

Edgar Filing: FARMER BROTHERS CO - Form 10-Q/A

FARMER BROTHERS CO  
Form 10-Q/A  
February 19, 2004

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q/A

☒ QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended December 31, 2003

Commission file number: 0-1375

FARMER BROS. CO.

California  
State of Incorporation

95-0725980  
IRS Employer Identification Number

20333 S. Normandie Avenue, Torrance, California 90502  
Registrant's address

(310) 787-5200  
Registrant's telephone number

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 ☐

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 definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). YES ☒ NO ☐

Number of shares of Common Stock, \$1.00 par value, outstanding as of December 31, 2003: 1,482,569 and the aggregate market value of the common shares held by non-affiliates of the Registrant was approximately \$200 million.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Dollars in thousands, except per share data)

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## FARMER BROS. CO. CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

	For the three months ended December 31,		For the six months ended December 31,	
	2003	2002	2003	2002
Net sales	\$51,511	\$54,118	\$97,176	\$104,507
Cost of goods sold	18,938	18,964	34,971	37,821
Gross profit	32,573	35,154	62,205	66,686
Selling expense	22,967	22,816	45,284	43,560
General and administrative expense	6,482	4,019	12,740	7,453
Operating expenses	29,449	26,835	58,024	51,013
Income from operations	3,124	8,319	4,181	15,673
Other income:				
Dividend income	881	772	1,683	1,629
Interest income	570	1,074	1,221	2,361
Other, net	-403	-573	1,169	-952
	1,048	1,273	4,073	3,038
Income before taxes	4,172	9,592	8,254	18,711
Income taxes	1,607	3,693	3,178	7,204
Net income	\$2,565	\$5,899	\$5,076	\$11,507
Weighted average shares outstanding	1,751,266	1,822,296	1,767,097	1,836,747
Earnings per common share	\$1.46	\$3.24	\$2.87	\$6.26
Dividends declared per share	\$0.95	\$0.90	\$1.90	\$1.80

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

## FARMER BROS. CO. CONSOLIDATED BALANCE SHEETS (Unaudited)

December 31,                  June 30,

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	2003	2003
ASSETS		
Current assets:		
Cash and cash equivalents	\$23,046	\$18,986
Restricted cash	1,060	975
Short term investments	162,954	274,444
Accounts and notes receivable, net	13,815	13,756
Inventories	34,114	34,702
Income tax receivable	2,546	2,878
Prepaid expenses	2,121	876
Total current assets	239,656	346,617
Property, plant and equipment, net	41,998	41,753
Notes receivable	193	193
Other assets	25,181	26,390
Deferred income taxes	1,462	1,462
Total assets	\$308,490	\$416,415
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$3,932	\$3,321
Accrued payroll expenses	6,323	7,362
Deferred income taxes	976	976
Other	4,343	5,000
Total current liabilities	15,574	16,659
Accrued postretirement benefits	26,208	25,041
Other long term liabilities	5,570	5,570
Total Liabilities	47,352	47,270
Commitments and contingencies	-	-
Shareholders' equity:		
Common stock, \$1.00 par value, authorized 3,000,000 shares; issued and outstanding 1,482,569	1,482	1,926
Additional paid-in capital	14,935	18,798
Retained earnings	278,576	382,831
Unearned ESOP shares	-32,809	-33,364
Less accumulated comprehensive loss	-1,046	-1,046
Total shareholders' equity	261,138	369,145
Total liabilities and shareholders' equity	\$308,490	\$416,415

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

## FARMER BROS. CO.

### CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Six months ended December 31,	
	2003	2002
Cash flows from operating activities:		
Net income	\$5,076	\$11,507
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation	3,508	2,802
(Gain) loss on sales of assets	-45	-383
ESOP compensation expense	2,343	1,923
Net (gain) loss on investments	1,323	-1,544

