

Big K

Depot Food Stores

ETNA

The Pantry, Inc.

Express Stop

Food Chief

Handy Way

Kangaroo

Lil' Champ

**convenience** (kən vĕn'yəns), *n.* 1. anything that saves or simplifies work or adds to one's ease or comfort. 2. advantage or accommodation. — *adj.* 3. easy to obtain, use or reach.

Mini Mart

On The Way

The Pantry

Quick Stop

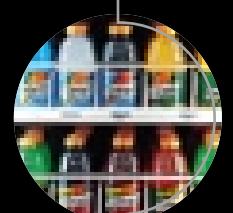
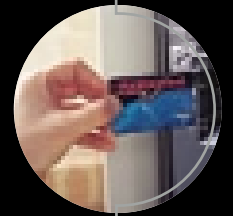
Sprint

Smokers Express

Wicker Mart

Zip Mart

STRENGTH THROUGH STRATEGIC ACQUISITIONS



ANNUAL REPORT 2000

## Region of Operations

*The Pantry, Inc. currently operates 1,313 stores throughout the Southeastern United States. However, as the Company continues to gain strength through strategic acquisitions, it will further extend its presence in principal markets and growing contiguous markets.*



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## strategic developments in 2000



The Pantry undertook an extensive capital expenditure program aimed at upgrading its store facilities and gasoline operations. The Company invested approximately \$24.5 million on these enhancements, which it views as integral to its ability to provide customers with the greatest convenience in its stores and at its pumps.



The Pantry focused on implementing strategic merchandising initiatives that would allow it to better serve its customers while also driving sales. In doing so, the Company closely monitored merchandise mix and inventory levels and focused on enhancing its promotional displays.



In fiscal 2000, The Pantry's ancillary services, which include ATMs, lottery, money orders, public phones and car washes, had a substantial impact on the bottom line as the Company continued to expand its service offerings in targeted locations throughout the Southeast.



Over the past year, the Company significantly broadened its fresh food offering and quick service restaurant locations. Today, The Pantry is operating 154 nationally branded food franchises in addition to a growing selection of proprietary food service programs including coffee, freshly ground and brewed, throughout its stores.



In fiscal 2000, The Pantry continued to expand its presence in existing markets and moved into growing bordering regions. For the year, the Company completed 18 acquisitions in six states, adding 143 new locations to its store network.

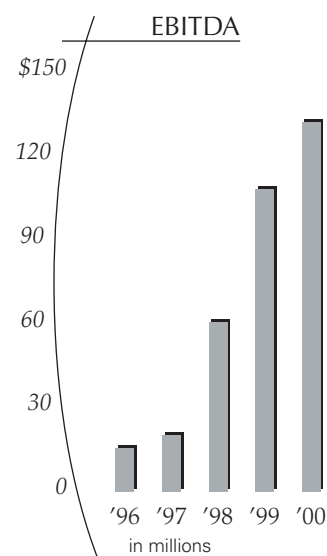
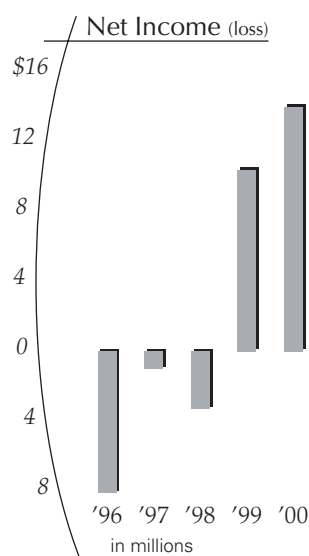
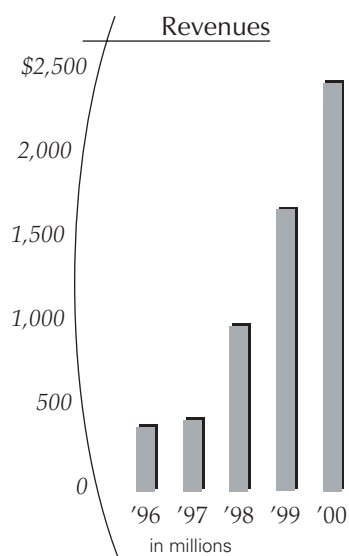
The Pantry, Inc. is the leading convenience store operator in the southeastern United States and the second largest independently operated convenience store chain in the country. The Company currently operates 1,313 stores in suburban areas of rapidly growing markets, coastal/resort areas and smaller towns located in Florida, North Carolina, South Carolina, Georgia, Kentucky, Indiana, Tennessee, Virginia and Mississippi.

The Pantry's stores offer a broad selection of merchandise; gasoline and ancillary services designed to appeal to the convenience needs of its customers.

Headquartered in Sanford, North Carolina, The Pantry, Inc. became a publicly traded company in June of 1999. Its common stock trades on the Nasdaq Stock Market® under the symbol "PTRY."

our company

## financial highlights



(Dollars in Thousands, except for per share information)

	Fiscal Year 2000	Fiscal Year 1999	Fiscal Year 1998
Total revenues	<b>\$2,432,260</b>	\$1,678,870	\$984,884
Gross profit	<b>471,879</b>	370,828	233,351
Depreciation and amortization	<b>56,062</b>	42,798	27,642
Income from operations	<b>76,031</b>	65,178	31,843
Interest expense	<b>52,329</b>	41,280	28,946
Net income (loss)	<b>13,996</b>	10,416	(3,325)
Earnings per share:			
Basic	<b>\$ 0.77</b>	\$ 0.45	\$ (0.64)
Diluted	<b>0.74</b>	0.41	(0.57)
Comparable store sales growth:			
Merchandise	<b>7.5%</b>	9.6%	5.3%
Gasoline gallons	<b>(2.4%)</b>	5.9%	4.8%
EBITDA(1)	<b>\$ 132,093</b>	\$ 107,976	\$ 60,501
Store count, end of year	<b>1,313</b>	1,215	954

(1) Before merger integration costs of \$1,016 in 1998.

# letter to our shareholders

Dear Shareholders:

Fiscal 2000 was another year of record financial results for The Pantry. We are particularly proud of our performance in light of the challenging environment in which we operated during the past year. By all accounts, fiscal 2000 was among the most difficult years faced by the convenience store industry. Unprecedented increases in the wholesale price of gasoline created significant volatility in the gasoline market and, as a result, greatly impacted gasoline demand, a major growth driver in our business. Nevertheless, we maintained a focused approach to managing these conditions and worked diligently to achieve strategic growth throughout our business as we leveraged our growing retail network to enhance our performance and continued to strengthen our presence in the Southeastern United States. In fiscal 2000, we:

- *Reported record revenues and net income, which grew 44.9% and 34.4%, respectively, over the previous year.*
- *Achieved a 33.3% increase in gasoline gross profits over last year, despite considerably higher wholesale costs throughout fiscal 2000.*
- *Added 145 new stores, reinforcing our leadership position throughout the Southeastern U.S.*
- *Expanded our reach into Mississippi through the acquisition of 37 convenience stores in that market.*
- *Completed the two-year rollout of our new corporate and store level accounting and management reporting systems, which have enhanced our ability to manage our business and immediately bring newly acquired locations online.*

We are confident that these achievements, and the initiatives we have taken throughout the year, will allow us to continue to deliver record results as we implement our core strategy of expanding our retail network throughout the Southeast and gaining even greater “Strength Through Strategic Acquisitions.”

## Financial Performance

Total revenues for 2000 increased by 44.9% to \$2.4 billion from \$1.7 billion in 1999. Earnings before interest, taxes, depreciation and amortization (EBITDA) increased by 22.3% to \$132.1 million versus \$108.1 million in 1999.

Net income for the year ended September 28, 2000 increased 34.4% to \$14 million compared to \$10.4 million in fiscal 1999, which included a \$3.6 million extraordinary loss related to a debt restructuring. Earnings per diluted share for fiscal 2000 were \$0.74 versus \$0.41 in 1999. Fiscal 2000 contained 52 weeks of operating results compared with 53 weeks in fiscal 1999.

Our record results continue to reflect our focused approach to merchandising and our ongoing efforts to manage the balance between gasoline gross profit and gallon volume. Merchandise gross profit margin increased to 33.6% in fiscal 2000 from 33.1% in 1999. Merchandise sales rose 24.0% to \$907.6 million, with merchandise comparable-store sales up 7.5% for the year. Gasoline sales increased by 62.1% to \$1.5 billion and gasoline gross profit rose 33.3% to \$139.9 million despite substantially higher wholesale gasoline costs. There was, however, a modest decline of 2.4% in comparable-store gallon sales, resulting from instability and dramatic price increases in the gasoline market throughout the year.

## Executing Our Strategy

In fiscal 2000, we executed an aggressive growth strategy aimed at expanding our presence in our existing markets and extending our reach into contiguous markets in the Southeast. During the year, our selective acquisition strategy continued to drive our growth and further allowed us to capitalize on ongoing consolidation in the convenience store industry. Throughout the year, we focused on identifying stores located in desirable areas with proven track records of high-volume sales. As a result, we successfully completed 18 acquisitions that added 143 stores to our retail network. These acquisitions strongly enhanced our presence in our existing markets, particularly in North Carolina, South Carolina, Virginia, Florida and Georgia. Among these were the addition of 49 Kangaroo stores in Georgia and 14 MiniMart stores in South Carolina. In addition, the acquisition of 19 Big K stores and 17 Metro Petroleum stores allowed us to enter and establish a strong foothold in the Mississippi market. The success of our acquisition program lies in our continued ability to quickly and effectively integrate new locations into our profitable network of stores. In fiscal 2000, we leveraged our recently rolled-out corporate and management reporting system to integrate all new stores into our system on the first day of the acquisition.

*"We are confident that these **achievements**, and the **initiatives** we have taken throughout the year, will allow us to continue to deliver **record results** as we implement our core **strategy** of expanding our retail network throughout the Southeast and gaining even greater '**Strength Through Strategic Acquisitions**'."*



*Peter J. Sodini*

Throughout the year, The Pantry also focused on increasing sales and enhancing profitability in our existing stores. To this end, we offered our customers the broadest range of competitively priced merchandise of any convenience store chain in the Southeast, further improved our ability to track inventory levels and adopted a more focused approach to merchandise item selections for store-specific locations. We are pleased with the results of these programs and confident that we will increase our same-store sales as we go forward. We have also increased our fresh food offerings, quick-serve restaurants and car wash locations in selected markets. These value-added services, along with our broad selection of other ancillary services, including ATM's, pay telephones and money orders continue to help drive store traffic and enhance the bottom line.

Upgrading our stores was another priority in fiscal 2000. We spent approximately \$24.5 million on our remodeling and conversion program in fiscal 2000. A new prototype for our remodeling has been put in place. We are focused on phasing out smaller units throughout our network, in favor of larger and more efficient stores, and we continue to upgrade our fueling locations with Multi-Product Dispensers (MPD) and pay-at-the-pump credit card readers. Fiscal 2000 also marks the rollout of our new corporate and store-level accounting and management reporting system. The completion of this two-year program has already begun to significantly enhance our reporting and monitoring capabilities as well as our overall performance.

### Looking Ahead

Going forward, we will continue to derive our "Strength through Strategic Acquisitions." We will identify and evaluate potential acquisition candidates that we believe can further strengthen our position in existing markets and expand our reach into other fast growing markets in the Southeast. In the first quarter of fiscal 2001, we have already completed the acquisition of 28 stores, which has further strengthened our presence in Mississippi and allowed us to enter the Louisiana market for the first time. Further, growth prospects in our industry remain strong and we are well positioned to take advantage of important opportunities as they arise. By leveraging our growing store network and our experience in effectively integrating newly acquired stores, we expect to add approximately 150 new locations in the year ahead. In doing so, we remain focused on providing convenience and ensuring that our customers have access to the highest quality and selection of products, both in our stores, and at our pumps.

In conclusion, we would like to take this opportunity to acknowledge the hard work and dedication of our employees. It is their continued commitment that allows us to enhance our performance and our results year after year. At this time, we would also like to thank our customers and shareholders for their support. As we enter fiscal 2001, we look forward to another year of record results. We will report to you on our progress throughout the year.

Sincerely,

A handwritten signature in black ink, appearing to read "Peter J. Sodini". The signature is stylized and written over a light-colored background.

Peter J. Sodini  
President and Chief Executive Officer

# strength through strategic acquisitions

In fiscal 2000, The Pantry maintained a sharp focus on strengthening its position in its principal markets and expanding its operations into contiguous markets. In doing so, the Company pursued an aggressive acquisition strategy and selectively developed new locations in high-growth areas. As a result, The Pantry added 145 stores to its growing network, which now includes 1,313 stores throughout the Southeastern United States.

The Company views acquisitions as the most cost-effective and expedient way to achieve rapid growth in the competitive convenience store industry. This strategy not only provides The Pantry with stores that have already been established, but also allows the Company to gain access to locations with a proven track record of high-volume sales. In implementing this strategy, the Company worked diligently to identify suitable acquisition candidates. The Pantry targeted well-known regional convenience store chains that would complement its profitable network of stores and help it to further enhance the bottom line. In fiscal 2000, The Pantry successfully completed 18 transactions and acquired 143 new stores in states such as North Carolina, South Carolina, Florida, Georgia, Virginia, and most recently, Mississippi.



Among these acquisitions was the addition of 14 stores operating under the MiniMart trade name. With the addition of these stores, the Company is now operating 251 stores in South Carolina, making it the single largest convenience store operator in that state.

In fiscal 2000, The Pantry also acquired 49 Kangaroo stores in Georgia. This acquisition has allowed the Company to significantly strengthen its presence in that market. Having entered the Georgia market only one year ago, the Company is pleased with the progress it has made over the past year in expanding its position there.

Another priority for the Company in fiscal 2000 was continued growth in contiguous markets. As a result, The Pantry made two key acquisitions, which allowed it to make inroads into Mississippi. Through the addition of 19 Big K stores and 17 Metro Petroleum stores, The Pantry is now poised to gain a significant share of this market.

It is the Company's aggressive growth strategy, and its ability to successfully integrate these newly acquired locations, that has allowed The Pantry to achieve record financial results, as reflected by increases of 44.9% in revenues and 34.4% in net income for the year.





*The Pantry's broad selection of products and services, including the leading brands of soft drinks and complementary snack foods, make the Company's locations convenient one-stop shops for its customers.*

*real selection*

Going forward, the Company remains committed to increasing its store base in important markets throughout the Southeast. The Pantry is well positioned to take advantage of continued fragmentation in the convenience store industry as well as opportunities to acquire complementary store locations as they arise. During the first quarter of fiscal 2001, the Company has already completed an important acquisition, in line with its strategy of expanding its presence in principal markets and establishing a leadership position in contiguous markets. The addition of 26 Fast Lane convenience stores, with eight of those in Louisiana, marks the Company's entrance into that state. The Company anticipates that this, along with other acquisitions currently in the pipeline, will continue to drive growth as it moves ahead in fiscal 2001.

#### Providing Convenience

The Pantry's ongoing success and its ability to continue to deliver record financial performance year after year is a direct result of the Company's commitment to providing convenience to its customers, both in its stores and at its pumps throughout the Southeastern U.S.

#### In Stores

In fiscal 2000, The Pantry reported an increase of 24.0% and 7.5% in merchandise revenues and merchandise comparable store sales, respectively. These gains are attributed to the Company's ability to provide its customers with the broadest selection of products and services including a variety of brand name, high-demand goods such as snack foods, soft drinks, coffee, beer and cigarettes. By offering customers these products, and many more, in one location, The Pantry continues to attract customers looking for quality, service and convenience.



## strength through strategic acquisitions continued

This year, the Company significantly enhanced its merchandising practices in an effort to drive sales and further strengthen its overall performance. In doing so, The Pantry more closely monitored store performance, on an individual basis, and worked to ensure that the products and services found at each store reflected customer demands at specific locations. This process was greatly facilitated by the rollout of the Company's new in-store and corporate level management systems. Completed in October 2000, this new system enabled the Company to more effectively monitor merchandise sales, better control inventory levels, and adjust merchandise mix on a regular basis. In addition, this system further allowed The Pantry to implement pricing by geographic area and adjust margins so that it could achieve even greater profitability. The Company's success is evident in the merchandise gross margin profit of 33.6%, an increase of 50 basis points over the previous year.

Further, as part of the Company's efforts to generate sales, The Pantry also focused on enhancing its promotional displays. In fiscal 2000, the Company introduced new slat-wall displays throughout its locations. These displays not only enhance the visibility of items such as cigarettes, they also prevent their procurement by underage individuals.

The continued development of The Pantry's value added ancillary services, which include lottery operations, money orders, pay telephones, phone cards and car washes, also boosted the bottom line. In total, these high-margin products and services accounted for \$27.0 million in commission revenues, net of expenses, in fiscal 2000 versus \$23.4 million in fiscal 1999. In addition, the Company continues to add food service programs and currently has 215 operating including such national brands as Taco Bell, Hardees, Subway, Blimpie's and Krystals as well as proprietary delis.

