

WILD OATS MARKETS INC
Form 10-Q
May 13, 2003
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

- (X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR SECTION 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED **MARCH 29, 2003**
OR
() TRANSITION REPORT PURSUANT TO SECTION 13 OR SECTION 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM _____ TO _____

Commission file number 0-21577

WILD OATS MARKETS, INC.

(Exact name of registrant as specified in its charter)

84-1100630

Delaware
(State or other jurisdiction of
Incorporation or organization)

(I.R.S. Employer Identification Number)

3375 Mitchell Lane
Boulder, Colorado 80301

(Address of principal executive offices, including zip code)

(303) 440-5220

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days:

Yes (X) No ()

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

Yes (X) No ()

As of May 1, 2003, there were 29,744,305 shares outstanding of the Registrant's Common Stock (par value \$.001 per share).

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

WILD OATS MARKETS, INC.

Consolidated Balance Sheets

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(in thousands, except share data)

| | March 29, 2003 | December 28, 2002 |
|---|--------------------|----------------------|
| | <i>(unaudited)</i> | |
| | <u> </u> | <u> </u> |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 10,652 | \$ 11,367 |
| Inventories | 49,159 | 47,175 |
| Accounts receivable | 3,933 | 2,524 |
| Income tax receivable | 240 | 250 |
| Prepaid expenses and other current assets | 2,455 | 2,163 |
| Deferred tax asset | 4,081 | 4,656 |
| | <u> </u> | <u> </u> |
| Total current assets | 70,520 | 68,135 |
| Property and equipment, net | 122,230 | 122,359 |
| Goodwill, net | 106,404 | 106,404 |
| Other intangible assets, net | 7,307 | 7,415 |
| Deposits and other assets | 3,985 | 3,622 |
| Deferred tax asset | 15,223 | 15,650 |
| | <u> </u> | <u> </u> |
| | \$ 325,669 | \$ 323,585 |
| | <u> </u> | <u> </u> |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 39,333 | \$ 34,819 |
| Book overdraft | 23,540 | 22,777 |
| Accrued liabilities | 38,560 | 37,943 |
| Current portion of debt and capital leases | 16 | 146 |
| | <u> </u> | <u> </u> |
| Total current liabilities | 101,449 | 95,685 |
| Long-term debt and capital leases | 38,890 | 43,075 |
| Other long-term obligations | 15,945 | 17,923 |
| | <u> </u> | <u> </u> |
| | 156,284 | 156,683 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |

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| | | |
|--|----------|----------|
| Preferred stock, \$0.001 par value; 5,000,000 shares | | |
| authorized; no shares issued and outstanding | | |
| Common stock, \$0.001 par value; 60,000,000 shares | | |
| authorized; 29,716,958 and 29,658,660 shares | | |
| issued and outstanding, respectively | 30 | 30 |
| Additional paid-in capital | 214,196 | 213,482 |
| Note receivable, related party | (10,340) | (10,200) |
| Accumulated deficit | (33,928) | (35,368) |
| Accumulated other comprehensive loss | (573) | (1,042) |
| | 169,385 | 166,902 |
| | \$ | \$ |
| | 325,669 | 323,585 |
| | | |

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

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WILD OATS MARKETS, INC.

Consolidated Statements of Operations

(in thousands, except per-share data) (unaudited)

| | THREE MONTHS ENDED | |
|--|--------------------|-------------------|
| | March 29, 2003 | March 30, 2002 |
| Sales | \$ 235,987 | \$ 233,013 |
| Cost of goods sold and occupancy costs | 165,128 | 165,370 |
| | 70,859 | 67,643 |
| Gross profit | | |
| Operating expenses: | | |
| Direct store expenses | 50,864 | 50,469 |
| Loss (gain) on disposal of assets | 1,468 | (57) |
| Selling, general and administrative expenses | 15,977 | 14,174 |
| Pre-opening expenses | 922 | 368 |
| Restructuring and asset impairment income | (1,736) | (652) |
| | 3,364 | 3,341 |
| Income from operations | | |

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| | | |
|---|-------------------|-------------------|
| Interest income | (176) | (180) |
| Interest expense | 993 | 2,435 |
| Loss on early extinguishment of debt | 186 | |
| | <u> </u> | <u> </u> |
| Income before income taxes | 2,361 | 1,086 |
| Income tax expense | 921 | 418 |
| | <u> </u> | <u> </u> |
| Net income | \$ 1,440 | \$ 668 |
| | <u> </u> | <u> </u> |
| Net income per common share: | | |
| Basic | \$ 0.05 | \$ 0.03 |
| Diluted | \$ 0.05 | \$ 0.03 |
| Weighted average common shares outstanding, basic | 29,704 | 24,823 |
| Dilutive effect of stock options | 212 | 278 |
| | <u> </u> | <u> </u> |
| Weighted average common shares outstanding, assuming dilution | 29,916 | 25,101 |
| | <u> </u> | <u> </u> |

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

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WILD OATS MARKETS, INC.

Consolidated Statements of Comprehensive Income

(in thousands) (unaudited)

| | THREE MONTHS ENDED | |
|--|--------------------|-------------------|
| | March 29, 2003 | March 30, 2002 |
| | <u> </u> | <u> </u> |
| Net income | \$ 1,440 | \$ 668 |
| Other comprehensive income (loss): | | |
| Foreign currency translation adjustments arising during the period | 218 | (92) |
| Recognition of hedge results to interest expense | | |

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| | | |
|---|-------------|-----------|
| during the period, net of tax of \$163 and \$188, respectively | 272 | 314 |
| Change in market value of cash flow hedge during the period, net of tax of \$13 and \$27, respectively | (21) | 46 |
| | <hr/> | <hr/> |
| Other comprehensive income | 469 | 268 |
| | <hr/> | <hr/> |
| Comprehensive income | \$ 1,909 | \$ 936 |
| | <hr/> | <hr/> |

The accompanying notes are an integral part of the consolidated financial statements

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WILD OATS MARKETS, INC.

