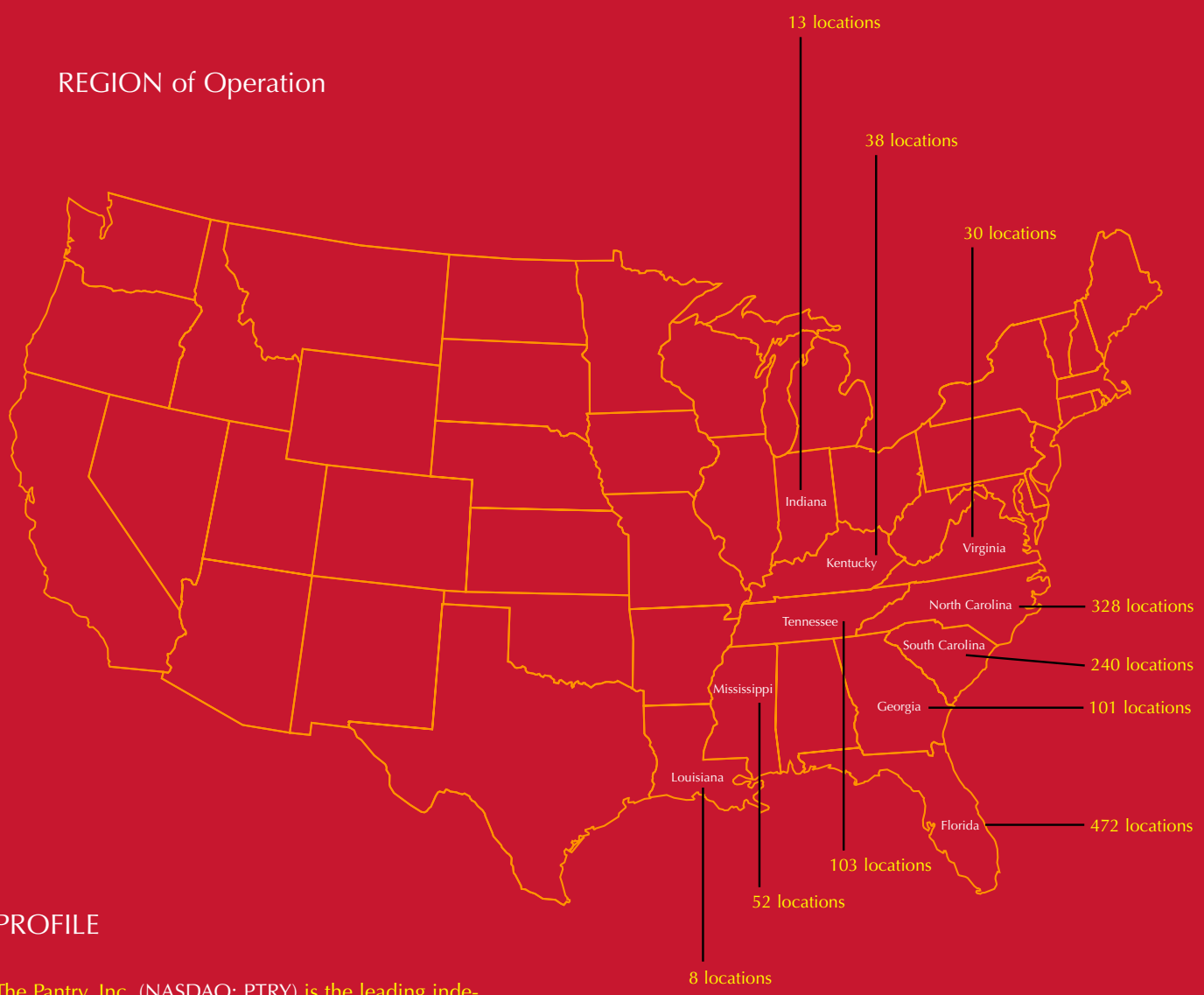
The Pantry, Inc.

2003 Annual Report

REGION of Operation



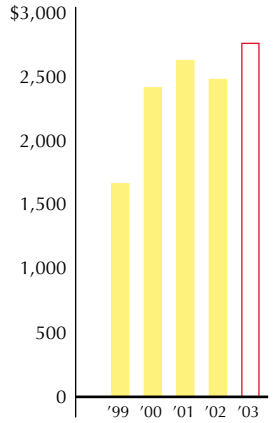
PROFILE

The Pantry, Inc. (NASDAQ: PTRY) is the leading independently operated convenience store chain in the southeastern United States and one of the largest in the country. As of December 25, 2003, the Company operated 1,385 stores in ten states under several banners including The Pantry®, Kangaroo Express™, Golden Gallon®, and Lil' Champ Food Store®. Our stores offer a broad selection of merchandise, gasoline and ancillary products and services designed to appeal to the convenience needs of our customers.

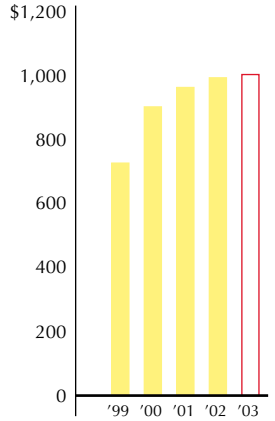
Financial HIGHLIGHTS

(dollars in thousands, except for per share information)	Fiscal Year 2003	2002	2001
Total revenues	**$2,776,361**	$2,494,064	$2,643,044
Gross profit	**510,804**	475,402	487,643
Depreciation and amortization	**54,403**	54,251	63,545
Income from operations	**70,831**	53,852	55,193
Interest expense	**49,265**	51,646	58,731
Net income (loss)	**14,986**	1,804	(2,656)
Earnings (loss) per share:			
Basic	**0.83**	0.10	(0.15)
Diluted	**0.82**	0.10	(0.15)
Comparable store sales growth:			
Merchandise	**2.1%**	3.4%	(0.2)%
Gasoline gallons	**0.7%**	1.5%	(3.8)%
Average sales per store:			
Merchandise sales	**791.3**	765.2	731.0
Gasoline gallons (in thousands)	**940.7**	924.2	890.4
EBITDA	**128,039**	108,831	120,491
Store count, end of year	**1,258**	1,289	1,324

Total Revenue
(In millions)



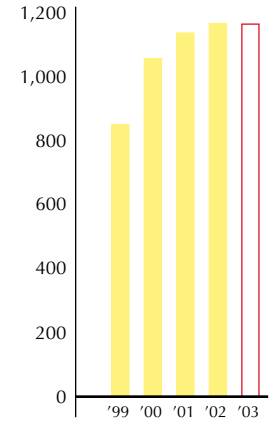
Merchandise Revenue
(In millions)



Fiscal 2003 HIGHLIGHTS

- Significantly improved our financial performance. Fiscal 2003 earnings per share before a change in accounting principle were $0.82, compared with $0.10 in fiscal 2002.
- Completed our store reset program, which we began last year. This effort, designed to boost individual store sales and raise merchandise margins, reflects our ongoing analysis of product mix and store layouts.
- Negotiated innovative gasoline branding and supply agreements with BP® Products and Citgo®, which together will supply about 85% of our gasoline needs. The agreements provided immediate cost benefits as well as funding for longer-term rebranding and reimaging programs that will benefit both gasoline and merchandise operations over the next two years.
- Completed gasoline upgrades related to the new supply agreements at 173 locations, including 65 stores converted to our Kangaroo® private label gasoline. All of these stores were also converted to Kangaroo Express™ branding for their merchandise operations.
- Announced a definitive agreement to purchase 138 Golden Gallon convenience stores in eastern Tennessee and northwest Georgia from Ahold USA. The acquisition was completed in October 2003.
- Expanded our Celeste® private label beverage line to include soft drinks and, shortly after year-end, Red Celeste.

Gasoline Gallons
(In millions)



The Convenience Store Segment

For most Americans, time is at a premium. Whether they're picking up kids after school, heading off to work, or going shopping, they need a place where they can buy gas or grab a gallon of milk, a cup of coffee or a quick meal while they are on their way to their ultimate destination. The convenience store meets this need. It's a reflection of enduring economic and social trends.

The convenience store segment that serves this need is huge, yet still highly fragmented. At the end of 2002, there were 132,000 convenience stores in the United States, located near highways and interstates, on commercial strips, and in small rural towns—with total annual sales of $289 billion. The vast majority of these stores are independent. The National Association of Convenience Stores categorizes nearly three-fifths of all convenience stores as single-store companies. The ten largest convenience store retailers accounted for less than 24% of total industry stores in 2002, while approximately 90% of all convenience store retailers operate 50 or fewer stores.

The convenience store industry tends to be undermanaged because smaller operators lack the economies of scale, and often the expertise, to manage their business efficiently. As a result, the convenience store segment provides significant opportunities for disciplined operators with the resources, the critical size, and the geographic concentration to implement sophisticated management and information systems and to forge mutually beneficial vendor relationships.

In addition, the industry itself is in a period of transition. The pace of store openings has slowed, and many weaker stores are shutting their doors. At the same time, a number of major oil companies are seeking to reduce their substantial presence in this industry and refocus on their core businesses. In short, it is an ideal time for a well-managed company committed to growth in the convenience store sector.

All of this is particularly true in the southeastern United States, with its favorable demographics and over 42,000 convenience stores. The Pantry is the region's leading operator, yet even in our largest markets (Florida and the Carolinas), our market share based on store count is below 10%.

LETTER to Shareholders

Fiscal 2003 was a very good year for The Pantry. We gained traction from strategic initiatives launched in recent years—including a comprehensive store reset program and our proprietary Gasoline Pricing System—just as competitive conditions in the convenience store industry stabilized and began improving. The result: our financial performance improved dramatically. Net income before a change in accounting principle was $15.0 million, or $0.82 per share, compared to $1.8 million, or $0.10 per share, in fiscal 2002. EBITDA for the year was $128.0 million, up 17.6% from a year ago.

Equally important, we took a number of key steps in 2003 that set the stage for future growth. We leveraged our size to achieve groundbreaking gasoline supply and branding agreements with BP® Products and Citgo®. These agreements provided significant immediate cost benefits and will enable us to consolidate gasoline operations at approximately 1,000 of our stores under just three brands: BP®/Amoco®, Citgo®, and our own Kangaroo® (supplied by Citgo). We expect meaningful longer-term benefits from more consistent branding on the merchandise side of our business.

Toward the end of the year, we also announced our first sizeable acquisition in almost three years, the purchase of 138 Golden Gallon® stores in Georgia and Tennessee. The deal was completed in October 2003. These stores were already strong performers, and they complement our existing operations extremely well. From a number of standpoints, we believe this is the best acquisition we have ever completed. It will be immediately and significantly accretive to our earnings per share.

Positioned for Results

In the convenience store business, you tend to build momentum more by moving steadily forward along a number of fronts than by striving to develop a single blockbuster product or service offering. Our store reset program illustrates the application of this principle to merchandising. Begun in 2002 and completed this year, this initiative involved fine-tuning our product assortment, upgrading our presentation in key categories, and reorganizing store layouts to promote better flow. The results were evident in 2003, as our comparable store merchandise revenue grew 2.1% in the face of significant price deflation in the cigarette category. In the fourth quarter of 2003, we registered our ninth consecutive quarterly increase in comparable store merchandise sales. Our merchandise gross margin for the year was 33.6%, compared with 33.0% in fiscal 2002. Merchandise operations accounted for 66.0% of total gross profits for the year.

In the gasoline business, profitability returned to more normal levels in fiscal 2003 as the competitive environment eased. Our new gasoline supply agreements generated significant cost savings in the second half of the year, and margins also benefited from the continued refinement of our cutting-edge gasoline pricing and inventory technology. For the full year, we improved our gasoline gross margin per gallon to 12.4 cents from 10.4 cents in fiscal 2002, and total gasoline gross profits increased 19.5% for the year.

We achieved these results in the face of a number of challenges, including the lackluster U.S. economic recovery. Political turmoil in Venezuela and the crisis in Iraq created volatility in the gasoline markets.

Building for the Future

In 2003, we moved forward with a number of merchandise initiatives in addition to our store reset program. We expanded our Celeste® private label beverage line, rolling out six flavors of soft drinks and our Red Celeste energy drink. We added the new Deli Express® sandwich program and repositioned our candy offerings in the form of more visible Candy Lane℠ aisles, which are designed to promote impulse purchases. We have substantially upgraded our coffee program with the addition of our Bean Street® coffee stations and have further developed our Chill Zone℠ fountain and frozen drink stations across our store base. And we added or strengthened our franchised and proprietary food service offerings in many stores. Over time, we want to make more high-margin choices more accessible and appealing to our customers.

In our gasoline business, the new supply agreements with BP® Products and Citgo® represent an important strategic move that should accelerate the Company's growth over the next few years. Our history of acquisitions had left us with multiple gasoline suppliers. After extensive research, we concluded that by consolidating and strengthening these relationships, we could reduce costs while maximizing gasoline gallon growth and gross profits. Under these agreements, BP® will supply approximately 35% of our total gasoline volume, which will be sold under the BP®/Amoco® brand, while Citgo® will supply 50% of our volume, which will be sold under the Citgo® brand as well as under our own Kangaroo® label.

Over the next two years, the gasoline operations at approximately 1,000 of our stores will be rebranded or reimaged, while their merchandise operations will be rebranded under the Kangaroo Express™ banner. The oil companies will provide approximately 40% of the necessary funds. The result will be a more consistent set of brand identities across The Pantry's store base, particularly in our merchandise operations. At the end of fiscal 2003, the Company had completed gasoline conversions at a total of 173 locations, including 68 stores to BP®/Amoco®, 40 stores to Citgo®, and 65 stores to the Kangaroo® private label format.

We believe the combined benefits from the rebranding/reimaging of both gasoline and merchandise operations at more than 70% of our stores will be substantial. We are particularly excited about the potential impact on transaction volumes and overall profitability at approximately 475 of our stores that will be converted from branded gasoline to our lower-cost Kangaroo® brand.

"We're focused on the leverage and efficiencies we gain through our size."

DANIEL J. KELLY
Vice President, Finance and Chief Financial Officer

"In 2003, we strengthened key relationships with our partners and set the stage to make Kangaroo Express the preeminent convenience store brand in the Southeast."

PETER J. SODINI
President and Chief Executive Officer

Looking Forward to 2004

We made significant progress in strengthening our company in 2003 in the face of a challenging economic environment. Thanks to the initiatives described in this letter—the completion of the reset program, the gasoline branding and supply agreements, and the Golden Gallon® acquisition—our prospects for 2004 are excellent. Much of the responsibility for this progress lies with our employees and our directors. We would like to express our gratitude for their hard work and commitment to the company. We would also like to thank our stockholders for their ongoing support.

Our challenge in 2004 is much the same as it was in 2003—building an increasingly solid foundation for future growth. The reset program and the gasoline branding and supply agreements completed this year were prerequisites to our rebranding and reimaging initiatives, which will be an important focus in 2004 and 2005. As these efforts gain momentum, there will be opportunities for us to streamline operations even further and to begin exploiting our newly created brand equity. We also expect to identify many potential acquisitions that could complement our existing store base in the Southeast; our challenge will be to select only the best, and only those that meet our economic criteria.

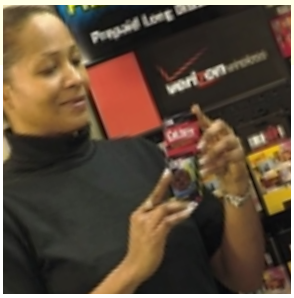
In short, the coming years will be exciting times for The Pantry. We look forward to reporting to you on our progress.

Sincerely,

Peter J. Sodini
President and Chief Executive Officer

"We bring operational excellence to an industry that is undermanaged."

STEVEN J. FERREIRA
Senior Vice President, Administration



Executing OUR STRATEGY at the Corporate Level

Today, The Pantry is the leading independently operated convenience store chain in the southeastern United States and one of the largest in the country. We have the expertise needed to grow wisely and the size to reap the full benefits of this growth. On the corporate level, this means we negotiate with our partners from a position of strength, with a balanced understanding of our objectives and capabilities. And it means we have the capacity to evaluate acquisitions quickly, structure complex deals in an advantageous way for both parties, and smoothly incorporate new locations and personnel into existing operational structures.

Building Strategic Relationships with Suppliers

In fiscal 2003, our new five-year gasoline branding and supply agreements with BP® Products and Citgo® Petroleum Corporation demonstrated our ability to negotiate from a position of strength. These were groundbreaking agreements for our industry, and we succeeded because we made the case to our partners that an alliance with us is worthwhile.

At the same time, the advantages to the company are also quite substantial. These agreements brought immediate cost benefits, as well as increased efficiencies throughout our operations as we began to consolidate our gasoline suppliers. They will give us greater control over gasoline pricing and inventory. And they pave the way for a more consistent operating identity, including the rebranding of most of our merchandise operations under the Kangaroo Express™ banner.

Growing Through Selective Acquisitions

The Golden Gallon® purchase reflects The Pantry's ability to identify a strategic match, structure a sophisticated financial arrangement that was leverage-neutral to the company (on a Debt-to-EBITDA basis), and integrate a major acquisition efficiently. The Golden Gallon® assets consisted of 138 operating stores, 131 of which were fee-owned, a dairy plant, a fuel-hauling operation, corporate headquarters buildings, and 25 undeveloped sites. We structured the acquisition as two simultaneous transactions. We purchased and financed the real estate through a $94.5 million sale-leaseback transaction for 114 of the fee-owned stores. And we acquired Golden Gallon®'s operations and the balance of the real estate assets for approximately $92.5 million, which was funded with $80 million of debt through an add-on to the Company's existing first lien loans and available cash. We also subsequently sold the dairy and fuel-hauling assets.

The operational integration of Golden Gallon® has gone very smoothly. An initial round of training for all store managers even before the deal closed helped us stay on track. We integrated Golden Gallon® information systems into our own, providing seamless Company-wide data from the first day, and completed a merchandise reset for all 138 Golden Gallon® stores by the end of November 2003. The acquisition was immediately accretive to earnings per share—before the realization of any synergies, which are expected to total $8 million to $10 million within two years.

"One of the benefits of our size is the personal and professional growth opportunities we can offer our people."

JOSEPH A. KROL
Senior Vice President, Operations

MAXIMIZING Our Local Presence

Executing our strategy requires us not only to deploy our corporate resources to maximum advantage, but also to establish a strong local presence in each of our markets and at each location.

One of the key differentiators of our locations is the range of choices we offer. Since the need for convenience cuts across ethnic, demographic, and economic boundaries, we try to offer products that attract a wide range of customers in each market. Our private label brands play a part in this strategy. We can offer our Kangaroo® gasoline and Celeste® beverage products for value-conscious customers, and national brands for those who prefer them. We also draw customers to our stores by stocking a wide range of ancillary products like lottery tickets, money orders, and prepaid cellular cards.

At the same time, we understand that the customers in each of our markets have different needs. Our ability to offer our customers the products they are likely to want is a powerful local differentiator for us. We have begun to install scanners at our registers to ensure that these merchandising decisions are fact-based.

At the end of 2003, we had scanners in place at more than 25% of our stores. Because of our size, this partial deployment has already produced a statistically valid analysis of customer preferences in each of our market sectors, such as college, interstate, or residential locations. In close to real time, we can identify our best sellers, assess the impact of particular promotions, and measure the success of our private label initiatives.

Motivating and Training Our Staff

Ultimately the success of our local operations depends on the quality of our staff. Operating a convenience store is a demanding job. Not only must our local associates tackle all the traditional responsibilities—keeping our stores clean, dealing with vendors and suppliers, and operating the cash register—they must be able to answer questions about our ancillary products and enter sales and marketing data in our computer systems.

Our challenge as an operator is not only to find people who can perform these tasks, but to retain them. One of the benefits of our size is that we can bring opportunities for personal and professional growth to our employees, offering them the possibility of a career in our company. This year, we completed the roll-out of our computer-based training for employees. In addition, we offer training programs that help front-line employees make the transition to management positions. We also have created a management certification program that sets the stage for advancement in the company.

The result: increased productivity at our stores, lower labor costs, and more satisfied customers.

"We are constantly fine-tuning our stores to maximize margin and volume."

DAVID M. ZABORSKI
Vice President, Marketing

"When all is said and done, the end product of our analysis of gasoline pricing is three numbers on a price sign. Our job is to make sure that they're the right three numbers for each store in our Company."

GREGORY J. TORNBERG
Vice President, Gasoline Marketing

The KNOWLEDGE to Set Corporate Strategy and Execute Locally

Given the number of smaller, less sophisticated operators in our business, we know we can develop significant competitive advantages by systematically gathering information on a real-time basis, disseminating this information throughout our organization, and deploying tools to analyze it and help us act on our conclusions. Our information systems enable us to understand and manage our stores on both an aggregate and individual basis, giving us the ability to set corporate strategy and execute locally. With accurate, timely information—not anecdotes or hunches—we can identify changing conditions and respond quickly and effectively.

Merchandising Systems

Our information systems are critical to our merchandise monitoring and management. In addition to our scanners, our corporate- and store-level accounting and management reporting systems allow us to monitor merchandise sales, control inventory levels, and adjust merchandise mix on a regular basis. For our quick service restaurants, we utilize Quick Servant® to provide menu costing and margin calculations.

