CENTRAL GARDEN & PET CO
Form 10-Q
August 02, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 23, 2012

or

¨ **TRANSITION REPORT PURSUANT OF SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission File Number: 001-33268

CENTRAL GARDEN & PET COMPANY

Delaware	**68-0275553**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

1340 Treat Blvd., Suite 600, Walnut Creek, California 94597

(Address of principle executive offices)

(925) 948-4000

(Registrant s telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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. x Yes ¨ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). x Yes ¨ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). ¨ Yes x No

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Common Stock Outstanding as of July 15, 2012	12,247,571
Class A Common Stock Outstanding as of July 15, 2012	34,508,826
Class B Stock Outstanding as of July 15, 2012	1,652,262

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PART I. FINANCIAL INFORMATION

Safe Harbor Statement under the Private Securities Litigation Reform Act of 1995

This Form 10-Q includes forward-looking statements. Forward-looking statements include statements concerning our plans, objectives, goals, strategies, future events, future revenues or performance, our transformational efforts, capital expenditures, plans or intentions relating to acquisitions, our competitive strengths and weaknesses, our business strategy, our ability to pass through grain and other raw material price increases and the trends we anticipate in the industries and economies in which we operate and other information that is not historical information. When used in this Form 10-Q, the words estimates, expects, anticipates, projects, plans, intends, believes and, variations words or similar expressions are intended to identify forward-looking statements. All forward-looking statements are based upon our current expectations and various assumptions. Our expectations, beliefs and projections are expressed in good faith, and we believe there is a reasonable basis for them, but we cannot assure you that our expectations, beliefs and projections will be realized.

There are a number of risks and uncertainties that could cause our actual results to differ materially from the forward-looking statements contained in this Form 10-Q. Important factors that could cause our actual results to differ materially from the forward-looking statements we make in this Form 10-Q are set forth in this Form 10-Q and our Form 10-K for the fiscal year ended September 24, 2011 including the factors described in the sections titled Risk Factors. If any of these risks or uncertainties materialize, or if any of our underlying assumptions are incorrect, our actual results may differ significantly from the results that we express in or imply by any of our forward-looking statements. We do not undertake any obligation to revise these forward-looking statements to reflect future events or circumstances. Presently known risk factors include, but are not limited to, the following factors:

- the success of our transformational change initiative;
- disruptions in our business as we implement our transformational change initiative and the resulting consequences to our business and results of operations;
- seasonality and fluctuations in our operating results and cash flow;

fluctuations in market prices for seeds and grains and other raw materials and our ability to pass-through cost increases in a timely manner;

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declines in consumer spending during economic downturns;

inflation, deflation and other adverse macro-economic conditions;

supply shortages in small animals and pet birds;

adverse weather conditions;

fluctuations in energy prices, fuel and related petrochemical costs;

access to and cost of additional capital

dependence on a small number of customers for a significant portion of our business;

consolidation trends in the retail industry;

uncertainty about new product innovations and marketing programs;

competition in our industries;

risks associated with our acquisition strategy;

dependence upon our key executive officers;

implementation of a new enterprise resource planning information technology system;

our ability to protect our intellectual property rights;

potential environmental liabilities;

risk associated with international sourcing;

litigation and product liability claims;

regulatory issues, including product recalls;

the voting power associated with our Class B stock; and

potential dilution from issuance of additional shares.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CENTRAL GARDEN & PET COMPANY

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share amounts)

