

PROVENA FOODS INC  
Form 10-K  
March 10, 2003  
Table of Contents

---

**SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

**Form 10-K**

---

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

---

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2002

Commission File Number 1-10741

**PROVENA FOODS INC.**

(Exact name of registrant as specified in its charter)

California

95-2782215

---

(State or other jurisdiction of incorporation or organization)

---

(I.R.S. employer identification number)

---

5010 Eucalyptus Avenue, Chino, California

---

91710

---

(Address of principal executive offices)

---

(ZIP Code)

(909) 627-1082

---

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the act:

---

Title of each class

---

Name of each exchange on which registered

---

COMMON STOCK

---

AMERICAN STOCK EXCHANGE

Securities registered pursuant to Section 12(g) of the act: None

---

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 No  
x o

The aggregate market value of Provena Foods Inc. Common Stock held by non-affiliates as of February 22, 2003 was \$3,631,942.

## Edgar Filing: PROVENA FOODS INC - Form 10-K

The number of shares of Provena Foods Inc. Common Stock outstanding on February 22, 2003 was 3,158,210.

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in any definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.  x

---

**Table of Contents**

**PROVENA FOODS INC.**

2002 FORM 10-K ANNUAL REPORT

Table of Contents

<u>Item</u>		<u>Page</u>
<u>PART I</u>		
1.	<u>Business</u>	1
2.	<u>Properties</u>	4
3.	<u>Legal Proceedings</u>	4
4.	<u>Submission of Matters to a Vote of Security Holders</u>	4
<u>PART II</u>		
5.	<u>Market for the Registrant's Common Stock and Related Stockholder Matters</u>	5
6.	<u>Selected Financial Data</u>	7
7.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	8
7A.	<u>Quantitative and Qualitative Disclosure About Market Risk</u>	11
8.	<u>Financial Statements and Supplementary Data</u>	11
9.	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	11
<u>PART III</u>		
10.	<u>Directors and Executive Officers of the Registrant</u>	12
11.	<u>Executive Compensation</u>	12
12.	<u>Security Ownership of Certain Beneficial Owners and Management</u>	14
13.	<u>Certain Relationships and Related Transactions</u>	14
14.	<u>Disclosure Controls and Procedures</u>	14
<u>PART IV</u>		
15.	<u>Exhibits, Financial Statement Schedules, and Reports on Form 8-K</u>	15
<hr/>		
	<u>Signatures</u>	16

Section 302 Certifications

-ii-

---

**Table of Contents**

**PART I**

**ITEM 1. BUSINESS**

**General**

Provena Foods Inc. (the Company) is a California-based specialty food processor engaged in the supply of food products to other food processors, distributors and canners. Its primary products are pepperoni and Italian-style sausage sold to frozen pizza processors, pizza restaurant chains and food distributors and dry pasta sold to food processors and canners, private label producers and food distributors. The Company's products are sold throughout the United States but primarily in the Western United States.

The Company's meat processing business is conducted through the Swiss American Sausage Co. Division (Swiss American or Swiss), and its pasta business is conducted through the Royal-Angelus Macaroni Company Division (Royal-Angelus or Royal). The Company acquired its present businesses between 1972 and 1975. The predecessor of Swiss was founded in 1922 and the two predecessors to Royal, Royal Macaroni Company and Angelus Macaroni Mfg. Co., were founded in 1878 and 1946, respectively. The Company was incorporated in 1972 in California with an initial capitalization of approximately \$12,000.

The Company's competitive strategy is to emphasize providing products of predictable quality and consistency at competitive prices as well as prompt and reliable service. The Company attempts to establish, refine and maintain procedures to assure that the Company's products comply with its customers' specifications and are delivered in a manner that will satisfy their delivery and production requirements.

For financial information about each of the Company's two divisions, see the segment data contained in Note 12 of Notes to Financial Statements.