Gasoline Systems

Highly accurate and responsive information systems are particularly crucial to our gasoline operations, as our cost can change on a daily basis. Our challenge is to manage information about gasoline at nearly 1,400 locations and make continual fact-based decisions about this commodity over the course of the day.

Our Gasoline Pricing System not only monitors sales, margins, and pricing for each individual location, it also enables us to monitor our top competitors and set a price that provides the optimum volume and margin. We are constantly making refinements to this system. For instance, this year we automated functions and added a number of filters that enable us to extract more fine-grained information for each store and provide a more inclusive way of looking at gasoline margins.

Our Telafuel™ supply chain system fully automates all gasoline inventory and dispatching functions. It monitors inventory levels by tank for each store. It also allows us to communicate with vendors and carriers electronically through the Internet and to schedule the timely reloading of fueling stations. With Telafuel™, we can search for and identify the most cost-effective fueling options for each location and conserve cash by identifying ways to utilize existing inventory efficiently.

A Company Priority

Gathering intelligence about our products, their pricing, and their performance is not just a corporate-level concern. It depends fundamentally on the efforts of local associates and store managers, who seek out intelligence, enter it into our systems, and communicate it to district managers. At The Pantry, intelligence gathering and analysis, as well as developing and executing the right response, are part of our culture.

Selected FINANCIAL DATA

The following table sets forth our historical consolidated financial data and store operating information for the periods indicated. The selected historical annual consolidated statement of operations and balance sheet data as of and for each of the five fiscal years ended September 1999, 2000, 2001, 2002 and 2003 are derived from, and are qualified in their entirety by, our consolidated financial statements. Historical results are not necessarily indicative of the results to be expected in the future. You should read the following data together with "Management's Discussion and Analysis of Financial Condition and Results of Operations," and our consolidated financial statements and the related notes appearing elsewhere in this report. In the following table, dollars are in millions, except per share, per store and per gallon data and as otherwise indicated.

	Fiscal Year Ended				
	September 25, 2003	September 26, 2002	September 27, 2001	September 28, 2000	September 30, 1999
Statement of Operations Data:					
Revenues:					
Merchandise revenue	**$1,008.9**	$ 998.6	$ 968.6	$ 907.6	$ 731.7
Gasoline revenue	**1,740.7**	1,470.8	1,652.7	1,497.7	923.8
Commission income	**26.8**	24.7	21.7	25.9	23.4
Total revenues	**2,776.4**	2,494.1	2,643.0	2,431.2	1,678.9
Gross profit:					
Merchandise gross profit	**338.7**	329.2	323.6	302.5	242.4
Gasoline gross profit	**145.3**	121.5	142.3	139.9	105.0
Commission income[a]	**26.8**	24.7	21.7	25.9	23.4
Total gross profit	**510.8**	475.4	487.6	468.3	370.8
Operating, general and administrative expenses	**385.6**[b]	367.3	364.1	337.1	268.8[b]
Restructuring and other charges	**—**	—	4.8[c]	—	—
Depreciation and amortization[d]	**54.4**[e]	54.3	63.5	56.1	42.8
Income from operations	**70.8**	53.9	55.2	75.2	59.3
Interest expense	**49.3**	51.6	58.7	52.3	41.3
Income (loss) before cumulative effect adjustment	**15.0**	1.8	(2.7)	14.0	10.4
Cumulative effect adjustment, net of tax	**(3.5)**[f]	—	—	—	—
Net income (loss)	**11.5**	1.8	(2.7)	14.0	10.4
Net income (loss) applicable to common shareholders[g]	**$ 11.5**	$ 1.8	$ (2.7)	$ 14.0	$ 6.2
Earnings (loss) per share before cumulative effect adjustment:					
Basic	**$ 0.83**	$ 0.10	$ (0.15)	$ 0.77	$ 0.45
Diluted	**$ 0.82**	$ 0.10	$ (0.15)	$ 0.74	$ 0.41
Earnings (loss) per share:					
Basic	**$ 0.64**	$ 0.10	$ (0.15)	$ 0.77	$ 0.45
Diluted	**$ 0.63**	$ 0.10	$ (0.15)	$ 0.74	$ 0.41
Weighted-average shares outstanding:					
Basic	**18,108**	18,108	18,113	18,111	13,768
Diluted	**18,370**	18,109	18,113	18,932	15,076
Dividends paid on common stock	**—**	—	—	—	—
Other Financial Data:					
EBITDA[h]	**$ 128.0**	$ 108.8	$ 120.5	$ 133.2	$ 108.8
Cash provided by (used in):					
Operating activities	**$ 68.3**	$ 54.0	$ 76.7	$ 88.2	$ 68.6
Investing activities[i]	**(22.4)**	(20.3)	(93.9)	(148.7)	(228.9)
Financing activities	**(15.2)**	(42.0)	14.5	82.7	157.1[j]
Gross capital expenditures[k]	**25.5**	26.5	43.6	56.4	47.4
Capital expenditures, net[l]	**18.9**	18.8	31.6	32.1	30.1

(continued on following page)

Selected FINANCIAL DATA *(cont.)*

	Fiscal Year Ended				
	September 25, 2003	September 26, 2002	September 27, 2001	September 28, 2000	September 30, 1999
Store Operating Data:					
Number of stores (end of period)	**1,258**	1,289	1,324	1,313	1,215
Average sales per store:					
Merchandise revenue (in thousands)	**$791.3**	$765.2	$731.0	$713.8	$666.4
Gasoline gallons (in thousands)	**940.7**	924.2	890.4	872.5	834.8
Comparable store sales[m]:					
Merchandise	**2.1%**	3.4%	(0.2)%	7.5%	9.6%
Gasoline gallons	**0.7%**	1.5%	(3.8)%	(2.4)%	5.9%
Operating Data:					
Merchandise gross margin	**33.6%**	33.0%	33.4%	33.3%	33.1%
Gasoline gallons sold (in millions)	**1,170.3**	1,171.9	1,142.4	1,062.4	855.7
Average retail gasoline price per gallon	**$ 1.49**	$ 1.25	$ 1.45	$ 1.41	$ 1.08
Average gasoline gross profit per gallon	**$0.124**	$0.104	$0.125	$0.132	$0.123
Balance Sheet Data (end of period):					
Cash and cash equivalents	**$ 72.9**	$ 42.2	$ 50.6	$ 53.4	$ 31.2
Working capital (deficiency)	**17.5**	(43.4)	(29.8)	(4.9)	(20.4)
Total assets	**914.2**	909.7	945.4	930.9	793.7
Total debt and capital lease obligations	**514.7**	521.1	559.6	541.4	455.6
Shareholders' equity	**128.7**	115.2	111.1	118.0	104.2[j]

(a) We consider commission income to represent our commission gross profit, since unlike merchandise revenue and gasoline revenue there are no associated costs related to commission income received.

(b) On January 28, 1999, we recognized an extraordinary loss of approximately $5.9 million in connection with the repurchase of the senior notes. This loss was previously classified as an extraordinary loss. In accordance with Statement of Financial Accounting Standards, or SFAS, No. 145, *Rescission of FASB Statement No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections,* we have reclassified this loss to operating, general and administrative expenses.

On April 14, 2003, we entered into a new senior secured credit facility. In connection with the refinancing, we recorded a non-cash charge of approximately $2.9 million related to the write-off of deferred financing costs associated with the previous credit facility.

(c) During fiscal 2001, we recorded restructuring and other charges of $4.8 million pursuant to a formal plan to centralize administrative functions.

(d) During fiscal 2002, we adopted the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets,* or SFAS No. 142, which eliminated the amortization of goodwill. Goodwill amortization expense was $5.8 million, $3.4 million and $3.1 million for the fiscal years ended September 27, 2001, September 28, 2000 and September 30, 1999, respectively.

(e) Effective March 28, 2003, we accelerated the depreciation on certain assets related to our gasoline and store branding. These changes were the result of our gasoline brand consolidation project which will result in either updating or changing the image of the majority of our stores within the next two years. Accordingly, we reassessed the remaining useful lives of these assets based on our plans and recorded an increase in depreciation expense of $3.4 million.

(f) Effective September 27, 2002, we adopted the provisions of SFAS No. 143, *Accounting for Asset Retirement Obligations,* or SFAS No. 143, and, as a result, we recognize the future cost to remove an underground storage tank over the estimated useful life of the storage tank in accordance with SFAS No. 143. A liability for the fair value of an asset retirement obligation with a corresponding increase to the carrying value of the related long-lived asset is recorded at the time an underground storage tank is installed. We will amortize the amount added to property and equipment and recognize accretion expense in connection with the discounted liability over the remaining life of the respective underground storage tanks. Upon adoption, we recorded a discounted liability of $8.4 million, which is included in other noncurrent liabilities, increased net property and equipment by $2.7 million and recognized a one-time cumulative effect adjustment of $3.5 million (net of deferred tax benefit of $2.2 million).

(g) Net income (loss) applicable to common shareholders represents net income (loss) adjusted for our preferred stock dividend requirements and any redemption of preferred stock in excess of the carrying amount. Our previously outstanding Series B preferred stock was redeemed during our 1999 fiscal year.

(footnotes continued on following page)

(h) EBITDA is defined by us as net income before interest expense, income taxes, depreciation and amortization and cumulative effect of change in accounting principle. 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. 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 because it reflects the resources available for strategic opportunities including, among others, to invest in the business, make strategic acquisitions and to service debt. EBITDA as defined by us may not be comparable to similarly titled measures reported by other companies.

The following table contains a reconciliation of EBITDA to net cash provided by operating activities and cash flows from investing and financing activities (amounts in thousands):

	Fiscal Year Ended				
	September 25, 2003	September 26, 2002	September 27, 2001	September 28, 2000	September 30, 1999
EBITDA	**$128,039**	$108,831	$120,491	$ 133,163	$ 108,828
Interest expense	**(49,265)**	(51,646)	(58,731)	(52,329)	(41,280)
Adjustments to reconcile net loss to net cash provided by operating activities (other than depreciation and amortization, provision for deferred income taxes and cumulative effect of change in accounting principle)	**9,016**	3,983	8,592	1,089	2,749
Changes in operating assets and liabilities, net:					
Assets	**(1,796)**	(7,463)	9,778	(2,364)	(3,261)
Liabilities	**(17,730)**	279	(3,428)	8,600	1,531
Net cash provided by operating activities	**$ 68,264**	$ 53,984	$ 76,702	$ 88,159	$ 68,567
Net cash used in investing activities	**$ (22,357)**	$ (20,313)	$ (93,947)	$(148,691)	$(228,918)
Net cash (used in) provided by financing activities	**$ (15,242)**	$ (42,046)	$ 14,502	$ 82,729	$ 157,104

(i) Investing activities include expenditures for acquisitions.

(j) 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 proceeds, before expenses.

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

(l) Net capital expenditures include vendor reimbursements for capital improvements and proceeds from asset dispositions and sale-leaseback transactions.

(m) The stores included in calculating comparable store sales growth are existing or replacement stores, which were in operation during the entire comparable period of both fiscal years. Remodeling, physical expansion or changes in store square footage are not considered when computing comparable store sales growth.

MANAGEMENT'S Discussion and Analysis of Financial Condition and Results of Operations

This discussion and analysis of our financial condition and results of operations should be read in conjunction with "Selected Financial Data" and our consolidated financial statements and the related notes appearing elsewhere in this report.

Safe Harbor Discussion

This report, including without limitation, our discussion and analysis of our financial condition and results of operations, contains statements that we believe are "forward-looking statements" under the meaning of the Private Securities Litigation Reform Act of 1995 and are intended to enjoy protection of the safe harbor for forward-looking statements provided by that Act. These forward-looking statements generally can be identified by use of phrases such as "believe," "plan," "expect," "anticipate," "intend," "forecast" or other similar words or phrases. Descriptions of our objectives, goals, targets, plans, strategies, costs and burdens of environmental remediation, anticipated capital expenditures, anticipated gasoline suppliers and percentages of our requirements to be supplied by particular companies, anticipated store banners and percentages of our stores that we believe will operate under particular banners, expected cost savings and benefits and anticipated synergies from the Golden Gallon® acquisition, anticipated costs of re-branding our stores, anticipated sharing of costs of conversion with our gasoline suppliers, and expectations regarding re-modeling, re-branding, re-imaging or otherwise converting our stores are also forward-looking statements. These forward-looking statements are based on our current plans and expectations and involve a number of risks and uncertainties that could cause actual results and events to vary materially from the results and events anticipated or implied by such forward-looking statements, including:

- Competitive pressures from convenience stores, gasoline stations and other non-traditional retailers located in our markets;
- Changes in economic conditions generally and in the markets we serve;
- Unfavorable weather conditions;
- Political conditions in crude oil producing regions, including South America and the Middle East;
- Volatility in crude oil and wholesale petroleum costs;
- Wholesale cost increases of tobacco products;
- Consumer behavior, travel and tourism trends;
- Changes in state and federal environmental and other regulations;
- Dependence on one principal supplier for merchandise and two principal suppliers for gasoline;
- Financial leverage and debt covenants;
- Changes in the credit ratings assigned to our debt securities, credit facilities and trade credit;
- Inability to identify, acquire and integrate new stores;
- The interests of our largest stockholder;
- Dependence on senior management;
- Acts of war and terrorism; and
- Other unforeseen factors.

For a discussion of these and other risks and uncertainties, please refer to "Risk Factors" beginning on page 26. The list of factors that could affect future performance and the accuracy of forward-looking statements is illustrative but by no means exhaustive. Accordingly, all forward-looking statements should be evaluated with the understanding of their inherent uncertainty. The forward-looking statements included in this report are based on, and include, our estimates as of January 6, 2004. We anticipate that subsequent events and market developments will cause our estimates to change. However, while we may elect to update these forward-looking statements at some point in the future, we specifically disclaim any obligation to do so, even if new information becomes available in the future.

This discussion and analysis of our financial condition and results of operations should be read in conjunction with our "Selected Financial Data" and our consolidated financial statements and the related notes appearing elsewhere in this report.

Introduction

We are the leading independently operated convenience store chain in the southeastern United States and the third largest independently operated convenience store chain in the country based on store count with 1,392 stores in ten states as of December 1, 2003. Our stores offer a broad selection of merchandise, gasoline and ancillary products and services designed to appeal to the convenience needs of our customers. Our strategy is to continue to improve upon our position as the leading independently operated convenience store chain in the southeastern United States by generating profitable growth through merchandising initiatives, sophisticated management of our gasoline business, upgrading our stores, leveraging our geographic economies of scale, benefiting from the favorable demographics of our markets and continuing to selectively pursue opportunistic acquisitions.

During fiscal 2003, we focused on several initiatives we believe will continue to help maximize the performance of our existing store network and position our company for continued improvement in financial results.

In the merchandise segment, we completed our store reset program, which we began during fiscal 2002, introduced our Candy Lane℠ aisle and began the conversion of many of our store banners to Kangaroo Express℠. We also rolled out our Celeste® private label beverage line and Deli Express® sandwich program to all locations. We believe these initiatives have improved our gross margin and contributed to a 2.1% increase in comparable store merchandise revenue for fiscal 2003, despite unusually wet weather throughout the Southeast and significant retail price deflation in our cigarette category.

In the gasoline segment, we began our brand consolidation project, which we believe will enable us to provide a more consistent operating identity while helping us in our efforts to maximize our gasoline gallon growth and gross profit dollars. To date, we have completed the gasoline conversions and/or image upgrades related to the branding and supply agreements at a total of 240 locations, including 106 stores to BP®/Amoco®, 55 stores to Citgo® and 79 stores to our Kangaroo® private brand format. All of these stores have also been converted to Kangaroo Express℠ branding for their merchandise operations. Over the two-year conversion period, we anticipate that a total of approximately 1,000 stores will be converted or re-imaged to Kangaroo Express℠ on the merchandise side and converted and/or re-imaged to BP®/Amoco®, Citgo® or Kangaroo® on the gasoline side.

During the third quarter of fiscal 2003, we completed a $356 million refinancing of our senior secured credit facility. This refinancing provided us greater liquidity and flexibility through a $7.0 million increase in the revolving credit facility to a total of $52.0 million and a $118 million reduction of scheduled principal payments through fiscal 2005. Subsequent to September 25, 2003, we entered into amendments to our senior credit facility to increase the borrowings under the first lien term loan by $80.0 million and to increase the revolving credit facility to $56.0 million.

During fiscal 2003, we closed 35 underperforming locations. Historically, the stores we close are underperforming in terms of volume and profitability, and, generally, we benefit from closing the locations by reducing direct overhead expenses and eliminating certain fixed costs.

On October 16, 2003, we completed the acquisition of 138 convenience stores operating under the Golden Gallon® banner from Ahold, USA, Inc. This acquisition included 90 stores in Tennessee and 48 stores in northwest Georgia and enhances our strong regional presence, increasing our store count to 1,392 stores as of December 1, 2003. The aggregate purchase price was $187 million. The acquisition included (1) the purchase of certain real estate assets (114 fee-owned stores), financed through a $94.5 million sale-leaseback transaction and (2) the purchase of the Golden Gallon® operations and the balance of the real estate assets (17 fee-owned stores, corporate headquarters building and certain undeveloped properties) for approximately $92.5 million in cash, financed with $12.5 million of existing cash and $80 million of debt through borrowings under our amended senior secured credit facility. The acquired assets also included a dairy plant and related assets and a fuel hauling operation, which we subsequently sold to two of our existing suppliers.

Results of Operations

The following table presents for the periods indicated selected items in the consolidated statements of income as a percentage of our total revenue:

	Fiscal Year Ended		
	September 25, 2003	September 26, 2002	September 27, 2001
Total revenue	**100.0%**	100.0%	100.0%
Gasoline revenue	**62.7**	59.0	62.5
Merchandise revenue	**36.3**	40.0	36.7
Commission income	**1.0**	1.0	0.8
Cost of sales	**81.6**	80.9	81.5
Gross profit	**18.4**	19.1	18.5
Gasoline gross profit	**5.2**	4.9	5.4
Merchandise gross profit	**12.2**	13.2	12.3
Commission gross profit	**1.0**	1.0	0.8
Operating, general and administrative expenses	**13.9**	14.7	13.8
Restructuring and other changes	**—**	—	0.2
Depreciation and amortization	**2.0**	2.2	2.4
Income from operations	**2.5**	2.2	2.1
Interest and miscellaneous expense	**1.7**	2.1	2.2
Income (loss) before taxes	**0.8**	0.1	(0.1)
Tax expense	**(0.3)**	0.0	0.0
Income (loss) before cumulative effect adjustment	**0.5**	0.1	(0.1)
Cumulative effect adjustment, net of tax	**(0.1)**	—	—
Net income (loss)	**0.4**	0.1	(0.1)

MANAGEMENT'S Discussion and Analysis of Financial Condition and Results of Operations *(cont.)*

The table below provides a summary of our selected financial data for fiscal 2001, 2002 and 2003. In the table, dollars are in millions, except per gallon data.

	Fiscal Year Ended		
	September 25, 2003	September 26, 2002	September 27, 2001
Merchandise margin	**33.6%**	33.0%	33.4%
Gasoline gallons	**1,170.3**	1,171.9	1,142.4
Gasoline margin per gallon	**$0.1241**	$0.1037	$0.1246
Gasoline retail per gallon	**$ 1.49**	$ 1.25	$ 1.45
Comparable store data:			
Merchandise sales %	**2.1%**	3.4%	(0.2)%
Gasoline gallons %	**0.7%**	1.5%	(3.8)%
Number of stores:			
End of period	**1,258**	1,289	1,324
Weighted-average store count	**1,275**	1,305	1,325

Fiscal 2003 Compared to Fiscal 2002

Total Revenue. Total revenue for fiscal 2003 was $2.8 billion compared to $2.5 billion for fiscal 2002, an increase of $282.3 million or 11.3%. The increase in total revenue is primarily due to a 19.2% increase in our average retail price of gasoline gallons sold, comparable store increases in merchandise sales of $20.3 million and in gasoline gallons of 7.6 million and higher commission income of $2.1 million. The impact of these factors was partially offset by lost volume from 35 closed stores.

Merchandise Revenue. Total merchandise revenue for fiscal 2003 was $1.0 billion compared to $998.6 million for fiscal 2002, an increase of $10.3 million or 1.0%. The increase in merchandise revenue is primarily due to a comparable store merchandise sales increase of 2.1% partially offset by lost volume from closed stores of approximately $12.5 million. This comparable store sales increase has been achieved despite significant retail price deflation in the cigarette category. With respect to the cigarette category, while the volume of cartons sold per store increased, the negative impact of cigarette retail price deflation was approximately 1.8% on merchandise sales. This deflation of cigarette retail prices during the period did not impact our gross dollar margin on the sale of cigarettes. Sales of tobacco products comprised approximately one-third of our merchandise sales during fiscal 2003.