Consolidated Statements of Cash Flows

(in thousands) (unaudited)

| | THREE MONTHS ENDED | |
|---|--------------------|-------------------|
| | March 29, 2003 | March 30, 2002 |
| | <hr/> | <hr/> |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | \$ 1,440 | \$ 668 |
| Adjustments to reconcile net income to net cash from operating activities: | | |
| Depreciation and amortization | 5,570 | 5,398 |
| Loss (gain) on disposal of property and equipment | 1,468 | (57) |
| Deferred tax expense | 873 | 351 |
| Income tax benefit from employee exercise of stock options | 12 | 2 |
| Restructuring and asset impairment income | (1,736) | (652) |
| Loss on early extinguishment of long-term debt | 186 | |
| Other | 77 | (109) |
| Change in assets and liabilities: | | |
| Inventories, net | (1,921) | 5,906 |
| Receivables, net, and other assets | (1,591) | (586) |
| Accounts payable | 5,252 | 809 |
| Accrued liabilities | 855 | 1,963 |
| | <hr/> | <hr/> |
| Net cash provided by operating activities | 10,485 | 13,693 |
| | <hr/> | <hr/> |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Capital expenditures | (6,621) | (2,713) |

The consolidated balance sheet as of March 29, 2003, the consolidated statements of operations and comprehensive income for the three months ended March 29, 2003 and March 30, 2002, as well as the consolidated statements of cash flows for the three months ended March 29, 2003 and March 30, 2002 have been prepared without an audit. In the opinion of management, all adjustments, consisting only of normal, recurring adjustments necessary for a fair statement thereof, have been made.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. These consolidated financial statements should be read in conjunction with financial statements and notes thereto included in the Company's 2002 Annual Report on Form 10-K. The results of operations for interim periods presented are not necessarily indicative of the operating results for the full year.

Certain prior period information has been reclassified to conform to the current presentation.

2. Implementation of New Accounting Pronouncements

The Company receives allowances from its vendors through a variety of programs and arrangements, including cooperative advertising and markdown reimbursement programs. The allowances are intended to offset the Company's costs of promoting, advertising and selling the vendors' products in its stores. Vendor allowances are recognized as a reduction of cost of sales or related selling expense when the intended purpose of the vendor funds is satisfied. Cooperative advertising allowances are reported as a reduction of advertising expense in the period in which the advertising occurs. Markdown reimbursements are credited to cost of goods sold during the period in which the related promotional markdown is taken.

The FASB's Emerging Issues Task Force ("EITF") Issue No. 02-16, *Accounting By a Customer (Including a Reseller) for Cash Consideration Received From a Vendor* addressed the accounting treatment for vendor allowances. The adoption of EITF Issue No. 02-16 in fiscal 2003 did not have a material impact on the Company's financial position or results of operations.

The FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities, An Interpretation of ARB 51* ("FIN 46"). The primary objectives of FIN 46 are to provide guidance on the identification of entities for which control is achieved through means other than through voting rights ("variable interest entities" or "VIEs") and how to determine when and which business enterprise should consolidate the VIE (the "primary beneficiary"). This new model for consolidation applies to an entity which either (1) the equity investors (if any) do not have a controlling financial interest or (2) the equity investment at risk is insufficient to finance that entity's activities without receiving additional subordinated financial support from other parties. In addition, FIN 46 requires that both the primary beneficiary and all other enterprises with a significant variable interest in a VIE make additional disclosures. As of March 29, 2003, the Company was not party to a VIE; therefore, management believes FIN 46 will not have a material effect on the Company.

In November 2002, the FASB issued Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* ("FIN 45"). FIN 45 elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial measurement provisions of FIN 45

are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The Company has adopted the disclosure provisions as of December 28, 2002.

SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, was issued on July 30, 2002. SFAS No. 146 will require companies to recognize costs associated with exit or disposal activities when they occur rather than at the date of a commitment to an exit or disposal plan. SFAS No. 146 became effective for the Company on January 1, 2003 and management believes it will have no material effect on the Company's historical financial results.

During the second quarter ended June 29, 2002, the Company 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*. SFAS No. 145, among other things, rescinds SFAS No. 4, which required that gains and losses from extinguishment of debt be classified as an extraordinary item, net of related income tax effects. SFAS No. 145 is to be applied in fiscal years beginning after May 15, 2002 and encourages early application of the rescission of SFAS No. 4. In connection with the refinancing of its credit facility, the Company incurred a non-cash charge to write off the remaining unamortized debt issuance cost from its prior credit facility in the first quarter of fiscal 2003 of approximately \$186,000, which is included in operating net income.

3. New Accounting Pronouncements

During April 2003, the FASB issued SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*. This statement amends and clarifies financial accounting and reporting for derivative instruments and hedging activities, resulting primarily from decisions reached by the FASB Derivatives Implementation Group subsequent to the original issuance of SFAS No. 133. This Statement is generally effective prospectively for contracts and hedging relationships entered into after June 30, 2003. Management believes that adoption of SFAS No. 149 will have minimal impact on the Company.

4. Stock-Based Compensation

In December 2002, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 148, *Accounting for Stock-Based Compensation - Transition and Disclosure* ("SFAS 148"). The statement amends SFAS 123 to provide alternative methods of transition for voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of SFAS 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. SFAS 148 improves the prominence and clarity of the pro forma disclosures required by SFAS 123 by prescribing a specific tabular format and by requiring disclosure in the "Summary of Significant Accounting Policies" or its equivalent. In addition, SFAS 148 improves the timeliness of those disclosures by requiring their inclusion in financial reports for interim periods. SFAS 148 is effective for financial statements for fiscal years ending after December 15, 2002.

At March 29, 2003, the Company has six stock-based employee compensation plans, which are described more fully in *Note 10 - Stock Plans and Options* in our fiscal 2002 Annual Report filed on Form 10-K for the period ended December 28, 2002. The Company accounts for those plans under the recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employees, and Related Interpretations*. Some stock-based employee compensation cost is reflected in net income for options issued at a discount as Board of Directors compensation. All other options granted under the plans had an exercise price equal to the market value of the underlying common stock on the date of grant; therefore, no other employee compensation cost is reflected in net income.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of FASB Statement No. 123, *Accounting for Stock-Based Compensation*, as amended, to stock-based employee compensation:

| | THREE MONTHS ENDED | |
|---|--------------------|-------------------|
| | March 29, 2003 | March 30, 2002 |
| Net income, as reported | \$ 1,440 | \$ 668 |
| Add: Stock-based employee compensation expense included in reported net income, net of tax | 132 | 14 |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of tax | (638) | (485) |
| Pro forma net income | \$ 934 | \$ 197 |
| Earnings per share: | | |
| Basic - as reported | \$ 0.05 | \$ 0.03 |
| Basic - pro forma | \$ 0.03 | \$ 0.01 |
| Diluted - as reported | \$ 0.05 | \$ 0.03 |
| Diluted - pro forma | \$ 0.03 | \$ 0.01 |

5. Property and Equipment

As a result of the significant store closings, remodels and resets, the Company undertook a review of all fixtures and equipment in its stores, including a physical inventory in conjunction with an asset tagging exercise. During the first quarter of fiscal 2003, the Company substantially completed the review and recorded a \$1.5 million loss on disposal of fixtures and equipment that will no longer be used in the stores. This loss approximates a 1.2% write-down of the fixed assets carrying value.