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Change in assets and liabilities:		
Short term investments	-994	14,412
Accounts and notes receivable	-78	-4,559
Inventories	588	1,073
Income tax receivable	332	2,553
Prepaid expenses and other assets	-36	-2,107
Accounts payable	611	881
Accrued payroll and expenses and other liabilities	-1,696	471
Accrued postretirement benefits	1,167	979
Total adjustments	7,023	16,501
Net cash provided by operating activities	\$ 12,099	\$28,008
Cash flows from investing activities:		
Purchases of property, plant and equipment	-3,760	-2,940
Proceeds from sales of property, plant and equipment	52	497
Notes repaid	19	29
Net cash used in investing activities	-3,689	-2,414
Cash flows from financing activities:		
Dividends paid	-3,088	-3,289
ESOP contributions	-1,177	-15,351
Proceeds from sale of short term investments	111,161	-
Purchase of capital stock	-111,161	-
Net cash used in financing activities	-4,265	-18,640
Net increase in cash and cash equivalents	4,145	6,954
Cash and cash equivalents at beginning of year	19,961	7,047
Cash and cash equivalents at end of year	\$24,106	\$14,001
Supplemental disclosure of cash flow information:		
Income tax payments	2,250	4,502

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

### Notes to Consolidated Financial Statements (Unaudited)

#### Note 1. Unaudited Financial Statements

The accompanying unaudited financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three month period ended December 31, 2003 are not necessarily indicative of the results that may be expected for the year ended June 30, 2004.

The balance sheet at June 30, 2003 has been derived from the audited financial statements at that date but does not include all of the information and

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footnotes required by accounting principles generally accepted in the United States for complete financial statements.

For further information, refer to the consolidated financial statements and footnotes thereto included in the Farmer Bros Co. annual report on Form 10-K for the year ended June 30, 2003.

### Note 2. Investments

Short term investments are as follows (in thousands):

	December 31 2003	June 30 2003
U.S. Treasury Obligations	\$105,842	\$220,057
Preferred Stock and Other	56,118	53,898
Futures, options and other derivative investments	994	490
Total short term investments	\$162,954	\$274,445

### Note 3. Inventories (In thousands)

#### December 31, 2003

	Processed	Unprocessed	Total
Coffee	\$3,976	\$9,285	\$13,261
Allied products	11,298	4,323	15,621
Coffee brewing equipment	2,123	3,109	5,232
	\$17,397	\$16,717	\$34,114

#### June 30, 2003

	Processed	Unprocessed	Total
Coffee	\$3,853	\$9,155	\$13,008
Allied products	11,776	4,213	15,989
Coffee brewing equipment	2,372	3,333	5,705
	\$18,001	\$16,701	\$34,702

### Interim LIFO Calculations

An actual valuation of inventory under the LIFO method can be made only at the end of each year based on the inventory levels and costs at that time. Accordingly, interim LIFO calculations must necessarily be based on management's estimates of expected year-end inventory levels and costs. Because these are subject to many forces beyond management's control, interim results are subject to the final year-end LIFO inventory valuation.

### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

#### Liquidity and Financial Condition

On December 24, 2003, the Company purchased the 443,845 shares of its common stock held by the Crowe Family and related trusts for approximately \$111 million or approximately \$250 per share. The purchase is part of a settlement of all outstanding issues between the Crowe and Farmer families and was approved by California's Superior Court for Los Angeles County.

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Concurrently with the purchase, the Company's Employee Stock Ownership Plan (ESOP) agreed to purchase 124,939 shares at the same price, \$250/share, fulfilling its previously announced authorization for the ESOP to purchase 300,000 shares or 18.7% of outstanding shares. This portion of the transaction was completed on January 11, 2004.

Estimated future costs to complete the information systems project exceed \$7,000,000, and the project is expected to continue until December 2004.

(in thousands)	December 30, 2003	June 30, 2003
Current assets	\$239,656	\$348,617
Current liabilities	15,574	\$ 16,659
Working capital	\$224,082	\$331,958
 Total assets	 \$308,490	 \$416,415

All present and future liquidity needs are expected to be met by internal sources. The Company tries not to rely on banks or other third parties for its working capital and other liquidity needs. There have been no changes in the needs or commitments described in the Company's Annual Report on Form 10-K/A.