Gasoline Revenue and Gallons. Total gasoline revenue for fiscal 2003 was $1.7 billion compared to $1.5 billion for fiscal 2002, an increase of $269.9 million or 18.4%. The increase in gasoline revenue is primarily due to higher average gasoline retail prices and a comparable store gallon volume increase of 0.7%. In fiscal 2003, our average retail price of gasoline was $1.49 per gallon, which represents a 24.0 cent per gallon or 19.2% increase in average retail price from fiscal 2002.

In fiscal 2003, gasoline gallon volume was 1.2 billion gallons, a decrease of 1.7 million gallons or 0.1% from fiscal 2002. The decrease in gasoline gallons was primarily due to lost volume from 34 closed stores of 14.2 million gallons, partially offset by the comparable store gallon volume increase of 0.7%. We believe that the fiscal 2003 comparable store gallon increase was driven by a more consistent and competitive gasoline pricing philosophy as well as the positive impact that our upgrade and remodel activity has had on gallon volume.

Commission Income. At certain of our store locations, we receive commission income from the sale of lottery tickets and money orders as well as from the provision of ancillary services, such as public telephones, amusement and video gaming, car washes and ATMs. Total commission income for fiscal 2003 was $26.8 million compared to $24.7 million for fiscal 2002, an increase of $2.1 million or 8.4%. The increase in commission income is primarily due to the January 2002 introduction of South Carolina's Educational Lottery program.

Total Gross Profit. Our fiscal 2003 gross profit was $510.8 million compared to $475.4 million for fiscal 2002, an increase of $35.4 million or 7.4%. The increase in gross profit is primarily attributable to increases in gasoline gross profit per gallon and merchandise margin, coupled with comparable store volume increases and the increase in commission income.

Merchandise Gross Profit and Margin. Merchandise gross profit was $338.7 million for fiscal 2003 compared to $329.1 million for fiscal 2002, an increase of $9.6 million or 2.9%. This increase is primarily attributable to the increase in merchandise revenue discussed above, coupled with a 60 basis points increase in our merchandise margin. Our merchandise gross margin increased to 33.6% for fiscal 2003, primarily driven by the retail price deflation in the cigarette category.

Gasoline Gross Profit and Margin Per Gallon. Gasoline gross profit was $145.3 million for fiscal 2003 compared to $121.5 million for fiscal 2002, an increase of $23.7 million or 19.5%. The increase is primarily attributable to a 2.0 cents per gallon increase in gasoline margin, partially offset

by the lost volume from closed stores. Gasoline gross profit per gallon was 12.4 cents in fiscal 2003 compared to 10.4 cents in fiscal 2002. The increase was due to our more advantageous gas supply contracts, a more favorable retail gasoline environment and our ongoing initiatives to better manage gasoline pricing and inventories.

Operating, General and Administrative Expenses. Operating expenses for fiscal 2003 were $385.6 million compared to $367.3 million for fiscal 2002, an increase of $18.3 million or 5.0%. The increase is primarily attributable to the write-off of deferred financing costs of approximately $2.9 million related to our debt refinancing completed in April 2003, higher insurance costs of approximately $3.1 million, larger losses on asset disposals and closed store activity of approximately $5.9 million and increased employee benefit costs of approximately $1.7 million.

Income from Operations. Income from operations for fiscal 2003 was $70.8 million compared to $53.8 million for fiscal 2002, an increase of $17.0 million or 31.5%. The increase is primarily attributable to the increases in gasoline and merchandise gross margins and higher commission income. These increases were partially offset by a change in accounting estimate related to estimated useful lives of certain gasoline imaging assets and the increase in operating, general and administrative costs discussed above. The change in accounting estimate resulted in an increase in depreciation expense of approximately $3.4 million in fiscal 2003.

EBITDA. EBITDA is defined by us as net income before interest expense, income taxes, depreciation and amortization and cumulative effect of change in accounting principle. EBITDA for fiscal 2003 was $128.0 million compared to $108.8 million for fiscal 2002, an increase of $19.2 million or 17.6%. 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. 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 because it reflects the resources available for strategic opportunities including, among others, to invest in the business, make strategic acquisitions and to service debt. EBITDA as defined by us may not be comparable to similarly titled measures reported by other companies.

The following table contains a reconciliation of EBITDA to net cash provided by operating activities and cash flows from investing and financing activities:

	Fiscal Year Ended	
(amounts in thousands)	**September 25, 2003**	September 26, 2002
EBITDA	**$128,039**	$108,831
Interest expense	**(49,265)**	(51,646)
Adjustments to reconcile net loss to net cash provided by operating activities (other than depreciation and amortization, provision for deferred income taxes and cumulative effect of change in accounting principle)	**9,016**	3,983
Changes in operating assets and liabilities, net:		
Assets	**(1,796)**	(7,463)
Liabilities	**(17,730)**	279
Net cash provided by operating activities	**$ 68,264**	$ 53,984
Net cash used in investing activities	**$ (22,357)**	$ (20,313)
Net cash used in financing activities	**$ (15,242)**	$ (42,046)

Interest Expense (see—"Liquidity and Capital Resources"). Interest expense is primarily interest on borrowings under our senior credit facility and senior subordinated notes. Interest expense for fiscal 2003 was $49.3 million compared to $51.6 million for fiscal 2002, a decrease of $2.4 million or 4.6%. The decrease is primarily attributable to $3.4 million in income from the fair market value changes in our non-qualifying derivatives for fiscal 2003 compared to $926 thousand of expense in fiscal 2002.

Income Tax Expense. We recorded income tax expense of $9.4 million in fiscal 2003 compared to $1.1 million for fiscal 2002. The increase in income tax expense was primarily attributable to the $21.4 million increase in income before taxes. Consistent with fiscal 2002, our effective tax rate was 38.5%.

Cumulative Effect Adjustment. We recorded a one-time cumulative effect charge of $3.5 million (net of taxes of $2.2 million) relating to the disposal of our underground storage tanks in accordance with the adoption of SFAS No. 143 during the first quarter of fiscal 2003.

Net Income or Loss. Net income for fiscal 2003 was $11.5 million compared to $1.8 million for fiscal 2002. The increase is due to the items discussed above.

MANAGEMENT'S Discussion and Analysis of Financial Condition and Results of Operations *(cont.)*

Fiscal 2002 Compared to Fiscal 2001

Total Revenue. Total revenue for fiscal 2002 was $2.5 billion compared to $2.6 billion for fiscal 2001, a decrease of $149.0 million or 5.6%. The decrease in total revenue is primarily due to a 13.8% decrease in our average retail price of gasoline gallons sold and lost volume from 38 closed stores. The impact of these factors was partially offset by comparable store increases in merchandise sales and gasoline gallons of 3.4% and 1.5%, respectively, as well as higher commission income of $3.0 million and the effect of the full year impact of our fiscal 2001 acquisitions.

Merchandise Revenue. Total merchandise revenue for fiscal 2002 was $998.6 million compared to $968.6 million for fiscal 2001, an increase of $30.0 million or 3.1%. The increase in merchandise revenue is primarily due to a comparable store merchandise sales increase of 3.4% and the effect of a full year of merchandise revenue from our fiscal 2001 acquisitions. The impact of these factors was partially offset by lost volume from closed stores of $15.5 million. The comparable store volume increases were primarily due to our efforts to enhance and reposition our merchandise offerings, to increase promotional activity and to more aggressively price key categories in an effort to drive customer traffic.

Gasoline Revenue and Gallons. Total gasoline revenue for fiscal 2002 was $1.5 billion compared to $1.7 billion for fiscal 2001, a decrease of $182.0 million or 11.0%. The decrease in gasoline revenue is primarily due to lower average gasoline retail prices and lost volume from closed stores of 11.9 million gallons. In fiscal 2002, our average retail price of gasoline was $1.25 per gallon, which represents a 20.0 cent per gallon or 13.8% decrease in average retail price from fiscal 2001. The impact of the decline in average retail price and fewer retail locations was partially offset by gasoline gallon comparable store volume increases of 1.5%.

In fiscal 2002, gasoline gallon volume was 1.2 billion gallons, an increase of 29.6 million gallons or 2.6% over fiscal 2001. The increase in gasoline gallons was primarily due to the effect of a full year of gasoline volume from fiscal 2001 acquisitions and a comparable store gasoline volume increase of 1.5%. The fiscal 2002 comparable store gallon increase was primarily due to a more consistent and competitive gasoline pricing philosophy as well as the impact our re-branding and re-imaging activity had on gallon volume.

Commission Income. Total commission income for fiscal 2002 was $24.7 million compared to $21.7 million for fiscal 2001, an increase of $3.0 million or 13.8%. The increase in commission income is primarily due to the January 2002 introduction of South Carolina's Educational Lottery program.

Total Gross Profit. Our fiscal 2002 gross profit was $475.4 million compared to $487.6 million for fiscal 2001, a decrease of $12.2 million or 2.5%. The decrease in gross profit is primarily attributable to declines in gasoline gross profit per gallon and merchandise margin, partially offset by comparable store volume increases of $31.4 million in merchandise revenue and 15.7 million gasoline gallons and the increase in commission income of $3.0 million.

Merchandise Gross Profit and Margin. Merchandise gross profit was $329.1 million for fiscal 2002 compared to $323.6 million for fiscal 2001, an increase of $5.5 million or 1.7%. This increase is primarily attributable to the increase in merchandise revenue discussed above, partially offset by a 40 basis point decline in our merchandise margin. Our merchandise gross margin decline to 33.0% for fiscal 2002 was primarily driven by our heightened promotional activity and more aggressive retail pricing in key categories, including cigarettes. We believe these initiatives were instrumental in increasing comparable store merchandise revenue and ultimately increasing merchandise gross profit dollars.

Gasoline Gross Profit and Margin Per Gallon. Gasoline gross profit was $121.5 million for fiscal 2002 compared to $142.3 million for fiscal 2001, a decrease of $20.8 million or 14.6%. The decrease is primarily attributable to a 2.1 cents per gallon decline in gasoline margin, and was partially offset by the comparable store gasoline gallon increase of 1.5% and the contribution of stores acquired or opened since September 28, 2000. Gasoline gross profit per gallon was 10.4 cents in fiscal 2002 compared to 12.5 cents in fiscal 2001. The decrease was due to fluctuations in petroleum markets, particularly in the second and fourth quarters of fiscal 2002, competition factors influenced by general market and economic indicators as well as our efforts to maintain a more consistent and competitive gasoline pricing philosophy.

Operating, General and Administrative Expenses. Operating expenses for fiscal 2002 were $367.3 million compared to $364.1 million for fiscal 2001, an increase of $3.2 million or 0.9%. The increase in operating expenses is primarily due to increases in lease expense of $1.9 million and insurance expense of $3.4 million as well as larger losses on asset disposals and closed store activity of approximately $1.5 million. The increases associated with these factors were partially offset by savings associated with our restructuring initiatives.

Income from Operations. Income from operations for fiscal 2002 was $53.9 million compared to $55.2 million for fiscal 2001, a decrease of $1.3 million or 2.4%. The decrease was primarily attributable to a 2.1 cents decline in gasoline margin per gallon as well as the operating, general and administrative expense variances discussed above. These decreases were partially offset by the positive commission

income and merchandise gross profit variances discussed above as well as a $9.3 million decrease in depreciation and amortization expense primarily as a result of the adoption of SFAS No. 142 and the absence of $4.8 million in restructuring charges incurred in fiscal 2001.

EBITDA. EBITDA is defined by us as net income before interest expense, income taxes, depreciation and amortization and cumulative effect of change in accounting principle. EBITDA for fiscal 2002 was $108.8 million compared to $120.5 million for fiscal 2001, a decrease of $11.7 million or 9.7%. The decrease 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. 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 because it reflects the resources available for strategic opportunities including, among others, to invest in the business, make strategic acquisitions and to service debt. EBITDA as defined by us may not be comparable to similarly titled measures reported by other companies.

The following table contains a reconciliation of EBITDA to net cash provided by operating activities and cash flows from investing and financing activities:

	Fiscal Year Ended	
(amounts in thousands)	September 26, 2002	September 27, 2001
EBITDA	$108,831	$120,491
Interest expense	(51,646)	(58,731)
Adjustments to reconcile net loss to net cash provided by operating activities (other than depreciation and amortization, provision for deferred income taxes and cumulative effect of change in accounting principle)	3,983	8,592
Changes in operating assets and liabilities, net:		
Assets	(7,463)	9,778
Liabilities	279	(3,428)
Net cash provided by operating activities	$ 53,984	$ 76,702
Net cash used in investing activities	$ (20,313)	$ (93,947)
Net cash (used in) provided by financing activities	$ (42,046)	$ 14,502

Interest Expense. Interest expense in fiscal 2002 was $51.6 million compared to $58.7 million for fiscal 2001, a decrease of $7.1 million or 12.1%. In fiscal 2002, interest expense was primarily related to interest costs of $20.5 million on our senior subordinated notes and $19.1 million on our senior credit facility, $8.8 million in settlements on our interest rate swaps, $2.2 million in capital lease interest and $926 thousand in fair value adjustments associated with our non-qualifying derivative instruments. The decrease in interest expense is primarily attributable to a general decline in interest rates, the decrease in our weighted-average outstanding borrowings and the change in fair market value of our non-qualifying interest rate derivatives, partially offset by an increase in our interest rate swap settlements of $7.0 million.

Income Tax Expense. We recorded income tax expense of $1.1 million in fiscal 2002 compared to $871 thousand for fiscal 2001. The increase in income tax expense was primarily attributable to the increase in income before taxes partially offset by a decline in our effective tax rate to 38.5%. The change in our effective tax rate for fiscal 2002 was primarily due to the elimination of non-deductive goodwill amortization expense associated with our adoption of SFAS No. 142.

Net Income or Loss. Net income for fiscal 2002 was $1.8 million compared to a net loss of $2.7 million for fiscal 2001, an increase of $4.5 million. The increase is due to the items discussed above.

Liquidity and Capital Resources

Cash Flows from Operations. Due to the nature of our business, substantially all sales are for cash and cash provided by operations is our primary source of liquidity. We rely primarily upon cash provided by operating activities, supplemented as necessary from time to time by borrowings under our revolving credit facility, sale-leaseback transactions, and asset dispositions to finance our operations, pay interest and principal payments and fund capital expenditures. Cash provided by operations for fiscal 2003 totaled $68.3 million, for fiscal 2002 totaled $54.0 million and for fiscal 2001 totaled $76.7 million. Our increase in net cash provided by operating activities for fiscal 2003 over fiscal 2002 is primarily attributable to the increase in gasoline and merchandise gross profit and its impact on operating income and EBITDA. We had $72.9 million of cash and cash equivalents on hand at September 25, 2003.

MANAGEMENT'S Discussion and Analysis of Financial Condition and Results of Operations *(cont.)*

Capital Expenditures. Gross capital expenditures (excluding all acquisitions) for fiscal 2003 were $28.2 million. Our capital expenditures are primarily expenditures for 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, proceeds from sale-leaseback transactions and asset dispositions and vendor reimbursements.

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 lease the property back to us under long-term leases. We retain ownership of all personal property and gasoline marketing equipment. Our leases are generally operating leases at market rates with lease terms between fifteen and twenty years plus several renewal option periods. The lease payment is based on market rates applied to the cost of each respective property. Our senior credit facility limits or caps the proceeds of sale-leasebacks that we can use to fund our operations or capital expenditures. We received $2.3 million in proceeds from sale-leaseback transactions in fiscal 2003 and $6.2 million during fiscal 2002.

In fiscal 2003, we had proceeds of $9.4 million including asset dispositions ($6.3 million), vendor reimbursements ($0.9 million) and sale-leaseback transactions ($2.3 million). As a result, our net capital expenditures, excluding all acquisitions, for fiscal 2003 were $18.9 million. We anticipate that net capital expenditures for fiscal 2004 will be approximately $40.0 million.

Cash Flows from Financing Activities. For fiscal 2003, net cash used in financing activities was $15.2 million. The net cash used was primarily the result of scheduled principal payments totaling $23.2 million and financing costs associated with the refinancing of our senior credit facility totaling $7.3 million. This decline was partially offset by new borrowings of $16.0 million under our senior credit facility. At September 25, 2003, our long-term debt consisted primarily of $297.5 million in loans under our senior credit facility and $200.0 million of our 10¼% senior subordinated notes. See "—Contractual Obligations and Commitments" for a summary of our long-term debt principal amortization commitments.

Senior Credit Facility. On April 14, 2003, we entered into a new senior secured credit facility, which consisted of a $253.0 million first lien term loan, a $51.0 million second lien term loan and a $52.0 million revolving credit facility (with the right, at our election through April 14, 2005, to increase the revolving credit facility by up to an additional $18.0 million, subject to participation by the existing lenders or new lenders we invite to participate), each maturing March 31, 2007. Proceeds from the new senior secured credit facility were used to repay all amounts outstanding under the previous senior credit facility and loan origination costs. The term loans were issued with an original issue discount of $4.6 million, which will be amortized over the life of the agreement. As of September 25, 2003, our outstanding term loan balance, net of unamortized original issue discount, was $297.5 million.

Subsequent to September 25, 2003, we entered into an amendment to our senior credit facility to increase the borrowings under the first lien term loan by $80.0 million. The proceeds from the term loan were used to fund the Golden Gallon® acquisition. Also, subsequent to September 25, 2003, we increased the availability under our revolving credit facility by $4.0 million to $56.0 million.

Our senior credit facility bears interest at variable interest rates. The credit facility permits us to choose between two basic rates for a given loan:

- a rate based on the greater of the prime rate of interest in effect on the day the loan is made or the federal funds rate in effect on the day the loan is made plus ½ of 1% and an additional margin, as described below; or
- a rate based on the London interbank offered rate, or LIBOR, plus an additional margin as described below.

The actual interest rate we pay depends on whether the loan is a first lien term loan, a second lien term loan or a revolving credit loan. The credit facility requires us to pay, in addition to the basic interest rate, an annual margin ranging from 3.00% to 6.50%, depending on the type of loan involved. We have from time to time entered into certain hedging agreements in an effort to mitigate the fluctuations in interest rates and manage our interest rate risk, and anticipate that we will continue to use hedging agreements for these purposes in the future.

Our senior credit facility is secured by substantially all of our assets, other than our leased real property, and guaranteed by our subsidiaries.

Our senior credit facility contains covenants restricting our ability and the ability of any of our subsidiaries to, among other things and subject to various exceptions:

- incur additional indebtedness or issue letters of credit;
- declare dividends or redeem or repurchase capital stock;
- prepay, redeem or purchase subordinated debt;
- incur liens;
- make loans and investments;
- make capital expenditures;
- engage in mergers, acquisitions, asset sales or sale-leaseback transactions; and
- engage in transactions with affiliates.

Our senior credit facility also contains financial ratios and tests that must be met with respect to maximum pro forma leverage ratios, minimum fixed charge coverage ratios, minimum pro forma EBITDA and maximum capital expenditures. As of December 1, 2003, we have satisfied all financial ratios and tests under our senior credit facility. The senior credit facility requires us to:

- comply with maximum consolidated pro forma leverage ratios on a sliding scale ranging from a high of 5.00 to 1.00 to a low of 3.75 to 1.00 over quarterly periods between April 14, 2003 and March 31, 2006 and thereafter;
- maintain a consolidated fixed charge coverage ratio of at least 1.00 to 1.00 on a quarterly basis;
- maintain minimum consolidated pro forma EBITDA for the trailing four quarters of $115 million (quarters through March 25, 2004), $120 million (quarters through December 30, 2004) and $125 million (thereafter); and
- limit consolidated capital expenditures in fiscal 2004 to $48.0 million and for fiscal years after 2004 to $44.0 million (plus unspent amounts that are permitted to be carried forward from prior fiscal years up to a limit of 25% of the previous year's dollar limit).

The senior credit facility limits us to paying aggregate consideration of $20,000,000 for any acquisition and requires that we remain in pro forma compliance with all of the financial ratios contained in the credit facility after giving effect to the acquisition. In addition, the senior credit agreement includes customary events of default, including payment defaults on more than $5.0 million of debt, judgments exceeding $5.0 million, and upon a change of control. Under the credit agreement, a change of control occurs if, among other things (a) any person other than a permitted holder (our current largest stockholder) holds more than 30% of the voting power of our common stock unless the permitted holder owns a greater percentage than such person or (b) permitted holders hold less than 35% of our common stock or (c) a change of control as defined by the indenture governing the senior subordinated notes occurs.

Our $56.0 million revolving credit facility is available to fund working capital, finance general corporate purposes and support the issuance of standby letters of credit. Borrowings under the revolving credit facility are limited by our outstanding letters of credit of approximately $30.0 million. Furthermore, the revolving credit facility limits our total outstanding letters of credit to $45.0 million. As of September 25, 2003, we had no borrowings outstanding under the revolving credit facility, we had approximately $22.0 million in available borrowing capacity and $30 million of standby letters of credit were issued under the facility.

The first lien term loans amortize on a quarterly basis with balloon payments at maturity. In addition, we are required to prepay the loans under the credit facility with (a) the net cash proceeds of most debt issuances, (b) 50% of the net cash proceeds received by us from any issuance of capital stock, (c) the net cash proceeds of asset sales (unless the proceeds are reinvested in the business) and (d) 50% of excess cash flow as defined in the credit facility (beginning with the fiscal quarter ending December 30, 2004).