The Company also invested approximately \$71.0 million in the remodeling and conversion of stores over the past four years. These enhancements included improvements to interior fixtures and equipment for self-service food and beverages, both interior and exterior lighting, in-store restrooms for customers and signage. In addition, the Company continued to phase out smaller units, in favor of expanding larger units with a higher volume of sales.



*As part of The Pantry's strategy to upgrade its gasoline facilities and provide its customers with even greater convenience in fueling, the Company continued to automate its operations and extend its Rapid Fuel card to more of its customers.*

*technology at work*



The Pantry will remain focused on providing its customers with an unsurpassed selection of quality products and the convenience that they have come to expect in Pantry stores throughout the Southeast. The Company will continue to closely monitor performance at every store, and work to further leverage the strength and scope of its growing network to reach more favorable purchasing agreements with key vendors. The Company is confident that these efforts will allow it to successfully strengthen its performance, while also ensuring the satisfaction of its customers.



#### At The Pump

Fiscal 2000 was a challenging year in The Pantry's gasoline operations. The crude oil market was characterized by significant volatility, which was brought on by a number of factors, including fluctuations in global supply and demand, a decline in domestic fuel inventories and concerns over domestic refining capacity. Together, these factors resulted in an unprecedented increase in the wholesale price of gasoline, which impacted the Company's performance over the past year.

Nevertheless, The Pantry executed a focused strategy that has helped it to minimize the effects of price increases on operations and, as a result, allowed the Company to make significant gains. By effectively managing the balance between gasoline gallon volume and gasoline gross profit, The Pantry reported total gasoline revenues of \$1.5 billion, an increase of 62.1% over fiscal 1999 results. This increase was driven in part by the significant rise in gasoline retail prices, and reflects a \$.33 per gallon increase from fiscal 1999 prices. These gains, however, were slightly offset by a 2.4 % decline in gasoline gallon comparable store sales.

*“Despite unprecedented volatility in the crude oil market, The Pantry **successfully** reached a **balance** between gasoline gallon volume and gasoline gross **profit**, allowing it to continue to **attract customers** and maintain a **high volume** of traffic at its pumps.”*



Also critical to the Company's success during this volatile period was its ability to attract customers and maintain a high volume of traffic at its pumps. To this end, the Company implemented several important initiatives including the expansion of its Rapid Fuel Card program. In fiscal 2000, The Pantry added approximately 300 new accounts and expects a greater number of its customers to sign on in the year ahead.

The Pantry also continued to concentrate on providing customers with convenience and quality products and services at all of its fueling locations. Significant investments were made in technological advancements at the Company's pumps. Today, Multi-Product Dispensers (MPD) have been installed at 86% of The Pantry's fueling locations, and pay-at-the-pump credit card readers can be found at 75% of the Company's pumps. In making these improvements, the Company effectively leveraged its strong gasoline sales volumes and its relationships with oil companies to implement upgrades in a cost-effective manner. As a result, it has received \$7.8 million in reimbursements for these upgrades from its major gasoline suppliers in fiscal 2000.

# strength through strategic acquisitions continued

## Investing in Growth

Over the past two years, The Pantry invested approximately \$10 million to develop a state-of-the-art management information system. As previously noted, fiscal 2000 marked the rollout of the Company's new corporate and store level accounting and management reporting systems, which have now been implemented in all of The Pantry's stores.

This system has greatly improved the overall efficiency of operational and accounting procedures at the store level and in the Company's accounting departments. Data consistency and accuracy has also been significantly enhanced. The Company is now able to utilize data on gallon and merchandise volumes, on a daily basis, to adjust margins and better manage and track total store gross profit. In addition, the implementation of this system has also allowed The Pantry to continue its strategic goal of integrating all newly acquired locations into the system on the first day of the acquisition.



At the same time, the Company has continued to expand its computer systems infrastructure and networking between administrative offices and stores and has established a centralized Help Desk to support its rapidly expanding network. These systems include an enterprise-wide email system, which has facilitated communication, and a food service system that has helped to improve controls and more rapid identification of inventory opportunities in this growing segment of the Company's business.

The Pantry plans to continue to expand the use of these new systems in the year ahead by adding additional features that can provide further enhancements and efficiencies to its operations. Particular emphasis will be placed on the development and strengthening of systems that will help the Company to more closely monitor and optimize gross profit at each of its stores.

## selected financial data

The following table sets forth historical consolidated financial data and store operating data for the periods indicated. The selected historical annual consolidated financial data is derived from, and is qualified in its entirety by, our annual Consolidated Financial Statements, including those contained elsewhere in this report. The information should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations," the Consolidated Financial Statements and related notes thereto included elsewhere in this report. In the table, dollars are in millions, except per store and per gallon data.

	September 28, 2000	September 30, 1999	September 24, 1998	September 25, 1997	September 26, 1996
<b>STATEMENT OF OPERATIONS DATA:</b>					
Revenues:					
Merchandise sales	\$ 907.6	\$ 731.7	\$ 460.8	\$ 202.4	\$ 188.1
Gasoline sales	1,497.7	923.8	510.0	220.2	192.7
Commissions	27.0	23.4	14.1	4.8	4.0
Total revenues	<b>2,432.3</b>	1,678.9	984.9	427.4	384.8
Cost of Sales:					
Merchandise	602.6	489.3	304.0	132.8	126.0
Gasoline	1,357.8	818.8	447.6	197.3	167.6
Gross profit	471.9	370.8	233.3	97.3	91.2
Operating, general and administrative expenses	339.8	262.9	172.9	77.0	75.6
Unusual charges	—	—	1.0 <sup>(e)</sup>	—	4.6 <sup>(e)</sup>
Depreciation and amortization	56.1	42.8	27.6	9.5	9.1
Income from operations	76.0	65.2	31.8	10.8	1.9
Interest expense	(52.3)	(41.3)	(28.9)	(13.0)	(12.0)
Income (loss) before other items	24.8	24.8	4.7	(1.0)	(8.1)
Extraordinary loss	—	(3.6) <sup>(e)</sup>	(8.0) <sup>(b)</sup>	—	—
Net income (loss)	\$ 14.0	\$ 10.4	\$ (3.3)	\$ (1.0)	\$ (8.1)
Net income (loss) applicable to common shareholders	\$ 14.0	\$ 6.2	\$ (6.3)	\$ (6.3)	\$ (10.8)
Earnings (loss) per share before extraordinary loss:					
Basic	\$ 0.77	\$ 0.71	\$ (0.18)	\$ (1.08)	\$ (1.89)
Diluted	\$ 0.74	\$ 0.65	\$ (0.16)	\$ (1.08)	\$ (1.89)
Weighted-average shares outstanding:					
Basic	18,111	13,768	9,732	5,815	5,688
Diluted	18,932	15,076	11,012	5,815	5,688
Dividends paid on common stock	—	—	—	—	—
<b>OTHER FINANCIAL DATA:</b>					
EBITDA <sup>(a)</sup>	\$ 132.1	\$ 108.0	\$ 60.5	\$ 20.3	\$ 15.6
Net cash provided by (used in):					
Operating activities	\$ 88.2	\$ 68.6	\$ 48.0	\$ 7.3	\$ 5.4
Investing activities	(148.7)	(228.9)	(285.4)	(25.1)	(7.2)
Financing activities	82.7	157.1	268.4	15.8	(3.9)
Capital expenditures <sup>(b)</sup>	56.4	47.4	42.1	14.7	7.1
Ratio of earnings to fixed charges <sup>(c)</sup>	1.4	1.4	1.1	—	—

selected financial data continued

	September 28, 2000	September 30, 1999	September 24, 1998	September 25, 1997	September 26, 1996
<b>STORE OPERATING DATA:</b>					
Number of stores (end of period)	<b>1,313</b>	1,215	954	390	379
Average sales per store:					
Merchandise sales (in thousands)	<b>\$ 713.8</b>	\$ 666.4	\$ 533.3	\$ 525.8	\$ 481.1
Gasoline gallons (in thousands)	<b>856.9</b>	834.8	603.9	501.2	450.0
Comparable store sales growth <sup>(d)</sup> :					
Merchandise	<b>7.5%</b>	9.6%	5.3%	8.5%	2.8%
Gasoline gallons	<b>(2.4)%</b>	5.9%	4.8%	7.2%	(4.3)%
<b>OPERATING DATA:</b>					
Merchandise gross margin	<b>33.6%</b>	33.1%	34.0%	34.4%	33.0%
Gasoline gallons sold (in millions)	<b>1,062.4</b>	855.7	466.8	179.4	160.7
Average retail gasoline price per gallon	<b>\$ 1.41</b>	\$ 1.08	\$ 1.09	\$ 1.23	\$ 1.20
Average gasoline gross profit per gallon	<b>\$ 0.132</b>	\$ 0.123	\$ 0.134	\$ 0.128	\$ 0.156
Operating, general and administrative expenses					
as a percentage of total revenues	<b>14.0%</b>	15.7%	17.6%	18.0%	19.6%
Operating income as a percentage of total revenues	<b>3.1%</b>	3.9%	3.2%	2.5%	0.5%
<b>BALANCE SHEET DATA (END OF PERIOD):</b>					
Working capital (deficiency)	<b>\$ (7.7)</b>	\$ (20.4)	\$ (9.0)	\$ (8.2)	\$ (6.5)
Total assets	<b>930.3</b>	793.7	554.8	142.8	120.9
Total debt and capital lease obligations	<b>541.4</b>	455.6	340.7	101.3	101.4
Shareholders' equity (deficit)	<b>118.0</b>	104.2 <sup>(f)</sup>	39.3	(17.9)	(27.5)

(a) "EBITDA" represents income from operations before depreciation and amortization, merger integration costs, restructuring charges, and impairment of long-lived assets. EBITDA is not a measure of performance under accounting principles generally accepted in the United States of America, and should not be considered as a substitute for net income, cash flows from operating activities and other income or cash flow statement data prepared in accordance with accounting principles generally accepted in the United States of America, or as a measure of profitability or liquidity. We have included information concerning EBITDA as one measure of our ability to service debt and because we believe investors find this information useful. EBITDA as defined herein may not be comparable to similarly titled measures reported by other companies.

(b) Purchases of assets to be held for sale are excluded from these amounts.

(c) For purposes of determining the ratio of earnings to fixed charges: (i) earnings consist of income (loss) before income tax benefit (expense) and extraordinary item plus fixed charges and (ii) fixed charges consist of interest expense, amortization of deferred financing costs, preferred stock dividends and the portion of rental expense representative of interest (deemed to be one-third of rental expense). Our earnings were inadequate to cover fixed charges by \$14.3 million, and \$6.3 million for fiscal years 1996 and 1997, respectively.

(d) The stores included in calculating comparable store sales growth are stores that were under management and in operation for both fiscal years of the comparable period; therefore, acquired stores, new stores and closed stores are not included.

(e) On January 28, 1999, we redeemed \$49.0 million in principal amount of our senior notes and paid accrued and unpaid interest up to, but not including, the date of purchase and a 4% call premium. We recognized an extraordinary loss of approximately \$3.6 million in connection with the repurchase of the senior notes including the payment of the 4% call premium of \$2.0 million, fees paid in connection with the amendments and commitments under our bank credit facility, and the write-off of deferred financing costs related to our repayment of our former bank credit facility.

(f) On June 8, 1999, we offered and sold 6,250,000 shares of our common stock in our initial public offering. The initial offering price was \$13.00 per share and we received \$75.6 million in net proceeds, before expenses.

(g) During fiscal 1998, we recorded an integration charge of approximately \$1.0 million for costs of combining our existing business with the acquired business of Lil' Champ.

(h) On October 23, 1997 in connection with the Lil' Champ acquisition, we completed the offering of our senior subordinated notes and, in a related transaction completed a tender offer and consent solicitation with respect to our senior notes. The tender offer resulted in our purchasing \$51 million in principal amount of the senior notes at a purchase price of 110% of the aggregate principal amount plus accrued and unpaid interest and other related fees. In connection with this repurchase, we incurred an extraordinary loss of approximately \$8.0 million related to cost of the tender offer and consent solicitation and write-off of deferred financing costs.

(i) During fiscal 1996, we recorded restructuring charges of \$1.6 million pursuant to a formal plan to restructure our corporate offices. Also during fiscal 1996, we early-adopted SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of. In addition, pursuant to SFAS No. 121, we evaluated our long-lived assets for impairment on a store-by-store basis. Based on this evaluation, we recorded an impairment loss of \$0.4 million for property and equipment and \$2.6 million for goodwill.

# management's discussion and analysis of financial condition and results of operations

The following discussion and analysis is provided to increase understanding of, and should be read in conjunction with, the Consolidated Financial Statements and accompanying notes. Additional discussion and analysis related to fiscal year 2000 is contained in our Quarterly Reports on Form 10-Q and 10-Q/A, Current Reports on Form 8-K and 8-K/A and our Registration Statement on Form S-1, as amended.

## Introduction

Fiscal 2000 was a historic year for The Pantry as we completed our first full fiscal year as a public company while recording record results of operations. We realized record revenues, operating profits, and net income in the midst of a challenging gasoline environment. Our revenues increased 44.9% to \$2.4 billion and EBITDA increased 22.3% to \$132.1 million. We earned record net income of \$14.0 million in fiscal 2000 compared to \$10.4 million in fiscal 1999. Fiscal 1999 net income included an extraordinary loss of \$3.6 million, net of taxes, associated with the refinancing of our senior notes and credit facilities.

These record operating results were the result of:

- increased sales and earnings associated with acquired stores,
- same store merchandise sales and earnings growth,
- higher merchandise gross margin and gasoline gross profit per gallon,
- our ability to manage the balance between total unit gross profit and gasoline gallon volume, and
- the absence of any extraordinary charges.

We believe our results continue to be driven by three key operating principles:

- the consistent execution of our core strategies, including focused attention on leveraging the quality and quantity of our growing retail network,
- our research and investment in new programs, particularly in the services sector, and
- sensible store growth in existing and contiguous markets.

We believe our growing retail network, merchandise programs, purchasing leverage and in-store execution will continue to drive merchandise comparable store sales and support stable merchandise margins. We have focused a lot of attention and resources on upgrading locations with the latest gasoline pump technology and designing site plans to drive customer traffic.

During fiscal 2000, we completed the installation of a leading, industry-specific retail information system across our entire network of stores. This technology provides field and corporate management with on-line communication tools and daily access to relevant operating information. We expect this technology will improve store-level execution of our merchandising programs, improve inventory management and other operating controls, and increase the overall service to our customers. We have also developed proprietary modeling systems to track location specific gasoline pricing decisions and their impact on key trends and performance factors such as gasoline volume, merchandise volume, and total unit gross profit.

On the services front, we continue to maintain a fresh and open approach to convenience and certain services that appeal to our customers. We are constantly reviewing opportunities to get the most out of our growing retail network—now at more than 1,300 stores located in 9 southeastern states. We have focused our attention on increasing ancillary revenues such as lottery commissions, money order sales, telephone income, selected on-site advertising commission, phone cards, prepaid cellular services, vending income, car wash offerings and other service revenues.

Finally, we plan to continue to sensibly acquire premium chains located in our existing and contiguous markets. We believe these markets have strong demographic and economic growth profiles and are pleased with the quantity and quality of acquisition candidates particularly those located in Mississippi and Louisiana, both new and attractive retail markets. In fiscal 2001, we anticipate increasing our net store count by 100 to 150 stores. This includes stores to be acquired in fiscal 2001, a small number of newly constructed stores in high growth areas and the closing of certain underperforming stores.

## Acquisition History

Our acquisition strategy focuses on acquiring convenience stores within or contiguous to our existing market areas. We believe acquiring locations with demonstrated operating results involves lower risk and is generally an economically attractive alternative to traditional site selection and new store development. We do, however, plan to develop new locations in high growth areas within our existing markets.