Unaudited

	June 25, 2011	June 23, 2012	(See Note 1) September 24, 2011
ASSETS			
Current assets:			
Cash and cash equivalents	$ 11,233	$ 40,699	$ 12,031
Short term investments	15,320	17,820	17,820
Accounts receivable (less allowance for doubtful accounts of $18,782, $18,297 and $15,590)	257,418	245,780	195,417
Inventories	343,788	334,796	329,546
Prepaid expenses and other	40,095	46,107	47,772
Total current assets	667,854	685,202	602,586
Land, buildings, improvements and equipment net	171,187	185,225	176,402
Goodwill	209,348	210,223	210,223
Other intangible assets net	85,705	80,529	84,526
Deferred income taxes and other assets	21,638	18,539	19,266
Total	$ 1,155,732	$ 1,179,718	$ 1,093,003
LIABILITIES AND EQUITY			
Current liabilities:			
Accounts payable	$ 115,380	$ 125,111	$ 116,524
Accrued expenses	92,678	106,818	75,128
Current portion of long-term debt	198	347	279
Total current liabilities	208,256	232,276	191,931
Long-term debt	450,266	449,530	435,330
Deferred income taxes and other long-term obligations	4,104	23,478	8,960
Equity:			
Common stock, $.01 par value: 13,755,693, 12,247,571 and 12,949,593 shares outstanding at June 25, 2011, June 23, 2012 and September 24, 2011	137	122	129
Class A common stock, $.01 par value: 38,191,629, 34,506,329 and 35,941,360 shares outstanding at June 25, 2011, June 23, 2012 and September 24, 2011	382	345	359
Class B stock, $.01 par value: 1,652,262 shares outstanding	16	16	16
Additional paid-in capital	421,351	381,751	396,208
Retained earnings	69,234	89,777	59,045
Accumulated other comprehensive income	1,386	1,127	1,019
Total Central Garden & Pet Company shareholders equity	492,506	473,138	456,776
Noncontrolling interest	600	1,296	6

Total equity	493,106	474,434	456,782
Total	$ 1,155,732	$ 1,179,718	$ 1,093,003

See notes to condensed consolidated financial statements.

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CENTRAL GARDEN & PET COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended		Nine Months Ended	
	June 25, 2011	June 23, 2012	June 25, 2011	June 23, 2012
Net sales	$ 484,303	$ 533,808	$ 1,251,746	$ 1,302,777
Cost of goods sold and occupancy	334,914	353,156	856,031	893,691
Gross profit	149,389	180,652	395,715	409,086
Selling, general and administrative expenses	112,795	131,683	305,974	326,175
Income from operations	36,594	48,969	89,741	82,911
Interest expense	(9,948)	(10,723)	(28,330)	(30,738)
Interest income	140	28	333	84
Other income (expense)	318	102	116	(19)
Income before income taxes and noncontrolling interest	27,104	38,376	61,860	52,238
Income taxes	9,879	14,554	21,952	19,716
Income including noncontrolling interest	17,225	23,822	39,908	32,522
Net income attributable to noncontrolling interest	144	1,123	653	1,290
Net income attributable to Central Garden & Pet Company	$ 17,081	$ 22,699	$ 39,255	$ 31,232
Net income per share attributable to Central Garden & Pet Company:				
Basic	$ 0.32	$ 0.48	$ 0.68	$ 0.66
Diluted	$ 0.31	$ 0.47	$ 0.68	$ 0.65
Weighted average shares used in the computation of net income per share:				
Basic	54,020	47,661	57,635	47,580
Diluted	54,498	48,388	58,115	48,253

See notes to condensed consolidated financial statements.

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CENTRAL GARDEN & PET COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Nine Months Ended	
	June 25, 2011	June 23, 2012
Cash flows from operating activities:		
Net income	$ 39,908	$ 32,522
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	21,316	23,076
Stock-based compensation	5,720	5,342
Excess tax benefits from stock-based awards	(791)	(938)
Deferred income taxes	14,859	12,117
Gain on sale of property and equipment	(4)	(102)
Change in assets and liabilities:		
Accounts receivable	(61,422)	(50,318)
Inventories	(45,648)	(5,189)
Prepaid expenses and other assets	11,836	6,911
Accounts payable	5,536	7,768
Accrued expenses	7,524	31,960
Other long-term obligations	(337)	1,005
Net cash provided by (used in) operating activities	(1,503)	64,154
Cash flows from investing activities:		
Additions to property and equipment	(20,191)	(26,930)
Payments to acquire companies, net of cash acquired	(24,432)	0
Net cash used in investing activities	(44,623)	(26,930)
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	0	49,288
Repayments of long-term debt	(221)	(266)
Borrowings under revolving line of credit	593,000	304,000
Repayments under revolving line of credit	(543,000)	(339,000)
Proceeds from issuance of common stock	1,436	1,291
Repurchase of common stock	(83,602)	(23,151)
Distribution to noncontrolling interest	(1,500)	0
Excess tax benefits from stock-based awards	791	938
Payment of financing costs	(1,034)	(1,715)
Net cash used in financing activities	(34,130)	(8,615)
Effect of exchange rate changes on cash and cash equivalents	29	59
Net increase (decrease) in cash and cash equivalents	(80,227)	28,668
Cash and equivalents at beginning of period	91,460	12,031
Cash and equivalents at end of period	$ 11,233	$ 40,699

Supplemental information:		
Cash paid for interest	$ 19,965	$ 21,256

See notes to condensed consolidated financial statements.