Senior Subordinated Notes. We have outstanding $200.0 million of 10¼% senior subordinated notes due October 15, 2007. Interest on the senior subordinated notes is due on October 15 and April 15 of each year. Our senior subordinated notes contain covenants that, among other things and subject to various exceptions, restrict our ability and any restricted subsidiary's ability to:

- pay dividends, make distributions or repurchase stock, except, (a) assuming the ratio of our pro forma EBITDA to fixed charges is at least 2 to 1, in amounts not in excess of the sum of 50% of our net income and 100% of the net proceeds of equity issuances or issuances of convertible debt which has been converted and (b) in amounts not in excess of $5.0 million;
- issue stock of subsidiaries;
- make investments in non-affiliated entities;
- incur liens to secure debt which is equal to or subordinate in right of payment to the senior subordinated notes, unless the notes are secured on an equal and ratable basis (or senior basis) with the obligations so secured;
- enter into transactions with affiliates;
- enter into sale-leaseback transactions; or
- 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:

- debt under our bank credit facility in an amount not to exceed (a) up to $50.0 million for acquisitions plus (b) the greater of $45.0 million or 4.0% times our annualized revenues;
- capital leases or purchase money debt in amounts not to exceed in the aggregate 10% of our tangible assets at the time of incurrence;
- intercompany debt;
- debt existing on the date the senior subordinated notes were issued;
- up to $15.0 million in any type of debt; or
- debt for refinancing of the above described debt, so long as such debt is subordinated to the senior subordinated notes to the same extent as the debt refinanced and meets certain other requirements.

MANAGEMENT'S Discussion and Analysis of Financial Condition and Results of Operations *(cont.)*

The senior subordinated notes also place conditions on the terms of asset sales or transfers and require us either to reinvest the cash proceeds of an asset sale or transfer, or, if we do not reinvest those proceeds, to pay down our senior credit facility or other senior debt or to offer to redeem our senior subordinated notes with any asset sale proceeds not so used. In addition, upon the occurrence of a change of control, we will be required to offer to purchase all of the outstanding senior subordinated notes at a price equal to 101% of their principal amount plus accrued and unpaid interest to the date of redemption. Under the indenture governing the senior subordinated notes, a change of control is deemed to occur if, among other things (a) any person, other than a permitted holder (our current largest stockholder), becomes the beneficial owner of 50% or more of our common stock or (b) any person becomes the owner of more than 33% of our common stock and the permitted holders own a lesser percentage of our Company than such other person and do not have the right or ability to elect a majority of the board. The senior subordinated notes may be redeemed, in whole or in part, at a redemption price that is currently 103.417% and decreases to 101.708% after October 15, 2004 and 100.0% after October 15, 2005.

The senior subordinated notes contain standard events of default, including acceleration of other debt aggregating $10.0 million, default in the payment at final maturity of other debt aggregating $10.0 million, and the imposition of final judgments in excess of $10.0 million.

Shareholders' Equity. As of September 25, 2003, our shareholders' equity totaled $128.7 million. The increase of $13.5 million in shareholders' equity from September 26, 2002 is primarily attributable to fiscal 2003 net income of $11.5 million and a decrease of $1.4 million in accumulated other comprehensive deficit related to the fair value changes in our qualifying derivative financial instruments.

Long-Term Liquidity. We believe that anticipated cash flows from operations and funds available from our existing revolving credit facility, together with cash on hand and vendor reimbursements, will provide sufficient funds to finance our operations at least for the next 12 months. Changes in our operating plans, lower than anticipated sales, increased expenses, additional acquisitions or other events may cause us to need to seek additional debt or equity financing in future periods. There can be no guarantee that financing will be available on acceptable terms or at all. Additional equity financing could be dilutive to the holders of our common stock; debt financing, if available, could impose additional cash payment obligations and additional covenants and operating restrictions. We have no current plans to seek any such additional financing.

Contractual Obligations and Commitments

Contractual Obligations. The following table shows our expected long-term debt amortization schedule, future capital lease commitments (including principal and interest) and future operating lease commitments as of September 25, 2003:

(Dollars in thousands)	Fiscal 2004	Fiscal 2005	Fiscal 2006	Fiscal 2007	Fiscal 2008	Thereafter	Total
Long-term debt[1]	$27,558	$16,029	$25,260	$232,751	$200,000	$ —	$ 501,598
Capital lease obligations	3,597	3,271	3,050	2,994	2,740	22,659	38,311
Operating leases[2]	54,599	51,990	48,885	46,947	44,964	312,465	559,850
Total contractual obligations	$85,754	$71,290	$77,195	$282,692	$247,704	$335,124	$1,099,759

(1) On October 16, 2003, we increased our borrowings under our senior credit facility by $80.0 million. The annual principal obligations on the increased borrowings are $7.9 million in fiscal 2004, $5.0 million in fiscal 2005, $8.0 million in fiscal 2006 and $59.1 million in fiscal 2007.

(2) On October 16, 2003, we financed the acquisition of 114 Golden Gallon® stores pursuant to a $94.5 million sale-leaseback transaction. The incremental annual rental expense on the related lease is $9.06 million in fiscal 2004, $9.45 million in each of fiscal 2005–2008 and an aggregate of $142.14 million from 2009 through 2023.

Letter of Credit Commitments. The following table shows the expiration dates of our standby letters of credit issued under our senior credit facility as of September 25, 2003:

(Dollars in thousands)	Fiscal 2004	Fiscal 2005	Total
Standby letters of credit	$24,883	$5,083	$29,966

Environmental Considerations. Environmental reserves of $13.8 million and $13.3 million as of September 25, 2003 and September 26, 2002, respectively, represent our estimates for future expenditures for remediation, tank removal and litigation associated with 236 and 240 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. We estimate that approximately $12.5 million of our environmental obligations will be funded by state trust funds and third-party insurance. Our environmental reserve, dated as of September 25, 2003, does not include the 31 Golden Gallon® sites that were known to be contaminated at the time of our October 2003 acquisition of Golden Gallon®. State trust funds, insurers or other third parties are responsible for the costs of remediation at all 31 Golden Gallon® sites. Also, as of September 25, 2003 and September 26, 2002 there were an additional 487 and 470 sites, respectively, that are known to be contaminated and that are being remediated by third parties and therefore, the costs to remediate such sites are not included in our environmental reserve.

Florida environmental regulations require all single-walled underground storage tanks to be upgraded/replaced with secondary containment by December 31, 2009. In order to comply with these Florida regulations, we will be required to upgrade or replace underground storage tanks at approximately 185 locations. We anticipate that these capital expenditures will be approximately $16.5 million and will begin during fiscal 2004. The ultimate costs incurred will depend on several factors including future store closures, changes in the number of locations upgraded or replaced and changes in the costs to upgrade or replace the underground storage tanks.

Merchandise Supply Agreement. We have a distribution service agreement with McLane pursuant to which McLane is the primary distributor of traditional grocery products to our stores. We also purchase a significant percentage of the cigarettes we sell from McLane. The agreement with McLane continues through October 10, 2008 and contains no minimum purchase requirements. We purchase products at McLane's cost plus an agreed upon percentage, reduced by any promotional allowances and volume rebates offered by manufacturers and McLane. In addition, we received an initial service allowance, which is being amortized over the term of the agreement, and also receive additional per store service allowances, both of which are subject to adjustment based on the number of stores in operation. Total purchases from McLane exceeded 50% of total merchandise purchases in fiscal 2003.

Gasoline Supply Agreements. We have historically purchased our branded gasoline and diesel fuel under supply agreements with major oil companies, including BP®, Chevron®, Citgo®, Shell®, Mobil® and Texaco®. The fuel purchased has generally been based on the stated rack price, or market price, quoted at each terminal. The initial terms of these supply agreements range from three to ten years and generally contain minimum annual purchase requirements as well as provisions for various payments to us based on volume of purchases and vendor allowances. These agreements also, in certain instances, give the supplier a right of first refusal to purchase certain assets that we may want to sell. We have met our purchase commitments under these contracts and expect to continue to do so. We purchase the majority of our private branded gallons from Citgo®.

During February 2003, we signed new gasoline supply agreements with both BP® and Citgo® to brand and supply most of our gasoline products for the next five years. After a conversion of approximately 760 locations over the next 18 months we expect that BP® will supply approximately 25% of our total gasoline volume, which will be sold under the BP®/Amoco® brand. Citgo® will supply both our private brand gasoline, which will be sold under our own Kangaroo® and other brands, and Citgo® branded gasoline. Including our private brand gasoline, we expect that after the 18-month conversion period, Citgo® will supply approximately 60% of our total gasoline volume. The remaining locations, primarily in Florida, will remain branded and supplied by Chevron® or Exxon®. We entered into these branding and supply agreements to provide a more consistent operating identity while helping us in our efforts to maximize our gasoline gallon growth and gasoline gross profit dollars.

Other Commitments. We make various other commitments and become subject to various other contractual obligations which we believe to be routine in nature and incidental to the operation of the business. Management believes that such routine commitments and contractual obligations do not have a material impact on our business, financial condition or results of operations. In addition, like all public companies, we expect that we may face slightly increased costs in order to comply with new rules and standards relating to corporate governance and corporate disclosure, including the Sarbanes-Oxley Act of 2002, new SEC regulations and Nasdaq Stock Market rules. We intend to devote all reasonably necessary resources to comply with evolving standards.

MANAGEMENT'S Discussion and Analysis of Financial Condition and Results of Operations *(cont.)*

Quarterly Results of Operations and Seasonality

The following table sets forth certain unaudited financial and operating data for each fiscal quarter during fiscal 2001, fiscal 2002 and fiscal 2003. The unaudited quarterly information includes all normal recurring adjustments that we consider necessary for a fair presentation of the information shown. This information should be read in conjunction with our consolidated financial statements and the related notes appearing elsewhere in this report. Due to the nature of our business and its reliance, in part, on consumer spending patterns in coastal, resort and tourist markets, we typically generate higher revenues and gross margins during warm weather months in the southeastern United States, which fall within our third and fourth fiscal quarters. In the following table, dollars are in thousands, except per gallon data.

	Fiscal 2003				Fiscal 2002				Fiscal 2001			
	First Quarter	**Second Quarter**	**Third Quarter**	**Fourth Quarter**	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Total Revenue	**$650,977**	**$673,444**	**$711,455**	**$740,485**	$577,373	$560,845	$681,308	$674,538	$634,243	$635,703	$707,957	$665,141
Merchandise revenue	**242,340**	**234,900**	**263,890**	**267,772**	237,238	232,477	265,074	263,832	228,470	229,740	256,254	254,150
Gasoline revenue	**401,933**	**431,719**	**441,093**	**465,917**	334,313	322,015	409,693	404,711	400,207	400,375	446,508	405,635
Commission income	**6,704**	**6,825**	**6,472**	**6,796**	5,822	6,353	6,541	5,995	5,566	5,588	5,195	5,356
Gross Profit	**125,991**	**113,129**	**135,017**	**136,667**	115,479	108,100	127,025	124,798	118,945	116,260	128,796	123,642
Merchandise gross profit	**79,773**	**77,495**	**88,502**	**92,953**	77,313	76,355	87,061	88,413	77,562	78,857	84,696	82,487
Gasoline gross profit	**39,514**	**28,809**	**40,043**	**36,918**	32,344	25,392	33,423	30,390	35,817	31,815	38,905	35,799
Commission income	**6,704**	**6,825**	**6,472**	**6,796**	5,822	6,353	6,541	5,995	5,566	5,588	5,195	5,356
Income from operations	**20,343**	**7,708**	**21,870**	**20,910**	13,111	4,626	20,503	15,612	16,397	5,955	20,111	12,730
Income (loss) before cumulative effect	**4,920**	**(2,353)**	**6,085**	**6,334**	475	(4,138)	4,064	1,403	1,907	(4,889)	3,616	(3,290)
Income from operations as a percentage of full year	**28.7%**	**10.9%**	**31.9%**	**29.5%**	24.3%	8.6%	38.1%	29.0%	29.7%	10.8%	36.4%	23.1%
Comparable store merchandise sales increase (decrease)	**3.3%**	**2.5%**	**0.5%**	**2.4%**	1.4%	1.9%	4.7%	4.9%	1.5%	(1.6)%	(0.6)%	0.3%
Comparable store sales gasoline gallons increase (decrease)	**(0.7)%**	**(0.2)%**	**0.6%**	**3.1%**	0.8%	0.2%	4.4%	0.7%	(6.1)%	(4.7)%	(3.8)%	0.8%
Merchandise gross margin as a percentage of total revenue	**12.25%**	**11.51%**	**12.44%**	**12.55%**	13.39%	13.61%	12.78%	13.11%	12.23%	12.40%	11.96%	12.40%
Gasoline gross profit per gallon	**0.139**	**0.104**	**0.133**	**0.120**	0.112	0.090	0.111	0.101	0.132	0.114	0.134	0.119

Inflation

During fiscal 2003, wholesale gasoline fuel prices remained volatile, hitting a high of approximately $38 per barrel in March 2003 and a low of approximately $25 per barrel in November 2002. Generally, we pass along wholesale gasoline cost changes to our customers through retail price changes. Gasoline price volatility has had an impact on total revenue, gross profit dollars and gross profit percentage.

General CPI, excluding energy, increased 1.4% during fiscal 2003 and food at home CPI, which is most indicative of our merchandise inventory, increased similarly. While we have generally been able to pass along these price increases to our customers, we can make no assurances that continued inflation will not have a material adverse effect on our sales and gross profit dollars.

Recently Adopted Accounting Standards

Effective December 27, 2002, we adopted the provisions of Emerging Issues Task Force, or EITF, No. 02-16, *Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor*, or EITF 02-16. EITF 02-16 requires that certain cash consideration received by a customer from a vendor is presumed to be a reduction of the prices of the vendor's products or services and should, therefore, be characterized as a reduction of cost of sales when recognized in the customer's income statement. However, that presumption is overcome if certain criteria are met. If the presumption is overcome, the consideration would be presented as revenue if it represents a payment for goods or services provided by the reseller to the vendor, or as an offset to an expense if it represents a reimbursement of a cost incurred by the reseller. The adoption of EITF 02-16 did not have a material impact on our results of operations or classification of expenses.

Effective December 27, 2002, we adopted the provisions of SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, or SFAS No. 146, which requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. The adoption of SFAS No. 146 did not have a material impact on our results of operations and financial condition.

Effective September 27, 2002, we adopted the provisions of SFAS No. 143 which addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. SFAS No. 143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. SFAS No. 143 requires us to recognize an estimated liability associated with the removal of our underground storage tanks. See "Notes to Consolidated Financial Statements—Note 9—Asset Retirement Obligations" for a discussion of our adoption of SFAS No. 143.

Effective September 27, 2002, we adopted the provisions of SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, or SFAS No. 144. This statement supersedes SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of* and Accounting Principles Board No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*. SFAS No. 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets and how the results of a discontinued operation are to be measured and presented. The adoption of SFAS No. 144 did not have a material impact on our results of operations and financial condition.

Effective September 27, 2002, we adopted the provisions of SFAS No. 145. SFAS No. 145 rescinds FASB Statement No. 4, *Reporting Gains and Losses from Extinguishment of Debt*, or SFAS No. 4. SFAS No. 145 also rescinds and amends other existing authoritative pronouncements. SFAS No. 145 eliminates SFAS No. 4 and, thus, the exception to applying APB Opinion No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*, or Opinion 30, to all gains and losses related to extinguishments of debt. As a result, gains and losses from extinguishment of debt should be classified as extraordinary items only if they meet the criteria in Opinion 30. See "Notes to Consolidated Financial Statements—Note 5— Long-Term Debt" for our discussion on our debt extinguishment.

Effective September 27, 2002, we adopted the provisions of SFAS No. 148, *Accounting for Stock-Based Compensation—Transition and Disclosure*, or SFAS No. 148, an amendment of SFAS No. 123, *Accounting for Stock-Based Compensation*, or SFAS No. 123. SFAS No. 148 was issued to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. We are following the disclosure requirements of SFAS No. 148 in our 2003 consolidated financial statements.

MANAGEMENT'S Discussion and Analysis of Financial Condition and Results of Operations *(cont.)*

In November 2002, the Financial Accounting Standards Board, or FASB, issued FASB Interpretation, or FIN, 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, or FIN 45. This interpretation addresses the disclosure requirements for guarantees and indemnification agreements entered into by an entity. FIN 45 requires that upon issuance of a guarantee, the entity (i.e., the guarantor) must recognize a liability for the fair value of the obligation it assumes under the guarantee. The disclosure provisions of FIN 45 are effective for financial statements of interim or annual periods that end after December 15, 2002. The provisions of FIN 45 for initial recognition and measurement are to be applied on a prospective basis to guarantees issued or modified after December 15, 2002, irrespective of the guarantor's fiscal year-end. The guarantor's previous accounting for guarantees that were issued before initial application of FIN 45 are not required to be revised or restated to reflect the effect of the recognition and measurement provisions of FIN 45. The adoption of FIN 45 did not have a material impact on our results of operations and financial condition.

In April 2003, the FASB issued SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*, or SFAS No. 149, to provide clarification on the meaning of an underlying derivative, the characteristics of a derivative that contains financing components and the meaning of an initial investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. In addition, all provisions of SFAS No. 149 should be applied prospectively. The provisions of SFAS No. 149 that relate to Statement 133 Implementation Issues that have been effective for fiscal quarters that began prior to June 15, 2003, should continue to be applied in accordance with their respective effective dates. The adoption of SFAS No. 149 did not have a material impact on our results of operations and financial condition.

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity*, or SFAS No. 150. SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity. Some of the provisions of SFAS No. 150 are consistent with the current definition of liabilities in FASB Concepts Statement No. 6, *Elements of Financial Statements*. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003, thus we adopted the provisions of SFAS No. 150 for our fourth quarter beginning June 27, 2003. The adoption of this SFAS No. 150 did not have a material impact on our results of operations and financial condition.

Recently Issued Accounting Standards Not Yet Adopted

In January 2003, the FASB issued FIN 46, *Consolidation of Variable Interest Entities—an Interpretation of ARB No. 51*, or FIN 46. This interpretation provides guidance related to identifying variable interest entities (previously known as special purpose entities or SPEs) and determining whether such entities should be consolidated. Certain disclosures are required if it is reasonably possible that a company will consolidate or disclose information about a variable interest entity when it initially applies FIN 46. This interpretation will be effective for our first quarter beginning September 26, 2003. We have no investment in or contractual relationship or other business relationship with a variable interest entity and therefore the adoption of FIN 46 will not have any impact on our results of operations and financial condition. However, if we enter into any such arrangement with a variable interest entity in the future (or an entity with which we currently have a relationship is reconsidered based on guidance in FIN 46 to be a variable interest entity), our results of operations and financial condition will be impacted.

Critical Accounting Policies

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

Critical accounting policies are those we believe are both most important to the portrayal of our financial condition and results, and require our most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Judgments and uncertainties affecting the application of those polices may result in materially different amounts being reported under different conditions or using

different assumptions. We believe the following policies to be the most critical in understanding the judgments that are involved in preparing our consolidated financial statements.

Environmental Liabilities and Related Receivables. We account for the cost incurred to comply with federal and state environmental regulations as follows:

- Environmental reserves reflected in the financial statements are based on internal and external estimates of costs to remediate sites relating to the operation of underground storage tanks. Factors considered in the estimates of the reserve are the expected cost and the estimated length of time to remediate each contaminated site.
- Deductibles and remediation costs 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 10% discount rate.
- Reimbursement under state trust fund programs or third-party insurers are recognized as receivables and a provision for uncollectible reimbursements is recorded based on historical and expected collection rates. Our historical collection experience exceeds 95%. All recorded reimbursements are expected to be collected within a period of twelve to eighteen months after submission of the reimbursement claim. 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.

Changes in laws and government regulation, the financial condition of the state trust funds and third-party insurers and actual remediation expenses compared to historical experience could significantly impact our statement of operations and financial position.

Revenue Recognition. Revenues from our three primary product categories, gasoline, merchandise and commissions, are recognized at the point of sale. We derive commission income from lottery ticket sales, money orders, car washes, public telephones, amusement and video gaming and other ancillary product and service offerings.

Vendor Allowances and Rebates. We receive payments for vendor allowances, volume rebates and other supply arrangements in connection with various programs. Payments are recorded as a reduction to cost of sales or expenses to which the particular payment relates. Unearned payments are deferred and amortized as earned over the term of the respective agreement.

Long-Lived Assets and Closed Stores. Long-lived assets are reviewed for impairment whenever events or 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 of that store to determine if a write-down to fair value is required.

Property and equipment of stores we are closing are written down to their estimated net realizable value at the time we close such stores. If applicable, we provide for future estimated rent and other exit costs associated with the store closure, net of sublease income, using a discount rate to calculate the present value of the remaining rent payments on closed stores. We estimate the net realizable value based on our experience in utilizing or disposing of similar assets and on estimates provided by our own and third-party real estate experts. Changes in real estate markets could significantly impact the net realizable value from the sale of assets and rental or sublease income.