6. Debt Covenant Compliance and Liquidity

In February of 2003, the Company completed the refinancing of its credit facility with Wells Fargo Bank N.A. The Company's new facility has a \$75.0 million limit, with a three-year term with a one-year renewal option. Under the new credit facility, the Company has the option to increase the total facility to \$135.0 million through the addition of new lenders and through the agreement of the current lending group to increase their total commitments.

As part of the new credit facility, the Company gave the lenders collateral in the form of cash, equipment and fixtures, inventory and other assets. The Company has also granted a leasehold mortgage in those leasehold interests previously mortgaged to secure our former credit facility, although it has no obligation to provide an interest in any new leaseholds. The new credit facility contains limitations on capital expenditures and the signing of new leases. The interest rate on the facility is currently either prime plus 1.0% or one-month LIBOR plus 2.25%, at the Company's election, and the rates modify depending on the ratio of average total funded debt, as defined under the credit facility, plus six times rent expense, to EBITDAR for the four fiscal quarter periods then ended, as calculated on our quarterly compliance certificate. The Company believes that cash generated from operations and available under its credit facility will be sufficient to meet its capital expenditure requirements in fiscal 2003.

The Company anticipates that it will comply with the monthly and quarterly financial covenants in the credit agreement. In the event that business conditions worsen, management has identified contingency actions to enable the Company to remain in compliance with the financial covenants. Even if the Company remains in compliance with its monetary covenants, a technical default could result due to a breach of the financial covenants. In the absence of a waiver or amendment to such financial covenants, such non-compliance would constitute a default under the credit agreement, and the lenders would be entitled to accelerate the maturity of the indebtedness outstanding thereunder. In the event that such non-compliance appears likely, or occurs, the Company will seek approval, as it has in the past, from the lenders to renegotiate financial covenants and/or obtain waivers, as required. However, there can be no assurance that future amendments or waivers will be obtained.

7. Derivatives and Hedging Activities

In accordance with the Company's interest rate risk-management strategy and as required by the terms of the Company's credit facility, in September 2000, the Company entered into a swap agreement to hedge the interest rate on \$30.0 million of its borrowings as of March 29, 2003. The swap agreement locks in a one-month LIBOR rate of 6.7% and expires in August 2003. The fair value of the swap at March 29, 2003 was (\$547,000), which has been recorded in the accompanying balance sheet in accrued liabilities. There is no obligation to renew the swap under the refinanced facility.

8. Earnings Per Share

Earnings per share are calculated in accordance with the provisions of SFAS No. 128, *Earnings Per Share*. SFAS No. 128 requires the Company to report both basic earnings per share, which is based on the weighted-average number of common shares outstanding, and diluted earnings per share, which is based on the weighted-average number of common shares outstanding and all dilutive potential common shares outstanding, except where the effect of their inclusion would be antidilutive (i.e., in a loss period). Antidilutive stock options of 2,113,188 and 1,568,007 for the three months ended March 29, 2003 and March 30, 2002, respectively, were not included in the earnings per share calculations.

9. Goodwill and Finite Lived Intangible Assets

During the first quarter of fiscal 2003, no goodwill was recognized as a result of acquisitions, no goodwill was impaired, and no other changes in the carrying amount of goodwill occurred.

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Finite lived intangible assets consist of the following (in thousands):

| | March 29, 2003 | December 28, 2002 |
|---------------------------------------|-------------------|----------------------|
| Leasehold interests | \$ 9,035 | \$ 9,035 |
| Liquor licenses and other intangibles | 116 | 104 |
| | 9,151 | 9,139 |
| Less accumulated amortization | (1,844) | (1,724) |
| | \$ 7,307 | \$ 7,415 |

Amortization expense related to finite lived intangible assets was \$120,000 and \$118,000 for the three months ended March 29, 2003 and March 30, 2002, respectively. The estimated amortization of finite lived intangible assets for each of the five fiscal years ending in fiscal 2007 is as follows (in thousands):

| FISCAL YEAR | AMORTIZATION EXPENSE |
|----------------|-------------------------|
| 2003 | \$ 479 |
| 2004 | \$ 482 |
| 2005 | \$ 482 |
| 2006 | \$ 466 |
| 2007 | \$ 462 |

10. Restructuring and Asset Impairment Income

During the first quarter of fiscal 2003, the Company recorded restructuring income of \$1.7 million consisting of the following components:

| | |
|---|------------------|
| Change in estimate related to lease-related liabilities for sites previously identified for closure or sale that were closed, sold or disposed of during the first quarter of fiscal 2003 | \$ (0.4 million) |
| Change in estimate related to lease-related liabilities for sites previously identified for closure or sale | (1.3 million) |
| Total restructuring income | \$ (1.7 million) |

Details of the significant components are as follows:

- *Change in estimate related to lease-related liabilities for sites previously identified for closure or sale that were closed, sold or disposed of during the first quarter of fiscal 2003 (\$0.4 million of restructuring income)*

- During the first quarter of fiscal 2003, the Company completed payment obligations under a lease for a site located in West Hartford, Connecticut and under lease termination agreements for sites located in West Hollywood, California and Kansas City, Missouri. The Company closed the commissary facility in Federal Heights, Colorado after weather-related structural damage rendered the facility untenable. Based on these changes in facts and circumstances, the Company reversed the remaining lease-related liabilities previously recorded for these locations and therefore recognized restructuring income of \$0.4 million during the first quarter of fiscal 2003.