**Swiss American Sausage Co. Meat Division**

During the years ended December 31, 2002 and 2001, sales by Swiss accounted for 85.07% and 84.18%, respectively, of the Company's net sales. Swiss's slightly higher proportion of Company sales in 2002 resulted from a modest increase in sales at Swiss and essentially flat sales at Royal. The Company's processed meat products are sold primarily to pizza restaurant chains, pizza processors and food service distributors. Pizza processors produce prepared pizza which is sold primarily as frozen pizza in food markets. Food service distributors supply food to delicatessens, restaurants and other retail businesses offering prepared food. The Company's meat products are sold nationally, but most of its sales are made to customers located in the Western United States. The Company also sells processed meat products to the U. S. Government. The Company does not have supply agreements with its major customers, many of whom purchase some of their meat products from other suppliers.

Swiss competes with numerous producers of processed meats, many of which are larger and have greater financial resources than the Company. Swiss's competitors include large national meat packers such as Hormel Foods Corporation, as well as smaller regional meat processors. Pizza processors that manufacture their own meat products diminish the market for Swiss's products. The Company competes in the meat processing business by emphasizing predictable quality and consistency.

The meat processing activities of the Company are conducted at its meat plant in Lathrop, California. The meat plant has an estimated theoretical production capacity of 46,000,000 pounds per year. The Company also owns 2 acres of land adjacent to the plant to ensure a capability of expansion. See **ITEM 2. PROPERTIES.**

The meat processing activities of Swiss are typified by its processing of pepperoni, its principal product, which consists of the following steps: (i) the purchase of beef and pork trimmings with a guaranteed lean content; (ii) the blending of the meat into the Company's meat product while carefully controlling the consistency and content of the product; (iii) the addition of spices and preservatives to the product; (iv) the extrusion of the product into sausage casings; (v) the oven cooking of the product in the casings; and (vi) the drying of the cooked product. Throughout the production process, the Company subjects its meat products to quality control inspection for the purposes of satisfying U.S. Department of Agriculture regulations, meeting customer specifications and assuring a consistent quality of the products to the Company's customers.

---

## Table of Contents

In addition to pepperoni and sausage, the Company processes moderate amounts of other meat products, including meatballs, breaded meat patties and crumbles. Crumbles are quick-frozen nuggets of a pre-cooked meat product, such as the sausage on a sausage pizza. The crumbles line extrudes the ground and blended ingredients into nuggets which are cooked and quick-frozen in one continuous operation. Breaded meat patties are produced on a line added in 2002, which forms, breads and cooks the patties.

### Royal-Angelus Macaroni Company Pasta Division

During the years ended December 31, 2002 and 2001, sales by Royal-Angelus accounted for 14.93% and 15.82%, respectively, of the Company's net sales. Royal's lower proportion of Company sales in 2002 resulted from increased sales at Swiss and basically unchanged sales at Royal. The Company sells its pasta products primarily to food processors and canners, private label customers, food service distributors, and specialty food distributors.

Royal's food processor and canner customers use the Company's pasta to produce retail products in which pasta is an ingredient, such as pasta salads, soups and entrees. Royal's private label customers are regional and national food suppliers that sell pasta under their own labels, purchased in bulk from the Company or packaged by the Company. Royal's food service distributor customers supply pasta to restaurants, institutional purchasers, and some retail establishments. The Company also sells its pasta products to government agencies, the military, schools and other pasta manufacturers.

The Company's pasta products are produced at its production plant in Chino, California. The Company also owns a building adjacent to the pasta plant and currently occupies 40% of the building as part of its pasta plant and leases 60% to a tenant through February 2003. An extension of the lease is currently being negotiated. The pasta plant has a theoretical production capacity estimated at 30,000,000 pounds per year.

In the basic pasta production process, durum semolina flour is mixed with water and the mixture is extruded into one of many shapes, cut to the proper length, dried, packaged and shipped to the Company's customers. If required by the particular variety of pasta, a different flour is used or flour is blended with egg powder, vegetable powder or other ingredients before the water is added. No preservatives are used in making pasta.

Royal-Angelus competes with several national and regional pasta manufacturers, many of which have greater financial resources than the Company. The Company competes in the pasta business by emphasizing predictable quality and consistency and by its capability of producing a larger variety of pastas with shorter lead times and production runs than most of its larger competitors.