Insurance Liabilities. We self-insure a significant portion of expected losses under our workers' compensation and employee medical programs. Accrued liabilities have been recorded based on our estimates of the ultimate costs to settle incurred and incurred but not reported claims. Our accounting policies regarding self-insurance programs include judgments and actuarial assumptions regarding economic conditions, the frequency and severity of claims, claim development patterns and claim management and settlement practices. Significant changes in actual expenditures compared to historical experience rates as a result of increased medical costs or incidence rates could significantly impact our statement of operations and financial position.

Goodwill Impairment. We have adopted the provisions of SFAS No. 142, which requires allocating goodwill to each reporting unit and testing for impairment using a two-step approach. Based on our current reporting structure, we have determined that we operate as one reporting unit and therefore have assigned goodwill at the enterprise level. Fair value is measured using a valuation based on market multiples, comparable transactions and discounted cash flow methodologies. The goodwill impairment test is performed annually or whenever an event has occurred that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Should the enterprise carrying value exceed the estimated fair market value we would have to perform additional valuations to determine if any goodwill impairment exists. Any impairment recognized will be recorded as a component of operating expenses.

MANAGEMENT'S Discussion and Analysis of Financial Condition and Results of Operations *(cont.)*

Changes in the long-term economics of the gasoline and convenience store markets, fluctuations in capital markets and competition could impact our fair value measurements which could significantly impact our statement of operations and financial position.

Derivative Financial Instruments. We enter into interest rate swap and collar agreements to modify the interest characteristics of our outstanding long-term debt and we have designated each qualifying instrument as a cash flow hedge. We formally document our hedge relationships, including identifying the hedge instruments and hedged items, as well as our risk management objectives and strategies for entering into the hedge transaction. At hedge inception, and at least quarterly thereafter, we assess whether derivatives used to hedge transactions are highly effective in offsetting changes in the cash flow of the hedged item. We measure effectiveness by the ability of the interest rate swaps to offset cash flows associated with changes in the variable LIBOR rate associated with our term loan facilities using the hypothetical derivative method. To the extent the instruments are considered to be effective, changes in fair value are recorded as a component of other comprehensive income. To the extent there is any hedge ineffectiveness, any changes in fair value relating to the ineffective portion are immediately recognized in earnings as interest expense. When it is determined that a derivative ceases to be a highly effective hedge, we discontinue hedge accounting, and subsequent changes in fair value of the hedge instrument are recognized in earnings.

The fair values of our interest rate swaps and collars are obtained from dealer quotes. These values represent the estimated amount that we would receive or pay to terminate the agreement taking into account the difference between the contract rate of interest and rates currently quoted for agreements of similar terms and maturities.

Risk Factors

You should carefully consider the risks described below before making a decision to invest in our securities. The risks and uncertainties described below are not the only ones facing us. Additional risks and uncertainties not presently known to us, or that we currently deem immaterial, could negatively impact our results of operations or financial condition in the future. If any of such risks actually occur, our business, financial condition or results of operations could be materially adversely affected. In that case, the trading price of our securities could decline, and you may lose all or part of your investment.

Risks Related to Our Industry

The Convenience Store Industry Is Highly Competitive and Impacted by New Entrants.

The industry and geographic areas in which we operate are highly competitive and marked by ease of entry and constant change in the number and type of retailers offering the products and services found in our stores. We compete with other convenience store chains, gasoline stations, supermarkets, drugstores, discount stores, club stores and mass merchants. In recent years, several non-traditional retailers, such as supermarkets, club stores and mass merchants, have impacted the convenience store industry by entering the gasoline retail business. These non-traditional gasoline retailers have obtained a significant share of the motor fuels market and their market share is expected to grow. In some of our markets, our competitors have been in existence longer and have greater financial, marketing and other resources than we do. As a result, our competitors may be able to respond better to changes in the economy and new opportunities within the industry. To remain competitive, we must constantly analyze consumer preferences and competitors' offerings and prices to ensure we offer a selection of convenience products and services consumers demand at competitive prices. We must also maintain and upgrade our customer service levels, facilities and locations to remain competitive and drive customer traffic to our stores. Major competitive factors include, among others, location, ease of access, gasoline brands, pricing, product and service selections, customer service, store appearance, cleanliness and safety.

Volatility of Wholesale Petroleum Costs Could Impact Our Operating Results.

Over the past three fiscal years, our gasoline revenue accounted for approximately 61.5% of total revenues and our gasoline gross profit accounted for approximately 27.8% of total gross profit. Crude oil and domestic wholesale petroleum markets are marked by significant volatility. General political conditions, acts of war or terrorism, and instability in oil producing regions, particularly in the Middle East and South America, could significantly impact crude oil supplies and wholesale petroleum costs. In addition, the supply of gasoline for our private brand locations and our wholesale purchase costs could be adversely impacted in the event of a shortage as our gasoline contracts do not guarantee an uninterrupted, unlimited supply of gasoline. Significant increases and volatility in wholesale petroleum costs could result in significant increases in the retail price of petroleum products and in lower gasoline gross margin per gallon. Increases in the retail price of petroleum products could impact consumer demand for gasoline. This

volatility makes it extremely difficult to predict the impact future wholesale cost fluctuations will have on our operating results and financial condition. These factors could materially impact our gasoline gallon volume, gasoline gross profit and overall customer traffic, which in turn would impact our merchandise sales.

Wholesale Cost Increases of Tobacco Products Could Impact Our Merchandise Gross Profit.

Sales of tobacco products have averaged approximately 12.8% of our total revenue over the past three fiscal years. Significant increases in wholesale cigarette costs and tax increases on tobacco products, as well as national and local campaigns to discourage smoking in the United States, may have an adverse effect on unit demand for cigarettes domestically. In general, we attempt to pass price increases on to our customers. However, due to competitive pressures in our markets, we may not be able to do so. These factors could materially impact our retail price of cigarettes, cigarette unit volume and revenues, merchandise gross profit and overall customer traffic.

Changes in Consumer Behavior, Travel and Tourism Could Impact Our Business.

In the convenience store industry, customer traffic is generally driven by consumer preferences and spending trends, growth rates for automobile and truck traffic and trends in travel, tourism and weather. Changes in economic conditions generally or in the Southeast specifically could adversely impact consumer spending patterns and travel and tourism in our markets. Approximately 40% of our stores are located in coastal, resort or tourist destinations. Historically, travel and consumer behavior in such markets is more severely impacted by weak economic conditions. If visitors to resort or tourist locations decline due to economic conditions, changes in consumer preferences, changes in discretionary consumer spending or otherwise, our sales could decline.

Risks Related to Our Business

Unfavorable Weather Conditions or Other Trends or Developments in the Southeast Could Adversely Affect Our Business.

Substantially all of our stores are located in the southeast region of the United States. Although the Southeast is generally known for its mild weather, the region is susceptible to severe storms including hurricanes, thunderstorms, extended periods of rain, ice storms and heavy snow, all of which we experienced in fiscal 2003. Inclement weather conditions as well as severe storms in the Southeast could damage our facilities or could have a significant impact on consumer behavior, travel and convenience store traffic patterns as well as our ability to operate our locations. In addition, we typically generate higher revenues and gross margins during warmer weather months in the Southeast, which fall within our third and fourth quarters. If weather conditions are not favorable during these periods, our operating results and cash flow from operations could be adversely affected. We would also be impacted by regional occurrences in the Southeast such as energy shortages or increases in energy prices, fires or other natural disasters.

Inability to Identify, Acquire and Integrate New Stores Could Adversely Affect Our Ability to Grow Our Business.

An important part of our historical growth strategy has been to acquire other convenience stores that complement our existing stores or broaden our geographic presence, such as our acquisition of 138 convenience stores operating under the Golden Gallon® banner on October 16, 2003. From April 1997 through October 2003, we acquired 1,303 convenience stores in 21 major and numerous smaller transactions. We expect to continue to selectively review acquisition opportunities as an element of our growth strategy.

Acquisitions involve risks that could cause our actual growth or operating results to differ adversely compared to our expectations or the expectations of securities analysts. For example:

- We may not be able to identify suitable acquisition candidates or acquire additional convenience stores on favorable terms. We compete with others to acquire convenience stores. We believe that this competition may increase and could result in decreased availability or increased prices for suitable acquisition candidates. It may be difficult to anticipate the timing and availability of acquisition candidates.
- During the acquisition process we may fail or be unable to discover some of the liabilities of companies or businesses which we acquire. These liabilities may result from a prior owner's noncompliance with applicable federal, state or local laws.
- We may not be able to obtain the necessary financing, on favorable terms or at all, to finance any of our potential acquisitions.
- We may fail to successfully integrate or manage acquired convenience stores.
- Acquired convenience stores may not perform as we expect or we may not be able to obtain the cost savings and financial improvements we anticipate.
- We face the risk that our existing systems, financial controls, information systems, management resources and human resources will need to grow to support significant growth.

MANAGEMENT'S Discussion and Analysis of Financial Condition and Results of Operations *(cont.)*

Our Financial Leverage and Debt Covenants Impact Our Fiscal and Financial Flexibility.

We are highly leveraged, which means that the amount of our outstanding debt is large compared to the net book value of our assets, and we have substantial repayment obligations under our outstanding debt. We have to use a portion of our cash flow from operations for debt service, rather than for investing in our operations or to implement our growth strategy. As of September 25, 2003, on a pro forma basis giving effect to the Golden Gallon® acquisition, we had consolidated debt including capital lease obligations of approximately $594.7 million and shareholders' equity of approximately $128.7 million. As of September 25, 2003, on a pro forma basis giving effect to the Golden Gallon® acquisition, our availability under our senior credit facility for borrowing or issuing additional letters of credit was approximately $23.6 million.

We are vulnerable to increases in interest rates because the debt under our senior credit facility is at a variable interest rate. Although in the past we have on occasion entered into certain hedging instruments in an effort to manage our interest rate risk, we cannot assure you that we will continue to do so, on favorable terms or at all, in the future.

Our senior credit facility and the indenture governing our senior subordinated notes contain numerous financial and operating covenants that limit our ability to engage in activities such as acquiring or disposing of assets, engaging in mergers or reorganizations, making investments or capital expenditures and paying dividends. These covenants require that we meet interest coverage, minimum EBITDA and leverage tests. Our senior credit facility and indenture permit us and our subsidiaries to incur or guarantee additional debt, subject to various limitations.

Any breach of these covenants could cause a default under our debt obligations and result in our debt becoming immediately due and payable, which would adversely affect our business, financial condition and results of operations. For the twelve-month period ending September 27, 2001, we failed to satisfy two financial covenants required by our senior credit facility. During the first quarter of fiscal 2002, we received a waiver from our senior credit group and executed an amendment to the senior credit facility that included, among other things, a modification to the financial covenants and certain increases in the floating interest rate. Our ability to respond to changing business conditions and to secure additional financing may be restricted by these covenants, which may become more restrictive in the future. We also may be prevented from engaging in transactions, including acquisitions that may be important to our long-term growth strategy, as a result of covenant restrictions or borrowing capabilities under our credit facilities.

We Are Subject to State and Federal Environmental and Other Regulations.

Our business is subject to extensive governmental laws and regulations including, but not limited to, environmental regulations, employment laws and regulations, regulations governing the sale of alcohol and tobacco, minimum wage requirements, working condition requirements, citizenship requirements and other laws and regulations. A violation or change of these laws could have a material adverse effect on our business, financial condition and results of operations.

Under various federal, state and local laws, ordinances and regulations, we may, as the owner or operator of our locations, be liable for the costs of removal or remediation of contamination at these or our former locations, whether or not we knew of, or were responsible for, the presence of such contamination. The failure to properly remediate such contamination may subject us to liability to third parties and may adversely affect our ability to sell or rent such property or to borrow money using such property as collateral. Additionally, persons who arrange for the disposal or treatment of hazardous or toxic substances may also be liable for the costs of removal or remediation of such substances at sites where they are located, whether or not such site is owned or operated by such person. Although we do not typically arrange for the treatment or disposal of hazardous substances, we may be deemed to have arranged for the disposal or treatment of hazardous or toxic substances and, therefore, may be liable for removal or remediation costs, as well as other related costs, including governmental fines, and injuries to persons, property and natural resources.

Compliance with existing and future environmental laws regulating underground storage tanks may require significant capital expenditures and the remediation costs and other costs required to clean up or treat contaminated sites could be substantial. We pay tank fees and other taxes to state trust funds in support of future remediation obligations.

These state trust funds or other responsible third parties including insurers are expected to pay or reimburse us for remediation expenses less a deductible. To the extent third parties do not pay for remediation as we anticipate, we will be obligated to make these payments, which could materially adversely affect our financial condition and results of operations. Reimbursements from state trust funds will be dependent on the continued viability of these funds.

In the future, we may incur substantial expenditures for remediation of contamination that has not been discovered at existing locations or locations that we may acquire. We cannot assure you that we have identified all environmental liabilities at all of our current and former locations;

that material environmental conditions not known to us do not exist; that future laws, ordinances or regulations will not impose material environmental liability on us; or that a material environmental condition does not otherwise exist as to any one or more of our locations. In addition, failure to comply with any environmental regulations or an increase in regulations could adversely affect our operating results and financial condition.

State laws regulate the sale of alcohol and tobacco products. A violation or change of these laws could adversely affect our business, financial condition and results of operations because state and local regulatory agencies have the power to approve, revoke, suspend or deny applications for, and renewals of, permits and licenses relating to the sale of these products or to seek other remedies.

Any appreciable increase in the statutory minimum wage rate or income or overtime pay or adoption of mandated health benefits would result in an increase in our labor costs and such cost increase, or the penalties for failing to comply with such statutory minimums, could adversely affect our business, financial condition and results of operations.

From time to time, regulations are proposed which, if adopted, could also have an adverse effect on our business, financial condition or results of operations.

We Depend on One Principal Supplier for the Majority of Our Merchandise.

We purchase over 50% of our general merchandise, including most tobacco products and grocery items, from a single wholesale grocer, McLane Company, Inc., or McLane. We have a contract with McLane until October 2008, but we may not be able to renew the contract upon expiration. A change of suppliers, a disruption in supply or a significant change in our relationship with our principal suppliers could have a material adverse effect on our business, cost of goods, financial condition and results of operations.

We Depend on Two Principal Suppliers for the Majority of Our Gasoline.

During February of 2003, we signed new gasoline supply agreements with BP Products, NA, or BP®, and Citgo Petroleum Corporation, or Citgo®. We expect that BP® and Citgo® will supply approximately 85% of our projected gasoline purchases after an approximately 18-month conversion process. We have contracts with each of BP® and Citgo® until 2008, but we may not be able to renew either contract upon expiration. A change of suppliers, a disruption in supply or a significant change in our relationship with our principal suppliers could have a material adverse effect on our business, cost of goods, financial condition and results of operations.

We May Not Achieve the Full Expected Cost Savings and Other Benefits of Our Acquisition of Golden Gallon®.

We expect to achieve $8–$10 million of cost savings and benefits within the 12 to 24 months following the acquisition of Golden Gallon®. These cost savings and benefits include, among others, savings associated with the elimination of duplicate overhead and infrastructure, benefits received by Golden Gallon® under our merchandise and gas supply agreements and the expansion of quick service restaurants in selected stores. While we believe our estimates of these cost savings and benefits to be reasonable, they are estimates which are difficult to predict and are necessarily speculative in nature. There can be no assurance that we will be able to replicate the results that we achieved at our stores at the Golden Gallon® stores. In addition, we cannot assure you that unforeseen factors will not offset the estimated cost savings and other benefits from the acquisition. As a result, our actual cost savings and other anticipated benefits could differ or be delayed, compared to our estimates and from the other information contained in this prospectus.

Because We Depend on Our Senior Management's Experience and Knowledge of Our Industry, We Would Be Adversely Affected if Senior Management Left The Pantry.

We are dependent on the continued efforts of our senior management team, including our President and Chief Executive Officer, Peter J. Sodini. Mr. Sodini's employment contract terminates in September 2006. If, for any reason, our senior executives do not continue to be active in management, our business, financial condition or results of operations could be adversely affected. We cannot assure you that we will be able to attract and retain additional qualified senior personnel as needed in the future. In addition, we do not maintain key personnel life insurance on our senior executives and other key employees. We also rely on our ability to recruit store managers, regional managers and other store personnel. If we fail to continue to attract these individuals, our operating results may be adversely affected.

Other Risks

Future Sales of Additional Shares into the Market May Depress the Market Price of Our Common Stock.

If our existing stockholders sell shares of our common stock in the public market, including shares issued upon the exercise of outstanding options, or if the market perceives such sales could occur, the market price of our common stock could decline. As of December 9, 2003, there were 19,743,615 shares of our common stock outstanding. Of these shares, 6,420,299 shares are freely tradable (unless held by one of our affiliates) and 13,423,393 shares are

held by affiliate investment funds of Freeman Spogli & Co. Pursuant to Rule 144 under the Securities Act of 1933, as amended, during any three-month period, our affiliates can resell up to the greater of (a) 1% of our aggregate outstanding common stock or (b) the average weekly trading volume for the four weeks prior to the sale. In addition, the Freeman Spogli & Co. investment funds, or Freeman Spogli, have registration rights allowing them to require us to register the resale of their shares. Sales by our existing stockholders also might make it more difficult for us to sell equity or equity-related securities in the future at a time and price that we deem appropriate or to use equity as consideration for future acquisitions.

In addition, we have filed registration statements with the Securities and Exchange Commission that cover up to 5,100,000 shares issuable pursuant to the exercise of stock options granted and to be granted under our stock option plans. Shares registered on a registration statement may be sold freely at any time.

The Interests of Our Largest Stockholder May Conflict with Our Interests and the Interests of Our Other Stockholders.

As of January 28, 2004, Freeman Spogli & Co. beneficially owned 39% of our common stock. In addition, four of the nine members of our board of directors are representatives of, or have consulting arrangements with, Freeman Spogli. As a result of its stock ownership and board representation, Freeman Spogli is in a position to affect our corporate actions such as mergers or takeover attempts of us or may take action on its own in a manner that could conflict with the interests of our other stockholders. In the past from time to time we have considered strategic alternatives, including a sale of The Pantry, at the request of Freeman Spogli and with the consent of our board of directors. Although we are not currently considering any strategic alternatives, we may do so in the future.

Any Issuance of Shares of Our Common Stock in the Future Could Have a Dilutive Effect on Your Investment.

If we raise funds in the future by issuing additional shares of common stock, you may experience dilution in the value of your shares. Additionally, certain types of equity securities that we may issue in the future could have rights, preferences or privileges senior to your rights as a holder of our common stock. We could choose to issue additional shares for a variety of reasons including for investment or acquisitive purposes. Such issuances may have a dilutive impact on your investment.

The Market Price for Our Common Stock Has Been and May in the Future Be Volatile, Which Could Cause the Value of Your Investment to Decline.

There currently is a public market for our common stock, but there is no assurance that there will always be such a market. Securities markets worldwide experience significant price and volume fluctuations. This market volatility could significantly affect the market price of our common stock without regard to our operating performance. In addition, the price of our common stock could be subject to wide fluctuations in response to the following factors among others:

- A deviation in our results from the expectations of public market analysts and investors;
- Statements by research analysts about our common stock, our Company or our industry;
- Changes in market valuations of companies in our industry and market evaluations of our industry generally;
- Additions or departures of key personnel;
- Actions taken by our competitors;
- Sales of common stock by the Company, senior officers or other affiliates; or
- Other general economic, political or market conditions, many of which are beyond our control.

The market price of our common stock will also be impacted by our quarterly operating results and quarterly comparable store sales growth, which may be expected to fluctuate from quarter to quarter. Factors that may impact our quarterly results and comparable store sales include, among others, general regional and national economic conditions, competition, unexpected costs and changes in pricing, consumer trends, the number of stores we open and/or close during any given period, costs of compliance with corporate governance and Sarbanes-Oxley requirements, and other factors discussed in "Risk Factors" beginning on page 26 and throughout "Management's Discussion and Analysis of Financial Condition and Results of Operations."

You may not be able to resell your shares of our common stock at or above the price you pay.

Our Charter Includes Provisions that May Have the Effect of Preventing or Hindering a Change in Control and Adversely Affecting the Market Price of Our Common Stock.

Our certificate of incorporation gives our board of directors the authority to issue up to five million shares of preferred stock and to determine the rights and preferences of the preferred stock, without obtaining stockholder approval. The existence of this preferred stock could make it more difficult or discourage an attempt to obtain control of The Pantry by means of a tender offer, merger, proxy contest or otherwise. Furthermore, this preferred stock could be issued with other rights, including economic rights, senior to our common stock, and, therefore, issuance of the preferred stock could have an adverse effect on the market price of our common stock. We have no present plans to issue any shares of our preferred stock.

Other provisions of our certificate of incorporation and bylaws and of Delaware law could make it more difficult for a third party to acquire us or hinder a change in management even if doing so would be beneficial to our stockholders. These governance provisions could affect the market price of our common stock. We may, in the future, adopt other measures that may have the effect of delaying, deferring or preventing an unsolicited takeover, even if such a change in control were at a premium price or favored by a majority of unaffiliated stockholders. These measures may be adopted without any further vote or action by our stockholders.