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- *Change in estimate related to lease-related liabilities for sites previously identified for closure or sale (\$1.3 million of restructuring income)*

- During the first quarter of fiscal 2003, the Company reviewed the viability of a subtenant in Fort Collins, Colorado and determined the subtenant's business stability supported reversal of the remaining reserves of \$0.6 million. Subsequent to the first quarter of fiscal 2003, the Company negotiated the early termination of leases in Cleveland, Ohio and Santa Fe, New Mexico with payment obligations to terminate in the second and fourth quarters of fiscal 2003, respectively. The settlements were for less than previously estimated and accrued, and \$1.0 million was reversed to income. Offsetting this income, the Company recorded a charge of \$0.3 million for the difference between the terms of a new signed sublease for a closed location in Hartford, Connecticut, and the terms of the prior sublease for the same location under which the prior subtenant had defaulted. Based on these changes in facts and circumstances and the related changes in estimates, the Company adjusted or reversed the remaining lease-related liabilities previously recorded for these locations and recognized net restructuring income of \$1.3 million during the first quarter of fiscal 2003.

The following table summarizes accruals related to the Company's restructuring activities during the first three months of fiscal 2003 (in thousands):

| EXIT PLANS | 1999 | | | | | | TOTAL |
|----------------------------------|--------------|------------|------------|------------|------------|------------|-----------|
| | AND PRIOR | Q2 2000 | Q4 2000 | Q2 2001 | Q4 2001 | Q4 2002 | |
| Balance, 12/28/02 | \$ 2,123 | \$ 1,162 | \$ 2,351 | \$ 6,032 | \$ 2,844 | \$ 3,552 | \$ 18,064 |
| New accruals: | | | | | | | |
| Lease- related liabilities | 313 | (250) | (230) | (701) | (868) | | (1,736) |
| Cash paid - Severance | | | | (1) | | | (1) |
| Cash paid - Lease- | | | | | | | |

| related liabilities | (133) | (73) | (170) | (494) | (133) | (1,003) |
|------------------------|----------|--------|----------|----------|----------|-----------|
| Balance, | 1 | 1 | 1 | 1 | 1 | 1 |
| 03/29/03 | \$ 2,303 | \$ 839 | \$ 1,951 | \$ 4,836 | \$ 1,843 | \$ 3,552 |
| | | | | | | \$ 15,324 |

¹ The restructuring accrual balance consists of lease-related liabilities.

As of March 29, 2003, the components of the accruals related to the Company's restructuring activities are accrued liabilities (\$4.0 million) and other long-term obligations (\$11.3 million).

11. Income Taxes

The Company has a \$19.3 million net deferred tax asset, primarily as a result of the \$54.9 million of restructuring and asset impairment charges recorded during fiscal 2001. For the three months ended March 29, 2003, the Company recorded \$921,000 of income tax expense, as a result of income before income taxes of \$2.4 million during the period. The recoverability of the net deferred tax asset is primarily dependent upon the Company generating sufficient taxable income in the future. Although realization of the net deferred tax asset is not assured, the Company believes it is more likely than not that the Company will generate sufficient taxable income in the future to realize the full amount of the deferred tax asset. The Company's assessment is based on projections that assume that the Company can maintain its current store contribution margin. Furthermore, the Company expects to maintain the aggregate sales growth experienced over the past five years, which would generate additional taxable income. The primary uncertainty related to the realization of the deferred tax asset is the Company's ability to achieve its four-year business plan and generate future taxable income to realize the full amount of the deferred tax asset. The Company believes that the sales, gross margin, store contribution margin, and selling, general and administrative expenses assumptions in its four-year business plan are reasonable and, more likely than not, attainable. The Company will continue to assess the recoverability of the net deferred tax asset, and to the extent it is determined in the future that a valuation allowance is required, it will be recognized as a charge to earnings at that time.

12. Related Party Transactions

The Company and Perry D. Odak, the Company's Chief Executive Officer and President, and a director of the Board, entered into an employment agreement in March 2001. As part of Mr. Odak's employment agreement, the Company agreed to purchase his home in York, Pennsylvania if he was unable to sell it within a specific period of time. In July 2001, the Company arranged for a relocation service to purchase the home from Mr. Odak for \$1.6 million. Despite substantial marketing efforts, the relocation service was unable to sell the house for a reasonable price. In November 2002, Mr. Odak offered to repurchase the house for the original \$1.6 million he had received. At December 28, 2002, Mr. Odak had remitted \$1.35 million to the Company as partial consideration to fund the purchase and the remaining funds were funded by Mr. Odak's fiscal 2002 bonus of \$250,000 to which he was contractually entitled. On March 6, 2003, the Company remitted the \$1.6 million to the relocation service.

In September 2002, the Company filed suit against Michael Gilliland and Elizabeth Cook, former officers and directors and greater than 5% stockholders of the Company, together with two individuals and three limited liability corporations, for a temporary restraining order and damages related to a breach of Mr. Gilliland's noncompetition covenant, contained in his 1996 employment agreement, arising from the opening of a competitive grocery store in New Mexico.

13. Contingencies

Wild Oats Markets Canada, Inc., as successor to Alfalfa's Canada, Inc., a Canadian subsidiary of the Company, is a defendant in Helen Fakhri and Ady Aylon, as Representative Plaintiffs v. Alfalfa's Canada, Inc., a class action suit brought in the Supreme Court, British Columbia, Canada in October 2002 by representative plaintiffs alleging to represent two classes of plaintiffs - those who contracted Hepatitis A allegedly through the consumption of food purchased at a Capers Community Market in the spring of 2002, and those who were inoculated against Hepatitis A as a result of news alerts by Capers and the Vancouver Health Authority. In April 2003, the plaintiffs filed a motion for certification of the litigation as a class action lawsuit. The Company intends to vigorously defend both class certification and the suit itself. The Company is not able to estimate the potential outcome of the suit at this time.

The Company also is named as defendant in various actions and proceedings arising in the normal course of business. In all of these cases, the Company is denying the allegations and is vigorously defending against them and, in some cases, has filed counterclaims. Although the eventual outcome of the various lawsuits cannot be predicted, it is management's opinion that these lawsuits will not result in liabilities that would materially affect the Company's consolidated results of operations, financial position, or cash flows.