### Results of Operations

All operating trends discussed in the Form 10-K/A for fiscal 2003 have continued into the first half of fiscal 2004. These trends resulted in a 5% decrease of net sales for the second quarter of fiscal 2004 to \$51,511,000 as compared to \$54,118,000 in the fiscal quarter ended December 31, 2002. Year to date sales decreased 7% to \$97,176,000 as compared to \$104,507,000 in the first half of fiscal 2003. In addition to the previously mentioned trends, the Company had decreased coffee brewing equipment sales of \$3,812,000 in the current fiscal year as compared to the same period of fiscal 2003.

Gross profit for the quarter ended December 31, 2003 decreased to \$32,572,000 as compared to \$35,153,000 in the same quarter of fiscal 2003. The average cost of green coffee during the first half of fiscal 2004 has decreased 2% since the June 30, 2003 year end, and is 6% lower than the average cost of green coffee for the same fiscal period of the prior fiscal year. Gross profit for the first half of fiscal 2004 decreased 7% to \$62,205,000 as compared to \$66,686,000 in the same period of the prior fiscal year primarily the result of decreased sales.

Operating expenses in the second quarter of fiscal 2004, consisting of selling and general and administrative expenses, increased 10% to \$29,449,000 as compared to \$26,834,000 in the same quarter of fiscal 2003. Operating expenses for the first half of fiscal 2004 increased 14% to \$58,024,000 as compared to \$51,013,000 in the same period of fiscal year 2003. This increase is primarily attributed to costs associated with our multi year program to update our information systems, increased employee benefits and legal expenses.

	2004	2003
Information systems	\$ 3,494,000	\$ 373,000
Employee benefits	9,566,000	7,121,000
Legal services	1,266,000	415,000
Total	\$14,326,000	\$7,909,000

Not included in the costs summarized above are Sarbannes-Oxley compliance costs that are expected to exceed \$500,000 over the balance of fiscal 2004.

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Also not included are the additional costs associated with the recent purchase of a sizable block of stock by the ESOP. The additional non-cash charge associated with this purchase is expected to exceed \$2,000,000 per year.

Other income in the second quarter of fiscal 2004 decreased 30% to \$1,048,000 from \$1,273,000 in the second quarter of fiscal 2003. Interest earned decreased 47% to \$570,000 as compared to \$1,074,000 in the quarter ended December 31, 2002. Other income for the first half of fiscal 2004 increased 34% to \$4,073,000 from \$3,038,000 in the same period of the prior fiscal year. Short term investments decreased 41%, or \$111,490,000, to \$162,954,000 at December 31, 2003 as compared to \$274,444,000 at June 30, 2003. This decrease is the primarily the result of the share purchase described in the Liquidity and Capital Resources section above.

As the result of the above mentioned factors, net income for the second quarter of fiscal 2004 decreased 57% to \$2,565,000 or \$1.46 per share, as compared to \$5,899,000, or \$3.24 per share, in the second quarter of fiscal 2003. Net income for the first half of fiscal 2004 decreased 56% to \$5,076,000 or \$2.87 per share, as compared to \$11,507,000 or \$6.26 in the same period of the prior fiscal year.

### Quarterly Summary of Results (in thousands of dollars):

	12/31/02	03/31/03	06/30/03	09/30/03	12/31/03
Net sales	\$54,118	\$49,267	\$47,784	\$45,665	\$51,511
Gross profit	\$35,154	\$32,038	\$32,172	\$29,632	\$32,573
Income from operations	\$8,319	\$4,985	\$3,230	\$1,057	\$3,124
Net income	\$5,899	\$6,339	\$5,783	\$2,511	\$2,565
Net income per share	\$3.24	\$3.52	\$3.23	\$1.41	\$1.46

### Forward Looking Statements

Certain statements contained in this Quarterly Report on Form 10-Q regarding The risks, circumstances and financial trends that may affect our future operating results, financial position and cash flows may be forward-looking statements within the meaning of federal securities laws. These statements are based on management's current expectations, assumptions, estimates and observations about our business and are subject to risks and uncertainties. As a result, actual results could materially differ from the forward looking statements contained herein. These forward looking statements can be identified by the use of words like "expects," "plans," "believes," "intends," "will," "assumes" and other words of similar meanings. These and other similar words can be identified by the fact that they do not relate solely to historical or current facts. While we believe our assumptions are reasonable, we caution that it is impossible to predict the impact of such factors which could cause actual results to differ materially from predicted results. We intend these forward-looking statements to speak only at the time of this report and do not undertake to update or revise these projections as more information becomes available. For these statements, we claim the protection of the safe harbor for forward-looking statements

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provided by the Private Securities Litigation Reform Act of 1995.