Any of the above factors may cause actual results to vary materially from anticipated results, historical results or recent trends in operating results and financial condition.

Quantitative and Qualitative Disclosures About Market Risk

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 senior credit facility.

We enter into interest rate swap agreements to modify the interest rate characteristics of our outstanding long-term debt and have designated each qualifying instrument as a cash flow hedge. We formally document our hedge relationships, including identifying the hedge instruments and hedged items, as well as our risk management objectives and strategies for entering into the hedge transaction. At hedge inception, and at least quarterly thereafter, we assess whether derivatives used to hedge transactions are highly effective in offsetting changes in the cash flow of the hedged item. We measure effectiveness by the ability of the interest rate swaps to offset cash flows associated with changes in the variable LIBOR rate associated with our term loan facilities using the hypothetical derivative method. To the extent the instruments are considered to be effective, changes in fair value are recorded as a component of other comprehensive income (loss). For those interest rate swap agreements that do not qualify for hedge accounting, changes in fair value are recorded as an adjustment to interest expense. Fixed rate swaps are used to reduce our risk of increased interest costs during periods of rising interest rates. At September 25, 2003, the interest rate on 80.8% of our debt was fixed by either the nature of the obligation or through the interest rate swap arrangements compared to 75.5% at September 26, 2002.

A one-percentage point increase in interest rates would not be expected to result in a loss in future earnings.

The following table presents the notional principal amount, weighted-average pay rate, weighted-average receive rate and weighted-average years to maturity on our interest rate swap contracts:

Interest Rate Swap Contracts *(dollars in thousands)*	**September 25, 2003**	September 26, 2002
Notional principal amount	**$202,000**	$180,000
Weighted-average pay rate	**3.77%**	6.12%
Weighted-average receive rate	**1.03%**	1.77%
Weighted-average years to maturity	**1.68**	0.87

As of September 25, 2003 and September 26, 2002, the fair value of our swap and collar agreements represented a liability of $2.9 million and $8.6 million, respectively.

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 the 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 25, 2003**	September 26, 2002
Assets		
Current assets:		
Cash and cash equivalents	**$ 72,901**	$ 42,236
Receivables (net of allowance for doubtful accounts of $665 at September 25, 2003 and $159 at September 26, 2002)	**30,423**	34,316
Inventories (Note 2)	**84,156**	84,437
Prepaid expenses	**6,326**	3,499
Property held for sale	**2,013**	388
Deferred income taxes (Note 11)	**4,334**	1,414
Total current assets	**200,153**	166,290
Property and equipment, net (Notes 3, 9 and 12)	**400,609**	435,518
Other assets:		
Goodwill (Note 4)	**278,629**	277,874
Deferred financing costs (net of accumulated amortization of $7,206 at September 25, 2003 and $8,854 at September 26, 2002)	**10,757**	8,965
Environmental receivables (Note 13)	**15,109**	11,696
Other	**8,908**	9,355
Total other assets	**313,403**	307,890
Total assets	**$914,165**	$909,698
Liabilities and Shareholders' Equity		
Current liabilities:		
Current maturities of long-term debt (Note 5)	**$ 27,558**	$ 43,255
Current maturities of capital lease obligations (Note 12)	**1,375**	1,521
Accounts payable	**78,885**	93,858
Accrued interest (Note 5)	**11,924**	13,175
Accrued compensation and related taxes	**12,840**	10,785
Other accrued taxes	**16,510**	17,463
Accrued insurance	**12,293**	9,687
Other accrued liabilities (Notes 6 and 13)	**21,314**	19,969
Total current liabilities	**182,699**	209,713
Long-term debt (Note 5)	**470,011**	460,920
Other liabilities:		
Environmental reserves (Note 13)	**13,823**	13,285
Deferred income taxes (Note 11)	**50,015**	38,360
Deferred revenue (Note 13)	**37,251**	51,772
Capital lease obligations (Note 12)	**15,779**	15,381
Other noncurrent liabilities (Notes 6, 9 and 13)	**15,922**	5,063
Total other liabilities	**132,790**	123,861
Commitments and contingencies (Notes 4, 5, 12 and 13)		
Shareholders' equity (Notes 7 and 15):		
Common stock, $.01 par value, 50,000,000 shares authorized; 18,107,597 and 18,107,597 issued and outstanding at September 25, 2003 and September 26, 2002, respectively (Note 15)	**182**	182
Additional paid-in capital	**128,002**	128,002
Shareholder loans	**(173)**	(708)
Accumulated other comprehensive deficit (net of deferred taxes of $432 at September 25, 2003 and $1,354 at September 26, 2002) (Note 7)	**(690)**	(2,112)
Accumulated earnings (deficit)	**1,344**	(10,160)
Total shareholders' equity	**128,665**	115,204
Total liabilities and shareholders' equity	**$914,165**	$909,698

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

Consolidated STATEMENTS OF OPERATIONS

(Dollars in thousands, except per share amounts)	**September 25, 2003**	September 26, 2002	September 27, 2001
	(52 weeks)	(52 weeks)	(52 weeks)
Revenues:			
Merchandise sales	**$1,008,902**	$ 998,621	$ 968,614
Gasoline sales	**1,740,662**	1,470,732	1,652,725
Commissions	**26,797**	24,711	21,705
Total revenues	**2,776,361**	2,494,064	2,643,044
Cost of sales:			
Merchandise	**670,179**	669,479	645,012
Gasoline	**1,595,378**	1,349,183	1,510,389
Total cost of sales	**2,265,557**	2,018,662	2,155,401
Gross profit	**510,804**	475,402	487,643
Operating expenses:			
Operating, general and administrative expenses	**385,570**	367,299	364,134
Restructuring and other charges (Note 8)	**—**	—	4,771
Depreciation and amortization	**54,403**	54,251	63,545
Total operating expenses	**439,973**	421,550	432,450
Income from operations	**70,831**	53,852	55,193
Other income (expense):			
Interest expense (Note 10)	**(49,265)**	(51,646)	(58,731)
Miscellaneous	**2,805**	728	1,753
Total other expense	**(46,460)**	(50,918)	(56,978)
Income (loss) before income taxes	**24,371**	2,934	(1,785)
Income tax expense (Note 11)	**(9,385)**	(1,130)	(871)
Income (loss) before cumulative effect adjustment	**$ 14,986**	$ 1,804	$ (2,656)
Cumulative effect adjustment, net of tax (Note 9)	**(3,482)**	—	—
Net income (loss)	**$ 11,504**	$ 1,804	$ (2,656)
Earnings (loss) per share (Note 17):			
Basic:			
Income (loss) before cumulative effect adjustment	**$ 0.83**	$ 0.10	$ (0.15)
Cumulative effect adjustment	**(0.19)**	—	—
Income (loss)	**$ 0.64**	$ 0.10	$ (0.15)
Diluted:			
Income (loss) before cumulative effect adjustment	**$ 0.82**	$ 0.10	$ (0.15)
Cumulative effect adjustment	**(0.19)**	—	—
Income (loss)	**$ 0.63**	$ 0.10	$ (0.15)

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

Consolidated STATEMENTS OF SHAREHOLDERS' EQUITY

(Shares and dollars in thousands)	Common Stock Shares	Common Stock Par Value	Additional Paid-in Capital	Shareholder Loans	Accumulated Comprehensive Deficit	Accumulated Earnings (Deficit)	Total
Balance at September 29, 2000	18,111	$182	$128,018	$(912)	$ —	$ (9,308)	$117,980
Comprehensive loss, net of tax:							
Net loss						(2,656)	(2,656)
Unrealized losses on qualifying cash flow hedges	—	—	—	—	(3,920)	—	(3,920)
Cumulative effect of adoption of SFAS No. 133	—	—	—	—	98	—	98
Comprehensive loss	—	—	—	—	(3,822)	(2,656)	(6,478)
Cumulative effect of change in accounting principal	—	—	—	—	(461)	—	(461)
Repayment of shareholder loans	—	—	—	75	—	—	75
Share repurchase	(4)	(1)	(43)	—	—	—	(44)
Exercise of stock options	8	1	68	—	—	—	69
Balance, September 27, 2001	18,115	182	128,043	(837)	(4,283)	(11,964)	111,141
Comprehensive income, net of tax:							
Net income	—	—	—	—	—	1,804	1,804
Unrealized gains on qualifying cash flow hedges	—	—	—	—	1,966	—	1,966
Cumulative effect of adoption of SFAS No. 133	—	—	—	—	205	—	205
Comprehensive income	—	—	—	—	2,171	1,804	3,975
Share repurchase	(7)	—	(41)	41	—	—	—
Repayment of shareholder loans	—	—	—	88	—	—	88
Balance, September 26, 2002	18,108	182	128,002	(708)	(2,112)	(10,160)	115,204
Comprehensive income, net of tax:							
Net income	—	—	—	—	—	11,504	11,504
Unrealized gains on qualifying cash flow hedges	—	—	—	—	1,264	—	1,264
Cumulative effect of adoption of SFAS No. 133	—	—	—	—	158	—	158
Comprehensive income	—	—	—	—	1,422	11,504	12,926
Repayment of shareholder loans	—	—	—	535	—	—	535
Balance, September 25, 2003	**18,108**	**$182**	**$128,002**	**$(173)**	**$ (690)**	**$ 1,344**	**$128,665**

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

Consolidated STATEMENTS OF CASH FLOWS

(Dollars in thousands)	**September 25, 2003**	September 26, 2002	September 27, 2001
	(52 weeks)	(52 weeks)	(52 weeks)
Cash Flows from Operating Activities:			
Net income (loss)	**$ 11,504**	$ 1,804	$ (2,656)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	**57,013**	54,251	63,545
Provision for deferred income taxes	**9,385**	1,130	871
Loss on extinguishment of debt	**2,888**	—	—
Loss on sale of property and equipment	**2,051**	601	131
Impairment of long-lived assets	**1,850**	383	2,298
Fair market value change in non-qualifying derivatives	**(3,381)**	926	4,244
Provision for closed stores	**2,469**	2,073	1,919
Cumulative effect of change in accounting principle	**3,482**	—	—
Amortization of long-term debt discount	**529**	—	—
Changes in operating assets and liabilities, net of effects of acquisitions:			
Receivables	**563**	(5,085)	(4,860)
Inventories	**281**	(2,705)	9,469
Prepaid expenses	**(2,818)**	(43)	2,121
Other noncurrent assets	**178**	370	3,048
Accounts payable	**(14,973)**	(311)	(7,762)
Other current liabilities and accrued expenses	**9,532**	12,688	1,194
Reserves for environmental expenses	**538**	1,078	(1,859)
Other noncurrent liabilities	**(12,827)**	(13,176)	4,999
Net cash provided by operating activities	**68,264**	53,984	76,702
Cash Flows from Investing Activities:			
Additions to property held for sale	**(2,761)**	(5,006)	(1,637)
Additions to property and equipment	**(25,470)**	(26,506)	(43,582)
Proceeds from sale-leaseback transactions	**2,306**	6,208	3,504
Proceeds from sale of property and equipment	**5,367**	5,503	3,761
Acquisitions of related businesses, net of cash acquired	**(1,799)**	(512)	(55,993)
Net cash used in investing activities	**(22,357)**	(20,313)	(93,947)
Cash Flows from Financing Activities:			
Principal repayments under capital leases	**(1,383)**	(1,199)	(2,070)
Principal repayments of long-term debt	**(306,577)**	(40,000)	(23,487)
Proceeds from issuance of long-term debt	**299,440**	—	40,037
Proceeds from exercise of stock options, net of repurchases	**—**	(41)	25
Repayment of shareholder loans	**535**	129	75
Other financing costs	**(7,257)**	(935)	(78)
Net cash provided by (used in) financing activities	**(15,242)**	(42,046)	14,502
Net increase (decrease)	**30,665**	(8,375)	(2,743)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	**42,236**	50,611	53,354
CASH AND CASH EQUIVALENTS AT END OF YEAR	**$ 72,901**	$ 42,236	$ 50,611
Supplemental Disclosure of Cash Flow			
Cash paid (refunded) during the year:			
Interest	**$ 51,469**	$ 50,556	$ 55,374
Taxes	**$ (214)**	$ (3,708)	$ 1,066

Supplemental Noncash Investing and Financing Activities

During fiscal 2003, 2003 and 2001, The Pantry financed certain capital expenditures totaling $1.9 million, $2.7 million and $3.5 million, respectively, through the issuance of capital leases.

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. Transactions and balances of each of these wholly-owned subsidiaries are also immaterial to the consolidated financial statements. All intercompany transactions and balances have been eliminated in consolidation. The Pantry owns and operates 1,259 convenience stores in Florida (477), North Carolina (329), South Carolina (240), Georgia (56), Mississippi (53), Kentucky (38), Virginia (30), Indiana (14), Tennessee (14), and Louisiana (8).

During fiscal 1996, Freeman Spogli & Co. ("Freeman Spogli") acquired a controlling interest in the Company through a series of transactions which included the purchase of common stock from certain stockholders and the purchase of newly issued common and preferred stock. During fiscal 1997 and 1998, the Company issued additional shares of common and preferred stock to existing stockholders and certain directors and executives of the Company. As of September 25, 2003, Freeman Spogli owns 11,815,538 shares of common stock and warrants to purchase 2,346,000 shares of common stock, which represents beneficial ownership of approximately 69.2% of our outstanding shares, including shares underlying warrants.

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 senior 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.

Accounting Period

The Pantry operates on a 52- or 53-week fiscal year ending on the last Thursday in September. Each of the three years presented contained 52 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.

Cash and Cash Equivalents

For purposes of the consolidated financial statements, cash and cash equivalents include 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. We attempt to identify third parties with which to enter into sale-leaseback transactions prior to developing new stores in order to minimize our capital outlays. If the Company identifies a store as one that it will attempt to enter into a sale-leaseback transaction prior to developing a new store or if it is able to enter into such a transaction for its existing stores, the property is classified as held for sale. These assets primarily consist of land and buildings.

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 30 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 Statement of Financial Accounting Standards ("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

We have adopted the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets*, which requires allocating goodwill to each reporting unit and testing for impairment using a two-step approach. Based on our current reporting structure, we have determined that we operate as one reporting unit and therefore have assigned goodwill at the enterprise

level. Fair value is measured using a valuation based on market multiples, comparable transactions and discounted cash flow methodologies. The goodwill impairment test is performed annually or whenever an event has occurred that would more likely than not reduce the fair value of a reporting unit below its carrying amount. For future valuation, should the enterprise carrying value exceed the estimated fair market value we would have to perform additional valuations to determine if any goodwill impairment exists. Any impairment recognized will be recorded as a component of operating expenses. See Note 4.

Long-Lived Assets

Long-lived assets are reviewed for impairment 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 are compared to the carrying value of the long-lived assets, including an allocation of goodwill if appropriate, to determine if a write-down to fair value is required. We recorded a provision of approximately $1.9 million, $383 thousand and $2.3 million for asset impairments for certain real estate, leasehold improvements and store and gasoline equipment at certain underperforming stores for fiscal 2003, 2002 and 2001, respectively. We record asset impairment as a component of operating, general and administrative expenses.

Revenue Recognition

Revenues from the Company's three primary product categories, gasoline, merchandise and commissions, are recognized at the point of sale. The Company derives commission revenues from lottery ticket sales, money orders, car washes, public telephones, amusement and video gaming and other ancillary product and service offerings.

Cost of Goods Sold

The primary components of cost of sales are gasoline, merchandise, repairs and maintenance of customer delivery equipment (e.g., gasoline dispensers) and franchise fees for branded fast food service less vendor allowances and rebates. Vendor allowances and rebates are amortized into cost of sales in accordance with vendor agreements.

Operating, General and Administrative Expenses

The primary components of operating, general and administrative expenses are store labor, store occupancy, operations management and administrative personnel, insurance, and other corporate costs necessary to operate the business.

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 12—Leases. Such amounts are being amortized over the remaining term of the respective financing and are included in interest expense.

Vendor Allowances, Rebates and Other Vendor Payments

The Company receives payments for vendor allowances, volume rebates and other supply arrangements in connection with various programs. The Company's accounting practices with regard to some of its most significant arrangements are discussed as follows:

- Vendor allowances for price markdowns are credited to cost of sales during the period in which the related markdown was taken and charged to cost of sales.
- Store imaging allowances are recognized as a reduction of cost of sales in the period earned in accordance with the vendor agreement. Store imaging includes signage, canopies, and other types of branding as defined in the Company's gasoline contracts.
- Volume rebates by the vendor in the form of a reduction of the purchase price of the merchandise reduce cost of sales when the related merchandise is sold. Generally, volume rebates under a structured purchase program with allowances awarded based on the level of purchases are recognized when realization is probable and reasonably estimable, as a reduction in the cost of sales in the appropriate monthly period based on the actual level of purchases in the period relative to the total purchase commitment.
- Slotting and stocking allowances received from a vendor to ensure that its products are carried or to introduce a new product at the Company's stores are recorded as a reduction of cost of sales over the period covered by the agreement.

Some of these typical vendor rebate, credit and promotional allowance arrangements require that the Company make assumptions and judgments regarding, for example, the likelihood of attaining specified levels of purchases or selling specified volumes of products, and the duration of carrying a specified product. The Company constantly reviews the relevant, significant factors and makes adjustments where the facts and circumstances dictate.

The amounts recorded against cost of sales were $92.6 million, $96.6 million and $81.2 million for fiscal 2003, 2002 and 2001, respectively.

Environmental Costs

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

- Environmental reserves reflected in the financial statements are 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.

NOTES to Consolidated Financial Statements *(cont.)*

- 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 10% 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 overfill/spill devices are capitalized and depreciated over the remaining useful life of the asset or the respective lease term, whichever is less.

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 basis.

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 $497.6 million, $471.9 million and $450.2 million for fiscal 2003, 2002 and 2001, respectively.

Advertising Costs

Advertising costs are expensed as incurred. Advertising expense was approximately $2.1 million, $1.8 million and $2.0 million for fiscal 2003, 2002 and 2001, respectively.

Stock-Based Compensation

The Company's stock option plans are described more fully in Note 16. The Company accounts for stock options under the intrinsic value method recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations. No stock-based employee compensation cost is reflected in net income (loss), as all options granted under these plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income (loss) and earnings (loss) per share if the Company had applied the fair value recognition provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*, to stock-based employee compensation:

	2003	2002	2001
Net income (loss) (in thousands):			
As reported	**$11,504**	$1,804	$(2,656)
Deduct—Total stock-based compensation expense determined under fair value method for all awards, net of tax	**(287)**	(278)	(234)
Pro forma	**$11,217**	$1,526	$(2,890)
Basic earnings (loss) per share:			
As reported	**$ 0.64**	$ 0.10	$ (0.15)
Pro forma	**$ 0.62**	$ 0.08	$ (0.16)
Diluted earnings (loss) per share:			
As reported	**$ 0.63**	$ 0.10	$ (0.15)
Pro forma	**$ 0.61**	$ 0.08	$ (0.16)

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:

	2003	2002	2001
Weighted-average grant date fair value	**$0.87**	$1.71	$3.93
Weighted-average expected lives (years)	**2.00**	2.00	2.00
Weighted-average grant date fair value—exercise price equals market price	**$0.87**	$1.71	$3.93
Weighted-average grant date fair value—exercise price greater than market price	**—**	—	—
Risk-free interest rate	**1.8%**	3.0%	4.9%
Expected volatility	**70%**	60%	66%
Dividend yield	**0.00%**	0.00%	0.00%

Due to the factors (assumptions) described above, the above pro forma disclosures are not necessarily representative of pro forma effects on reported net income for future years.

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

The Pantry provides segment reporting in accordance with 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 operating segment. The Company's chief operating decision maker believes the Company operates in one segment due to the following: the sales of both gasoline and merchandise are interrelated, the target customers are the same for all products, and the Company's stores are homogeneous in product offerings.

Reclassifications

Certain amounts in the fiscal 2002 and 2001 consolidated financial statements have been reclassified to conform to the fiscal 2003 presentation.

Recently Adopted Accounting Standards

Effective December 27, 2002, we adopted the provisions of Emerging Issues Task Force ("EITF") No. 02-16, *Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor*. EITF 02-16 requires that certain cash consideration received by a customer from a vendor is presumed to be a reduction of the prices of the vendor's products or services and should, therefore, be characterized as a reduction of cost of sales when recognized in the customer's income statement. However, that presumption is overcome if certain criteria are met. If the presumption is overcome, the consideration would be presented as revenue if it represents a payment for goods or services provided by the reseller to the vendor, or as an offset to an expense if it represents a reimbursement of a cost incurred by the reseller. The adoption of EITF 02-16 did not have a material impact on our results of operations or classification of expenses.

Effective December 27, 2002, we adopted the provisions of SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, which requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. The adoption of SFAS No. 146 did not have a material impact on our results of operations and financial condition.