### Suppliers

The primary ingredients used by the Company in processed meat products are beef, pork, spices and casings and in pasta products are flour, egg powder and vegetable powder. The ingredients are purchased from suppliers at prevailing market prices. The Company has not recently experienced any shortages in the supply of ingredients and generally expects the ingredients to continue to be available for the foreseeable future.

### Patents, Trademarks and Licenses

The Company owns no patents. It owns the United States registered trademarks Royal with the crown design, Vegeroni and Fortune for use on pasta products and licenses from the Del Monte Company until 2009 the United States registered trademark Capo di Monte for use on meat products. Registrations of the trademarks owned by the Company must be and are renewed from time to time. These trademarks are used primarily on products intended for processors and restaurant chains rather than consumers. No substantial portion of the Company's sales is dependent upon any Company trademark.

### Commodity Price Fluctuations and Availability

The Company contracts to sell its products at a fixed price for production and delivery in the future (generally four to six months or less). The Company is, therefore, subject to the risk of price fluctuations with respect to its product ingredients from the time the Company contracts with its customers until the time the Company purchases the commodities used to fill the orders. Prices for meat and flour, the Company's major product ingredients, fluctuate widely based upon supply, market speculation, governmental trade and agricultural policies, and other unpredictable factors.

**Table of Contents**

The Company is able to contract at fixed prices for delivery of domestic beef and pork up to 30 days in advance, imported beef and sometimes pork up to 90 days in advance, and flour up to 90 days or more in advance. The Company generally covers its committed sales by purchasing commodities at fixed prices for future delivery, but is subject to the risk of commodity price fluctuations when it contracts for sales beyond the period it can cover or when it orders commodities in anticipation of sales.

**Effects of Inflation**

It is the Company's general policy, subject to current competitive conditions, to pass on increases in costs of commodities used in production by increasing prices of the products it sells to its customers. However, because the Company agrees on the price of its products to its customers in advance of purchasing the product ingredients, there may be a delay in passing on increasing commodity costs to customers, temporarily decreasing profit margins. Competitive conditions may limit the Company's ability to pass on commodity price increases to its customers, prolonging or increasing the adverse effect on profit margins.

**Marketing and Distribution**

The Company's processed meat and pasta products have been marketed primarily by the Company's management personnel, food brokers, and four full-time salaried sales people. Because the Company sells most of its processed meat and pasta products to customers who either further process the products before they reach the consumer or sell the products under private labels, the Company does not advertise its products in a manner designed to reach the ultimate consumer.

**Dependency on a Limited Number of Large Customers**

A substantial portion of the Company's net sales has in recent years resulted from sales to a few customers. See Note 12 of Notes to Financial Statements. The Company does not enter into continuing sales contracts with its customers, and has different major customers from time to time. The following table shows, by division and for the Company, the percentage of sales represented by the Company's largest customers for the year ended December 31, 2002:

<u>Division</u>	<u>Number of Customers</u>	<u>Division Sales%</u>	<u>Company Sales%</u>
Swiss American	3	44%	38%
Royal-Angelus	1	10%	2%
Totals	4		40%

The Company fills orders as they are received from its customers, normally within a few weeks or less, and does not have a meaningful backlog of orders for its products. The Company carries significant inventories of its products for only a few major customers, and does not provide extended payment terms to customers.

**Food Industry Risks**

The business of the Company is subject to the risks inherent in the food industry, including the risk that a food product or ingredient may be banned or its use limited or declared unhealthful, that product tampering or contamination will require a recall or reduce sales of a product, or that a product's acceptability will diminish because of generally perceived health concerns or changes in consumer tastes.

**Employees**

As of December 31, 2002, the Company employed 216 full-time employees, 156 in production at Swiss in Lathrop, California, 44 in production at Royal-Angelus in Chino, California, 7 in clerical and office functions, 4 in sales activities, and 5 in management activities.

---

## **Table of Contents**

Swiss's plant employees are represented by the United Food and Commercial Workers Union, Local 588, AFL-CIO, CLC under a collective bargaining agreement dated April 1, 2002 which expires April 2, 2006. Royal's plant employees are represented by United Food and Commercial Workers Union, Local 1428, AFL-CIO, CLC under a collective bargaining agreement dated October 2, 2002 which expires September 30, 2006. There has been no significant labor unrest at the division's plants and the Company believes it has a satisfactory relationship with its employees.