# management's discussion and analysis of financial condition and results of operations continued

The tables below provide information concerning the acquisitions we have completed during the last three fiscal years:

## Fiscal 2000 Acquisitions

<i>Date Acquired</i>	<i>Trade Name</i>	<i>Locations</i>	<i>Stores</i>
September 14, 2000	Food Mart	Mississippi	18
July 3, 2000	Mini Mart	South Carolina	14
June 29, 2000	Big K	Mississippi	19
April 27, 2000	Market Express	South Carolina	5
January 27, 2000	On-The-Way	North Carolina and Southern Virginia	12
November 11, 1999	Kangaroo	Georgia	49
November 4, 1999	Cel Oil	Charleston, South Carolina	7
October 7, 1999	Wicker Mart	North Carolina	7
Others (less than five stores)	Various	Florida, North Carolina, Virginia, Mississippi and South Carolina	12
Total			143

## Fiscal 1999 Acquisitions

<i>Date Acquired</i>	<i>Trade Name</i>	<i>Locations</i>	<i>Stores</i>
July 22, 1999	Depot Food	South Carolina and Northern Georgia	53
July 8, 1999	Food Chief	Eastern South Carolina	29
February 25, 1999	ETNA	North Carolina and Virginia	60
January 28, 1999	Handy Way	North Central Florida	121
November 5, 1998	Express Stop	Southeast North Carolina and Eastern South Carolina	22
October 22, 1998	Dash-N	East Central North Carolina	10
Others (less than five stores)	Various	North Carolina and South Carolina	2
Total			297

## Fiscal 1998 Acquisitions

<i>Date Acquired</i>	<i>Trade Name</i>	<i>Locations</i>	<i>Stores</i>
July 15, 1998	Zip Mart	Central North Carolina and Virginia	42
July 2, 1998	Quick Stop	Southeast North Carolina and Coastal South Carolina	75
May 2, 1998	Sprint	Gainesville, Florida	10
March 19, 1998	Kwik Mart	Eastern North Carolina	23
October 23, 1997	Lil' Champ	Northeastern Florida	440 <sup>(a)</sup>
Others (less than five stores)	Various	North Carolina and South Carolina	13
Total			603

(a) Net of the disposition of 48 convenience stores located throughout eastern Georgia.

Subsequent to September 28, 2000, we have entered into agreements to acquire 28 stores located in Mississippi (19), Louisiana (8) and North Carolina (1) in three separate transactions. These transactions will be primarily funded from borrowings under our bank credit facility and cash on hand.

We seek to improve the productivity and profitability of acquired stores by implementing our merchandising and gasoline initiatives, eliminating duplicative costs, reducing overhead and centralizing functions such as purchasing and information technology. We believe it takes six to twelve months to fully integrate and achieve operational and financial improvements at acquired locations. There can be no assurance, however, that we can achieve revenue increases or cost savings with respect to any acquisition.

*Impact of Acquisitions.* These acquisitions and the related transactions have had a significant impact on our financial condition and results of operations since each of their respective transaction dates. Due to the method of accounting for these acquisitions, the Consolidated Statements of Operations for the fiscal years presented include results of operations for each of the acquisitions from the date of each acquisition only. For fiscal 2000 acquisitions, the Consolidated Balance Sheets as of September 30, 1999 and the Consolidated Statements of Operations for fiscal years September 30, 1999 and September 24, 1998 do not include the assets, liabilities, and results of operations relating to these acquisitions. As a result, comparisons of fiscal 2000 results to such prior fiscal years are impacted materially and the underlying performance of same store results is obscured.

## Results of Operations

### Fiscal 2000 Compared to Fiscal 1999

*We operate on a 52 or 53-week fiscal year. Our operations for fiscal 2000 contained 52 weeks while fiscal 1999 contained 53 weeks or an additional week. When we make references to fiscal 1999 adjusted for the number of weeks, we have simply adjusted last year's fourth quarter results to approximate a 13-week period.*

**Total Revenue.** Total revenue for fiscal 2000 was \$2.4 billion compared to \$1.7 billion for fiscal 1999, an increase of \$753.4 million or 44.9%. The increase in total revenue is primarily due to the revenue from stores acquired in fiscal 2000 of \$217.6 million, the effect of a full year of revenue from fiscal 1999 acquisitions of \$290.9 million, and comparable store merchandise sales growth of 7.5%. Comparable store merchandise sales increases at our locations are primarily due to increased customer counts and average transaction size resulting from more competitive gasoline pricing, enhanced store appearance and store merchandising, and increased in-store promotional activity. Adjusting for the number of weeks in fiscal 1999, the increase in total revenues was 48.3%.

**Merchandise Revenue.** Total merchandise revenue for fiscal 2000 was \$907.6 million compared to \$731.7 million for fiscal 1999, an increase of \$175.9 million or 24.0%. The increase in merchandise revenue is primarily due to the revenue from stores acquired in fiscal 2000 of \$68.6 million, the effect of a full year of merchandise revenue from fiscal 1999 acquisitions of \$90.1 million, and comparable store merchandise sales growth of 7.5% or an increase of approximately \$42.3 million. Adjusting for the number of weeks in fiscal 1999, the increase in merchandise revenues was 26.9%.

**Gasoline Revenue and Gallons.** Total gasoline revenue for fiscal 2000 was \$1.5 billion compared to \$923.8 million for fiscal 1999, an increase of \$573.9 million or 62.1%. The increase in gasoline revenue is primarily due to the revenue from stores acquired in fiscal 2000 of \$146.4 million, the effect of a full year of gasoline revenue from fiscal 1999 acquisitions of \$197.2 million, and the impact of raising gasoline retail prices. In fiscal 2000, our average retail price of gasoline was \$1.41 per gallon, which represents a \$.33 per gallon increase from fiscal 1999. These increases were partially offset by a gasoline gallon comparable store sales decline of 2.4%.

In fiscal 2000, total gasoline gallons were 1.1 billion gallons compared to 855.7 million gallons in fiscal 1999, an increase of 206.7 million gallons or 24.2%. The increase in gasoline gallons is primarily due to gallon volume of 106.1 million from stores acquired in fiscal 2000, the effect of a full year of gasoline volume from 1999 acquisitions of 151.3 million offset by comparable store gasoline volume decreases of 2.4% or a decrease of approximately 14.9 million gallons. The fiscal 2000 same store gallon decline was primarily due to lower demand coupled with heightened competitive

factors in selected markets such as Tampa and Orlando. Demand has been influenced by higher gasoline retail prices as a result of wholesale gasoline cost increases and our efforts to manage the balance between gasoline gross profit and gallon volume.

**Commission Revenue.** Total commission revenue for fiscal 2000 was \$27.0 million compared to \$23.4 million for fiscal 1999, an increase of \$3.6 million or 15.4%. The increase in commission revenue is primarily due to revenue from stores acquired in fiscal 2000 of \$2.6 million, the effect of a full year of commission revenue from 1999 acquisitions of \$3.6 million and comparable store commission revenue growth. These increases were partially offset by the loss of video poker revenue in the State of South Carolina as of July 1, 2000. As a result, video poker commission in fiscal 2000 decreased 35.5% to \$4.0 from \$6.2 in fiscal 1999.

**Total Gross Profit.** Total gross profit for fiscal 2000 was \$471.9 million compared to \$370.8 million for fiscal 1999, an increase of \$101.1 million or 27.3%. The increase in gross profit is primarily due to the gross profit from stores acquired in fiscal 2000 of \$37.4 million, the effect of a full year of operations from stores acquired in 1999 of \$51.9 million and higher merchandise and gasoline margins. Adjusting for the number of weeks in fiscal 1999, the increase in total gross profit was 30.1%.

**Merchandise Gross Margin.** Fiscal 2000 merchandise gross margin was 33.6%, a 50 basis point increase over fiscal 1999. The increase was primarily due to margin improvements in selected categories and an increase in food service sales, which earn higher gross margin percentages.

**Gasoline Gross Profit Per Gallon.** Gasoline gross profit per gallon increased to \$0.132 in fiscal 2000 from \$0.123 in fiscal 1999 primarily due to our efforts to manage the balance between gasoline gallon volume and gasoline gross profit per gallon. During fiscal 2000, we experienced a volatile wholesale gasoline market due to many factors, including world crude supply and demand fundamentals, domestic fuel inventories, and domestic refining capacity. Due to this volatility, our margin per gallon sold on a quarterly basis ranged from a low of \$0.101 in our second quarter to a high of \$0.153 in our fourth quarter of fiscal 2000.

**Operating, General and Administrative Expenses.** Operating expenses for fiscal 2000 were \$339.8 million compared to \$262.9 million for fiscal 1999, an increase of \$76.9 million or 29.3%. The increase in operating expenses is primarily due to the operating and lease expenses associated with the stores acquired in fiscal 2000 of \$26.1 million, the effect of a full year of expenses for stores acquired in fiscal 1999 of \$38.3 million, as well as an increase in general corporate expenses associated with our store growth initiatives. As a percentage of total revenue, operating, general and administrative expenses decreased to 14.0% in fiscal 2000 from 15.7% in fiscal 1999.

# management's discussion and analysis

## of financial condition and results of operations continued

**Income from Operations.** Income from operations for fiscal 2000 was \$76.0 million compared to \$65.2 million for fiscal 1999, an increase of \$10.9 million or 16.7%. The increase is primarily due to the items discussed above. As a percentage of total revenue, income from operations decreased to 3.1% in fiscal 2000 from 3.9% in fiscal 1999.

**EBITDA.** EBITDA represents income from operations before depreciation and amortization, merger integration costs, and extraordinary loss. EBITDA for fiscal 2000 was \$132.1 million compared to \$108.0 million for fiscal 1999, an increase of \$24.1 million or 22.3%. The increase is primarily due to the items discussed above.

EBITDA is not a measure of performance under accounting principles generally accepted in the United States of America, and should not be considered as a substitute for net income, cash flows from operating activities and other income or cash flow statement data prepared in accordance with accounting principles generally accepted in the United States of America, or as a measure of profitability or liquidity. We have included information concerning EBITDA as one measure of our cash flow and historical ability to service debt and because we believe investors find this information useful. EBITDA as defined herein may not be comparable to similarly titled measures reported by other companies.

**Interest Expense (see—"Liquidity and Capital Resources—Long-Term Debt").** Interest expense in fiscal 2000 was \$52.3 million compared to \$41.3 million for fiscal 1999, an increase of \$11.0 million or 26.8%. In fiscal 2000, interest expense was primarily related to interest costs on (i) our senior subordinated notes of \$20.5 million and (ii) our bank credit facility of approximately \$30.4 million. The increase in interest expense was primarily due to increased borrowings associated with our acquisition activity and a general rise in interest rates.

**Income Tax Expense.** Our effective income tax rate for fiscal 2000 was 43.5%. Our effective tax rate is negatively impacted by non-deductible goodwill related to certain acquisitions and other permanent book-tax differences.

**Net Income.** Net income for fiscal 2000 was \$14.0 million compared to net income of \$10.4 million for fiscal 1999, an increase of \$3.6 million or 34.4%. The increase is primarily due to the absence of any extraordinary charges in fiscal 2000 as compared to fiscal 1999, which had an extraordinary loss of \$3.6 million associated with certain debt restructuring activity. Adjusting for the number of weeks in fiscal 1999 and excluding the fiscal 1999 extraordinary loss, the increase in net income in fiscal 2000 was 4.0%.

### Fiscal 1999 Compared to Fiscal 1998

*Our operations for fiscal 1999 contained 53 weeks while fiscal 1998 contained 52. When we make references to the effect of an extra week in fiscal 1999, we have simply calculated the impact of the additional week in fiscal 1999.*

**Total Revenue.** Total revenue for fiscal 1999 was \$1.7 billion compared to \$984.9 million for fiscal 1998, an increase of \$694.0 million or 70.5%. The increase in total revenue is primarily due to the revenue from stores acquired in fiscal 1999 of \$346.4 million, the effect of a full year of revenue from fiscal 1998 acquisitions of \$259.9 million, and comparable store revenue growth of 6.9% or approximately \$29.3 million. Also, the effect of an extra week in fiscal 1999 contributed \$39.4 million or 5.7% of the increase. Comparable store sales increases at our locations are primarily due to increased customer counts and average transaction size resulting from more competitive gasoline pricing, enhanced store appearance and store merchandising, and increased in-store promotional activity.

**Merchandise Revenue.** Total merchandise revenue for fiscal 1999 was \$731.7 million compared to \$460.8 million for fiscal 1998, an increase of \$270.9 million or 58.8%. The increase in merchandise revenue is primarily due to the revenue from stores acquired in fiscal 1999 of \$133.8 million, the effect of a full year of merchandise revenue from fiscal 1998 acquisitions of \$92.7 million, and comparable store sales growth of 9.6% or approximately \$20.3 million. Based on purchase and sales information, we estimate that cigarette inflation during fiscal year 1999 accounted for 3% to 4% of the 9.6% increase in comparable store sales. Also, the effect of an extra week in fiscal 1999 contributed \$16.3 million.

**Gasoline Revenue and Gallons.** Total gasoline revenue for fiscal 1999 was \$923.8 million compared to \$510.0 million for fiscal 1998, an increase of \$413.8 million or 81.1%. The increase in gasoline revenue is primarily due to the revenue from stores acquired in fiscal 1999 of \$208.2 million, the effect of a full year of gasoline revenue from fiscal 1998 acquisitions of \$165.2 million, and comparable store gasoline revenue growth of 3.8% or approximately \$7.9 million. Also, the effect of an extra week in fiscal 1999 contributed \$22.3 million. In fiscal 1999, our average retail price of gasoline was \$1.08, which represents a \$.01 decrease from fiscal 1998.

In fiscal 1999, total gasoline gallons were 855.7 million gallons compared to 466.8 million gallons in fiscal 1998, an increase of 388.9 million gallons or 83.3%. The increase in gasoline gallons is primarily due to gallon volume of 189.4 million from stores acquired in fiscal 1999, the effect of a full year of

gasoline volume from fiscal 1998 acquisitions of 163.2 million and comparable store gasoline volume increases of 5.9% or approximately 11.6 million gallons. Also, the effect of an extra week in fiscal 1999 contributed 18.8 million gallons. Fiscal 1999 same store gallon sales growth was 5.9% and is primarily due to more competitive gasoline pricing, rebranding and promotional activity, enhanced store appearance and local market and economic conditions.

*Commission Revenue.* Total commission revenue for fiscal 1999 was \$23.4 million compared to \$14.1 million for fiscal 1998, an increase of \$9.3 million or 65.6%. The increase in commission revenue is primarily due to revenue from stores acquired in fiscal 1999 of \$4.4 million, the effect of a full year of commission revenue from fiscal 1998 acquisitions of \$2.0 million and comparable store commission revenue growth of 18.7% or \$1.1 million. The effect of an extra week in fiscal 1999 contributed \$0.4 million.

*Total Gross Profit.* Total gross profit for fiscal 1999 was \$370.8 million compared to \$233.4 million for fiscal 1998, an increase of \$137.5 million or 58.9%. The increase in gross profit is primarily due to the gross profit from stores acquired in fiscal 1999 of \$72.1 million, the effect of a full year of operations from stores acquired in fiscal 1998 of \$50.7 million and the effect of an extra week in fiscal 1999 of \$8.2 million.

*Merchandise Gross Margin.* Merchandise gross margin in fiscal 1999 remained relatively constant compared to fiscal 1998, decreasing only 90 basis points despite significant cost inflation in the tobacco category in fiscal 1999. See “—Inflation.”

*Gasoline Gross Profit Per Gallon.* Gasoline gross profit per gallon decreased to \$0.123 in fiscal 1999 from \$0.134 in fiscal 1998 primarily due to rising crude oil prices, the impact of rising crude oil prices on wholesale fuels costs, and lower average margin in acquired locations.

*Operating, General and Administrative Expenses.* Operating, general and administrative expenses for fiscal 1999 were \$262.9 million compared to \$172.9 million for fiscal 1998, an increase of \$90.0 million or 52.1%. The increase in store expenses is primarily due to the operating and lease expenses associated with stores acquired in fiscal 1999 of \$47.9 million, the effect of a full year of expenses for stores acquired in fiscal 1998 of \$29.9 million, the effect of an extra week of operations in fiscal 1999 of \$3.8 million, as well as an increase in general corporate expenses associated with our store growth initiative. As a percentage of total revenue, operating, general and administrative expenses decreased to 15.7% in fiscal 1999 from 17.6% in fiscal 1998.

*Income from Operations.* Income from operations for fiscal 1999 was \$65.2 million compared to \$31.8 million for fiscal 1998, an increase of \$33.3 million or 104.7%. The increase is primarily due to the items discussed above. As a percentage of total revenue, income from operations increased to 3.9% in fiscal 1999 from 3.2% in fiscal 1998.

*EBITDA.* EBITDA for fiscal 1999 was \$108.0 million compared to \$60.5 million for fiscal 1998, an increase of \$47.5 million or 78.5%. The increase is primarily due to the items discussed above.

*Interest Expense (see—“Liquidity and Capital Resources—Long-Term Debt”).* Interest expense in fiscal 1999 was \$41.3 million compared to \$28.9 million for fiscal 1998, an increase of \$12.3 million or 42.6%. Interest expense is primarily related to interest costs on (i) our senior subordinated notes of \$21.9 million, (ii) our bank credit facility of approximately \$16.6 million and (iii) our senior notes of \$2.0 million which was partially offset by \$1.1 million in interest savings related to the redemption and refinancing of \$49.0 million in principal amount of the senior notes.

*Income Tax Expense.* Our effective income tax rate for fiscal 1999 was 43.4%. Our effective income tax rate is negatively impacted by non-deductible goodwill related to acquisitions and other permanent book/tax differences.