Effective September 27, 2002, we adopted the provisions of SFAS No. 143, *Accounting for Asset Retirement Obligations*, which addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. SFAS No. 143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. SFAS No. 143 requires us to recognize an estimated liability associated with the removal of our underground storage tanks. See Note 9 for a discussion of our adoption of SFAS No. 143.

Effective September 27, 2002, we adopted the provisions of SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. This statement supersedes SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of* and Accounting Principles Board No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*. SFAS No. 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets and how the results of a discontinued operation are to be measured and presented. The adoption of SFAS No. 144 did not have a material impact on our results of operations or financial condition.

Effective September 27, 2002, we adopted the provisions of SFAS No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections*. This statement rescinds SFAS No. 4, *Reporting Gains and Losses from Extinguishment of Debt*. SFAS No. 145 also rescinds and amends other existing authoritative pronouncements. This statement eliminates SFAS No. 4 and, thus, the exception to applying APB Opinion No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions* ("Opinion 30"), to all gains and losses related to extinguishments of debt. As a result, gains and losses from extinguishment of debt should be classified as extraordinary items only if they meet the criteria in Opinion 30. See Note 5 for our discussion on our debt extinguishment.

Effective September 27, 2002, we adopted the provisions of SFAS No. 148, *Accounting for Stock-Based Compensation—Transition and Disclosure*, an amendment of SFAS No. 123, *Accounting for Stock-Based Compensation*. This statement was issued to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based compensation. In addition, this statement amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. We are following the disclosure requirements of SFAS No. 148 in our 2003 consolidated financial statements.

NOTES to Consolidated Financial Statements *(cont.)*

In November 2002, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation ("FIN") 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. This interpretation addresses the disclosure requirements for guarantees and indemnification agreements entered into by an entity. FIN 45 requires that upon issuance of a guarantee, the entity (i.e., the guarantor) must recognize a liability for the fair value of the obligation it assumes under the guarantee. The disclosure provisions of FIN 45 are effective for financial statements of interim or annual periods that end after December 15, 2002. The provisions of FIN 45 for initial recognition and measurement are to be applied on a prospective basis to guarantees issued or modified after December 15, 2002, irrespective of the guarantor's fiscal year-end. The guarantor's previous accounting for guarantees that were issued before initial application of FIN 45 are not required to be revised or restated to reflect the effect of the recognition and measurement provisions of FIN 45. The adoption of FIN 45 did not have a material impact on our results of operations and financial condition.

In April 2003, the FASB issued SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*, to provide clarification on the meaning of an underlying derivative, the characteristics of a derivative that contains financing components and the meaning of an initial investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors. This statement is effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. In addition, all provisions of this statement should be applied prospectively. The provisions of this statement that relate to Statement 133 Implementation Issues that have been effective for fiscal quarters that began prior to June 15, 2003, should continue to be applied in accordance with their respective effective dates. The adoption of SFAS No. 149 did not have a material impact on our results of operations and financial condition.

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity*. SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity. Some of the provisions of this statement are consistent with the current definition of liabilities in FASB Concepts Statement No. 6, *Elements of Financial Statements*. This statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003, thus the Company adopted the provisions of SFAS No. 150 for its fourth quarter beginning June 27, 2003. The adoption of this SFAS No. 150 did not have a material impact on our results of operations and financial condition.

Recently Issued Accounting Standards Not Yet Adopted

In January 2003, the FASB issued FIN 46, *Consolidation of Variable Interest Entities—an Interpretation of ARB No. 51*. This interpretation provides guidance related to identifying variable interest entities (previously known as special purpose entities or SPEs) and determining whether such entities should be consolidated. Certain disclosures are required if it is reasonably possible that a company will consolidate or disclose information about a variable interest entity when it initially applies FIN 46. This interpretation will be effective for the Company's first quarter beginning September 26, 2003. The Company has no investment in or contractual relationship or other business relationship with a variable interest entity and therefore the adoption of FIN 46 will not have any impact on our results of operations and financial condition. However, if the Company enters into any such arrangement with a variable interest entity in the future (or an entity with which we currently have a relationship is reconsidered based on guidance in FIN 46 to be a variable interest entity), the Company's results of operations and financial condition will be impacted.

Change in Accounting Estimate

Effective March 28, 2003, we accelerated the depreciation on certain assets related to our gasoline and store branding. These changes were the result of our gasoline brand consolidation project which will result in either updating or changing the image of the majority of our stores within the next two years. Accordingly, we reassessed the remaining useful lives of these assets based on our plans and recorded an increase in depreciation expense of $3.4 million. This additional expense had an impact on net income of $2.1 million and reduced earning per share—basic and diluted by $0.11 per share.

Note 2—Inventories:

At September 25, 2003 and September 26, 2002, inventories consisted of the following (in thousands):

	2003	2002
Inventories at FIFO cost:		
Merchandise	**$ 74,483**	$ 79,535
Gasoline	**20,996**	21,669
	95,479	101,204
Less adjustment to LIFO cost:		
Merchandise	**(11,323)**	(16,767)
Inventories at LIFO cost	**$ 84,156**	$ 84,437

The positive effect on cost of sales of LIFO inventory liquidations was $1.2 million, $692 thousand and $2.2 million for fiscal 2003, 2002 and 2001, respectively.

Note 3—Property and Equipment:

At September 25, 2003 and September 26, 2002, property and equipment consisted of the following (in thousands):

	2003	2002
Land	**$ 78,586**	$ 81,653
Buildings	**138,857**	140,793
Equipment	**387,502**	373,243
Leasehold improvements	**72,221**	69,294
Construction in progress	**10,460**	11,643
	687,626	676,626
Less—accumulated depreciation and amortization	**(287,017)**	(241,108)
Property and equipment, net	**$ 400,609**	$ 435,518

Note 4—Goodwill and Other Intangible Assets:

Effective September 28, 2001, we adopted the provisions of SFAS No. 142 and as a result, our goodwill asset is no longer amortized but reviewed at least annually for impairment. Other intangible assets will continue to be amortized over their useful lives. We determined that we operate in one reporting unit based on the current reporting structure and have thus assigned goodwill at the enterprise level.

During the quarter ended March 27, 2003, we changed the date of our annual goodwill impairment test to the last day of our monthly period ending in January. We selected our period ending in January to perform our annual goodwill impairment test because we believe such date represents the end of our annual seasonal business cycle. Typically, our business increases during warmer weather months in the southeastern United States and extends to the holiday season, which ends within our second fiscal quarter. We believe that the change will not delay, accelerate or avoid an impairment charge. Accordingly, we believe that the accounting change described above is to an alternative date which is preferable under the circumstances.

We completed our annual goodwill impairment test as of January 23, 2003 by comparing the enterprise fair value to its carrying or book value. This valuation indicated an aggregate fair value in excess of our book value; therefore, we have determined that no impairment existed. Fair value was measured using a valuation by an independent third party as of January 23, 2003, which was based on market multiples, comparable transactions and discounted cash flow methodologies. We utilized an independent valuation to determine our fair value rather than our market capitalization, as we believe our market capitalization may not be representative of the fair value of the Company because two institutions own approximately 84% of our outstanding common stock.

On an ongoing basis, we will perform an annual goodwill impairment test at the end of January. At least quarterly, we will analyze whether an event has occurred that would more likely than not reduce our enterprise fair value below its carrying amount and, if necessary, we will perform a goodwill impairment test between the annual dates. Impairment adjustments recognized after adoption, if any, will be recognized as operating expenses.

Other intangible assets consist of noncompete agreements with a carrying value of $6.6 million and $7.2 million at September 25, 2003 and September 26, 2002, respectively, net of accumulated amortization of $2.4 million and $1.8 million, respectively. Amortization expense was $626 thousand, $725 thousand and $665 thousand for fiscal 2003, 2002 and 2001, respectively. The weighted-average amortization period of all noncompete agreements is 29.2 years. Estimated amortization expense for each of the five fiscal years following September 25, 2003 and thereafter is: $428 thousand in fiscal 2004; $351 thousand in fiscal 2005; $305 thousand in fiscal 2006; $206 thousand in fiscal 2007; $197 thousand in fiscal 2008 and $5.1 million thereafter. Noncompete agreements are classified in other noncurrent assets in the accompanying audited consolidated balance sheets.

The following information presents a summary of consolidated results of operations as if we adopted the provisions of SFAS No. 142 at the beginning of the fiscal year for each of the periods presented (amounts in thousands, except per share data):

	2003	2002	2001
Net income (loss)	**$11,504**	$1,804	$(2,656)
Goodwill amortization, net	**—**	—	5,846
Adjusted net income	**$11,504**	$1,804	$ 3,190
Adjusted earnings (loss) per share—basic:			
Net income (loss)	**$ 0.64**	$ 0.10	$ (0.15)
Goodwill amortization, net	**—**	—	0.32
Adjusted net income per share—basic	**$ 0.64**	$ 0.10	$ 0.17
Adjusted earnings (loss) per share—diluted:			
Net income (loss)	**$ 0.63**	$ 0.10	$ (0.15)
Goodwill amortization, net	**—**	—	0.32
Adjusted net income per share—diluted	**$ 0.63**	$ 0.10	$ 0.17

NOTES to Consolidated Financial Statements *(cont.)*

NOTE 5—LONG-TERM DEBT:

Long-term debt consisted of the following (amounts in thousands):

	September 25, 2003	September 26, 2002
Senior subordinated notes payable; due October 15, 2007; interest payable semi-annually at 10.25%	**$200,000**	$200,000
Tranche A term loan; interest payable monthly at LIBOR plus 3.5%	**—**	26,906
Tranche B term loan; interest payable monthly at LIBOR plus 4.0%	**—**	176,185
Tranche C term loan; interest payable monthly at LIBOR plus 4.25%	**—**	73,125
Acquisition term loan; interest payable monthly at LIBOR plus 3.5%	**—**	27,500
First lien term loan; interest payable monthly at LIBOR plus 4.25%; principal due in quarterly installments through March 31, 2007, net of unamortized original issue discount of $3,347	**247,153**	—
Second lien term loan; interest payable monthly at LIBOR plus 6.5%; principal due in full on March 31, 2007, net of unamortized original issue discount of $682	**50,318**	—
Notes payable to McLane Company, Inc.; paid in full	**—**	297
Other notes payable; various interest rates and maturity dates	**98**	162
Total long-term debt	**497,569**	504,175
Less—current maturities	**(27,558)**	(43,255)
Long-term debt, net of current maturities	**$470,011**	$460,920

On April 14, 2003, we entered into a new senior secured credit facility, which consisted of a $253.0 million first lien term loan, a $51.0 million second lien term loan and a $52.0 million revolving credit facility, each maturing March 31, 2007. Proceeds from the new senior secured credit facility were used to repay all amounts outstanding under the previously existing senior credit facility and loan origination costs. The term loans were issued with an original issue discount of $4.6 million, which will be amortized over the life of the agreement, using the effective interest method. In connection with the refinancing, we recorded a non-cash charge of approximately $2.9 million related to the write-off of deferred financing costs associated with the previous credit facility and is included in operating, general and administrative expenses.

At September 25, 2003, our senior credit facility consists of a $52.0 million revolving credit facility, which expires March 31, 2007 and bears interest at a rate of LIBOR plus 4.25%, and $297.5 million in outstanding term loans. Our revolving credit facility is available for working capital financing, general corporate purposes and issuing commercial and standby letters of credit. As of September 25, 2003, there were no outstanding borrowings under the revolving credit facility and we had approximately $30.0 million of standby letters of credit issued under the facility. Therefore, we had approximately $22.0 million in available borrowing capacity. Furthermore, the revolving credit facility limits our total outstanding letters of credit to $45.0 million. The LIBOR associated with our senior credit facility resets periodically and has certain LIBOR floors. As of September 25, 2003, the effective LIBOR rate was 1.75% for the first lien term loan and 1.50% for the second lien term loan.

The senior secured credit facility contains various restrictive covenants including a minimum EBITDA, maximum leverage ratio, minimum fixed charge coverage, maximum capital expenditures as well as other customary covenants, representations and warranties and events of default. At September 25, 2003, we were in compliance with all covenants and restrictions related to all outstanding borrowings. Substantially all of our net assets are restricted as to payment of dividends and distributions.

Subsequent to September 25, 2003, we entered into an amendment to our senior credit facility to increase the borrowings under the first lien term loan by $80.0 million. The proceeds from the term loan were used to fund the Golden Gallon® acquisition. See Note 19—Subsequent Events. Also, subsequent to September 25, 2003, we increased the availability under our revolving credit facility by $4.0 million to $56.0. As of December 1, 2003, there were no borrowings outstanding under this facility and $30.0 million of standby letters of credit issued under the facility.

The remaining annual maturities of our long-term debt are as follows (amounts in thousands):

Year Ended September:	
2004	$ 27,558
2005	16,029
2006	25,260
2007	232,751
2008	200,000
Thereafter	—
Total principal payments	$501,598
Less: Original issue discount	(4,029)
Total long-term debt—net	$497,569

The fair value of our indebtedness approximated $509.2 million at September 25, 2003.

Note 6—Derivative Financial Instruments:

We enter into interest rate swap agreements to modify the interest rate characteristics of our outstanding long-term debt and have designated each qualifying instrument as a cash flow hedge. We formally document our hedge relationships, including identifying the hedge instruments and hedged items, as well as our risk management objectives and strategies for entering into the hedge transaction. At hedge inception, and at least quarterly thereafter, the Company assesses whether derivatives used to hedge transactions are highly effective in offsetting changes in the cash flow of the hedged item. We measure effectiveness by the ability of the interest rate swaps to offset cash flows associated with changes in the variable LIBOR rate associated with our term loan facilities using the hypothetical derivative method. To the extent there is any hedge ineffectiveness, changes in fair value are recorded as a component of other comprehensive income (loss). To the extent the instruments are considered ineffective, any changes in fair value relating to the ineffective portion are immediately recognized in earnings (interest expense). When it is determined that a derivative ceases to be a highly effective hedge, we discontinue hedge accounting, and subsequent changes in fair value of the hedge instrument are recognized in earnings. Interest income (expense) was $3.4 million, $(926) thousand and $(4.2) million for fiscal 2003, 2002 and 2001, respectively, for the mark-to-market adjustment of those instruments that do not qualify for hedge accounting.

The fair values of our interest rate swaps are obtained from dealer quotes. These values represent the estimated amount we would receive or pay to terminate the agreement taking into consideration the difference between the contract rate of interest and rates currently quoted for agreements of similar terms and maturities. At September 25, 2003, other accrued liabilities and other noncurrent liabilities include derivative liabilities of $1.5 million and $1.4 million, respectively. At September 26, 2002, other accrued liabilities and other noncurrent liabilities include derivative liabilities of $699 thousand and $7.9 million, respectively. Cash flow hedges at September 25, 2003 have various settlement dates, the latest of which are April 2006 interest rate swaps.

Note 7—Comprehensive Income:

The components of accumulated other comprehensive deficit, net of related taxes, are as follows (amounts in thousands):

	2003	2002
Cumulative effect of adoption of SFAS No. 133 (net of related taxes of $0 and $93, respectively)	**$ —**	$ (158)
Unrealized losses on qualifying cash flow hedges (net of related taxes of $432 and $1,261, respectively)	**(690)**	(1,954)
Accumulated other comprehensive deficit	**$(690)**	$(2,112)

The components of comprehensive income, net of related taxes, for the periods presented are as follows (amounts in thousands):

	2003	2002	2001
Cumulative effect of adoption of SFAS No. 133 (net of deferred taxes of $93, $135 and $61, respectively)	**$ 158**	$ 205	$ 98
Net unrealized gains (losses) on qualifying cash flow hedges (net of deferred taxes of $708, $1,292 and $(2,553), respectively)	**1,264**	1,966	(3,920)
Other comprehensive income (loss)	**$ 1,422**	$ 2,171	$(3,822)

The components of unrealized gains on qualifying cash flow hedges, net of related taxes, for the periods presented are as follows (amounts in thousands):

	2003	2002	2001
Unrealized gains (losses) on qualifying cash flow hedges	**$ 3,272**	$ 5,465	$(4,674)
Less: Reclassification adjustment recorded as interest expense	**(2,008)**	(3,499)	754
Net unrealized gains (losses) on qualifying cash flow hedges	**$ 1,264**	$ 1,966	$(3,920)

NOTES to Consolidated Financial Statements *(cont.)*

NOTE 8—RESTRUCTURING AND OTHER CHARGES:

During fiscal 2001, we completed a plan designed to strengthen our organizational structure and reduce operating costs by centralizing corporate administrative functions. The plan included closing an administrative facility located in Jacksonville, Florida and integrating key marketing, finance and administrative activities into our corporate headquarters located in Sanford, North Carolina.

As a result of these actions, we recorded pre-tax restructuring and other charges of $4.8 million during fiscal 2001. The restructuring charge consisted of $1.7 million of employee termination benefits, $650 thousand of lease obligations and $490 thousand of legal and other professional consultant fees. During fiscal 2001, the Company also incurred and expended $1.9 million in other non-recurring charges for related actions. Employee termination benefits represent severance and out-placement benefits for 100 employees, 49 of which are in administrative positions and 51 of which are in managerial positions. Lease obligations represent remaining lease payments in excess of estimated sublease rental income for the Jacksonville facility. Substantially all remaining obligations as of the balance sheet date will be expended by the end of fiscal 2003 (except for lease obligations which expire in fiscal 2005). Fiscal 2003, 2002 and 2001 activity related to the restructuring reserve was as follows (amounts in thousands):

	Fiscal Year 2001 Expense	Cash Outlays	Non-cash Write-offs	September 27, 2001	Cash Outlays	Non-cash Write-offs	September 26, 2002	Cash Outlays	**September 25, 2003**
Employee termination benefits	$1,736	$ 943	$ —	$ 793	$275	$499	$ 19	$ 19	**$ —**
Lease buyout costs	650	47	—	603	397	—	206	206	**—**
Legal and other professional costs	490	341	—	149	109	40	—	—	**—**
Total restructuring reserve	2,876	1,331	—	1,545	781	539	225	225	**—**
Other non-recurring charges	1,895	845	1,050	—	—	—	—	—	**—**
Total restructuring and other charges	$4,771	$2,176	$1,050	$1,545	$781	$539	$225	$225	**$ —**

NOTE 9—ASSET RETIREMENT OF OBLIGATIONS:

Effective September 27, 2002, we adopted the provisions of SFAS No. 143 and, as a result, we recognize the future cost to remove an underground storage tank over the estimated useful life of the storage tank in accordance with SFAS No. 143. A liability for the fair value of an asset retirement obligation with a corresponding increase to the carrying value of the related long-lived asset is recorded at the time an underground storage tank is installed. We will amortize the amount added to property and equipment and recognize accretion expense in connection with the discounted liability over the remaining life of the respective underground storage tanks.

The estimated liability is based on historical experience in removing these tanks, estimated tank useful lives, external estimates as to the cost to remove the tanks in the future and federal and state regulatory requirements. The liability is a discounted liability using a credit-adjusted risk-free rate of approximately 9%. Revisions to the liability could occur due to changes in tank removal costs, tank useful lives or if federal and/or state regulators enact new guidance on the removal of such tanks.

Upon adoption, we recorded a discounted liability of $8.4 million, which is included in other noncurrent liabilities, increased net property and equipment by $2.7 million and recognized a one-time cumulative effect adjustment of $3.5 million (net of deferred tax benefit of $2.2 million). We will amortize the amount added to property and equipment and recognize accretion expense in connection with the discounted liability over the remaining lives of the respective underground storage tanks. The effects on earnings from continuing operations before cumulative effect of change in accounting principle for years ended September 26, 2002 and September 27, 2001, assuming the adoption of SFAS No. 143 as of September 28, 2000, were not material to net income or earnings per share.

A reconciliation of our liability for the year ended September 25, 2003, is as follows (amounts in thousands):

Upon adoption at September 27, 2002	$8,443
Liabilities incurred	191
Liabilities settled	(159)
Accretion expense	765
Total asset retirement obligation	$9,240

NOTE 10—INTEREST EXPENSE:

The components of interest expense are as follows (amounts in thousands):

	2003	2002	2001
Interest on long-term debt, including amortization of deferred financing costs	**$41,572**	$39,577	$50,652
Fair market value change in non-qualifying derivatives	**(3,381)**	926	4,244
Interest on capital lease obligations	**2,281**	2,189	1,936
Interest rate swap settlements	**8,470**	8,840	1,822
Miscellaneous	**323**	114	77
	$49,265	$51,646	$58,731

Note 11—Income Taxes:

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

	2003	2002	2001
Current:			
Federal	**$ —**	$ —	$ —
State	**—**	—	—
	$ —	$ —	$ —
Deferred:			
Federal	**$ 8,286**	$ 998	$776
State	**1,099**	132	95
	9,385	1,130	871
	$ 9,385	$1,130	$871

As of September 25, 2003 and September 26, 2002, deferred tax liabilities (assets) are comprised of the following (in thousands):

	2003	2002
Depreciation	**$ 67,541**	$ 65,224
Inventories	**3,430**	3,770
Amortization	**15,275**	8,588
Miscellaneous expenses	**—**	3,013
Environmental expenses	**824**	1,101
Other	**67**	80
Gross deferred tax liabilities	**87,137**	81,776
Capital lease obligations	**(1,987)**	(1,568)
Allowance for doubtful accounts	**(256)**	(267)
Accrued insurance	**(4,634)**	(3,631)
Accrued compensation	**(461)**	—
Derivative liabilities	**(1,019)**	(3,214)
Asset retirement obligation	**(2,180)**	—
Deferred income	**(7,565)**	(5,191)
Accrued vacation	**(323)**	(391)
Reserve for closed stores	**(1,382)**	(787)
Restructuring reserve	**—**	(87)
Other	**(819)**	(380)
Gross deferred tax assets	**(20,626)**	(15,516)
Net operating loss carryforwards	**(17,065)**	(25,613)
General business credits	**(1,024)**	(1,233)
AMT credits	**(2,741)**	(2,468)
	$ 45,681	$ 36,946

As of September 25, 2003 and September 26, 2002, net current deferred income tax assets totaled $4.3 million and $1.4 million, respectively, and net noncurrent deferred income tax liabilities totaled $50.0 million and $38.4 million, respectively.