CENTRAL GARDEN & PET COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Three and Nine Months Ended June 23, 2012

(unaudited)

1. Basis of Presentation

The condensed consolidated balance sheets of Central Garden & Pet Company and subsidiaries (the Company or Central) as of June 25, 2011 and June 23, 2012, the condensed consolidated statements of operations for the three and nine months ended June 25, 2011 and June 23, 2012, and the condensed consolidated statements of cash flows for the nine months ended June 25, 2011 and June 23, 2012 have been prepared by the Company, without audit. In the opinion of management, all adjustments (which include only normal recurring adjustments) considered necessary to present fairly the financial position, results of operations and cash flows of the Company for the periods mentioned above, have been made.

For the Company s foreign business in the UK, the local currency is the functional currency. Assets and liabilities are translated using the exchange rate in effect at the balance sheet date. Income and expenses are translated at the average exchange rate for the period. Deferred taxes are not provided on translation gains and losses, because the Company expects earnings of its foreign subsidiary to be permanently reinvested. Transaction gains and losses are included in results of operations. See Note 7, Supplemental Equity and Comprehensive Income Information, for further detail.

Due to the seasonal nature of the Company s garden business, the results of operations for the three and nine month periods ended June 25, 2011 and June 23, 2012 are not indicative of the operating results that may be expected for the entire fiscal year. These interim financial statements should be read in conjunction with the annual audited financial statements, accounting policies and financial notes thereto, included in the Company s 2011 Annual Report on Form 10-K, which has previously been filed with the Securities and Exchange Commission, as well as other subsequent Securities and Exchange Commission filings. The September 24, 2011 balance sheet presented herein was derived from the audited financial statements.

Noncontrolling Interest

Noncontrolling interest in the Company s condensed consolidated financial statements represents the 20% interest not owned by Central in a consolidated subsidiary. Since the Company controls this subsidiary, its financial statements are fully consolidated with those of the Company, and the noncontrolling owner s 20% share of the subsidiary s net assets and results of operations is deducted and reported as noncontrolling interest on the consolidated balance sheets and as net income (loss) attributable to noncontrolling interest in the consolidated statements of operations. See Note 7, Supplemental Equity and Comprehensive Income Information, for additional information.

Derivative Instruments

The Company principally uses a combination of purchase orders and various short and long-term supply arrangements in connection with the purchase of raw materials, including certain commodities. The Company also enters into commodity futures and options contracts to reduce the volatility of price fluctuations of corn, which impacts the cost of raw materials. The Company s primary objective when entering into these derivative contracts is to achieve greater certainty with regard to the future price of commodities purchased for use in its supply chain. These derivative contracts are entered into for periods consistent with the related underlying exposures and do not constitute positions independent of those exposures. The Company does not enter into derivative contracts for speculative purposes and does not use leveraged instruments.

The Company does not perform the assessments required to achieve hedge accounting for commodity derivative positions. Accordingly, the changes in the values of these derivatives are recorded currently in cost of sales in its condensed consolidated statements of operations. As of June 23, 2012, the notional amount of these contracts was not significant.

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Recent Accounting Pronouncements

In January 2010, the FASB issued Accounting Standards Update (ASU) No. 2010-6, Improving Disclosures about Fair Value Measurements. This ASU requires new disclosures regarding transfers in and out of Level 1 and Level 2 fair value measurements, as well as requiring presentation on gross basis information about purchases, sales, issuances and settlements in Level 3 fair value measurements. The ASU also clarifies existing disclosures regarding level of disaggregation, inputs and valuation techniques. The ASU is effective for interim and annual reporting periods beginning after December 15, 2009 and became effective for the Company on December 27, 2009. Disclosures about purchases, sales, issuances and settlements in the roll forward of activity in Level 3 fair value measurements are effective for fiscal years beginning after December 15, 2010 and were effective for the Company on September 25, 2011. The adoption of this ASU had no impact on the Company s consolidated financial statements.