During the normal course of its business, the Company has made certain indemnities under which it may be required to make payments in relation to certain transactions. These indemnities include indemnities to the Company's landlords for losses arising from the Company's use and occupation of leased premises and indemnities to directors and officers of the Company to the maximum extent permitted by the laws of the State of Delaware. The duration of these indemnities varies, and in certain cases, is indefinite. In addition, the majority of these indemnities do not provide for any limitation of the maximum potential future payments the Company would be obligated to make. As such, the Company is unable to estimate with any reasonableness its potential exposure under the indemnities. The Company has not recorded any liability for the indemnities in the accompanying consolidated balance sheets. The Company does, however, accrue for losses for any known contingent liability, including those that may arise from indemnification provisions, when future payment is both reasonably determinable and probable. The Company carries specific and general liability insurance policies, which the Company believes would provide, in most circumstances, some, if not total, recourse to any claims arising from these indemnifications.

Item 2. Management's Discussion And Analysis Of Financial Condition And Results Of Operations

This report on Form 10-Q contains certain forward-looking statements regarding our future results of operations and performance. Important factors that could cause differences in results of operations include, but are not limited to, the timing and execution of new store openings, relocations, remodels, sales and closures; the timing and impact of promotional and advertising campaigns; the impact of competition; changes in product supply or suppliers; changes in management information needs; changes in customer needs and expectations; governmental and regulatory actions; general industry or business trends or events; changes in economic or business conditions in general or affecting the natural foods industry in particular; and competition for and the availability of sites for new stores and potential

acquisition candidates. See *"Management's Discussion and Analysis of Financial Condition and Results of Operations - Cautionary Statement Regarding Forward-Looking Statements."*

Overview

Marketing and Merchandising Initiatives and Operational Improvements

. In fiscal 2003, we are implementing or completing programs and controls designed to promote steady growth in value to our stakeholders, including but not limited to:

- centralized buying and pricing
- centralized scale hosting
- centralized back door replenishment
- sku rationalization and new item introductions
- validated asset tracking
- resetting, remerchandising and remodeling our stores
- increased staff training and product demonstrations

We have begun executing on our real estate strategy, and to the date of this report have signed leases or letters of intent for 27 proposed new sites opening in fiscal 2003 and fiscal 2004. In the first quarter of fiscal 2003 and continuing to the date of filing this report on Form 10-Q, we signed 10 new leases; five of which are for stores proposed to open during fiscal 2003, with the remaining five leases for stores scheduled to open in fiscal 2004.

In the first quarter of fiscal 2003, we were named 19th in a list of the 100 best corporate citizens for 2002 in the United States by Business Ethics Magazine.

Store format.

We operate two store formats: the natural foods supermarket and farmers market formats. The natural foods supermarket format store, operated under the Wild Oats(R) Natural Marketplace and Nature's(R) - A Wild Oats Market tradenames, is generally 20,000 to 35,000 gross square feet, and the farmers market store, operated under the Henry's Marketplace(R) and Sun Harvest(TM) tradenames, is generally 15,000 to 25,000 gross square feet. In the first quarter of fiscal 2003, we opened stores using our natural foods supermarket format prototype design in Portland, Maine and Louisville, Kentucky. We have also redesigned the prototype for our farmers market store format, and opened our first prototype store in Costa Mesa, California in the first quarter of fiscal 2003.

Store openings, closings and remodels.

At March 29, 2003, we had 102 stores located in 25 states and Canada, as compared to 102 stores in 23 states and Canada at the end of the first quarter of fiscal 2002. In the first quarter of fiscal 2003, we opened three new stores in Costa Mesa, California, Louisville, Kentucky and Portland, Maine. Subsequent to the first quarter of fiscal 2003, we closed one underperforming store in Los Angeles, California. In fiscal 2003, we have commenced major remodeling and/or major resetting of seven of our stores, four of which were completed in the first quarter of fiscal 2003.

We currently have an inventory of 12 vacant sites comprising closed store and office locations and excess unoccupied space acquired during acquisitions or other leasing transactions, for which we have rent obligations; appropriate accruals have been made for such obligations. In the first quarter of fiscal 2003, we terminated one lease for a vacant site and added excess space adjacent to a new store to the inventory of vacant sites. Subsequent to the first quarter of fiscal 2003, we negotiated the termination of two leases for vacant sites, and added one closed store. We are actively seeking subtenants or assignees for the spaces, although many of the sites are difficult to sublease or assign because of unusual site characteristics, surpluses of vacant retail space in the markets in which the sites are located, or because the remaining lease terms are relatively short.

In February of 2003, we completed a refinancing of \$75.0 million under our existing credit facility with a group of banks led by the lead bank in our former credit facility. The funds available under the credit facility will be used to finance proposed growth of nine to 13 new stores in fiscal 2003, up to 15 to 20 stores in fiscal 2004 and up to 20 to 25 stores in fiscal 2005. See *"Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources."*

Critical Accounting Policies and Estimates

. Our discussion and analysis of the Company's financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates. See our fiscal 2002 Annual Report filed on Form 10-K for the period ended December 28, 2002, for disclosures of critical accounting policies. See also *"Notes to Consolidated Financial Statements - Note 2 - Implementation of New Accounting Pronouncements and Note 3 - New Accounting Pronouncements"* for disclosure of the effect of new accounting pronouncements during the first quarter of fiscal 2003.

Results of Operations

The following table sets forth for the periods indicated, certain selected income statement data expressed as a percentage of sales:

| | THREE MONTHS ENDED | |
|--|--------------------|----------------|
| | March 29, 2003 | March 30, 2002 |
| Sales | 100.0% | 100.0% |
| Cost of goods sold and occupancy costs | 70.0 | 71.0 |
| Gross margin | 30.0 | 29.0 |
| Direct store expenses | 21.6 | 21.6 |
| Loss (gain) on disposal of assets | 0.6 | (0.0) |
| Selling, general and administrative expenses | 6.8 | 6.1 |
| Pre-opening expenses | 0.3 | 0.1 |
| Restructuring and asset impairment charges | (0.7) | (0.3) |
| Income from operations | 1.4 | 1.5 |
| Interest income | (0.1) | (0.1) |
| Interest expense | 0.4 | 1.1 |
| Loss on early extinguishment of debt | 0.1 | |
| Income before income taxes | 1.0 | 0.5 |
| Income tax expense | 0.4 | 0.2 |
| Net income | 0.6% | 0.3% |

Sales.