### Item 3. Quantitative and Qualitative Disclosure About Market Risk.

#### Financial Markets

We are exposed to market value risk arising from changes in interest rates on our securities portfolio. Our portfolio of investment grade money market instruments includes discount commercial paper, medium term notes, federal agency issues and treasury securities. As of December 31, 2003 over 50% of these funds were invested in instruments with maturities shorter than 92 days. This portfolio's interest rate risk is not hedged and its average maturity is approximately 44 days. A 100 basis point increase in the general level of interest rates would result in a change in the market value of the portfolio of approximately \$1,071,000.

Our portfolio of preferred securities includes investments in derivatives that provide a natural economic hedge of interest rate risk. We review the interest rate sensitivity of these securities and (a) enter into "short positions" in futures contracts on U.S. Treasury securities or (b) hold put options on such futures contracts in order to reduce the impact of certain interest rate changes on such preferred stocks. Specifically, we attempt to manage the risk arising from changes in the general level of interest rates. We do not transact in futures contracts or put options for speculative purposes.

The following table demonstrates the impact of varying interest rate changes based on the preferred stock holdings, futures and options positions, and market yield and price relationships as of December 31, 2003. This table is predicated on an instantaneous change in the general level of interest rates and assumes predictable relationships between the prices of preferred securities holdings, the yields on U.S. Treasury securities and related futures and options.

#### Interest Rate Changes (In thousands)

	Market Value at Preferred Stock	December 31, 2003 Futures & Options	Total Portfolio	Change in Market Value of Total Portfolio
-150 basis points ("b.p.")	\$62,245	\$2	\$62,247	\$5,309
-100 b.p.	60,592	36	60,627	3,419
Unchanged	56,104	1,104	57,208	0
+100 b.p.	50,936	5,552	56,488	(720)
+150 b.p.	48,424	8,058	56,482	(726)

The number and type of future and option contracts entered into depends on, among other items, the specific maturity and issuer redemption provisions for each preferred stock held, the slope of the Treasury yield curve, the expected volatility of Treasury yields, and the costs of using futures and/or options.

#### Commodity Price Changes

We are exposed to commodity price risk arising from changes in the market price of green coffee. We price our inventory on the LIFO basis. In the normal course of business, we enter into commodity purchase agreements with suppliers and we purchase green coffee contracts.



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The following table demonstrates the impact of changes in the price of green coffee on inventory and green coffee contracts at December 31, 2003. It assumes an immediate change in the price of green coffee, and the valuations of coffee index futures and put options and relevant commodity purchase agreements at December 31, 2003.

### Commodity Risk Disclosure

(In thousands)

Coffee Cost Change	Market Value of		Totals	Change in Market Value	
	Coffee Inventory	Futures & Options		Derivatives	Inventory
-20%	\$12,000	\$ 2,907	\$14,907	\$2,907	(\$1,261)
unchanged	13,261	110	13,371	-	-
20%	15,000	(\$2,797)	12,203	(373)	\$1,739

At December 31, 2003 the derivatives consisted mainly of commodity futures with maturities shorter than four months.

### Item 4 Controls & Procedures

As of December 31, 2003, with the participation of the Chief Executive Officer and Chief Financial officer, we evaluated the effectiveness of our disclosure controls and procedures and concluded that they were effective as of that date. No changes occurred during the quarter ended December 31, 2003 that materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting, except that during that quarter we implemented part of our multi-year program to update our information systems which program includes enhancements to such internal controls.