In December 2010, the FASB issued ASU No. 2010-28, Intangibles Goodwill and Other (Topic 350) When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts (ASU 2010-28). The amendments in this update modify Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist. ASU 2010-28 is effective for fiscal years and interim periods within those years, beginning after December 15, 2010 and was effective for the Company on September 25, 2011. The adoption of this ASU had no impact on the Company s consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. ASU No. 2011-05 requires that all nonowner changes in stockholders equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements, eliminating the option to present other comprehensive income in the statement of changes in equity. Under either choice, items that are reclassified from other comprehensive income to net income are required to be presented on the face of the financial statements where the components of net income and the components of other comprehensive income are presented. In December 2011, the FASB issued an update to ASU No. 2011-05, ASU No. 2011-12, which was issued to defer the effective date for amendments to the reclassifications of items out of accumulated other comprehensive income in ASU No. 2011-05. ASU No. 2011-05 and the amendments in ASU No. 2011-12 are effective for fiscal years and interim periods within those years, beginning after December 15, 2011 and will be effective for the Company on September 30, 2012. The guidance will be applied retrospectively. This amendment will change the manner in which the Company presents comprehensive income. The Company is in the process of evaluating the impact on its consolidated financial statements.

In September 2011, the FASB issued ASU No. 2011-08, Intangibles Goodwill and Other (Topic 350): Testing Goodwill for Impairment , which amended the guidance on the annual testing of goodwill for impairment. The amended guidance will allow companies to assess qualitative factors to determine if it is more-likely-than-not that goodwill might be impaired and whether it is necessary to perform the two-step goodwill impairment test required under current accounting standards. The guidance is effective for fiscal years beginning after December 15, 2011, and will be effective for the Company on September 30, 2012. The Company has determined that this new guidance will not have a material impact on its consolidated financial statements.

2. Fair Value Measurements

ASC 820 established a single authoritative definition of fair value, a framework for measuring fair value and expands disclosure of fair value measurements. ASC 820 requires financial assets and liabilities to be categorized based on the inputs used to calculate their fair values as follows:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

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Level 3 Unobservable inputs for the asset or liability, which reflect the Company s own assumptions about the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk).

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The Company had short- term investments, consisting of bank certificates of deposit, measured at fair value under Level 2 inputs in the fair value hierarchy, as of June 23, 2012. The Company had no other significant financial assets or liabilities on the balance sheet that were measured at fair value as of June 23, 2012.

Assets and Liabilities Measured at Fair Value on a Non-Recurring Basis

The Company measures certain non-financial assets and liabilities, including long-lived assets, goodwill and intangible assets, at fair value on a non-recurring basis. Fair value measurements of non-financial assets and non-financial liabilities are used primarily in the impairment analyses of long-lived assets, goodwill and other intangible assets. During the period ended June 23, 2012, the Company was not required to measure any significant non-financial assets and liabilities at fair value.

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3. Financial Instruments

The Company s financial instruments include cash and equivalents, short term investments consisting of bank certificates of deposit, accounts receivable and payable, short-term borrowings, and accrued liabilities. The carrying amount of these instruments approximates fair value because of their short-term nature.

The estimated fair value of the Company s $450 million 8.25 % senior subordinated notes due 2018 as of June 23, 2012 was $459.0 million, compared to a carrying value of $449.3 million, net of unamortized discount of $0.7 million. The estimated fair value is based on quoted market prices for these notes. See Note 6, Long Term Debt, for additional information.

4. Goodwill

The Company accounts for goodwill in accordance with ASC 350, Intangibles Goodwill and Other, and tests goodwill for impairment annually, or whenever events occur or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. This assessment involves the use of significant accounting judgments and estimates as to future operating results and discount rates. Changes in estimates or use of different assumptions could produce significantly different results. An impairment loss is generally recognized when the carrying amount of the reporting unit s net assets exceeds the estimated fair value of the reporting unit. The Company uses discounted cash flow analysis to estimate the fair value of our reporting units. The Company s goodwill impairment analysis also includes a comparison of the aggregate estimated fair value of all four reporting units to the Company s total market capitalization. Based on the Company s annual analysis of goodwill performed during the fourth quarter of fiscal 2011, it concluded there was no impairment of goodwill during fiscal 2011.

Contingent performance payments of $1.0 million were paid in fiscal 2011 for previous acquisitions and recorded as goodwill.

On February 28, 2011, the Company acquired certain assets of a privately-held maker of premium fertilizer for the professional and retail markets for approximately $23 million in cash. The acquired assets were integrated into the business of Pennington Seed, Inc., a wholly owned subsidiary of the Company. The purchase price exceeded the estimated fair value of the tangible and intangible assets acquired by $1.0 million, which was recorded as goodwill.