### **Health Benefits**

The Company provides health insurance benefits to all of its employees and their dependents. Its union employees are covered by a union-sponsored health insurance plan and the Company pays for a group health insurance plan for its non-union employees.

### **Regulation**

Food products purchased, processed and sold by the Company are subject to various federal, state and local laws and regulations, including the federal Meat Inspection Act and the Federal Food, Drug and Cosmetic Act. Since January 25, 1999, the Company has complied with the U. S. Department of Agriculture's Hazardous and Analysis Critical Control Points Program which enables the Company to self-inspect its meat products and production conditions and techniques. As required by law, U.S. Department of Agriculture employees visit the Company's plant to inspect meat products processed by the Company and to review the Company's compliance with the program. The Company is also subject to various federal, state and local regulations regarding workplace health and safety, environmental protection, equal employment opportunity and other matters. The Company maintains quality control departments at both its Lathrop and Chino facilities for purposes of testing product ingredients and finished products to ensure the production of products of predictable quality and consistency, as well as compliance with applicable regulations and standards.

## **ITEM 2. PROPERTIES**

The Company's meat processing plant is an approximately 85,000 square foot facility located in Lathrop, California, constructed by the Company in 1999. The estimated theoretical production capacity of the meat plant is 46,000,000 pounds per year. The Company purchased an additional 2 acres of land adjacent to the new plant in 1999 to ensure a capability of expansion.

The Company's pasta production plant is an approximately 41,000 square foot facility located in Chino, California, occupied by the Company since 1987. In 1995, the Company purchased an approximately 44,000 square foot building adjacent to the pasta plant and currently occupies 40% of the building for pasta warehousing and leases 60% to a cold storage manufacturer through February 2003. An extension of the lease is currently being negotiated. The Chino plant has a theoretical production capacity estimated at 30,000,000 pounds annually.

## **ITEM 3. LEGAL PROCEEDINGS**

The Company, from time to time, is involved in routine claims and litigation incidental to its business. Management believes that none will have a material adverse effect on the Company's business, financial condition or liquidity.

## **ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

The Company held its annual meeting of shareholders on Tuesday, April 30, 2002, at 11:00 a.m. at the Company's principal office. Shareholders representing 2,393,696 or 77.5% of the 3,089,516 shares entitled to vote were present in person or by proxy, with 23,942 broker non-votes. The following persons were nominated and elected directors, with votes for, withheld from specified nominees, or without authority to vote for directors, as indicated:



**Table of Contents**

Nominee	For	Withheld	Without Authority
John D. Determan	2,388,696	-0-	5,000
Theodore L. Arena	2,388,696	-0-	5,000
Ronald A. Provera	2,387,096	1,600	5,000
Santo Zito	2,387,096	1,600	5,000
Thomas J. Mulroney	2,388,696	-0-	5,000
Louis A. Arena	2,388,696	-0-	5,000
Joseph W. Wolbers	2,387,096	1,600	5,000
John M. Boukather	2,388,696	-0-	5,000

**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS**

The Company's common stock is traded on the American Stock Exchange under the symbol PZA. The following table sets forth high and low prices as traded on the American Stock Exchange:

		Quarter of Fiscal Year Ended December 31			
		First	Second	Third	Fourth
2001	High	2.00	2.00	2.20	1.88
	Low	1.63	1.74	1.75	1.42
2002	High	1.60	1.75	1.45	1.39
	Low	1.00	1.22	1.05	1.00

The closing price on December 31, 2002 was \$1.22.

**Common Stock**

The Company's Articles of Incorporation as amended authorize the Company to issue up to 10,000,000 shares of common stock, without par value. The Company is not authorized to issue any class or series of shares except shares of common stock. At December 31, 2002 the Company had issued and outstanding 3,147,087 shares held by approximately 240 shareholders of record. In addition, the Company estimates that there are approximately 800 shareholders holding shares in street or nominee names.

