Pro forma shares outstanding . . . . .	15,074,868	14,905,068
Pro forma earnings per share from continuing operations . . . . .	\$ 0.07	\$ 0.12
	=====	=====

</TABLE>

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

Results of Operations - First Quarter 1994  
Compared with First Quarter 1993



Net sales are classified into two categories: (i) branded specialty products, which include historical sales of the Company's four national branded products -- International Delight(R) non-dairy coffee creamer, Second Nature(R) egg product, Lactaid(R) reduced lactose milk and Naturally Yours(R) no fat sour cream; and (ii) other specialty products, which includes all sales of the Company's specialty foods business other than branded specialty products.

Net sales for the first quarter of 1994 totalled \$70.7 million, an increase of \$14.2 million from net sales for the same period in 1993. The following table reflects net sales by business category from year to year (dollars in thousands):

Business Category	Three Months Ended March 31,	
	1993	1994
Branded specialty products . . . . .	\$ 19,251	\$ 23,861
Other specialty products . . . . .	37,325	46,878
Net Sales . . . . .	\$ 56,576	\$ 70,739

Net sales of branded specialty products increased by 24.0% for the first quarter of 1994 when compared to the same period of 1993. This improvement was accomplished through increased sales volume for all four branded products. Net sales of other specialty products increased by 25.6% during the first quarter when compared to 1993 primarily due to the acquisition of Favorite on March 31, 1993.

Gross margin was 23.0% for the first quarter of 1994 compared to 25.9% for the like period of 1993, due to a shift in branded products sales mix, increased branded trade promotions and competitive pricing activity in the other specialty products category.

Operating expenses as a percentage of net sales were 17.7% for the first quarter of 1994 compared to 21.1% for the same period of 1993. Distribution expenses as a percentage of sales increased slightly during the quarter due to a higher proportion of branded product sales in 1994 than 1993, which carry a slightly higher distribution expense related to a wider distribution area served. Selling expenses declined as a percentage of sales during the quarter primarily due to reduced introductory expenses for branded products. A slight increase in sales expense was incurred to absorb the increased specialty products sales provided by the Favorite acquisition. General and administrative expenses declined as a percentage of sales during the quarter as the result of reduced personnel costs and reduced amortization of intangibles.

The Company's operating income during the first quarter of 1994 was \$3.7 million, an increase of 35.9% from operating income for the first quarter of 1993 of approximately \$2.7 million. The increase in operating income was primarily due to the combination of increasing sales of branded products, which contribute higher operating margins and improved operating expenses and ratios.

For the first quarter, interest expense increased by 7.1% from \$1.1 million during 1993 to \$1.2 million during 1994. The increase resulted from higher debt levels and slightly higher average interest rates in 1994 on the Company's floating rate senior debt as compared with the first quarter of 1993.

The Company recorded income from continuing operations of \$1.8 million in the first quarter of 1994 compared to income from continuing operations of \$1.0 million in the same period last year. The improved profitability was primarily the result of higher sales and lower operating expense margins.

During the fourth quarter of 1993, the Company recorded a charge of \$9.0 million which included provisions for reductions in workforce, relocation of the manufacturing of certain product lines to gain operating efficiencies, and the abandonment of other product lines. The charge also included \$1.9 million representing the excess of the book value of operating assets sold in 1991 and 1992 over their estimated realizable value. Cash expenditures during the first quarter of 1994 related to this charge were approximately \$1.0 million, with an additional \$3.6 million expected in the remainder of 1994.

#### Liquidity and Capital Resources

Cash provided by continuing operations was \$9.2 million during the first three months of 1994 compared to cash provided by continuing operations of \$2.8 million during the first three months of 1993. The sources of cash during the first quarter of 1994 were the \$9.2 million provided by continuing operations, \$2.0 million from the sale of Morningstar's packaging operation, and \$.2 million from the exercise of stock options. These sources of cash were utilized to pay down debt of \$7.6 million, to provide for capital and other expenditures of \$3.0 million, to pay dividends of \$.5 million, to provide \$.2 million used by discontinued operations, and to provide for an increase in cash balances of \$.1 million.

Capital expenditures during the first quarter of 1994 were spent primarily on equipment additions for increased operating efficiencies. As of the end of the quarter of 1994, the Company was not in compliance with its fixed charge coverage ratio and has obtained a waiver of this covenant from its senior lenders. The Company was in compliance with all other covenants and financial ratios contained in its senior credit agreement.

At March 31, 1994 the Company had approximately \$12.2 million in unused borrowing capacity under its revolving credit facility. The Company expects that operating cash flows, together with borrowings under its revolving credit facility, will be sufficient to fund the Company's requirements for working capital and capital expenditures for the foreseeable future.

#### Financing

As of March 31, 1994, the Company's senior credit agreement consisted of a \$97.0 million term loan and a \$30.0 million revolving credit facility. As of March 31, 1994, approximately \$12.6 million was borrowed under the revolving credit facility and approximately \$5.2 million in letters of credit were outstanding.

On April 13, 1994, Morningstar completed the divestiture of Velda, its Florida-based fluid milk operation, to Engles Dairy Acquisition L.P. at an approximate selling price of \$48 million including \$3.0 million of 9% Series A Preferred Stock. After adjusting the selling price for increases in working capital, approximately \$46 million was received in cash. Following the application of the cash proceeds on April 13, 1994, the Company had no revolver balance outstanding and had a remaining term loan balance of approximately \$64.2 million. No further quarterly payments are required on the term loan until June 20, 1995. The remaining amortization schedule for the term loan is as follows:

<TABLE>  
<CAPTION>

Quarterly payment date(s) -----	Approximate Quarterly payment -----
<S>	<C>
June 20, 1995	\$ 3,306,000
September 20, 1995 - March 20, 1997	3,890,000
June 20, 1997 - December 20, 1998	4,731,000
March 20, 1999	505,000

</TABLE>

On June 20, 1994, the borrowing capacity available under the revolving credit facility will be reduced from a total of \$30 million to \$25 million.

PART II  
OTHER INFORMATION

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## 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.

THE MORNINGSTAR GROUP INC.

/s/ TRACY L. NOLL  
Tracy L. Noll  
Vice President and Chief Financial Officer  
(Authorized Officer and Principal Financial Officer)

Date: May 13, 1994

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