Sales for the three months ended March 29, 2003, increased 1.3% to \$236.0 million from \$233.0 million in the same period in fiscal 2002. The year-to-date increase was primarily attributed to four new store openings. Comparable store sales were negative 0.9% for the first quarter of fiscal 2003, as compared to a positive 7.3% in the first quarter of fiscal 2002, due to continued disruptions in operations resulting from our SKU rationalization program, distributor transition, and out-of-stocks in private label products as we phase into a new private label program, as well as a continued weakening in the economy, a shift of the Easter holiday from the first quarter of fiscal 2002 to the second quarter of fiscal 2003, adverse weather conditions, including a record-setting blizzard affecting more than 10% of our store base that contribute over 20% of our total sales, and road construction adjacent to a number of our stores.

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Gross Profit.

Gross profit for the three months ended March 29, 2003 increased 4.8% to \$70.9 million from \$67.6 million in the same period in fiscal 2002. As a percentage of sales, gross profit increased to 30.0% in the first quarter of fiscal 2003 from 29.0% in the same period in fiscal 2002 due primarily to price optimization, improved procurement and shrink reduction strategies.

Direct Store Expenses.

Direct store expenses for the three months ended March 29, 2003 increased 0.8% to \$50.9 million from \$50.5 million in the same period in fiscal 2002. As a percentage of sales, direct store expenses remained constant at 21.6% in the first quarter of fiscal 2003 compared to the same period in fiscal 2002 as a result of consistent execution of operational improvements.

Loss (Gain) on Disposal of Assets.

Loss (gain) on disposal of assets for the three months ended March 29, 2003 increased to a \$1.5 million loss from a \$57,000 gain in the same period in fiscal 2002. As a result of the significant store closings, remodels and resets, we undertook a physical inventory of all fixtures and equipment in our stores, in conjunction with an asset tagging exercise. During the first quarter of fiscal 2003, we substantially completed the physical inventory and recorded a \$1.5 million loss on disposal of fixtures and equipment (approximately 1.2% of our fixed assets carrying value) that we will no longer use in our stores.

Selling, General and Administrative Expenses.

Selling, general and administrative expenses for the three months ended March 29, 2003 increased 12.7% to \$16.0 million from \$14.2 million in the same period in fiscal 2002. As a percentage of sales, selling, general and administrative expenses increased to 6.8% in the first quarter of fiscal 2003 from 6.1% in the same period in fiscal 2002. The increases are attributable to the addition of employees and associated expenses as we prepare for future growth.

Pre-Opening Expenses.

Pre-opening expenses for the three months ended March 29, 2003, increased to \$922,000 compared to \$368,000 during the same period in fiscal 2002. As a percentage of sales, pre-opening expenses increased to 0.3% in the first quarter of fiscal 2003 from 0.1% in the same period in fiscal 2002, due to the opening of three new stores in the first quarter of fiscal 2003 as compared to the anticipated opening of one new store in the second quarter of fiscal 2002.

Restructuring and Asset Impairment Income.

During the first quarter of fiscal 2003, we recorded restructuring income of \$1.7 million. Details of the significant components are as follows:

- *Change in estimate related to lease-related liabilities for sites previously identified for closure or sale that were closed, sold or disposed of during the first quarter of fiscal 2003 (\$0.4 million of restructuring income) -*

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During the first quarter of fiscal 2003, we completed payment obligations under a lease for a site located in West Hartford, Connecticut and under lease termination agreements for sites located in West Hollywood, California and Kansas City, Missouri. We also closed a Colorado commissary facility after weather-related structural damage rendered the facility untenable. Based on these facts and circumstances, we reversed the remaining lease-related liabilities previously recorded for these locations and therefore recognized restructuring income of \$0.4 million during the first quarter of fiscal 2003.

- *Change in estimate related to lease-related liabilities for sites previously identified for closure or sale (\$1.3 million of restructuring income)*

- During the first quarter of fiscal 2003, we reviewed the viability of a subtenant in Fort Collins, Colorado and determined the subtenant's business stability supported reversal of the remaining reserves of \$0.6 million. Subsequent to the first quarter of fiscal 2003, we negotiated the early termination of leases in Cleveland, Ohio and Santa Fe, New Mexico with payment obligations to terminate in the second and fourth quarters of fiscal 2003, respectively. The settlements were for less than previously estimated and accrued, and \$1.0 million was reversed to income. Offsetting this income, we recorded a charge of \$0.3 million for the difference between the terms of a new signed sublease for a closed location in Hartford, Connecticut, and the terms of the prior sublease for the same location under which the prior subtenant had defaulted. Based on these changes in facts and circumstances and the related changes in estimates, we adjusted or reversed the remaining lease-related liabilities previously recorded for these locations and recognized net restructuring income of \$1.3 million during the first quarter of fiscal 2003.

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Interest Income

. Interest income for the three months ended March 29, 2003 decreased 2.2% to \$176,000 from \$180,000 for the same period in fiscal 2002, as a result of a lower level of daily invested funds.

Interest Expense.

Interest expense for the three months ended March 29, 2003 decreased 59.2% to \$1.0 million from \$2.4 million in the same period in fiscal 2002, due to decreased borrowings during the three-month period. Due to the current state of the U.S. economy, management believes that the variable interest rates will remain constant during the next six to 12 months. See *"Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources"* below.

Loss on Early Extinguishment of Debt

. Loss on early extinguishment of debt for the three months ended March 29, 2003 was \$186,000 due to the refinancing of the credit facility, which required the write-off of the unamortized debt costs associated with the old facility.

Income Tax Expense.

For the three months ended March 29, 2003, we recorded \$921,000 of income tax expense, as a result of income before income taxes of \$2.4 million during the period. Our effective tax rate on income from continuing operations will be in the range of 38.5% to 40.0% for fiscal 2003. See *"Management's Discussion and Analysis of Financial Conditions and Results of Operations - Liquidity and Capital Resources"* below.

Liquidity and Capital Resources

Our primary sources of capital have been cash flow from operations (which includes trade payables), bank indebtedness, and the sale of equity securities. Primary uses of cash have been the financing of new store development, new store openings, relocations, remodels and acquisitions and repayment of debt.

Net cash provided by operating activities was \$10.5 million during the first three months of fiscal 2003 as compared to \$13.7 million during the same period in fiscal 2002. Cash from operating activities decreased during this period primarily due to changes in working capital items, primarily inventory. We have not required significant external

financing to support inventory requirements at our existing and new stores because we have been able to rely on vendor financing for most of the inventory costs, and we anticipate that vendor financing will continue to be available for new store openings.