*Extraordinary Loss.* We recognized an extraordinary loss, net of taxes, of approximately \$3.6 million in fiscal 1999 in connection with the redemption of the remaining outstanding balance of our senior notes and the related consent fees. The extraordinary item includes the payment of the 4% call premium of \$2.0 million and the write-off of related deferred financing costs on our senior notes and former credit facility. The extraordinary item also reflects an income tax benefit of approximately \$2.3 million.

*Net Income.* Net income for fiscal 1999 was \$10.4 million compared to a net loss of \$3.3 million for fiscal 1998, an increase of \$13.7 million or 413.3%. The increase is primarily due to results from acquired stores, improved results from operations, and the lower extraordinary charges related to redemption and refinancing activities. Our income before extraordinary loss was \$14.0 million for fiscal 1999 compared to \$4.7 million during fiscal 1998, an increase of \$9.3 million or a 200% increase. Pursuant to Emerging Issues Task Force Topic No. (“EITF”) D-42, in connection with our redemption of our preferred stock in our third fiscal quarter, we were required to recognize a one-time deduction to net income applicable to common stockholders (and a related reclassification to accumulated deficit) in the amount of \$1,500,000 associated with original issue costs incurred in connection

# management's discussion and analysis of financial condition and results of operations continued

with the issuance of preferred stock in December 1996. At that time, the original issue costs were netted against the gross proceeds and thus charged to additional paid-in capital. EITF D-42 requires that the excess of fair value of the consideration transferred to the preferred stockholders over the carrying amount of the preferred stock be subtracted from net income applicable to common stockholders in the calculation of earnings per share.

## Liquidity and Capital Resources

*Cash Flows from Operations.* Due to the nature of our business, substantially all sales are for cash. Cash provided by operations is our primary source of liquidity. Acquisitions, interest expense and capital expenditures represent the primary uses of funds. We rely primarily upon cash provided by operating activities, supplemented as necessary from time to time by borrowings under our bank credit facility, sale-leaseback transactions, asset dispositions and equity investments, to finance our operations, pay interest, and fund capital expenditures and acquisitions. Cash provided by operating activities for fiscal 1998 totaled \$48.0 million, for fiscal 1999 totaled \$68.6 million and for fiscal 2000 totaled \$88.2 million. We had \$53.4 million of cash and cash equivalents on hand at September 28, 2000.

*Bank Credit Facility.* On January 28, 1999, we entered into our bank credit facility. The bank credit facility consists of a \$45.0 million revolving credit facility, a \$50.0 million acquisition facility and a \$240.0 million term loan facility. The revolving credit facility is available to fund working capital financing, general corporate purposes and for the issuance of standby letters of credit. The acquisition facility is available to fund future acquisitions of related businesses. As of September 28, 2000, there were no borrowings outstanding under the revolving credit facility and \$10.0 million outstanding under the acquisition facility. As of September 28, 2000, approximately \$17.0 million of letters of credit were issued under the revolving credit facility.

During fiscal 2000, we entered into amendments to our bank credit facility to include an additional \$100.0 million under our term loan facility. Proceeds from the term loans were used to prepay amounts outstanding under our acquisition facility and to fund acquisitions closed during fiscal 2000. As of September 28, 2000, we have approximately \$68.0 million in additional borrowing capacity.

Our bank credit facility contains covenants restricting our ability and the ability of any of our subsidiaries to, among other things: (i) incur additional indebtedness; (ii) declare dividends or redeem or repurchase capital stock; (iii) prepay, redeem or purchase debt; (iv) incur liens; (v) make loans and investments; (vi) make capital expenditures; (vii) engage in mergers, acquisitions or asset sales; and (viii) engage in transactions with affiliates. Our bank credit facility also

contains financial ratios and tests which must be met with respect to minimum coverage and leverage ratios, pro forma cash flow and maximum capital expenditures. Restrictive covenants in our debt agreements may restrict our ability to implement our acquisition strategy.

*2000 Acquisitions.* In fiscal 2000, we acquired a total of 143 convenience stores in 18 transactions for approximately \$106.7 million, net of cash acquired. These acquisitions were funded with borrowings under our bank credit facility and cash on hand.

Subsequent to September 28, 2000, we have entered into agreements to acquire 28 stores located in Mississippi (19), Louisiana (8) and North Carolina (1) in three separate transactions. These transactions will be primarily funded from borrowings under our bank credit facility and cash on hand.

*Capital Expenditures.* Capital expenditures (excluding all acquisitions) for fiscal 2000 were \$56.4 million. Capital expenditures are primarily expenditures for existing store improvements, store equipment, new store development, information systems and expenditures to comply with regulatory statutes, including those related to environmental matters. We finance substantially all capital expenditures and new store development through cash flow from operations, a sale-leaseback program or similar lease activity, vendor reimbursements and asset dispositions.

Our sale-leaseback program includes the packaging of our owned convenience store real estate, both land and buildings, for sale to investors in return for their agreement to leaseback the property to us under long-term leases. Generally, the leases are operating leases at market rates with terms of twenty years with four five-year renewal options. The lease payment is based on market rates ranging from 10.5% to 11.5% applied to the cost of each respective property. We retain ownership of all personal property and gasoline marketing equipment. The bank credit facility limits or caps the proceeds of sale-leasebacks that we can use to fund our operations or capital expenditures. Under this sale-leaseback program, we received \$9.5 million in fiscal 2000 and \$10.7 million during fiscal 1999.

In fiscal 2000, we received approximately \$24.3 million in sale-leaseback proceeds, vendor reimbursements for capital improvements and proceeds from asset dispositions; therefore, net capital expenditures, excluding all acquisitions, for fiscal 2000 were \$32.1 million. We anticipate that net capital expenditures for fiscal 2001 will be approximately \$45.0 million.

*Long-Term Debt.* At September 30, 2000, our long-term debt consisted primarily of \$200.0 million of the senior subordinated notes, \$316.5 million in term loans, and \$10.0 million outstanding under the acquisition facility. See "—Bank Credit Facility."

We have outstanding \$200.0 million of 10¼% senior subordinated notes due 2007. Interest on the senior subordinated notes is due on October 15 and April 15 of each year. The senior subordinated notes are unconditionally guaranteed, on an unsecured basis, as to the payment of principal, premium, if any, and interest, jointly and severally, by our subsidiaries, except for PH Holding and its subsidiaries. The senior subordinated notes contain covenants that, among other things, restrict our ability and any restricted subsidiary's ability to (i) pay dividends or make distributions, except in amounts not in excess of a percentage of our net income of proceeds of debt or equity issuances and in amounts not in excess of \$5.0 million, (ii) issue stock of subsidiaries, (iii) make investments of non-affiliated entities, except employee loans of up to \$3.0 million, (iv) repurchase stock, except stock owned by employees in amounts not in excess of \$2.0 million with the proceeds from debt or equity issuances, (v) incur liens not securing debt permitted under the senior subordinated notes, (vi) enter into transactions with affiliates, (vii) enter into sale-leaseback transactions, or (viii) engage in mergers or consolidations.

We can incur debt under the senior subordinated notes if the ratio of our pro forma EBITDA to fixed charges, after giving effect to such incurrence, is at least 2 to 1. Even if we do not meet this ratio we can incur: (i) bank credit facility debt of up to \$50.0 million of acquisition debt and other debt in an amount equal to the greater of \$45.0 million or an amount equal to 4.0% times our annualized revenues, (ii) capital leases or acquisition debt in amounts not to exceed the aggregate 10% of our tangible assets at time of incurrence, (iii) intercompany debt, (iv) pre-existing debt, (v) up to \$15.0 million in any type of debt or (vi) debt for refinancing of the above described debt.

The senior subordinated notes also place conditions on the terms of asset sales or transfers and require us either to reinvest the proceeds of an asset sale or transfer, or, if we do not reinvest those proceeds, to pay down our bank credit facility or other senior debt or to offer to redeem our senior subordinated notes with any asset sale proceeds not so used. All of the senior subordinated notes may be redeemed after October 15, 2002 at a redemption price which begins at 105.125% and decreases to 100.0% after October 2005.

*Cash Flows From Financing Activities.* We used proceeds from our bank credit facility and cash on hand to finance fiscal 2000 acquisitions and long-term debt principal requirements.

*Cash Requirements.* We believe that cash on hand, together with cash flow anticipated to be generated from operations, short-term borrowing for seasonal working capital, permitted borrowings under our credit facilities and permitted borrowings by our unrestricted subsidiary will be sufficient to enable us to satisfy anticipated cash requirements for operating, investing and financing activities, including debt service, for the next twelve months.

*Shareholders' Equity.* As of September 28, 2000, our shareholders' equity totaled \$118.0 million. The increase of \$13.8 million in shareholders' equity is attributed to fiscal year 2000 net income of \$14.0 million less stock issuance costs of \$0.2 million.

Additional paid in capital is impacted by the accounting treatment applied to a 1987 leveraged buyout of the outstanding common stock of our predecessor which resulted in a debit to equity of \$17.1 million. This debit had the effect, among others, of offsetting \$7.0 million of equity capital invested in us by our shareholders.

*Environmental Considerations.* We are required by federal and state regulations to maintain evidence of financial responsibility for taking corrective action and compensating third parties in the event of a release from our underground storage tank systems. In order to comply with this requirement, as of December 12, 2000, we maintain surety bonds in the aggregate amount of approximately \$900,000 in favor of state environmental enforcement agencies in the states of North Carolina, South Carolina, Georgia and Virginia and a letter of credit in the amount of approximately \$1.1 million issued by a commercial bank in favor of state environmental enforcement agencies in the states of Florida, Tennessee, Indiana and Kentucky. We also rely on reimbursements from applicable state trust funds. In Florida we also meet such financial responsibility requirements through a combination of private commercial liability insurance and a letter of credit. In Georgia, we meet our financial responsibility requirements by a combination of state trust fund coverage, private commercial liability insurance and a surety bond. In Mississippi, we meet our financial responsibility requirements through coverage under the state trust fund.

All states in which we operate or have operated underground storage tank systems have established trust funds for the sharing, recovering and reimbursing of certain cleanup costs and liabilities incurred as a result of releases from underground storage tank systems. These trust funds, which essentially provide insurance coverage for the cleanup of environmental damages caused by the operation of underground storage tank systems, are funded by an underground storage tank registration fee and a tax on the wholesale purchase of motor fuels within each state. We have paid underground storage tank registration fees and gasoline taxes to each state where we operate to participate in these trust programs and we have filed claims and received reimbursement in North Carolina, South Carolina, Kentucky, Indiana, Georgia, Florida and Tennessee. The coverage afforded by each state fund varies but generally provides from \$150,000 to \$1.0 million per site or occurrence for the cleanup of environmental contamination, and most provide coverage for third-party liabilities.

# management's discussion and analysis of financial condition and results of operations continued

Environmental reserves of \$14.1 million as of September 28, 2000, represent estimates for future expenditures for remediation, tank removal and litigation associated with 376 all known contaminated sites as a result of releases (e.g., overfills, spills and underground storage tank releases) and are based on current regulations, historical results and certain other factors. Although we can make no assurances, we anticipate that we will be reimbursed for a portion of these expenditures from state trust funds and private insurance. As of September 28, 2000, amounts which are probable of reimbursement (based on our experience) from those sources total \$12.8 million and are recorded as long-term environmental receivables. These receivables are expected to be collected within a period of twelve to eighteen months after the reimbursement claim has been submitted. In Florida, remediation of such contamination before January 1, 1999, will be performed by the state and we expect substantially all of the costs will be paid by the state trust fund. We will perform remediation in other states through independent contractor firms engaged by us. For certain sites the trust fund does not cover a deductible or has a co-pay which may be less than the cost of such remediation.

We have reserved \$1.5 million to cover third party claims for environmental conditions at adjacent real properties that are not covered by state trust funds or by private insurance. This reserve is based on management's best estimate of losses that may be incurred over the next several years based on, among other things, the average remediation cost for contaminated sites and our historical claims experience. Although we are not aware of releases or contamination at other locations where we currently operate or have operated stores, any such releases or contamination could require substantial remediation costs, some or all of which may not be eligible for reimbursement from state trust funds.

Several of the locations identified as contaminated are being cleaned up by third parties who have indemnified us as to responsibility for clean up matters. Additionally, we are awaiting closure notices on several other locations which will release us from responsibility related to known contamination at those sites. These sites continue to be included in our environmental reserve until a final closure notice is received.

## Recently Issued Accounting Standards Not Yet Adopted

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards ("SFAS") No. 133, Accounting for Derivative Instruments and Hedging Activities. SFAS No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives), and for hedging activities. It requires that an entity recognize all derivatives as either

assets or liabilities in the statement of financial position and measure those instruments at fair value. In June 1999, the effective date of SFAS No. 133 was extended for one year and, consequently, the statement is now effective for the first fiscal quarter of fiscal 2001. Adoption of SFAS 133 is not anticipated to have a material impact on our consolidated financial statements.

## Inflation

During fiscal 2000, cigarette prices increased 16.2%. In general, we have passed cigarette price increases to our customers. However, during fiscal 2000 as in years past, major cigarette manufacturers offered rebates to retailers, and we passed along these rebates to our customers.

During 2000, wholesale gasoline fuel prices increased significantly from a low of \$21 per barrel in October 1999 to a high of \$37 per barrel in September 2000. Generally we pass along wholesale gasoline cost changes to our customers through retail price changes. Gasoline price inflation has had an impact on total revenue and gross profit dollars.

General CPI increased 4.2% during fiscal 2000 and food at home, which is most indicative of our merchandise inventory, increased 3.1%. While we have generally been able to pass along these price increases to our customers, we make no assurances that continued inflation will not have a material adverse effect on our sales and gross profit dollars.

## Forward-Looking Statements

This annual report contains forward-looking statements. We have tried, wherever possible, to identify forward-looking statements by using words such as "anticipate," "believe," "estimate," "expect," "intend," and similar expressions. The forward-looking statements contained in this report, which have been based on our current expectations and projections and which are subject to numerous risks, uncertainties, and assumptions about The Pantry, our industry, and related economic conditions, include among other things:

- Our anticipated growth strategy, which includes our strategy to increase our store base through acquisition
- Anticipated trends in our businesses
- Future expenditures for capital projects including the cost of environmental regulatory compliance
- Our ability to pass along cigarette and gasoline price increases to our customers without a corresponding decrease in sales and gross profit
- Our ability to control costs, including our ability to achieve cost savings in connection with our acquisitions

These forward-looking statements contained in this report are subject to numerous risks and uncertainties, including without limitation risks related to:

- Future economic trends, including interest rate movements and general business conditions in the Southeast

- The intense competition in the convenience store and retail gasoline industries
- Our planned growth strategies, including our strategy to grow through acquisition
- Our dependence on gasoline and tobacco sales
- The concentration of our stores in the southeastern United States
- Our dependence on favorable weather conditions in spring and summer months
- Our rapid growth and our related ability to control costs and achieve cost savings in connection with our acquisitions
- The extensive governmental regulation of our business, including various environmental, federal, state and local regulations
- Our dependence on one principal wholesaler
- Control of The Pantry by one principal stockholder
- Dependence on our senior management
- Other factors identified in Exhibit 99.1 of our Annual Report on Form 10K for the period ending September 28, 2000

As a result of these and other risks actual results may differ from the forward-looking statements included in this annual report.

## Quantitative And Qualitative Disclosures About Market Risk

### Quantitative Disclosures:

We are exposed to certain market risks inherent in our financial instruments. These instruments arise from transactions entered into in the normal course of business and, in some cases, relate to our acquisitions of related businesses. We are subject to interest rate risk on our existing long-term debt and any future financing requirements. Our fixed rate debt consists primarily of outstanding balances on our senior subordinated notes and our variable rate debt relates to borrowings under our bank credit facility.

In order to reduce our exposure to interest rate fluctuations, we have entered into two interest rate swap arrangements, in which we agree to exchange, at specified intervals, the difference between fixed and variable interest amounts calculated by reference to an agreed upon notional amount. The interest rate differential is reflected as an adjustment to interest expense over the life of the swaps. On March 2, 1999, we entered into an interest rate swap arrangement with a notional amount of \$45.0 million that fixes our Euro-dollar rate at 5.62% through January 2001. On November 30, 1999, we entered into a swap arrangement with a notional amount of \$50 million that fixes our Eurodollar rate at 6.28% through November 2001. Effective June 16, 2000, we entered into two additional swap arrangements with notional amounts of \$25.0 million and \$50.0 million that fix our Eurodollar rate at 6.96% and 6.90%, respectively, through June 2003.

The following table presents the future principal cash flows and weighted-average interest rates expected on our existing long-term debt instruments. Fair values have been determined based on quoted market prices as of December 12, 2000.