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5. Other Intangible Assets

The following table summarizes the components of gross and net acquired intangible assets:

	Gross	Accumulated Amortization (in millions)	Impairment	Net Carrying Value
June 23, 2012				
Marketing-related intangible assets amortizable	$ 12.3	$ (7.2)	$ 0	$ 5.1
Marketing-related intangible assets nonamortizable	59.6	0	(16.9)	42.7
Total	71.9	(7.2)	(16.9)	47.8
Customer-related intangible assets amortizable	42.7	(14.8)	0	27.9
Other acquired intangible assets amortizable	10.8	(6.0)	0	4.8
Other acquired intangible assets nonamortizable	1.2	0	(1.2)	0
Total	12.0	(6.0)	(1.2)	4.8
Total other intangible assets	$ 126.6	$ (28.0)	$ (18.1)	$ 80.5
June 25, 2011				
Marketing-related intangible assets amortizable	$ 12.3	$ (5.9)	$ 0	$ 6.4
Marketing-related intangible assets nonamortizable	59.6	0	(16.9)	42.7
Total	71.9	(5.9)	(16.9)	49.1
Customer-related intangible assets amortizable	42.7	(12.5)	0	30.2
Other acquired intangible assets amortizable	10.8	(4.4)	0	6.4
Other acquired intangible assets nonamortizable	1.2	0	(1.2)	0
Total	12.0	(4.4)	(1.2)	6.4
Total other intangible assets	$ 126.6	$ (22.8)	$ (18.1)	$ 85.7
September 24, 2011				
Marketing-related intangible assets amortizable	$ 12.3	$ (6.3)	$ 0	$ 6.0
Marketing-related intangible assets nonamortizable	59.6	0	(16.9)	42.7
Total	71.9	(6.3)	(16.9)	48.7
Customer-related intangible assets amortizable	42.7	(13.0)	0	29.7
Other acquired intangible assets amortizable	10.8	(4.7)	0	6.1
Other acquired intangible assets nonamortizable	1.2	0	(1.2)	0
Total	12.0	(4.7)	(1.2)	6.1
Total other intangible assets	$ 126.6	$ (24.0)	$ (18.1)	$ 84.5

Other intangible assets acquired include contract-based and technology-based intangible assets.

On February 28, 2011, the Company acquired approximately $2.7 million of identified customer related and other intangible assets as part of its acquisition of certain assets of a privately-held maker of premium fertilizer.

The Company evaluates long-lived assets, including amortizable and indefinite-lived intangible assets, for impairment whenever events or changes in circumstances indicate the carrying value may not be recoverable. The Company evaluates indefinite-lived intangible assets on an annual basis. In fiscal 2011, the Company tested its indefinite-lived intangible assets and no impairment was indicated. Other factors indicating the carrying value of the Company s amortizable intangible assets may not be recoverable were not present in fiscal 2011, and accordingly, no impairment testing was performed on these assets.

The Company is currently amortizing its acquired intangible assets with definite lives; over weighted average remaining lives of eight years for marketing-related intangibles, 18 years for customer-related intangibles and six years for other acquired intangibles. Amortization expense for intangibles subject to amortization was approximately $1.6 million and $1.4 million for the three month periods ended June 23, 2012 and June 25, 2011, respectively, and $4.0 million and $3.8 million for the nine month periods ended June 23, 2012 and June 25, 2011, respectively, and is classified within operating expenses in the condensed consolidated statements of operations. Estimated annual amortization expense related to acquired intangible assets in each of the succeeding five years is estimated to be approximately $4 million per year from fiscal 2012 through fiscal 2016.

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6. Long-Term Debt

Long-term debt consists of the following:

	June 23, 2012	September 24, 2011
	(in thousands)	
Senior subordinated notes, net of unamortized discount(1), interest at 8.25%, payable semi- annually, principal due March 2018	$ 449,288	$ 400,000
Revolving credit facility, interest at Alternate Base Rate plus a margin of 0.75% to 1.75%, or LIBOR plus a margin of 1.75% to 2.75%, final maturity June 2016	0	35,000
Other notes payable	589	609
Total	449,877	435,609
Less current portion	(347)	(279)
Long-term portion	$ 449,530	$ 435,330

(1) Represents unamortized original issue discount of $712,000 as of June 23, 2012, which is amortizable until March 2018.