## PART II OTHER INFORMATION

### Item 1. Legal proceedings.

On December 4, 2003, Leonard Rosenthal brought suit in United States District Court for the Central District of California (Case No. CV03845) against the Company, the present directors and a former director ("Directors"), on behalf of himself and a purported class of persons (the "Rosenthal Litigation"). The Plaintiff alleged that the Company was operating as an unregistered investment company in violation of the Investment Company Act of 1940 (the "ICA"). The Plaintiff also alleged that the Company's loans of corporate funds to the ESOP to purchase stock of the Company violate federal law and that such purchases by the ESOP were intended to preserve the voting control of the Farmer family and entrench management. In addition, the Plaintiff alleged that the Company was pursuing an estate planning strategy designed to depress the stock price in order to lessen the estate taxes anticipated on the death of Roy F. Farmer. Plaintiff sought recovery against the Directors in an amount not less than the amount of the loans to the ESOP. Plaintiff also filed a motion for a preliminary injunction to prevent the Company and the Directors from voting the Company stock beneficially owned by the ESOP at the Annual Meeting. On December 23, 2003, the U.S. District Court denied plaintiff's motion, ruling, inter alia, that plaintiff lacked standing to bring an action for violation of the ICA and that plaintiff had failed to show a likelihood of prevailing at trial on his claims that the Company was in violation of the ICA or that the Directors had violated their duties with respect to the ESOP.

On February 4, 2004, Leonard Rosenthal filed a Notice of Dismissal Without Prejudice with the United States District Court for the Central District of California.

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Item 2. Changes in securities none.

Item 3. Defaults upon senior securities. none.

Item 4. Submission of matters to a vote of security holders. none.

Item 5. Other information none.

Item 6. Exhibits and reports on Form 8-K.

(a) Exhibits.

10.1 Settlement Agreement 12/24/2003 among the Company, the Farmer Family and the Crowe Family

10.2 Mutual General Release 12/24/03 among the Company, the Farmer Family and the Crowe Family

10.3 Stock Purchase Agreement 12/24/03 among the Company, Catherine Crowe and Roy F. Farmer as Trustee of various trusts

10.4 Stock Purchase Agreement 01/09/04 between Wells Fargo Bank, Trustee of the Farmer Bros. Co. ESOP and the Company

31.1 Certification of Chief Executive Officer (Section 302 of the Sarbannes-Oxley Act of 2002)

31.2 Certification of Chief Financial Officer (Section 302 of the Sarbannes-Oxley Act of 2002)

32.1 Certification of Chief Executive Officer (Section 906 of the Sarbannes-Oxley Act of 2002)

32.2 Certification Chief Financial Officer (Section 906 of the Sarbannes-Oxley Act of 2002)

99.1 Plan Amendment 2 12/22/03 to ESOP

99.2 Plan Amendment 3 12/23/03 to ESOP

99.3 Loan Agreement 07/21/2003 between Wells Fargo Bank, Trustee of the Farmer Bros. Co. ESOP and the Company

(b) Reports on Form 8-K.

Reports on Form 8-K were filed as follows:

A form 8-K dated July 23, 2003 and filed with the Commission on July 24, 2003 announced approval by the Board of Directors of a loan by the Company to the ESOP to purchase up to 129,575 shares of Farmer Bros. Co. common stock.

A form 8-K dated December 24, 2003 and filed with the Commission on December 24, 2003 announced the purchase of all Crowe family shares at a cost of approximately \$110.96 million, and the rejection of a request for injunction on behalf of a shareholder by U.S. District Judge Margaret M. Morrow.

A form 8-K dated January 12, 2004 and filed with the Commission on January 12, 2004 announced finalization of the purchase of the ESOP's purchase of 129,575 shares of Farmer Bros. Co. common stock bringing the ESOP's holdings to 300,000 shares or 18.7% of the Company's shares outstanding.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

FARMER BROS. CO.

/s/ Roy E. Farmer

Roy E. Farmer, President and Chief Executive Officer and Director

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(principal executive officer)

Date: February 18, 2004

/s/ John E. Simmons

John E. Simmons, Treasurer and Chief Financial Officer

(principal financial and accounting officer)

Date: February 18, 2004