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

	2003	2002	2001
Tax expense (benefit) at federal statutory rate	**$8,286**	$ 998	$ (607)
Tax expense at state rate, net of federal income tax expense	**926**	109	—
Permanent differences:			
Amortization of goodwill	**—**	—	1,320
Other	**173**	23	158
Net income tax expense	**$9,385**	$1,130	$ 871

As of September 25, 2003, 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 as deferred tax assets. Loss carryforwards as of September 25, 2003 have the following expiration dates (in thousands):

	Federal	State
2009	$ —	$ 3,158
2010	—	2,974
2011	—	10,919
2012	—	5,101
2013	—	13,274
2014	—	5,162
2015	—	5,841
2016	—	13,928
2017	—	6,969
2020	20,171	—
2021	21,108	—
Total loss carryforwards	$41,279	$67,326

Note 12—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 25, 2003 and September 26, 2002 are as follows (in thousands):

	2003	2002
Buildings	**$ 24,837**	$24,466
Less—accumulated amortization	**(10,580)**	(9,936)
	$ 14,257	$14,530

Amortization expense related to capitalized leased assets was $1.5 million, $1.4 million and $1.3 million for fiscal 2003, 2002 and 2001, respectively.

NOTES to Consolidated Financial Statements *(cont.)*

Future minimum lease payments as of September 25, 2003 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
2004	$ 3,597	$ 54,599
2005	3,271	51,990
2006	3,050	48,885
2007	2,994	46,947
2008	2,740	44,964
Thereafter	22,659	312,465
Net minimum lease payments	38,311	$559,850
Amount representing interest (8% to 20%)	21,157	
Present value of net minimum lease payments	17,154	
Less—current maturities	1,375	
	$15,779	

Rental expense for operating leases was approximately $56.3 million, $56.0 million and $54.0 million for fiscal 2003, 2002 and 2001, respectively. The Company has facility leases with step rent provisions, capital improvement funding, and other forms of lease concessions. In accordance with generally accepted accounting principles, the Company records step rent provisions and lease concessions on a straight-line basis over the minimum lease term. Some of The Pantry's leases require contingent rental payments; such amounts are not material for the fiscal years presented.

During fiscal 2003, 2002 and 2001, The Pantry entered into sale-leaseback transactions with unrelated parties with net proceeds of $2.3 million, $6.2 million and $3.5 million, 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 13—COMMITMENTS AND CONTINGENCIES: As of September 25, 2003, The Pantry was contingently liable for outstanding letters of credit in the amount of $30.0 million 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. At September 25, 2003, other accrued liabilities and other noncurrent liabilities include the unamortized liabilities associated with these payments of $7.7 million and $37.3 million, respectively. At September 26, 2002, other accrued liabilities and other noncurrent liabilities include the unamortized liabilities associated with these payments of $3.3 million and $51.7 million, 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, which was amended on October 5, 2002 and expires on October 10, 2008. 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 October 10, 2004, 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 brand imaging 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 to cost of goods sold 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.

Environmental Liabilities and Contingencies

We are subject to various federal, state and local environmental laws. We make financial expenditures in order to comply with regulations governing underground storage tanks adopted by federal, state and local regulatory agencies. 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.

Federal and state regulations require us to provide and maintain evidence that we are taking financial responsibility for corrective action and compensating third parties in the event of a release from our underground storage tank systems. In order to comply with these requirements, as of December 10, 2003, we maintain letters of credit in the aggregate amount of approximately $1.1 million in favor of state environmental agencies in North Carolina, South Carolina, Virginia, Georgia, Indiana, Tennessee, Kentucky and Louisiana. We also rely upon the reimbursement provisions of applicable state trust funds. In Florida, we meet our financial responsibility requirements by state trust fund coverage through December 31, 1998 and meet such requirements thereafter through private commercial liability insurance. In Georgia, we meet our financial responsibility requirements by state trust fund coverage through December 29, 1999 and meet such requirements thereafter through private commercial liability insurance and a letter of credit. In Mississippi, we meet our financial responsibility requirements through coverage under the state trust fund.

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; and
- maintaining evidence of financial responsibility for taking corrective action and compensating third parties for bodily injury and property damage resulting from releases.

These regulations permit states to develop, administer and enforce their own regulatory programs, incorporating requirements which are at least as stringent as the federal standards. In 1998, Florida developed their own regulatory program, which incorporated requirements more stringent than the 1988 EPA regulations. We believe our facilities in Florida meet or exceed those regulations developed by the state of Florida in 1998. We believe all company-owned underground storage tank systems are in material compliance with these 1988 EPA regulations and all applicable state environmental regulations.

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 fund programs. We have filed claims and received reimbursements in North Carolina, South Carolina, Kentucky, Indiana, Georgia, Florida, Tennessee, Mississippi and Virginia. The coverage afforded by each state fund varies but generally provides up to $1.0 million per site or occurrence for the cleanup of environmental contamination, and most provide coverage for third-party liabilities. Costs for which we do not receive reimbursement include:

- the per-site deductible;
- costs incurred in connection with releases occurring or reported to trust funds prior to their inception;
- removal and disposal of underground storage tank systems; and
- costs incurred in connection with sites otherwise ineligible for reimbursement from the trust funds.

The trust funds generally require us to pay deductibles ranging from $5 thousand to $150 thousand per occurrence depending on the upgrade status of our underground storage tank system, the date the release is discovered and/or reported and the type of cost for which reimbursement is sought. The Florida trust fund will not cover releases first reported after December 31, 1998. We obtained private insurance coverage for remediation and third-party claims arising out of releases reported after December 31, 1998. We believe that this coverage exceeds federal and Florida financial responsibility regulations. In Georgia, we opted not to participate in the state trust fund effective December 30, 1999. We obtained private coverage for remediation and third-party claims arising out of releases reported after December 29, 1999. We believe that this coverage exceeds federal and Georgia financial responsibility regulations.

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

NOTES to Consolidated Financial Statements *(cont.)*

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 $13.8 million and $13.3 million as of September 25, 2003 and September 26, 2002, respectively, represent our estimates for future expenditures for remediation, tank removal and litigation associated with 236 and 240 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. We estimate that approximately $12.5 million of our environmental obligation will be funded by state trust funds and third-party insurance. Our environmental reserve, dated as of September 25, 2003, does not include the 31 Golden Gallon® sites that were known to be contaminated at the time of our October 2003 acquisition. State trust funds, insurers or other third parties are responsible for the costs of remediation at all 31 such Golden Gallon® sites. Also, as of September 25, 2003 and September 26, 2002 there were an additional 495 and 470 sites, respectively, that are known to be contaminated sites that are being remediated by third parties and therefore the costs to remediate such sites are not included in our environmental reserve. 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 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 10% rate. The undiscounted amount of future estimated payments for which The Pantry does not expect to be reimbursed for each of the five fiscal years and thereafter at September 25, 2003 and other cost amounts covered by responsible third parties are as follows (in thousands):

Fiscal Year	Expected Payments
2004	$ 508
2005	495
2006	370
2007	181
2008	42
Thereafter	74
Total undiscounted amounts not covered by a third party	1,670
Other current cost amounts	15,677
Amount representing interest (10%)	(3,524)
Environmental reserve	$13,823

The Pantry anticipates that it will be reimbursed for a portion of these expenditures from state trust funds and private insurance. As of September 25, 2003, anticipated reimbursements of $15.1 million are recorded as long-term environmental receivables. In Florida, remediation of such contamination reported before January 1, 1999 will be performed by the state (or state-approved independent contractors) and substantially all of the remediation costs, less any applicable deductibles, 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.

Several of the locations identified as contaminated are being remediated 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 14—Benefit Plans:

The Pantry sponsors a 401(k) Employee Retirement Savings Plan for eligible employees. Employees must be at least twenty-one 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 100% 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 $731 thousand, $719 thousand and $718 thousand for fiscal 2003, 2002 and 2001, respectively.

Note 15—Common Stock:

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). Subsequent to the IPO, Freeman Spogli has purchased an additional 2,466,014 shares from other stockholders giving them beneficial ownership of approximately 69.2% of the outstanding common stock (including shares underlying warrants).

Note 16—Stock Options and Other Equity Instruments:

On January 1, 1998, we adopted an incentive and non-qualified stock option plan. Pursuant to the provisions of the plan, options may be granted to officers, key employees, consultants or any of our subsidiaries and certain members of the board of directors to purchase up to 1,275,000 shares of common stock. On June 3, 1999, we 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 and up to 3,825,000 shares of the Company's common stock available for grant. The plans are 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. All options granted vest over a three-year period, with one-third of each grant vesting on the anniversary of the initial grant and have contractual lives of seven years. Additionally, the terms and conditions of awards under the plans may differ from one grant to another. Under the plans, 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.

On January 15, 2003, the board of directors amended the 1999 plan to increase the number of shares of common stock that may be issued under the plan by 882,505 shares. This number of shares corresponded to the number of shares that remained available at that time for issuance under the 1998 plan, which the board of directors terminated (except for the purpose of continuing to govern options outstanding under that plan) on January 15, 2003.

A summary of the status of the plans for the three fiscal years ended September 25, 2003, September 26, 2002 and September 27, 2001 and changes during the years ending on those dates is as follows:

	Shares	Option Price Per Share	Weighted-Average Exercise Price Per Share
September 29, 2000	812,861	$8.82–$13.00	$10.43
Options granted	328,000	10.00	10.00
Options forfeited	(111,878)	8.82– 13.00	10.50
Options exercised	(7,700)	8.82	8.82
September 27, 2001 (654,783 shares exercisable)	1,021,283	8.82– 13.00	10.30
Options granted	240,000	4.00– 5.12	4.94
Options forfeited	(136,078)	5.12– 13.00	10.54
September 26, 2002 (709,538 shares exercisable)	1,125,205	4.00– 13.00	9.13
Options granted	430,000	1.66– 8.09	2.23
Options forfeited	(249,313)	5.12– 13.00	9.15
September 25, 2003	**1,305,892**	**1.66– 13.00**	**6.85**
Options exercisable	**670,558**	**$4.00–$13.00**	**$ 9.82**

The following table summarizes information about stock options outstanding at September 25, 2003:

Date Granted	Exercise Prices	Number Outstanding at September 25, 2003	Weighted-Average Remaining Contractual Life	Number of Options Exercisable
1/1/98	$ 8.82	242,607	4 years	242,607
8/25/98	$11.27	78,285	4 years	78,285
6/8/99, 9/30/99	$13.00	129,000	3 years	129,000
12/29/00	$10.00	236,000	4 years	157,333
11/26/01	$ 5.12	150,000	5 years	50,000
3/26/02	$ 4.00	40,000	6 years	13,333
10/22/02	$ 1.66	20,000	6 years	—
11/13/02	$ 1.70	335,000	6 years	—
1/6/03	$ 3.97	35,000	6 years	—
3/25/03	$ 4.50	30,000	7 years	—
7/23/03	$ 8.09	10,000	7 years	—
	Total	1,305,892		670,558

NOTES to Consolidated Financial Statements *(cont.)*

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; or
- 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 has 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 terminates upon the latter of:

- the first anniversary of the date the shares were originally acquired; or
- 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 stock 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 stock 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 stock subscription plan. These shares were sold at fair value ($11.27), as determined by the most recent equity investment (July 1998).

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 thousand and is included in additional paid-in capital. None of these warrants had been exercised at September 25, 2003.

Note 17—Earnings (Loss) Per Share:

We compute 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 (dollars in thousands, except per share data):

	2003	2002	2001
Income (loss) before cumulative effect adjustment	**$14,986**	$ 1,804	$ (2,656)
Cumulative effect adjustment	**(3,482)**	—	—
Net income (loss)	**$11,504**	$ 1,804	$ (2,656)
Earnings (loss) per share—basic:			
Weighted-average shares outstanding	**18,108**	18,108	18,113
Income (loss) per share before cumulative effect adjustment—basic	**$ 0.83**	$ 0.10	$ (0.15)
Loss per share on cumulative effect adjustment—basic	**(0.19)**	—	—
Net income (loss) per share—basic	**$ 0.64**	$ 0.10	$ (0.15)
Earnings (loss) per share—diluted:			
Weighted-average shares outstanding	**18,108**	18,108	18,113
Dilutive impact of options and warrants outstanding	**262**	1	—
Weighted-average shares and potential dilutive shares outstanding	**18,370**	18,109	18,113
Income (loss) per share before cumulative effect adjustment—diluted	**$ 0.82**	$ 0.10	$ (0.15)
Loss per share on cumulative effect adjustment—diluted	**(0.19)**	—	—
Net income (loss) per share—diluted	**$ 0.63**	$ 0.10	$ (0.15)

Options and warrants to purchase shares of common stock that were not included in the computation of diluted earnings per share, because their inclusion would have been antidilutive, were 3.0 million, 3.4 million and 3.4 million for fiscal 2003, 2002, and 2001, respectively.

NOTE 18—QUARTERLY FINANCIAL DATA (UNAUDITED):

Summary quarterly financial data for fiscal 2003 and 2002, respectively, is as follows (dollars in thousands, except per share amounts):

	Year Ended September 25, 2003					Year Ended September 26, 2002				
	First Quarter	**Second Quarter**	**Third Quarter**	**Fourth Quarter**	**Year**	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
Total revenue	**$650,977**	**$673,444**	**$711,455**	**$740,485**	**$2,776,361**	$577,373	$560,845	$681,308	$674,538	$2,494,064
Gross profit	**$125,991**	**$113,129**	**$135,017**	**$136,667**	**$ 510,804**	$115,479	$108,100	$127,025	$124,798	$ 475,402
Income (loss) before income taxes	**$ 8,004**	**$ (3,827)**	**$ 9,894**	**$ 10,300**	**$ 24,371**	$ 793	$ (6,895)	$ 6,773	$ 2,263	$ 2,934
Net income (loss)	**$ 1,438**	**$ (2,353)**	**$ 6,085**	**$ 6,334**	**$ 11,504**	$ 475	$ (4,138)	$ 4,064	$ 1,403	$ 1,804
Earnings per share:										
Basic	**$ 0.08**	**$ (0.13)**	**$ 0.34**	**$ 0.35**	**$ 0.64**	$ 0.03	$ (0.23)	$ 0.22	$ 0.08	$ 0.10
Diluted	**$ 0.08**	**$ (0.13)**	**$ 0.33**	**$ 0.33**	**$ 0.63**	$ 0.03	$ (0.23)	$ 0.22	$ 0.08	$ 0.10

NOTE 19—SUBSEQUENT EVENTS:

On October 16, 2003, The Pantry completed the acquisition of 138 convenience stores operating under the Golden Gallon® banner from Ahold USA, Inc. The acquired assets include 138 operating convenience stores, 131 of which are fee-owned stores, a dairy plant and related assets, a fuel hauling operation, corporate headquarters buildings and 25 undeveloped sites. Other than the dairy plant and related assets and the fuel hauling operation, the Company intends to use the acquired assets in the convenience store retail business. Simultaneous with the closing, the Company sold the dairy plant and related assets and the fuel hauling operation to existing suppliers of the Company.

The aggregate purchase price of the acquired assets, which was determined through arm's-length negotiations between the Company and Ahold USA, Inc., was $187 million. The acquisition was structured as two simultaneous transactions whereby certain real estate assets (114 of the 131 fee-owned stores) were purchased and financed through a $94.5 million sale-leaseback transaction, and the Golden Gallon® operations and the balance of the real estate assets were purchased for approximately $92.5 million in cash. The Company funded the second transaction with $80 million of debt through borrowings under the Company's existing senior secured credit facility (see Note 5—Long-Term Debt) and available cash.

On December 9, 2003, Freeman Spogli exercised its warrants to purchase 2,346,000 shares of common stock at an exercise price of $7.45 per share. The exercise was cashless whereby shares of common stock received were reduced by the number of shares having an aggregate fair market value equal to the exercise price, or approximately $17.5 million. The aggregate fair market value was based on the average closing price on each of the ten days prior to December 9, 2003, or $23.68 per share. Consequently, Freeman Spogli received 1,607,855 shares of common stock upon exercise (unaudited).

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. and subsidiaries ("The Pantry") as of September 25, 2003 and September 26, 2002, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three fiscal years in the period ended September 25, 2003. These financial statements are the responsibility of The Pantry's management. Our responsibility is to express an opinion on the 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 as of September 25, 2003 and September 26, 2002, and the results of their operations and their cash flows for each of the three fiscal years in the period ended September 25, 2003 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 9 to the consolidated financial statements, in 2003, The Pantry adopted Statement of Financial Accounting Standards ("SFAS") No. 143, *Accounting for Asset Retirement Obligations*. Also, as discussed in Note 4 to the consolidated financial statements, in 2002, The Pantry adopted SFAS No. 142, *Goodwill and Other Intangible Assets*.

Deloitte & Touche LLP

Raleigh, North Carolina
December 4, 2003

MARKET FOR OUR COMMON EQUITY and Related Stockholder Matters

(a) Market Information—Our common stock, $.01 par value, represents our only voting securities. There are 19,743,615 shares of common stock issued and outstanding as of December 9, 2003. 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 our common stock over the last two fiscal years as reported on the Nasdaq National Market through September 25, 2003, based on published financial sources.

	2003		2002	
Quarter	**High**	**Low**	High	Low
First	**$ 4.32**	**$0.83**	$7.30	$5.12
Second	**$ 5.05**	**$3.65**	$5.70	$3.40
Third	**$ 9.45**	**$3.78**	$4.77	$3.16
Fourth	**$11.25**	**$6.42**	$3.55	$2.01

(b) Holders—As of December 9, 2003, there were approximately 45 holders of record of our common stock. This number does not include beneficial owners of our common stock whose stock is held in nominee or "street" name accounts through brokers.

(c) Dividends—During the last two fiscal years, we have not paid any cash dividends on our common stock, and we do not expect to pay cash dividends on our common stock for the foreseeable future. We intend to retain earnings to support operations, to reduce debt and to finance expansion. 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 indenture relating to our senior subordinated notes and our senior credit facility. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources" and "Notes to Consolidated Financial Statements—Note 5—Long-Term Debt."

CORPORATE DIRECTORY

Directors

Peter J. Sodini
President and Chief Executive Officer

Todd W. Halloran[3]
Principal
Freeman Spogli & Co.

Jon D. Ralph[2][3]
Principal
Freeman Spogli & Co.

Charles P. Rullman[2]
Principal
Freeman Spogli & Co.

Byron E. Allumbaugh[1][2]
Consultant

Peter M. Starrett
Consultant

Thomas M. Murnane[1][3]
Consultant

Paul L. Brunswick[1]
President
General Management Advisory

Hubert E. Yarborough III[1]
The Yarborough Group of South Carolina LLC

Board Committees:
(1) Audit Committee
(2) Compensation Committee
(3) Corporate Governance and Nominating Committee

Executive Officers

Peter J. Sodini
President and Chief Executive Officer

Steven J. Ferreira
Senior Vice President, Administration and Strategic Planning

Daniel J. Kelly
Vice President, Chief Financial Officer and Corporate Secretary

Joseph A. Krol
Senior Vice President, Operations

David M. Zaborski
Vice President, Marketing

Gregory J. Tornberg
Vice President, Gasoline Marketing

Financial Information

Forms 10-K and 10-Q are available without charge.
Direct requests to:

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Vice President and Chief Financial Officer
The Pantry, Inc.
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Phone: 919-774-6700
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Internet

Additional information on The Pantry, Inc. is available on the World Wide Web at: www.thepantry.com

Executive Office

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Transfer Agent

Wachovia Bank, NA
Equity Services
Charlotte, North Carolina

Independent Accountants

Deloitte & Touche LLP
Raleigh, North Carolina

Annual Meeting

The annual meeting of stockholders will be held on Wednesday, March 31, 2004 at 10:00 AM Eastern Standard Time at the Sheraton Imperial Hotel, 4700 Emperor Boulevard, I-40 at Exit 282 (Page Road), Durham, North Carolina 27730 (approximately 3 miles from RDU airport).

Designed by Curran & Connors, Inc. / www.curran-connors.com

The Pantry, Inc.

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