Holder of the Company's common stock are entitled to receive such dividends as may be declared by the Board of Directors out of funds legally available therefor. The Company commenced paying quarterly cash dividends in March 1988 and paid a dividend every quarter through the second quarter of 2001. A covenant under the Company's credit facility with Comerica Bank-California limits quarterly dividends to quarterly earnings. The declaration and timing of future dividends, if any, will depend on the Company's financial condition and results of operations, compliance with the bank covenant and other factors deemed relevant by the Board.

All outstanding shares of common stock are fully paid and nonassessable and are not subject to redemption. Holders of common stock are entitled to one vote for each share held of record and have cumulative voting rights in the election of directors. Holders of common stock do not have preemptive rights and have no right to convert their shares into any other security. Upon liquidation of the Company, the holders of common stock would share ratably in all assets of the Company after the payment of all liabilities.

Shareholder communications regarding transfers, changes of address, missing dividends, lost certificates or similar matters should be directed to the Company's transfer agent and registrar, Registrar and Transfer Company, 10 Commerce Drive, Cranford, NJ 07016-3572, (800) 368-5948, [www.rtc.com](http://www.rtc.com).

**Table of Contents**

**Common Stock Repurchase and Sales**

The Company has had an announced intention to repurchase shares of its common stock since January 11, 1988. Currently, purchases are authorized up to the number of shares issued under the Company's 1988 Employee Stock Purchase Plan. Since January 1988 the Company has repurchased 220,985 shares at an average cost of \$3.14 per share under its stock repurchase program, but the Company has not repurchased any shares under this program since 1995. Purchases were made from time to time on the open market or in privately negotiated transactions.

In addition, the Company must accept outstanding shares at fair market value in payment of the exercise price of options under the Company's 1987 Incentive Stock Option Plan. In 2002, the Company received no shares in payment of the exercise price of options.

Under the Employee Stock Purchase Plan, in 2002 employees purchased 57,571 newly issued shares at an average price of \$1.32 per share. Employees have purchased a total of 668,633 shares under the plan through December 31, 2002, at an average price of \$2.71 per share. Employee contributions plus Company matching funds are used monthly to purchase shares at the market price under the plan and are accumulating at a rate of about \$80,000 per year.

No shares were purchased by exercise of Incentive Stock Options in 2002.

**Table of Contents****ITEM 6. SELECTED FINANCIAL DATA**

The selected financial data presented below under the headings **Statement of operations data** and **Balance sheet data** as of and for each of the years in the five-year period ended December 31, 2002 is derived from the financial statements of the Company, which financial statements have been audited by KPMG LLP, independent auditors. The selected financial data should be read in conjunction with **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations** and the balance sheets as of December 31, 2002 and 2001 and the statements of operations, shareholder's equity and cash flows for each of the years in the three-year period ended December 31, 2002, included in a separate section at the end of this report beginning on Page F-1. Financial reports are the responsibility of management, and are based on corporate records maintained by management, which maintains an internal control system, the sophistication of which is considered in relation to the benefits received.

	Year Ended December 31,				
	2002	2001	2000	1999	1998
(Amounts in thousands except per share data)					
<b>Statement of operations data:</b>					
Net Sales	\$ 37,977	36,007	27,309	20,628	24,503
Cost of sales	33,571	33,295	25,535	20,371	21,794
Gross profit	4,406	2,712	1,774	257	2,709
Distribution, general and administrative expenses	3,239	2,897	2,638	2,651	2,253
Operating income (loss)	1,167	(185)	(864)	(2,394)	456
Interest income (expense), net	(522)	(690)	(746)	(175)	18
Other income, net	266	292	155	2,637	3,326
Earnings (loss) before income taxes	911	(583)	(1,455)	68	3,800
Income tax expense (benefit)	(353)	(313)	(577)	30	1,558
Net earnings (loss)	\$ 558	(270)	(878)	38	2,242
<b>Earnings (loss) per share</b>					
Basic	\$ .18	(.09)	(.29)	.01	.78
Diluted	\$ .18	(.09)	(.29)	.01	.77
Cash dividends paid per share	\$ .06	.12	.12	.12	