	EXPECTED MATURITY DATE							Fair Value
	As of September 28, 2000							
(dollars in thousands)	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	Thereafter	Total	
<b>Long-Term Debt</b>	<b>\$20,650</b>	<b>\$25,319</b>	<b>\$28,573</b>	<b>\$45,073</b>	<b>\$88,654</b>	<b>\$319,354</b>	<b>\$527,623</b>	<b>\$503,472</b>
<b>Weighted-Average Interest Rate</b>	<b>10.14%</b>	<b>10.22%</b>	<b>10.23%</b>	<b>10.22%</b>	<b>10.24%</b>	<b>10.26%</b>	<b>10.22%</b>	
	As of September 30, 1999							
	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	Thereafter	Total	
Long-Term Debt	\$10,687	\$19,939	\$24,942	\$28,196	\$39,510	\$317,633	\$440,907	
Weighted-Average Interest Rate	9.42%	9.46%	9.52%	9.60%	9.69%	10.08%	9.67%	

### Qualitative Disclosures:

Our primary exposure relates to:

- interest rate risk on long-term and short-term borrowings,
- our ability to refinance our senior subordinated notes at maturity at market rates,
- the impact of interest rate movements on our ability to meet interest expense requirements and exceed financial covenants, and

- the impact of interest rate movements on our ability to obtain adequate financing to fund future acquisitions.

We manage interest rate risk on our outstanding long-term and short-term debt through our use of fixed and variable rate debt. While we cannot predict or manage our ability to refinance existing debt or the impact interest rate movements will have on our existing debt, management continues to evaluate our financial position on an ongoing basis.

## consolidated balance sheets

(Dollars in Thousands)	September 28, 2000	September 30, 1999
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 53,354	\$ 31,157
Receivables (net of allowance for doubtful accounts of \$766 at September 30, 1999, \$1,205 at September 28, 2000)	23,601	24,947
Inventories (Note 3)	87,962	76,220
Prepaid expenses	3,131	3,524
Property held for sale	2,324	135
Deferred income taxes (Note 6)	2,070	4,849
Total current assets	<b>172,442</b>	140,832
Property and equipment, net (Notes 4, 5, and 7)	<b>466,967</b>	421,685
Other assets:		
Goodwill (net of accumulated amortization of \$18,324 at September 30, 1999, \$24,352 at September 28, 2000) (Note 2)	250,977	197,705
Deferred financing costs (net of accumulated amortization of \$3,499 at September 30, 1999, \$4,513 at September 28, 2000) (Note 5)	12,317	12,680
Environmental receivables (Note 8)	12,819	13,136
Other	14,819	7,693
Total other assets	<b>290,932</b>	231,214
Total assets	<b>\$930,341</b>	\$793,731
<b>LIABILITIES AND SHAREHOLDERS' EQUITY:</b>		
Current liabilities:		
Current maturities of long-term debt (Note 5)	\$ 20,649	\$ 10,687
Current maturities of capital lease obligations (Note 7)	1,151	1,205
Accounts payable	101,903	92,577
Accrued interest (Note 5)	12,050	9,928
Accrued compensation and related taxes	13,889	9,593
Income taxes payable (Note 6)	1,250	6,784
Other accrued taxes	13,396	13,834
Accrued insurance	5,270	6,158
Other accrued liabilities	10,551	10,422
Total current liabilities	<b>180,109</b>	161,188
Long-term debt (Note 5)	<b>506,974</b>	430,220
Other noncurrent liabilities:		
Environmental costs (Note 8)	14,066	15,402
Deferred income taxes (Note 6)	34,508	26,245
Deferred revenue (Note 8)	54,802	34,249
Capital lease obligations (Note 7)	12,648	13,472
Employment obligations	—	486
Other	9,254	8,272
Total other noncurrent liabilities	<b>125,278</b>	98,126
Commitments and contingencies (Notes 5, 7, 8 and 13)		
Shareholders' Equity:		
Common stock, \$.01 par value, 50,000,000 shares authorized; 18,111,474 issued and outstanding at September 30, 1999, and September 28, 2000 (Note 10)	182	182
Additional paid-in capital (Note 11)	128,018	128,256
Shareholder loans	(912)	(937)
Accumulated deficit	(9,308)	(23,304)
Total shareholders' equity	<b>117,980</b>	104,197
Total liabilities and shareholders' equity	<b>\$930,341</b>	\$793,731

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

## consolidated statements of operations

(Dollars in Thousands, except per share amounts)	September 28, 2000 (52 weeks)	September 30, 1999 (53 weeks)	September 24, 1998 (52 weeks)
<b>Revenues:</b>			
Merchandise sales	<b>\$ 907,550</b>	\$ 731,681	\$460,798
Gasoline sales	<b>1,497,696</b>	923,786	509,958
Commissions	<b>27,014</b>	23,403	14,128
Total revenues	<b>2,432,260</b>	1,678,870	984,884
<b>Cost of sales:</b>			
Merchandise	<b>602,615</b>	489,258	303,968
Gasoline	<b>1,357,766</b>	818,784	447,565
Total cost of sales	<b>1,960,381</b>	1,308,042	751,533
Gross profit	<b>471,879</b>	370,828	233,351
<b>Operating expenses:</b>			
Operating, general and administrative expenses	<b>339,786</b>	262,852	172,850
Merger integration costs (Note 2)	—	—	1,016
Depreciation and amortization	<b>56,062</b>	42,798	27,642
Total operating expenses	<b>395,848</b>	305,650	201,508
Income from operations	<b>76,031</b>	65,178	31,843
<b>Other income (expense):</b>			
Interest expense	<b>(52,329)</b>	(41,280)	(28,946)
Miscellaneous	<b>1,070</b>	852	1,776
Total other expense	<b>(51,259)</b>	(40,428)	(27,170)
Income before income taxes and extraordinary loss	<b>24,772</b>	24,750	4,673
Income tax expense (Note 6)	<b>(10,776)</b>	(10,750)	—
Net income before extraordinary loss	<b>13,996</b>	14,000	4,673
Extraordinary loss (Note 5)	—	(3,584)	(7,998)
Net income (loss)	<b>\$ 13,996</b>	\$ 10,416	\$ (3,325)
Net income (loss) applicable to common shareholders (Note 14)	<b>\$ 13,996</b>	\$ 6,233	\$ (6,267)
<b>Earnings per share (Note 14):</b>			
Basic:			
Income before extraordinary loss	<b>\$ 0.77</b>	\$ 0.71	\$ 0.18
Extraordinary loss	—	\$ (0.26)	\$ (0.82)
Net income (loss)	<b>\$ 0.77</b>	\$ 0.45	\$ (0.64)
Diluted:			
Income before extraordinary loss	<b>\$ 0.74</b>	\$ 0.65	\$ 0.16
Extraordinary loss	—	\$ (0.24)	\$ (0.73)
Net income (loss)	<b>\$ 0.74</b>	\$ 0.41	\$ (0.57)

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

## consolidated statements of shareholders' equity (deficit)

(Dollars in Thousands)	Preferred Stock		Common Stock		Additional Paid-In Capital	Other <sup>(1)</sup>	Total Additional Paid-In Capital	Shareholder Loans	Accumulated Deficit	Total
	Shares	Par Value	Shares	Par Value			Capital			
Balance, September 25, 1997	43,499	\$—	5,815,479	\$ 58	\$ 22,448	\$(17,109)	\$ 5,339	\$ —	\$(23,270)	\$(17,873)
Net loss	—	—	—	—	—	—	—	—	(3,325)	(3,325)
Issuances of common stock	—	—	5,889,378	59	57,092	—	57,092	(215)	—	56,936
Contribution of Series A preferred stock and related dividends to additional paid in capital	(25,999)	—	—	—	6,508	—	6,508	—	—	6,508
Dividends on preferred stock	—	—	—	—	—	—	—	—	(2,942)	(2,942)
Balance, September 24, 1998	17,500	—	11,704,857	117	86,048	(17,109)	68,939	(215)	(29,537)	39,304
Net income	—	—	—	—	—	—	—	—	10,416	10,416
Issuances of common stock	—	—	156,617	2	1,788	—	1,788	(722)	—	1,068
Public sale of common stock at \$13.00 per share, net of expenses	—	—	6,250,000	63	72,916	—	72,916	—	—	72,979
Redemption of Series B preferred stock	(17,500)	—	—	—	(15,387)	—	(15,387)	—	(2,113)	(17,500)
Dividends on preferred stock	—	—	—	—	—	—	—	—	(2,070)	(2,070)
Balance, September 30, 1999	—	—	18,111,474	182	145,365	(17,109)	128,256	(937)	(23,304)	104,197
Net income	—	—	—	—	—	—	—	—	13,996	13,996
Repayment of shareholder loans	—	—	—	—	—	—	—	25	—	25
Stock issue costs	—	—	—	—	(238)	—	(238)	—	—	(238)
<b>Balance, September 28, 2000</b>	<b>—</b>	<b>\$—</b>	<b>18,111,474</b>	<b>\$182</b>	<b>\$145,127</b>	<b>\$(17,109)</b>	<b>\$128,018</b>	<b>\$(912)</b>	<b>\$ (9,308)</b>	<b>\$117,980</b>

(1) Represents excess of amount paid in 1987 leveraged buy-out over net book value for "carry over" shareholders. See Note 1.

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

## consolidated statements of cash flows

Year Ended (Dollars in Thousands)	September 28, 2000 (52 weeks)	September 30, 1999 (53 weeks)	September 24, 1998 (52 weeks)
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income (loss)	<b>\$ 13,996</b>	\$ 10,416	\$ (3,325)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Extraordinary loss	—	3,406	2,006
Depreciation and amortization	<b>56,062</b>	42,798	27,642
Provision for deferred income taxes	<b>8,168</b>	530	138
Loss on sale of property and equipment	<b>1,995</b>	4,484	531
Provision for environmental expenses	<b>(1,336)</b>	(1,735)	6,181
Provision for closed stores	<b>430</b>	—	50
Changes in operating assets and liabilities, net of effects of acquisitions:			
Receivables	<b>1,217</b>	8,741	(8,512)
Inventories	<b>(2,447)</b>	(11,138)	(4,518)
Prepaid expenses	<b>834</b>	(34)	390
Other noncurrent assets	<b>(1,968)</b>	(830)	5,111
Accounts payable	<b>2,328</b>	22,556	13,896
Other current liabilities and accrued expenses	<b>(2,352)</b>	(27,310)	2,241
Employment obligations	<b>(496)</b>	(448)	(407)
Other noncurrent liabilities	<b>11,728</b>	17,131	6,608
Net cash provided by operating activities	<b>88,159</b>	68,567	48,032
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Additions to property held for sale	<b>(2,094)</b>	(178)	(5,203)
Additions to property and equipment	<b>(56,414)</b>	(47,416)	(42,067)
Proceeds from sale lease-back transactions	<b>9,470</b>	10,724	4,807
Proceeds from sale of property and equipment	<b>7,033</b>	2,366	7,648
Acquisitions of related businesses, net of cash acquired	<b>(106,686)</b>	(194,414)	(250,592)
Net cash used in investing activities	<b>(148,691)</b>	(228,918)	(285,407)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Principal repayments under capital leases	<b>(1,703)</b>	(1,495)	(1,424)
Principal repayments of long-term debt	<b>(71,284)</b>	(184,888)	(51,543)
Proceeds from issuance of long-term debt	<b>158,000</b>	297,000	278,508
Redemption of Series B preferred stock	—	(17,500)	—
Net proceeds from initial public offering	—	72,979	—
Net proceeds from other equity issues	—	1,068	56,935
Accrued dividends paid on preferred stock	—	(6,461)	—
Stock issue costs	<b>(238)</b>	—	—
Repayment of shareholder loans	<b>25</b>	—	—
Other financing costs	<b>(2,071)</b>	(3,599)	(14,044)
Net cash provided by financing activities	<b>82,729</b>	157,104	268,432
Net increase (decrease)	<b>22,197</b>	(3,247)	31,057
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<b>31,157</b>	34,404	3,347
CASH AND CASH EQUIVALENTS AT END OF YEAR	<b>\$ 53,354</b>	\$ 31,157	\$ 34,404

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

# notes to consolidated financial statements

## NOTE 1—HISTORY OF COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

### The Pantry

The consolidated financial statements include the accounts of The Pantry, Inc. (the “Company” or “The Pantry”) and its wholly-owned subsidiaries, Sandhills, Inc., Lil’ Champ Food Stores, Inc. and its wholly-owned subsidiary, Miller Enterprises Inc., Global Communications, Inc., PH Holding Corporation and PH Holding’s wholly-owned subsidiaries, TC Capital Management, Inc. and Pantry Properties, Inc. All intercompany transactions and balances have been eliminated in consolidation. The Pantry owns and operates 1,313 convenience stores in Florida (517), North Carolina (343), South Carolina (251), Georgia (57), Kentucky (45), Mississippi (37), Virginia (30), Indiana (18), and Tennessee (15).

During fiscal 1996, Freeman Spogli & Co. (“Freeman Spogli”) and Chase Manhattan Capital Corporation (“Chase”) acquired a controlling interest in the Company through a series of transactions which included the purchase of common stock from certain shareholders and the purchase of newly issued common and preferred stock. During fiscal years 1997 and 1998, the Company issued additional shares of common and preferred stock to existing shareholders and certain directors and executives of the Company. As of September 28, 2000, Freeman Spogli owns 10,329,524 shares of common stock and warrants to purchase 2,346,000 shares of common stock which represents beneficial ownership of approximately 62.0% of our outstanding shares, including shares underlying warrants. Chase and its affiliates own 2,298,438 shares of common stock, or 12.7% of the outstanding shares.

On June 8, 1999, we offered and sold 6,250,000 shares of our common stock in our initial public offering (the “IPO”). The initial offering price was \$13.00 per share and the Company received \$75.6 million in net proceeds, before expenses. The net proceeds were used (i) to repay \$19.0 million in indebtedness under the 1999 bank credit facility; (ii) to redeem \$17.5 million in outstanding preferred stock; and (iii) to pay accrued dividends on the preferred stock of \$6.5 million. Of the remaining \$32.6 million, \$30.2 million was used to fund acquisitions closed during the fourth quarter of fiscal 1999, \$2.4 million was reserved to pay fees and expenses associated with the IPO.

### Accounting Period

The Pantry operates on a 52 or 53 week fiscal year ending on the last Thursday in September. For 1998 and 2000, The Pantry’s fiscal years contained 52 weeks and for 1999 The Pantry’s fiscal year contained 53 weeks.

### Acquisition Accounting

Generally, our acquisitions are accounted for under the purchase method of accounting whereby purchase price is allocated to assets acquired and liabilities assumed based on fair value. Excess of purchase price over fair value of net assets acquired is recorded as goodwill. Accordingly, the Consolidated Statement of Operations for the fiscal years presented includes the results of operations for each of the acquisitions from the date of acquisition only.

On August 13, 1987, Montrose Pantry Acquisition Corporation acquired all of our common stock in a leveraged buy-out. Certain individuals and entities which held an ownership interest retained approximately 45% ownership after the leveraged buy-out and a new basis of accounting was established which resulted in a partial step-up in basis. In accordance with EITF 88-16 and to the extent that certain individuals and entities maintained their equity interests, the excess amount paid over net book value was recorded as a debit in shareholders’ deficit (\$17,109,000).

### Cash and Cash Equivalents

For purposes of the consolidated financial statements, cash and cash equivalents includes cash on hand, demand deposits, and short-term investments with original maturities of three months or less.

### Inventories

Inventories are valued at the lower of cost or market. Cost is determined using the last-in, first-out method for merchandise inventories and using the first-in, first-out method for gasoline inventories.

### Property Held for Sale

Property is classified as current assets when management’s intent is to sell these assets in the ensuing fiscal year, and is recorded at the lower of cost or fair value less cost to sell.

### Property and Equipment

Property and equipment are stated at cost, less accumulated depreciation and amortization. Depreciation and amortization is provided primarily by the straight-line method over the estimated useful lives of the assets for financial statement purposes and by accelerated methods for income tax purposes.

Estimated useful lives for financial statement purposes are as follows:

Buildings	20 to 33½ years
Equipment, furniture and fixtures	3 to 10 years
Automobiles	3 to 5 years

Upon sale or retirement of depreciable assets, the related cost and accumulated depreciation are removed from the accounts and any gain or loss is recognized. Leased buildings capitalized in accordance with SFAS No. 13, Accounting for Leases, are recorded at the lesser of fair value or the discounted present value of future lease payments at the inception of the leases. Amounts capitalized are amortized over the estimated useful lives of the assets or terms of the leases (generally 5 to 20 years) using the straight-line method.

### Goodwill

Goodwill, which represents the excess of purchase price over fair value of net assets acquired, is amortized on a straight-line basis over periods of 20 to 40 years. The Pantry considers legal, contractual, regulatory, obsolescence and competitive factors in determining the useful life and amortization period of this intangible asset. Additions to goodwill and increases in goodwill amortization expense primarily relate to our acquisition of the stock or assets of convenience store operators. The useful life of the associated goodwill is either indefinite for real property purchased or tied directly to leases with terms, including renewal options of 30 to 40 years.