Net cash used in investing activities was \$6.6 million during the first three months of fiscal 2003 as compared to \$2.7 million during the same period in fiscal 2002. The increase is due to an increase in capital expenditures for new stores and remodels.

Net cash used in financing activities was \$4.6 million during the first three months of fiscal 2003 as compared to \$15.6 million during the same period in fiscal 2002. The decrease reflects lower debt repayments due to an increase in capital expenditures and a decrease in cash flow from operations.

We have a net deferred tax asset of \$19.3 million on our balance sheet, primarily as a result of \$54.9 million of restructuring and asset impairment charges recorded during fiscal 2001. The net deferred tax asset will reduce cash required for payment of federal and state income taxes, as we believe we will generate sufficient taxable income for realization of the asset in the future. The recoverability of the net deferred tax asset is primarily dependent upon the Company generating sufficient taxable income in the future. Although realization of the net deferred tax asset is not assured, we believe it is more likely than not that the Company will generate sufficient taxable income in the future to realize the full amount of the deferred tax asset. Our assessment is based on projections that assume that the Company can maintain its current store contribution margin. Furthermore, we expect to maintain the sales growth experienced over the past five years that would generate additional taxable income. The primary uncertainty related to the realization of the deferred tax asset is the Company's ability to achieve its four-year business plan and generate future taxable income to realize the full amount of the deferred tax asset. We believe that the sales, gross margin, store contribution margin, and selling, general and administrative expenses assumptions in our four-year business plan are reasonable and, more likely than not, attainable. We will continue to assess the recoverability of the net deferred tax asset and to the extent it is determined in the future that a valuation allowance is required, it will be recognized as a charge to earnings at that time.

Refinancing of Credit Facility.

On February 26, 2003, we completed the refinancing of our credit facility with Wells Fargo Bank N.A., our former administrative agent, again acting as lead bank and administrative agent. Our new facility has a \$75.0 million limit, which we believe to be adequate for our current borrowing needs, with a three-year term with a one-year renewal option. Under the new facility, we have the option to increase the total facility to \$135.0 million through the addition of new lenders and through the agreement of the current lending group to increase their total commitments. Outstanding borrowings under the new facility were approximately \$38.9 million as of March 29, 2003.

As part of the new facility, we have given our lenders collateral in the form of cash, equipment and fixtures, inventory and other assets. We have also granted leasehold mortgages in those leasehold interests previously mortgaged to secure our former credit facility, although we have no obligation to provide an interest in any new leaseholds. The new facility contains limitations on capital expenditures and the signing of new leases, although we believe such limitations will not restrict our announced growth plans of nine to 13 stores in fiscal 2003, up to 15 to 20 stores in fiscal 2004 and up to 20 to 25 stores in fiscal 2005. The interest rate on the facility is currently either prime plus 1.0% or one-month LIBOR plus 2.25% at our election, and the rates modify depending on the ratio of average total funded debt, as defined under the credit facility, plus six times rent expense, to EBITDAR for the four fiscal quarter periods then ended, as calculated on our quarterly compliance certificate. Additionally, we are charged a commitment fee on the unused portion of the line ranging from 0.25% to 0.5% based on performance objectives as defined in the credit agreement. We believe that cash generated from operations and available under our credit facility will be sufficient to

meet our capital expenditure requirements in fiscal 2003.

Capital Expenditures

. We spent approximately \$6.6 million during the first three months of fiscal 2003 for new store construction, development, remodels and other capital expenditures, exclusive of acquisitions. Our average capital expenditures to open a leased store, including leasehold improvements, equipment and fixtures, have ranged from approximately \$2.0 million to \$5.0 million historically, excluding inventory costs and initial operating losses. We anticipate that the average capital expenditures to open a natural foods supermarket format store will be \$2.5 million to \$3.0 million in the future; however, our ability to negotiate turnkey leases in the future will result in substantially lower capital expenditure per store, in return for a slightly higher rent rate over the lease term. Our average capital expenditures to open a farmers market format store are estimated at \$1.5 million to \$2.0 million in the future. Delays in opening new stores may result in increased capital expenditures and increased pre-opening costs for the site, as well as lower than planned sales for the Company.

The cost of initial inventory for a new store is approximately \$300,000 to \$600,000 depending on the store format; however, we obtain vendor financing for most of this cost. Pre-opening costs for natural foods supermarket format stores currently are between \$400,000 and \$500,000 per store, and pre-opening costs for farmers market format stores are between \$200,000 and \$300,000, and are expensed as incurred. The amounts and timing of such pre-opening costs will depend upon the availability of new store sites and other factors, including the location of the store and whether it is in a new or existing market for us, the size of the store, and the required build-out at the site.

Cautionary Statement Regarding Forward-Looking Statements

This Report on Form 10-Q contains "forward-looking statements," within the meaning of the Private Securities Litigation Reform Act of 1995, which involve known and unknown risks. Such forward-looking statements include statements as to the Company's plans to open, acquire or relocate additional stores; the anticipated performance of such stores; the impact of competition and current economic uncertainty; the sufficiency of funds to satisfy the Company's cash requirements through the remainder of fiscal 2003, our expectations for comparable store sales; the impact of changes resulting from our merchandising, advertising and pricing programs; expected pre-opening expenses and capital expenditures; and other statements

containing words such as "believes," "anticipates," "estimates," "expects," "may," "intends" and words of similar import or statements of management's opinion. These forward-looking statements and assumptions involve known and unknown risks, uncertainties and other factors that may cause the actual results, market performance or achievements of the Company to differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. Important factors that could cause differences in results of operations include, but are not limited to, the timing and execution of new store openings, relocations, remodels, sales and closures; the impact of competition; changes in product supply or suppliers and supplier performance levels; changes in management information needs; changes in customer needs and expectations; governmental and regulatory actions; general industry or business trends or events; changes in economic or business conditions in general or affecting the natural foods industry in particular; and competition for and the availability of sites for new stores and potential acquisition candidates. The Company undertakes no obligation to update any forward-looking statements in order to reflect events or circumstances that may arise after the date of this Report.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

In the normal course of business, the Company is exposed to fluctuations in interest rates and the value of foreign currency. The Company employs various financial instruments to manage certain exposures when practical.

The Company is exposed to foreign currency exchange risk. The Company owns and operates three natural foods supermarkets and a commissary kitchen in British Columbia, Canada. The commissary supports the three Canadian stores and does not independently generate sales revenue. Sales made from the Canadian stores are made in exchange for Canadian dollars. To the extent that those revenues are repatriated to the United States, the amounts repatriated are subject to the exchange rate fluctuations between the two currencies. The Company does not hedge against this risk because of the small amounts of funds at risk.