The Pantry assesses the recoverability of this intangible asset by determining whether amortization of the goodwill balance over its remaining life can be recovered through estimated undiscounted future operating results. Estimated future results are based on a trend of historical results for the trailing three fiscal years and management's estimate of future results which indicate that the goodwill balances will be recovered over the various periods remaining to be benefited.

### Long-Lived Assets

Long-lived assets are reviewed for impairment on a store-by-store basis whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. When an evaluation is required, the projected future undiscounted cash flows due to each store are compared to the carrying value of the long-lived assets, including an allocation of goodwill if appropriate, of that store to determine if a write-down to fair value is required.

### Deferred Financing Cost

Deferred financing cost represents expenses related to issuing The Pantry's long-term debt, obtaining its lines of credit and obtaining lease financing. See Note 5—Long-Term Debt and Note 7—Leases. Such amounts are being amortized over the remaining term of the respective financing.

### Vendor Allowances, Rebates and Other Vendor Payments

The Pantry receives payments for vendor allowances, volume rebates and other supply arrangements in connection with various programs. The Pantry records these payments as a reduction to cost of sales or expenses to which the particular vendor payment relates. The amounts recorded against cost of sales were \$78.6 million, \$54.7 million and \$21.6 million for fiscal years 2000, 1999 and 1998, respectively. For unearned payments, The Pantry records deferred income and amortizes the balance, as earned, over the term of the respective agreement.

### Environmental Costs

The Pantry accounts for the cost incurred to comply with federal and state environmental regulations as follows:

- The environmental reserve reflected in the financial statements is based on internal and external estimates of the costs to remediate sites relating to the operation of underground storage tanks. Factors considered in the estimates of the reserve are the expected cost to remediate each contaminated site and the estimated length of time to remediate each site.
- Future remediation costs for amounts of deductibles under, or amounts not covered by, state trust fund programs and third party insurance arrangements and for which the timing of payments can be reasonably estimated are discounted using a ten-percent rate. All other environmental costs are provided for on an undiscounted basis.
- Amounts which are probable of reimbursement under state trust fund programs or third party insurers, based on The Pantry's experience, are recognized as receivables and are expected to be collected within a period of twelve to eighteen months after the reimbursement claim has been submitted. These receivables exclude all deductibles and an estimate for uncollectible reimbursements. The Pantry's reimbursement experience exceeds a 95% collection rate. The adequacy of the liability and uncollectible receivable reserve is evaluated quarterly and adjustments are made based on updated experience at existing sites, newly identified sites and changes in governmental policy.
- Annual fees for tank registration and environmental compliance testing are expensed as incurred.
- Expenditures for upgrading tank systems including corrosion protection, installation of leak detectors and overflow/spill devices are capitalized and depreciated over the remaining useful life of the asset or the respective lease term, whichever is less.
- The tank removal costs associated with locations which The Pantry plans to sell or dispose of in the near future are estimated annually and a liability is established through a charge to expense. The costs to remove tanks at active locations are expensed as incurred.

# notes to consolidated financial statements

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## Income Taxes

All operations of The Pantry and its subsidiaries are included in a consolidated Federal income tax return. Pursuant to SFAS No. 109, Accounting for Income Taxes, The Pantry recognizes deferred tax liabilities and assets for the expected future tax consequences of temporary differences between financial statement carrying amounts and the related tax bases.

## Excise and Use Taxes

The Pantry collects and remits various federal and state excise taxes on petroleum products. Gasoline sales and cost of sales included excise taxes of approximately \$419,341,000, \$303,466,000 and \$154,954,000 for 2000, 1999 and 1998, respectively.

## Advertising costs

Advertising costs are expensed as incurred. Advertising expense was approximately \$2,219,000, \$1,694,000 and \$1,019,000 for fiscal 2000, 1999 and 1998, respectively.

## Stock Based Compensation

The Pantry's stock option plan is accounted for in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees. The Pantry follows the disclosure requirements of SFAS No. 123, Accounting for Stock Based Compensation.

## Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

## Segment Reporting

In 1999, The Pantry adopted SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, which establishes annual and interim reporting standards for an enterprise's business segments and related disclosures about its products, services, geographic areas and major customers. The Pantry operates in one reportable segment.

## Reclassifications

Certain amounts in the fiscal 1998 and 1999 consolidated financial statements have been reclassified to conform to the fiscal 2000 presentation.

## Newly Adopted Accounting Standards and Recently Issued Accounting Standards Not Yet Adopted

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. SFAS No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives), and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. If certain conditions are met, a derivative may be specifically designated as (i) a hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment, (ii) a hedge of the exposure to variable cash flows of a forecasted transaction, or (iii) a hedge of the foreign currency exposure of a net investment in a foreign operation, an unrecognized firm commitment, an available-for-sale security, or a foreign-currency-denominated forecasted transaction.

Under SFAS No. 133, an entity that elects to apply hedge accounting is required to establish at the inception of the hedge the method it will use for assessing the effectiveness of the hedging derivative and the measurement approach for determining the ineffective aspect of the hedge. Those methods must be consistent with the entity's approach to managing risk. In June 1999, the effective date of SFAS No. 133 was extended one year; consequently, the statement will now be effective for the first quarter of fiscal 2001. Adoption of SFAS 133 is not anticipated to have a material impact on The Pantry's consolidated financial statements.

## NOTE 2—BUSINESS ACQUISITIONS:

During fiscal 2000, The Pantry acquired 143 convenience stores located in North Carolina, South Carolina, Florida, Georgia, Mississippi and Virginia in 18 separate transactions. The transactions were accounted for by the purchase method of accounting. The 2000 acquisitions were funded from borrowings under the bank credit facility, as amended, and cash on hand.

During fiscal 1999, The Pantry acquired 297 convenience stores located in North Carolina, South Carolina, Florida, Georgia and Virginia in eight separate transactions. The transactions were accounted for by the purchase method of accounting. The 1999 acquisitions were funded from borrowings under the 1998 bank credit facility, an equity investment, and cash on hand.

The purchase prices have been allocated to the assets purchased and the liabilities assumed based upon the fair values on the dates of the acquisitions, as follows (amounts in thousands):

	2000	1999
<b>ASSETS ACQUIRED:</b>		
Receivables, net	\$ 1,464	\$ 23,220
Inventories	9,275	17,347
Deferred income taxes	—	733
Prepaid expenses and other current assets	441	1,192
Property and equipment	52,750	120,856
Other noncurrent assets	5,203	4,308
Total assets acquired	69,133	167,656
<b>LIABILITIES ASSUMED:</b>		
Accounts payable—trade	6,998	15,308
Other liabilities and accrued expenses	2,039	20,615
Income taxes payable	—	6,863
Environmental remediation liabilities	25	—
Noncurrent deferred income taxes	—	5,221
Other noncurrent liabilities	7,325	4,402
Total liabilities assumed	16,387	52,409
Net tangible assets acquired	52,746	115,247
Excess of purchase price over fair value of net assets acquired	53,940	79,167
Total consideration paid, including direct costs, net of cash acquired	\$106,686	\$194,414

The purchase price allocations for certain of the 2000 acquisitions are preliminary estimates, based on available information, internal estimates and certain assumptions management believes are reasonable. Accordingly, the purchase price allocations are subject to finalization pending the completion of internal and external appraisals of assets acquired. The excess of the purchase prices over fair values of the net assets acquired for all acquisitions has been recorded as goodwill, which is being amortized on a straight-line basis over 30 years.

The following unaudited pro forma information presents a summary of consolidated results of operations of The Pantry and acquired businesses as if the 2000 transactions occurred at the beginning of the fiscal year for each of the periods presented (amounts in thousands):

	2000	1999
Total revenues	\$2,545,661	\$2,189,686
Income before extraordinary loss	\$ 14,906	\$ 12,333
Net income	\$ 14,906	\$ 8,749
Net income applicable to common shareholders	\$ 14,906	\$ 4,566
Earnings per share applicable to common shareholders:		
Basic:		
Income before extraordinary loss	\$ 0.82	\$ 0.59
Extraordinary loss	—	(0.26)
Net income	\$ 0.82	\$ 0.33
Diluted:		
Income before extraordinary loss	\$ 0.79	\$ 0.54
Extraordinary loss	—	(0.24)
Net income	\$ 0.79	\$ 0.30

In connection with the Lil' Champ acquisition, The Pantry recorded an integration charge of approximately \$1.0 million in fiscal 1998 for costs of combining its existing businesses with the acquired businesses of Lil' Champ. The charge included:

- \$300,000 for relocation costs
- \$600,000 for elimination of duplicated contractual services for which there is no future economic benefit
- \$100,000 for other consolidation and related expenses

The Pantry's integration plan included:

- the relocation of approximately 11 employees
- the elimination of duplicate contractual services
- conforming Lil' Champ's corporate and field operations to The Pantry's policies and procedures
- the disposal of unprofitable and unstrategic locations and operations

In accordance with accounting principles generally accepted in the United States of America, these integration costs were not included as part of the purchase price allocation for the Lil' Champ acquisition.

In connection with the Lil' Champ acquisition, The Pantry sold all 48 Lil' Champ store operations and idle property in the state of Georgia. The sale was completed on September 1, 1998. As required by SFAS No. 121, these assets were measured at fair value less costs to sell during the allocation period following the consummation date of the acquisition. The Pantry received cash proceeds of \$2.5 million from the disposition, which approximated the carrying value of the assets. Accordingly, no gain or loss was recorded on the disposition. Revenues and net loss before taxes related to the 48 stores disposed of and included in our historical financial statements totaled approximately \$30,313,000 and \$(954,000), respectively, for the year ended September 24, 1998.

#### NOTE 3—INVENTORIES:

At September 30, 1999 and September 28, 2000, inventories consisted of the following (in thousands):

	2000	1999
Inventories at FIFO cost:		
Merchandise	\$ 70,461	\$ 63,924
Gasoline	28,806	22,431
	99,267	86,355
Less adjustment to LIFO cost:		
Merchandise	(11,305)	(10,135)
Inventories at LIFO cost	\$ 87,962	\$ 76,220

The positive effect on cost of sales of LIFO inventory liquidations was \$4,000, \$53,000 and \$482,000 for fiscal years 2000, 1999 and 1998, respectively.

# notes to consolidated financial statements

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## NOTE 4—PROPERTY AND EQUIPMENT:

At September 28, 2000 and September 30, 1999, property and equipment consisted of the following (in thousands):

	2000	1999
Land	\$ 86,568	\$ 86,708
Buildings	129,643	127,609
Equipment	345,240	266,794
Leasehold improvements	57,811	51,985
Construction in progress	9,749	10,072
	<b>629,011</b>	543,168
Less—accumulated depreciation and amortization	<b>(162,044)</b>	(121,483)
	<b>\$ 466,967</b>	\$ 421,685

## NOTE 5—LONG-TERM DEBT:

At September 28, 2000 and September 30, 1999, long-term debt consisted of the following (in thousands):

	2000	1999
Senior subordinated notes payable; due October 15, 2007; interest payable semi-annually at 10.25%	<b>\$ 200,000</b>	\$ 200,000
Term loan facility—Tranche A; interest payable monthly at LIBOR (6.62% at September 28, 2000) plus 3.0%; principal due in quarterly installments through January 31, 2004	<b>61,906</b>	70,656
Term loan facility—Tranche B; interest payable monthly at LIBOR (6.62% at September 28, 2000) plus 3.5%; principal due in quarterly installments through January 31, 2006	<b>179,973</b>	156,794
Term loan facility—Tranche C; interest payable monthly at LIBOR (6.62% at September 28, 2000) plus 3.75%; principal due in quarterly installments through January 31, 2006	<b>74,625</b>	—
Acquisition facility; interest payable monthly at LIBOR (6.62% at September 28, 2000) plus 3.0%; principal due in quarterly installments beginning April 30, 2001 through January 31, 2004	<b>10,000</b>	12,000
Note payable; zero (0.0%) interest, with principal due in annual installments through February 26, 2003	<b>889</b>	1,185
Other notes payable; various interest rates and maturity dates	<b>230</b>	272
	<b>527,623</b>	440,907
Less—current maturities	<b>(20,649)</b>	(10,687)
	<b>\$ 506,974</b>	\$ 430,220

On October 23, 1997, in connection with the Lil' Champ acquisition, The Pantry completed the offering of the senior subordinated notes. The senior subordinated notes are unconditionally guaranteed, on an unsecured senior subordinated basis, as to the payment of principal, premium, if any, and interest, jointly and severally, by all guarantors. See Note 15—Supplemental Guarantors Information. The senior subordinated notes contain covenants that, among other things, restrict the ability of The Pantry and any restricted subsidiary to (i) incur additional debt, (ii) pay dividends or make distributions, (iii) issue stock of subsidiaries, (iv) make certain investments or repurchase stock, (v) create liens, (vi) enter into transactions with affiliates or sale-leaseback transactions, and (vii) merge or consolidate The Pantry or any of its subsidiaries or sell or transfer assets. The senior subordinated notes also contain financial ratios and tests which must be met with respect to minimum coverage and leverage ratios, pro forma cash flow and capital expenditures.

On January 28, 1999, The Pantry entered into its bank credit facility consisting of (i) a \$45.0 million revolving credit facility available for working capital financing, general corporate purposes and issuing commercial and standby letters of credit, (ii) a \$50.0 million acquisition facility available to finance acquisitions of related businesses, and (iii) a \$240 million term loan facility.

On October 27, 1999, The Pantry entered into an amendment to its bank credit facility which increased the borrowing capacity to include an additional \$75.0 million term loan. The term loan bears interest, at The Pantry's option, based on margins over a base rate or an adjusted Eurodollar rate. Proceeds from the term loan were used to prepay amounts outstanding under the acquisition facility and to fund fiscal 2000 acquisition.

On November 30, 1999, The Pantry entered into an amendment to its Bank credit facility to include an additional \$25.0 million under Tranche B of the term loan facility. Proceeds from the term loan were used to fund fiscal 2000 acquisitions.

The bank credit facility contains covenants restricting the ability of The Pantry and any of its subsidiaries to among other things (i) incur additional indebtedness, (ii) declare dividends or redeem or repurchase capital stock, (iii) prepay, redeem or purchase debt, (iv) incur liens, (v) make loans and investments, (vi) make capital expenditures, (vii) engage in mergers, acquisitions or asset sales, and (viii) engage in

transactions with affiliates. The bank credit facility also contains financial ratios and tests which must be met with respect to minimum coverage and leverage ratios, pro forma cash flow and maximum capital expenditures.

The Pantry used the proceeds of the term loan facilities and a \$5.0 million initial draw under its revolving credit facility, along with cash on hand, to:

- finance the fiscal 1999 acquisition of Miller Enterprises, Inc.
- repay \$94.0 million outstanding under the prior bank credit facility, and replace outstanding letters of credit
- redeem its outstanding senior notes in the aggregate principal amount of \$49.0 million
- pay related transaction costs

As of September 28, 2000, there was \$10,000,000 outstanding under the acquisition facility, outstanding letters of credit of \$16,999,000, issued under the revolving credit facility and \$68 million in available credit under these facilities.

As of September 28, 2000, The Pantry was in compliance with all covenants and restrictions relating to all its outstanding borrowings.

As of September 28, 2000, substantially all of The Pantry's and its subsidiaries' net assets are restricted as to payment of dividends and other distributions.

The Pantry's long-term debt maturities for each of the five years following September 28, 2000 and thereafter are: \$20.6 million in 2001; \$25.3 million in 2002; \$28.6 million in 2003; \$45.1 million in 2004; \$88.7 million in 2005; and \$319.3 million thereafter.

#### NOTE 6—INCOME TAXES:

The components of income tax expense (benefit) are summarized below (in thousands):

	2000	1999	1998
Current:			
Federal	\$ 2,444	\$ 7,093	\$ —
State	164	800	138
	<b>2,608</b>	7,893	138
Deferred:			
Federal	7,279	2,488	—
State	889	369	(138)
	<b>8,168</b>	2,857	(138)
	<b>\$10,776</b>	\$10,750	\$ —

As of September 28, 2000 and September 30, 1999, deferred tax liabilities (assets) are comprised of the following (in thousands):

	2000	1999
Depreciation	\$50,565	\$ 39,695
Deferred lease cost	17	17
Inventory	3,640	2,761
Amortization	857	1,315
Other	635	581
Gross deferred tax liabilities	<b>55,714</b>	44,369
Capital lease obligations	(1,609)	(1,499)
Allowance for doubtful accounts	(464)	(301)
Environmental expenses	27	(345)
Accrued insurance reserves	(3,715)	(4,692)
Accrued compensation	(156)	—
Exit and employee termination costs	(10)	(1,328)
Other	(1,609)	(2,470)
Gross deferred tax assets	<b>(7,536)</b>	(10,635)
Net operating loss carryforwards	<b>(7,992)</b>	(3,223)
General business credits	<b>(1,833)</b>	(1,833)
AMT credits	<b>(5,915)</b>	(7,282)
	<b>\$32,438</b>	\$ 21,396

As of September 28, 2000 and September 30, 1999, net current deferred income tax assets totaled \$2,070,000 and \$4,849,000, respectively, and net noncurrent deferred income tax assets (liabilities) totaled \$(34,508,000) and \$(26,245,000), respectively.

Reconciliations of income taxes at the Federal statutory rate (34%) to actual taxes provided are as follows (in thousands):

	2000	1999	1998
Tax expense (benefit) at Federal statutory rate	\$ 8,422	\$ 8,415	\$(1,131)
Tax expense (benefit) at state rate, net of Federal income tax expense (benefit)	1,013	1,188	(149)
Permanent differences:			
Amortization of goodwill	1,161	1,081	677
Other	180	66	52
Tax benefit from creation of general business credits	—	—	—
Valuation allowance	—	—	551
Net income tax expense	<b>\$10,776</b>	\$10,750	\$ —

As of September 28, 2000, The Pantry had net operating loss carryforwards, general business credits and AMT credits which can be used to offset future Federal income taxes. The benefit of these carryforwards is recognized, net of a valuation allowance for a portion of the net operating losses and

# notes to consolidated financial statements

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credits which The Pantry believes may expire unused, as deferred tax assets. Loss carryforwards as of September 28, 2000 have the following expiration dates (in thousands):

	Federal	State
2009	\$ —	\$ 3,158
2010	—	2,974
2011	—	10,919
2012	2,332	5,101
2013	—	13,274
2014	—	5,162
2015	—	5,841
2017	9,374	—
2018	5,662	—
Total loss carryforwards	\$17,368	\$46,429

## NOTE 7—LEASES:

The Pantry leases store buildings, office facilities and store equipment under both capital and operating leases. The asset balances related to capital leases at September 28, 2000, and September 30, 1999 are as follows (in thousands):

	2000	1999
Buildings	\$12,965	\$13,542
Less—accumulated amortization	(1,976)	(1,564)
	\$10,989	\$11,978

Amortization expense related to capitalized leased assets was \$1,345,000, \$1,299,000 and \$1,249,000 for fiscal 2000, 1999 and 1998, respectively.

Future minimum lease payments as of September 28, 2000, for capital leases and operating leases that have initial or remaining terms in excess of one year are as follows (in thousands):

Fiscal Year	Capital Leases	Operating Leases
2001	\$ 2,684	\$ 40,673
2002	2,626	39,161
2003	2,534	37,888
2004	2,368	36,637
2005	2,029	33,564
Thereafter	13,408	96,051
Net minimum lease payments	25,649	\$283,975
Amount representing interest (8% to 20%)	11,850	
Present value of net minimum lease payments	13,799	
Less—current maturities	1,151	
	\$12,648	

Rental expense for operating leases was approximately \$50,856,000, \$40,551,000 and \$23,758,000 for fiscal years 2000, 1999 and 1998, respectively. Some of The Pantry's leases require contingent rental payments; such amounts are not material for the fiscal years presented.

During fiscal 2000, 1999 and 1998, The Pantry entered into sale-leaseback transactions with unrelated parties with net proceeds of \$9,470,000, \$10,724,000 and \$4,807,000, respectively. The assets sold in these transactions consisted of newly constructed or acquired convenience stores. The Pantry retained ownership of all personal property and gasoline marketing equipment at these locations. The net proceeds from these transactions approximated the carrying value of the assets at the time of sale; accordingly, any gains or losses recognized on these transactions were insignificant for all periods presented. Generally, the leases are operating leases at market rates with terms of twenty years with four five-year renewal options.

## NOTE 8—COMMITMENTS AND CONTINGENCIES:

As of September 28, 2000, The Pantry was contingently liable for outstanding letters of credit in the amount of \$16,999,000 related primarily to several areas in which The Pantry is self-insured. The letters of credit are not to be drawn against unless The Pantry defaults on the timely payment of related liabilities.

The Pantry is involved in certain legal actions arising in the normal course of business. In the opinion of management, based on a review of such legal proceedings, the ultimate outcome of these actions will not have a material effect on the consolidated financial statements.

### Unamortized Liabilities Associated with Vendor Payments

In accordance with the terms of each service or supply agreement and in accordance with accounting principles generally accepted in the United States of America, service and supply allowances are amortized over the life of each agreement in accordance with the specific terms. The unamortized liabilities associated with these payments as of September 28, 2000 and September 30, 1999, were \$58,898,000 and \$35,195,000, respectively.

McLane Company, Inc. ("McLane")—The Pantry purchases over 50% of its general merchandise from a single wholesaler, McLane. The Pantry's arrangement with McLane is governed by a five-year distribution service agreement under which McLane supplies general merchandise, including tobacco products, grocery items, health and beauty aids and other products. The Pantry receives annual service allowances based on the number of stores operating on each contract anniversary date. If The Pantry were to default under the contract or terminate the distribution service agreement prior to March 28, 2003, The Pantry must reimburse McLane the unearned, unamortized portion of the service allowance payments received to date. In accordance with the terms of the distribution service agreement and in accordance with generally accepted accounting principles,

the original service allowances received and all future service allowances are amortized to cost of goods sold on a straight-line method over the life of the agreement.

**Major Oil Companies**—The Pantry has entered into product purchase agreements with numerous oil companies to buy specified quantities of gasoline at market prices. The length of these contracts range from five to thirteen years and in some cases include minimum annual purchase requirements. In connection with these agreements, The Pantry may receive upfront vendor allowances, volume incentive payments and other vendor assistance payments. If The Pantry were to default under the terms of any contract or terminate the supply agreement prior to the end of the initial term, The Pantry must reimburse the respective oil company for the unearned, unamortized portion of the payments received to date. In accordance with accounting principles generally accepted in the United States of America, these payments are amortized using the specific amortization periods in accordance with the terms of each agreement, either using the straight-line method or based on gasoline volume purchased. The Pantry has exceeded the minimum required annual purchases each year and expects to exceed the minimum required annual purchase levels in future years.

#### Environmental Liabilities and Contingencies

The Pantry is subject to various federal, state and local environmental laws and regulations governing underground petroleum storage tanks that require The Pantry to make certain expenditures for compliance. In particular, at the federal level, the Resource Conservation and Recovery Act of 1976, as amended, requires the EPA to establish a comprehensive regulatory program for the detection, prevention, and cleanup of leaking underground storage tanks. Regulations enacted by the EPA in 1988 established requirements for:

- installing underground storage tank systems
- upgrading underground storage tank systems
- taking corrective action in response to releases
- closing underground storage tank systems
- keeping appropriate records
- maintaining evidence of financial responsibility for taking corrective action and compensating third parties for bodily injury and property damage resulting from releases

In addition to the technical standards, The Pantry is required by federal and state regulations to maintain evidence of financial responsibility for taking corrective action and compensating third parties in the event of a release from its underground storage tank systems. In order to comply with this requirement, The Pantry maintains surety bonds in the aggregate amount of approximately \$900,000 in favor of state environmental agencies in the states of North Carolina, Virginia, South Carolina and Georgia and a letter of credit in the aggregate amount of approximately \$1.1 million issued

by a commercial bank in favor of state environmental agencies in the states of Florida, Tennessee, Indiana and Kentucky and relies on reimbursements from applicable state trust funds. In Florida, The Pantry meets such financial responsibility requirements by state trust fund coverage through December 31, 1998 and met such requirements thereafter through a combination of private commercial liability insurance and a letter of credit. In Mississippi we meet our financial responsibility requirements through coverage under the state trust fund.

All states in which The Pantry operates or has operated underground storage tank systems have established trust funds for the sharing, recovering, and reimbursing of certain cleanup costs and liabilities incurred as a result of releases from underground storage tank systems. These trust funds, which essentially provide insurance coverage for the cleanup of environmental damages caused by the operation of underground storage tank systems, are funded by an underground storage tank registration fee and a tax on the wholesale purchase of motor fuels within each state. The Pantry has paid underground storage tank registration fees and gasoline taxes to each state where it operates to participate in these programs and has filed claims and received reimbursement in North Carolina, South Carolina, Kentucky, Indiana, Florida, Georgia, and Tennessee. The coverage afforded by each state fund varies but generally provides from \$150,000 to \$1.0 million per site or occurrence for the cleanup of environmental contamination, and most provide coverage for third party liabilities.

In addition to immaterial amounts to be spent by The Pantry, a substantial amount will be expended for remediation on behalf of The Pantry by state trust funds established in The Pantry's operating areas or other responsible third parties (including insurers). To the extent such third parties do not pay for remediation as anticipated by The Pantry, The Pantry will be obligated to make such payments, which could materially adversely affect The Pantry's financial condition and results of operations. Reimbursement from state trust funds will be dependent upon the maintenance and continued solvency of the various funds.

Environmental reserves of \$14,066,000 and \$15,402,000 as of September 28, 2000 and September 30, 1999, respectively, represent estimates for future expenditures for remediation, tank removal and litigation associated with 233 and 376 known contaminated sites, respectively, as a result of releases (e.g., overfills, spills and underground storage tank releases) and are based on current regulations, historical results and certain other factors. As of September 30, 2000 the current average remediation cost per site is approximately \$70,000. Remediation costs for known sites are expected to be incurred over the next one to ten years. Environmental reserves have been established on an undiscounted basis with remediation costs based on internal and external estimates for each site. Future remediation costs for

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amounts of deductibles under, or amounts not covered by, state trust fund programs and third party insurance arrangements and for which the timing of payments can be reasonably estimated are discounted using a ten-percent rate. The undiscounted amount of future estimated payments for which The Pantry does not expect to be reimbursed for each of the five years and thereafter at September 30, 2000 are as follows (in thousands):

Fiscal Year	Expected Payments
2001	\$ 910
2002	283
2003	249
2004	146
2005	28
Thereafter	54
Total undiscounted amounts not covered by a third party	1,670
Other current cost amounts	15,140
Amount representing interest (10%)	(2,744)
Environmental reserve	\$14,066

The Pantry anticipates that it will be reimbursed for a portion of these expenditures from state trust funds and private insurance. As of September 28, 2000, anticipated reimbursements of \$12,819,000 are recorded as long-term environmental receivables. In Florida, remediation of such contamination reported before January 1, 1999 will be performed by the state and substantially all of the costs will be paid by the state trust fund. The Pantry will perform remediation in other states through independent contractor firms engaged by The Pantry. For certain sites the trust fund does not cover a deductible or has a co-pay which may be less than the cost of such remediation. Although The Pantry is not aware of releases or contamination at other locations where it currently operates or has operated stores, any such releases or contamination could require substantial remediation expenditures, some or all of which may not be eligible for reimbursement from state trust funds.

The Pantry has reserved \$1.5 million to cover third party claims for environmental conditions at adjacent real properties that are not covered by state trust funds or by private insurance. This reserve is based on management's best estimate of losses that may be incurred over the next several years based on, among other things, the average remediation cost for contaminated sites and our historical claims experience.

Several of the locations identified as contaminated are being cleaned up by third parties who have indemnified The Pantry as to responsibility for clean up matters. Additionally, The Pantry is awaiting closure notices on several other locations which will release The Pantry from responsibility related to known contamination at those sites. These sites continue to be included in our environmental reserve until a final closure notice is received.

## NOTE 9—BENEFIT PLANS:

The Pantry sponsors a 401(k) Employee Retirement Savings Plan for eligible employees. Employees must be at least nineteen years of age and have one year of service with at least 1,000 hours worked to be eligible to participate in the plan. Employees may contribute up to 15% of their annual compensation, and contributions are matched by The Pantry on the basis of 50% of the first 5% contributed. Matching contribution expense was \$687,000, \$573,000 and \$396,000 for fiscal years 2000, 1999 and 1998, respectively.

## NOTE 10—COMMON STOCK:

On June 4, 1999, the Company effected a 51 for 1 stock split of its common stock. In connection with the stock split, the number of authorized shares of common stock was increased to 50,000,000 (300,000 shares previously). The accompanying financial statements give effect to the stock split, retroactively applied to all periods presented. There was no change in par values of the common stock as a result of the stock split.

On June 8, 1999, the Company completed an initial public offering of 6,250,000 shares of its common stock at a public offering price of \$13.00 per share (the "IPO"). The net proceeds from the IPO of \$75.6 million, before expenses, were used (i) to repay \$19.0 million in indebtedness under the 1999 bank credit facility; (ii) to redeem \$17.5 million in outstanding preferred stock; and (iii) to pay accrued dividends on the preferred stock of \$6.5 million. Of the remaining \$32.6 million, \$30.2 million was used to fund acquisitions closed during the fourth quarter of fiscal 1999 and \$2.4 million was reserved to pay fees and expenses associated with the IPO.

Upon completion of the IPO, Freeman Spogli owned approximately 9,349,524 shares and owned warrants for the purchase of an additional 2,346,000 shares giving Freeman Spogli beneficial ownership of approximately 57.2% of the outstanding common stock (including shares underlying warrants). During fiscal 2000, Freeman Spogli purchased an additional 980,000 shares giving them beneficial ownership of approximately 62.0% of the outstanding common stock (including shares underlying warrants).

In 1998 and in connection with the Lil' Champ acquisition and related transactions, The Pantry issued 3,672,000 shares of common stock, par value \$0.01, to certain existing shareholders and a member of management for \$32.4 million. Prior to the purchase of common stock, Freeman Spogli and Chase contributed all outstanding shares of Series A preferred stock and related accrued and unpaid dividends to the capital of The Pantry. As a result, the par value of preferred stock and accrued dividends were reduced by \$260 and \$6,508,000 respectively, and additional paid in capital was increased by \$6,508,260.

On July 2, 1998 in connection with two acquisitions completed in July 1998, The Pantry issued 2,217,378 shares of common stock, par value \$0.01 per share, to certain existing shareholders for an aggregate purchase price of \$25.0 million.

#### NOTE 11—PREFERRED STOCK:

As of September 24, 1998, preferred stock consisted of 150,000 authorized shares. As discussed in Note 10—Common Stock, holders of The Pantry's 25,999 shares of Series A preferred stock contributed all outstanding shares of Series A preferred stock and related accrued and unpaid dividends to the capital of The Pantry in connection with the Lil' Champ acquisition. Issued and outstanding shares of preferred stock at September 24, 1998 included 17,500 shares designated as Series B, all of which were held by the Freeman Spogli entities. On June 8, 1999 in conjunction with the IPO, The Pantry redeemed the outstanding preferred stock for \$17.5 million and paid accrued dividends on the preferred stock of \$6.5 million. As of September 28, 2000, the Company has no preferred stock issued or outstanding.

Upon the redemption of its Series B preferred stock, The Pantry recorded a one-time dividend of \$613,000 which represents the difference between the gross proceeds (\$16,887,000) from the initial sale of Series B preferred stock and the consideration paid upon redemption (\$17,500,000). In accordance with Emerging Issues Task Force Topic No. ("EITF") D-42, The Pantry was also required to recognize a one-time deduction to net income applicable to common stockholders (and a related reclassification to accumulated deficit) in the amount of \$1,500,000 associated with original issue costs incurred in connection with the issuance of the Series B preferred stock in December 1996. At that time, the original issue costs were netted against the gross proceeds and, thus, charged to additional paid in capital. EITF D-42 requires that the excess of fair value of the consideration transferred to the preferred shareholders over the carrying

amount of the preferred stock be subtracted from net income applicable to common shareholders in the calculation of earnings per share.

#### NOTE 12—STOCK OPTIONS AND OTHER EQUITY INSTRUMENTS:

On January 1, 1998, The Pantry adopted an incentive and non-qualified stock option plan. Pursuant to the provisions of the plan, options may be granted to officers, key employees and consultants of The Pantry or any of its subsidiaries and certain members of the board of directors to purchase up to 1,275,000 shares of The Pantry's common stock. The plan is administered by the board of directors or a committee of the board of directors. Options are granted at prices determined by the board of directors and may be exercisable in one or more installments. Additionally, the terms and conditions of awards under the plan may differ from one grant to another. Under the plan, incentive stock options may only be granted to employees with an exercise price at least equal to the fair market value of the related common stock on the date the option is granted. Fair values are based on the most recent common stock sales. During 1998, options to acquire 576,861 shares of common stock were granted under the plan with exercise prices ranging from \$8.82-\$11.27 per share (weighted-average exercise price of \$9.39 per share).

On June 3, 1999, The Pantry adopted a new 1999 stock option plan providing for the grant of incentive stock options and non-qualified stock options to officers, directors, employees and consultants, with provisions similar to the 1998 stock option plan. During 1999, options to acquire 240,000 shares of common stock were granted under the 1999 plan with exercise prices of \$13.00 per share. These options vest over three years and have contractual lives of seven years. No options were granted during the year ended September 28, 2000.