The Company's exposure to interest rate changes is primarily related to its variable rate debt issued under its credit facility. On February 26, 2003, the Company refinanced the credit facility and reduced the total commitment available to a \$75.0 million revolving line of credit, with a three-year term expiring February 25, 2006. The interest rate on the amended facility is currently either prime plus 1.0% or one-month LIBOR plus 2.25%, at our election, and the rates modify depending on the ratio of average total funded debt, as defined under the credit facility, plus six times rent expense, to EBITDAR for the four fiscal quarter periods then ended, as calculated on our quarterly compliance certificate. Because the interest rate on the facility is variable, based upon the prime rate or LIBOR, the Company's interest expense and net income are affected by interest rate fluctuations. If interest rates were to increase or decrease by 100 basis points, the result, based upon the existing outstanding non-hedged variable rate debt as of March 29, 2003, would be an annual increase or decrease of approximately \$89,000 in interest expense and a corresponding decrease or increase of approximately \$54,000 in the Company's net income after taxes.

In September 2000, as required by the Company's former credit facility, the Company entered into an interest rate swap to hedge its exposure on variable rate debt positions. Variable rates are predominantly linked to LIBOR as determined by one-month intervals. The interest rate provided by the swap fixed one-month LIBOR at 6.7%. At March 29, 2003, the notional principal amount of the interest rate swap agreement was \$30.0 million, expiring in August 2003. There is no obligation to renew the swap under the refinanced facility. The notional amount is the amount used for the calculation of interest payments that are exchanged over the life of the swap transaction on the amortized principal balance. In the first quarter of fiscal 2003, the loss, net of taxes, included in other comprehensive income for this cash flow hedge was approximately \$272,000.

Item 4. Controls and Procedures

We maintain a system of controls and procedures designed to provide reasonable assurance as to the reliability of the financial statements and other disclosures included in this report, as well as to safeguard assets from unauthorized use or disposition. We evaluated the effectiveness of the design and operation of our disclosure controls and procedures under supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, within 90 days prior to the filing date of this report. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information required to be included in our periodic Securities and Exchange Commission filings. No significant changes were made to our internal controls or other factors that could significantly affect these controls subsequent to the date of their evaluation.

Part II. OTHER INFORMATION

Item 1. Legal Proceedings

Wild Oats Markets Canada, Inc., as successor to Alfalfa's Canada, Inc., a Canadian subsidiary of the Company, is a defendant in Helen Fakhri and Ady Aylon, as Representative Plaintiffs v. Alfalfa's Canada, Inc., a class action suit brought in the Supreme Court, British Columbia, Canada in October 2002 by representative plaintiffs alleging to represent two classes of plaintiffs - those who contracted Hepatitis A allegedly through the consumption of food purchased at a Capers Community Market in the spring of 2002, and those who were inoculated against Hepatitis A as a result of news alerts by Capers and the Vancouver Health Authority. In April 2003, the plaintiffs filed for certification of the suit as a class action lawsuit. The Company intends to vigorously defend both class certification and the suit itself. The Company is not able to estimate the potential outcome of the suit at this time.

The Company also is named as defendant in various actions and proceedings arising in the normal course of business. In all of these cases, the Company is denying the allegations and is vigorously defending against them and, in some cases, has filed counterclaims. Although the eventual outcome of the various lawsuits cannot be predicted, it is management's opinion that these lawsuits will not result in liabilities that would materially affect the Company's consolidated results of operations, financial position, or cash flows.

Item 2. Changes in Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

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

Not applicable.

Item 5. Other Information

The Audit Committee of the Board of Directors pre-approves all non-audit services provided by the Company's independent accountants, PricewaterhouseCoopers LLP. The aggregate fees billed for non-audit services rendered for the first quarter of fiscal 2003 were \$16,000, for tax services.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

Exhibit 10.1 Second Amended and Restated Credit Agreement dated as of February 26, 2002, among Registrant, the lenders named therein and Wells Fargo Bank National Association, as Administrative Agent. Portions have been omitted pursuant to a request for confidential treatment. Incorporated by reference from the Registrant's Form 10-K filed for the year ended December 29, 2002 (File No. 0-21577).

Exhibit 99.1 - CEO Certification

Exhibit 99.2 - CFO Certification

(b) Reports on Form 8-K:

- (1) Report dated February 3, 2003 on Form 8-K, reported under Item 5, "Other Events," announcing change in Board membership.
- (2) Report dated February 26, 2003 on Form 8-K, reported under Item 5, "Other Events," announcing fourth quarter 2002 and fiscal 2002 financial results.
- (3) Report dated May 9, 2003 on Form 8-K, reported under Item 5, "Other Events," announcing addition of Board member.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Boulder, County of Boulder, State of Colorado, on the 13th day of May, 2003.

Wild Oats Markets, Inc.
(Registrant)
By: /s/ Edward F. Dunlap
Edward F. Dunlap
Executive Officer and Chief Financial Officer
(Principal Financial and Accounting Officer)

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CERTIFICATION OF CEO

Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Perry D. Odak, Chief Executive Officer of Wild Oats Markets, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Wild Oats Markets, Inc. (the "Registrant");
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations

- and cash flows of the Registrant as of, and for, the periods presented in this quarterly report;
4. The Registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the Registrant and have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the Registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
 5. The Registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the Registrant's auditors and the audit committee of Registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the Registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls;
 6. The Registrant's other certifying officers and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 13, 2003

/s/ Perry D. Odak

Perry D. Odak, Chief Executive Officer

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CERTIFICATION OF CFO

Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

- I, Edward F. Dunlap, Chief Financial Officer of Wild Oats Markets, Inc., certify that:
1. I have reviewed this quarterly report on Form 10-Q of Wild Oats Markets, Inc. (the "Registrant");
 2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
 3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations

- and cash flows of the Registrant as of, and for, the periods presented in this quarterly report;
4. The Registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the Registrant and have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the Registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
 5. The Registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the Registrant's auditors and the audit committee of Registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the Registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls;
 6. The Registrant's other certifying officers and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 13, 2003

/s/ Edward F. Dunlap

Edward F. Dunlap, Chief Financial Officer