The following table summarizes information about stock options outstanding at September 28, 2000:

Exercise Prices	Number Outstanding at Date Issued	Weighted-Average September 28, 2000	Remaining Contractual Life	Weighted-Average Exercise Price
\$ 8.82	1/1/98	443,751	7 years	\$ 8.82
\$11.27	8/25/98	133,110	7 years	\$11.27
\$13.00	6/8/99, 9/30/99	236,000	6 years	\$13.00
Total		812,861		

# notes to consolidated financial statements

continued

All options granted in 1998 and 1999 vest over a three-year period, with one-third of each grant vesting on the anniversary of the initial grant. There were no exercises, forfeitures, or terminations of options in 1998 or 1999. There were 4,000 options forfeited and none exercised or terminated during fiscal 2000. All stock options are granted at estimated fair market value of the common stock at the grant date.

Had compensation cost for the plan been determined consistent with SFAS No. 123, Accounting for Stock-Based Compensation, The Pantry's pro forma net income (loss) for fiscal 2000, 1999 and 1998 would have been approximately \$13,784,000, \$10,266,000 and \$(3,446,000), respectively. Pro forma basic earnings (loss) per share for fiscal 2000, 1999 and 1998 would have been \$0.76, \$0.44 and \$(0.66), respectively. Pro forma diluted earnings (loss) per share for fiscal 2000, 1999 and 1998 would have been \$0.73, \$0.40 and \$(0.58), respectively. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	1999	1998
Weighted-average grant date fair value	\$2.07	\$1.12
Weighted-average expected lives (years)	2.00	2.33
Weighted-average grant date fair value— exercise price equals market price	\$2.24	\$1.12
Weighted-average grant date fair value— exercise price greater than market price	\$1.18	—
Risk-free interest rate	5.5%	5.5%
Expected volatility	0.00%–21.0%	0.00%
Dividend yield	0.00%	0.00%

On August 31, 1998, The Pantry adopted a stock subscription plan. The subscription plan allows The Pantry to offer to certain employees the right to purchase shares of common stock at a purchase price equal to the fair market value on the date of purchase. A purchaser may not sell, transfer or pledge their shares

- prior to the first anniversary of the date on which the purchaser acquires the shares
- after the first anniversary, except in compliance with the provisions of the subscription agreement and a pledge agreement if part of the consideration for such shares includes a secured promissory note

In the event that the purchaser's employment with The Pantry and all of its subsidiaries terminates for any reason, The Pantry shall have the option to repurchase from the purchaser all or any portion of the shares acquired by the purchaser under the subscription agreement for a period of six months after the effective date of such termination. The repurchase option shall terminate upon the later to occur of

- the first anniversary of the date the shares were originally acquired

- an initial public offering of common stock by The Pantry registered under the Securities Act (other than an offering registered on Form S-4 or Form S-8) resulting in gross proceeds to The Pantry in excess of \$25 million

After the first anniversary of the date the shares were originally acquired by the purchaser, the purchaser may transfer the shares for cash (only) to a third party, subject to The Pantry's right of first refusal with respect to such sale. Finally, under certain circumstances, a purchaser of shares under the subscription plan may be forced to sell all or part of the shares purchased under such plan if Freeman Spogli finds a third-party buyer for all or part of the shares of common stock held by Freeman Spogli. No issuances of shares under the subscription plan had been made at September 24, 1998. On September 25, 1998 and November 30, 1999, 134,436 shares, net of subsequent repurchases of 6,273 shares, were sold under the subscription plan. These shares were sold at fair value (\$11.27), as determined by the most recent equity investment (July 1998). In connection with these sales, The Pantry received \$722,000 of secured promissory notes receivable, bearing an interest rate of 8.5%, due August 31, 2003.

In December 1996, in connection with its purchase of 17,500 shares of Series B preferred stock, Freeman Spogli acquired warrants to purchase 2,346,000 shares of common stock. The warrants are exercisable at \$7.45 per share until December 30, 2006, and contain adjustment provisions in the event The Pantry declares dividends or distributions, makes stock splits, or engages in mergers, reorganizations or reclassifications. The fair value of the warrants at date of issuance approximated \$600,000 and is included in additional paid-in capital. None of these warrants had been exercised at September 28, 2000.

## NOTE 13—RELATED PARTIES:

### Transactions With Affiliates

#### Stock Issuances

In December 1996, Freeman Spogli purchased 17,500 shares of Series B preferred stock and warrants to purchase 2,346,000 shares of common stock for approximately \$17.5 million. The purchase price for the Series B preferred stock was \$1,000.00 per share and the purchase price for each of the two warrants was \$1.00. The warrants are exercisable at \$7.45 per share until December 30, 2006 and contain adjustment provisions in the event The Pantry declares dividends or distributions, makes stock splits or engages in mergers, reorganizations or reclassifications. In connection with the IPO, The Pantry repurchased the Series B preferred stock from Freeman Spogli for \$17.5 million, plus approximately \$6.5 million in accrued dividends. See also Note 11—Preferred Stock.

In October 1997, in connection with the Lil' Champ acquisition, Freeman Spogli purchased 3,030,471 shares of common stock and Chase purchased 596,190 shares of common stock for an aggregate purchase price of approximately \$32.0 million. Peter J. Sodini, The Pantry's Chief Executive Officer, purchased 45,339 shares of common stock for an aggregate purchase price of \$400,050, payable \$185,000 in cash and \$215,050 in the form of a secured promissory note in our favor. The purchase price for the common stock was \$8.82 per share. All of the outstanding Series A preferred stock was contributed back to The Pantry and cancelled at this time.

In July 1998, in connection with the acquisition of Quick Stop and the acquisition of Stallings, Freeman Spogli purchased 1,845,690 shares of common stock and Chase purchased 371,688 shares of common stock for an aggregate purchase price of \$25.0 million. The purchase price for the common stock was \$11.27 per share.

In November 1998, Peter Starrett, a director of The Pantry, purchased 22,185 shares of common stock for a purchase price of \$250,125. Freeman Spogli has the right to require the sale of Mr. Starrett's shares in the event it sells all of its holdings of common stock.

#### Payments to Freeman Spogli

Transaction fees of \$3.0 million for the fiscal year ended September 24, 1998, were paid to Freeman Spogli in connection with previous investments and assistance with analyzing acquisition candidates and obtaining financing.

#### Stockholders' Agreement

The Pantry has a stockholders' agreement, as amended July 1998, with Freeman Spogli, Chase and Peter J. Sodini in which:

- Freeman Spogli has a right of first offer enabling it to purchase shares held by Chase or Mr. Sodini prior to transfers of shares of common stock to non-affiliates, other than transfers pursuant to a registration statement or under Rule 144
- Freeman Spogli has the right to require Chase and Mr. Sodini to sell their shares of common stock to a third party buyer on the same terms as Freeman Spogli if Freeman Spogli is selling all of its shares
- Freeman Spogli, Chase and Mr. Sodini have rights to be included in sales of common stock by the other stockholders
- Freeman Spogli has agreed, as long as Chase holds 10% of The Pantry's common stock, to vote for a director nominated by Chase
- Transactions with affiliates will be on terms no less favorable to The Pantry than would be obtained in an arms length transaction

#### NOTE 14—EARNINGS PER SHARE:

The Pantry computes earnings per share data in accordance with the requirements of SFAS No. 128, Earnings Per Share. Basic earnings per share is computed on the basis of the weighted-average number of common shares outstanding. Diluted earnings per share is computed on the basis of the weighted-average number of common shares outstanding plus the effect of outstanding warrants and stock options using the "treasury stock" method. The following table reflects the calculation of basic and diluted earnings per share (see also Note 11—Preferred Stock) (dollars in thousands except per share amounts):

	2000	1999	1998
Net income (loss) applicable to common shareholders:			
Net income before extraordinary loss	\$13,996	\$14,000	\$ 4,673
Preferred stock dividend requirement	—	(2,070)	(2,942)
Redemption of preferred stock in excess of carrying amount	—	(2,113)	—
Net income applicable to common shareholders before extraordinary loss	13,996	9,817	1,731
Extraordinary loss	—	(3,584)	(7,998)
Net income (loss) applicable to common shareholders	\$13,996	\$ 6,233	\$ (6,267)
Earnings per share—basic:			
Weighted-average shares outstanding	18,111	13,768	9,732
Income before extraordinary loss per share—basic	\$ 0.77	\$ 0.71	\$ 0.18
Extraordinary loss per share—basic	—	(0.26)	(0.82)
Net income (loss) per share—basic	\$ 0.77	\$ 0.45	\$ (0.64)
Earnings per share—diluted:			
Weighted-average shares outstanding	18,111	13,768	9,732
Dilutive impact of options and warrants outstanding	821	1,308	1,280
Weighted-average shares and potential dilutive shares outstanding	18,932	15,076	11,012
Income before extraordinary loss per share—diluted	\$ 0.74	\$ 0.65	\$ 0.16
Extraordinary loss per share—diluted	—	(0.24)	(0.73)
Net income (loss) per share—diluted	\$ 0.74	\$ 0.41	\$ (0.57)

# notes to consolidated financial statements

continued

For the year ended September 28, 2000, 372,363 shares of common stock were not included in the computation of diluted earnings per share because the exercise prices of the options to purchase such shares were greater than the average market price of our common stock for that period and their inclusion would have been antidilutive.

## NOTE 15—SUPPLEMENTAL DISCLOSURE OF CASH FLOW:

Year Ended	September 28, 2000	September 30, 1999	September 24, 1998
Cash paid (refunded) during the year:			
Interest	\$50,207	\$43,064	\$21,826
Taxes	\$ 1,600	\$ 34	\$ 784

## Supplemental Noncash Investing and Financing Activities

During fiscal 1998 and 1999, The Pantry entered into several business acquisitions and divestitures. See Note 2—Business Acquisitions and Note 10—Common Stock. In 1998 and in connection with the Lil' Champ acquisition, the holders of The Pantry's Series A preferred stock contributed all outstanding shares of Series A preferred stock and related

accrued and unpaid dividends to the capital of The Pantry, resulting in an increase in paid in capital of \$6,508.

During 2000, 1999 and 1998, The Pantry financed certain capital expenditures totaling \$825,000, \$2,803,000 and \$1,086,000, respectively, through the issuance of capital leases.

## NOTE 16—SUBSEQUENT EVENTS:

In three separate transactions subsequent to fiscal year end 2000, The Pantry has entered into agreements to acquire 28 stores located in Mississippi (19), Louisiana (8) and North Carolina (1). These transactions will be primarily funded from borrowings under The Pantry's bank credit facility and cash on hand.

In order to provide for more efficient and streamlined operations, the following direct or indirect subsidiaries of The Pantry were eliminated by being liquidated or being merged into The Pantry, effective as of September 29, 2000: (i) Pantry Properties, Inc.; (ii) TC Capital Management, Inc.; (iii) PH Holding Corporation; (iv) Sandhills, Inc.; and (v) Global Communications, Inc. As a result of the elimination of these subsidiaries, the operations and property formerly carried on and held by such subsidiaries are now carried on and held directly by The Pantry.

## NOTE 17—QUARTERLY FINANCIAL DATA (UNAUDITED):

Summary quarterly financial data for fiscal 2000 and 1999, respectively, is as follows (dollars in thousands, except per share amounts):

	Year Ended September 28, 2000					Year Ended September 30, 1999				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
Total revenue	\$540,390	\$584,109	\$643,091	\$664,670	\$2,432,260	\$315,607	\$359,792	\$456,704	\$546,767	\$1,678,870
Gross profit	\$108,884	\$104,980	\$125,542	\$132,473	\$ 471,879	\$ 72,380	\$ 83,561	\$100,431	\$114,456	\$ 370,828
Income (loss) before income taxes and extraordinary loss:										
Net income (loss)	\$ 4,063	\$ (4,514)	\$ 11,046	\$ 14,177	\$ 24,772	\$ 1,397	\$ 398	\$ 9,119	\$ 13,836	\$ 24,750
Earnings per share before extraordinary loss:										
Basic	\$ 0.13	\$ (0.14)	\$ 0.34	\$ 0.45	\$ 0.77	\$ 0.03	\$ (0.06)	\$ 0.19	\$ 0.42	\$ 0.71
Diluted	\$ 0.12	\$ (0.14)	\$ 0.33	\$ 0.42	\$ 0.74	\$ 0.03	\$ (0.06)	\$ 0.18	\$ 0.40	\$ 0.65
Earnings per share:										
Basic	\$ 0.13	\$ (0.14)	\$ 0.34	\$ 0.45	\$ 0.77	\$ 0.03	\$ (0.36)	\$ 0.19	\$ 0.42	\$ 0.45
Diluted	\$ 0.12	\$ (0.14)	\$ 0.33	\$ 0.42	\$ 0.74	\$ 0.03	\$ (0.36)	\$ 0.18	\$ 0.40	\$ 0.41

# independent auditors' report

To The Board of Directors and Shareholders of  
The Pantry, Inc.  
Sanford, North Carolina

We have audited the accompanying consolidated balance sheets of The Pantry, Inc. ("The Pantry") and subsidiaries as of September 30, 1999 and September 28, 2000, and the related consolidated statements of operations, shareholders' equity (deficit), and cash flows for each of the three years in the period ended September 28, 2000. These financial statements are the responsibility of The Pantry's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of The Pantry, Inc. and subsidiaries as of September 30, 1999 and September 28, 2000, and the results of their operations and their cash flows for each of the three years in the period ended September 28, 2000, in conformity with accounting principles generally accepted in the United States of America.

Raleigh, North Carolina  
November 14, 2000

## market for our common equity and related stockholder matters

(a) *Market Information.* We have one class of common equity, our common stock, \$.01 par value per share. Our common stock represents our only voting securities. There are 18,111,474 shares of common stock issued and outstanding as of December 12, 2000. Our common stock is traded on the Nasdaq National Market® under the symbol "PTRY." The following table sets forth for each fiscal quarter the high and low sale prices per share of common stock since our initial public offering as reported on the Nasdaq National Market through September 28, 2000.

Quarter	2000		1999	
	High	Low	High	Low
First	15%	7%	N/A	N/A
Second	16 <sup>5</sup> / <sub>16</sub>	7	N/A	N/A
Third	11½	7%	13%	12%
Fourth	13 <sup>1</sup> / <sub>16</sub>	9	18 <sup>1</sup> / <sub>16</sub>	10¼

(b) *Holder.* As of December 12, 2000, there were 67 holders of record of our common stock.

(c) *Dividends.* During the last two fiscal years, we have not paid any cash dividends on our common stock. We intend to retain earnings to support operations and to finance expansion and do not intend to pay cash dividends on our common stock for the foreseeable future. The payment of cash dividends in the future will depend upon our ability to remove certain loan restrictions and other factors such as our earnings, operations, capital requirements, financial condition and other factors deemed relevant by our Board of Directors. The payment of any cash dividends is prohibited under restrictions contained in the indentures relating to the senior subordinated notes and our bank credit facility.

## corporate information

### Directors

**Peter J. Sodini**

President and Chief Executive Officer

**Todd W. Halloran**

Principal  
Freeman Spogli & Co.

**Jon D. Ralph (2)**

Principal  
Freeman Spogli & Co.

**Charles P. Rullman (1) (2)**

Principal  
Freeman Spogli & Co.

**Edfred L. Shannon (1)**

Private Investor

**Peter M. Starrett**

Consultant

**Hubert E. Yarborough III (1)**

Shareholder  
McNair Law Firm

Board Committees:

(1) *Audit Committee*

(2) *Compensation Committee*

### Financial Information

Forms 10-K and 10-Q are available without charge.

Direct requests to:

William T. Flyg

Senior Vice President, Finance

**The Pantry**

P.O. Box 1410

Sanford, North Carolina 27330

Phone: 919-774-6700

Fax: 919-774-3329

### Internet

Additional information on The Pantry is available on the  
Worldwide Web at: [www.ThePantry.com](http://www.ThePantry.com)

### Executive Officers

**Peter J. Sodini**

President and Chief Executive Officer

**Dennis R. Crook**

Senior Vice President,  
Administration and Gasoline Marketing

**William T. Flyg**

Senior Vice President, Finance,  
Chief Financial Officer and Corporate Secretary

**Daniel J. McCormack**

Senior Vice President, Marketing

**Douglas M. Sweeney**

Senior Vice President, Operations

### Executive Office

1801 Douglas Drive  
Sanford, North Carolina 27330  
Phone: 919-774-6700  
Fax: 919-774-3329

### Transfer Agent

First Union National Bank  
Corporate Trust Division  
Charlotte, North Carolina

### Independent Accountants

Deloitte & Touche LLP  
Raleigh, North Carolina

### Investor Relations Firm

Morgen-Walke Associates  
New York, New York

### Annual Meeting

The annual meeting of stockholders will be held on  
Thursday, March 22, 2001 at 10:00AM Eastern Standard  
Time at the North Raleigh Hilton, 3145 Wake Forest Road,  
Raleigh, North Carolina 27609.