Senior Credit Facility

On June 8, 2011, the Company amended its $275 million, five-year senior secured revolving credit facility (the Credit Facility) included in its Amended and Restated Credit Agreement (the Credit Agreement). Under the modified terms, the Credit Facility has a borrowing capacity of $375 million, an increase of $100 million, and an extension of maturity date by approximately one year, to June 2016. As amended, the Credit Facility bears lower interest rates and commitment fees and requires less interest coverage. The Company continues to have the option to increase the size of the Credit Facility by an additional $200 million of incremental term loans and/or revolving loans should it exercise its option and one or more lenders are willing to make such increased amounts available to it. There was no outstanding balance as of June 23, 2012 under the Credit Facility. There were no letters of credit outstanding under the Credit Facility as of June 23, 2012. As of June 23, 2012, there were $375.0 million of unused commitments under the Credit Facility or, after giving effect to the financial covenants in the Credit Agreement, $231.9 million of remaining borrowing capacity.

Interest on the amended Credit Facility is based, at the Company s option, on a rate equal to the Alternate Base Rate (ABR), which is the greatest of the prime rate, the Federal Funds rate plus $^1/_2$ of 1% or one month LIBOR plus 1%, plus a margin, which fluctuates from 0.75% to 1.75%, or LIBOR plus a margin, which fluctuates from 1.75% to 2.75% and commitment fees that range from 0.30% to 0.50%, determined quarterly based on consolidated total debt to consolidated EBITDA for the most recent trailing 12-month period. As of June 23, 2012, the applicable interest rate on the Credit Facility related to alternate base rate borrowings was 5.0%, and the applicable interest rate related to LIBOR rate borrowings was 3.0%.

The Credit Facility is guaranteed by the Company s material subsidiaries and is secured by the Company s assets, excluding real property but including substantially all of the capital stock of the Company s subsidiaries. The Credit Agreement contains certain financial and other covenants which require the Company to maintain minimum levels of interest coverage and maximum levels of senior debt to EBITDA and that restrict the Company s ability to repurchase its stock, make investments in or acquisitions of other businesses and pay dividends above certain levels over the life of the Credit Facility. Under the terms of the Company s Credit Facility, it may make restricted payments, including cash dividends and stock repurchases, in an aggregate amount initially not to exceed $200 million over the life of the Credit Facility, subject to qualifications and baskets as defined in the Credit Agreement. As of June 23, 2012, the Company s Total Leverage Ratio, as defined in the Credit Agreement, was 3.9 to 1.0, and the Company s Senior Secured Leverage Ratio, as defined in the Credit Agreement with a maximum of 2.0 to 1.0, was 0 to 1.0. The Company s minimum Interest Coverage Ratio was reduced to 2.50 times, from 2.75 times as part of the modification of the Credit Facility. As of June 23, 2012, the Company s Interest Coverage ratio was 3.0 times. Apart from the covenants limiting restricted payments and capital expenditures, the Credit Facility does not restrict the use of retained earnings or net income. The Company was in compliance with all financial covenants as of June 23, 2012.

Senior Subordinated Notes and Debt Refinancing

On March 8, 2010, the Company issued $400 million aggregate principal amount of 8.25% senior subordinated notes due March 1, 2018 (the 2018 Notes).

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On February 8, 2012, the Company issued an additional $50 million aggregate principal amount of its 2018 Notes at a price of 98.501%, plus accrued interest from September 1, 2011, in a private placement. The Company used the net proceeds from the offering to pay a portion of the outstanding balance under its Credit Facility.

The Company incurred approximately $1.7 million of debt issuance costs in conjunction with this offering, which included underwriter fees and legal, accounting and rating agency expenses. The debt issuance costs are being amortized over the remaining term of the 2018 notes.

The 2018 Notes require semiannual interest payments, which commenced on September 1, 2010. The 2018 Notes are unsecured senior subordinated obligations and are subordinated to all of the Company s existing and future senior debt, including the Company s Credit Facility. The obligations under the 2018 Notes are fully and unconditionally guaranteed on a senior subordinated basis by each of the Company s existing and future domestic restricted subsidiaries with certain exceptions. The guarantees are general unsecured senior subordinated obligations of the guarantors and are subordinated to all existing and future senior debt of the guarantors.

The Company may redeem some or all of the 2018 Notes at any time prior to March 1, 2014 at the principal amount plus a make whole premium. The Company may redeem some or all of the 2018 Notes at any time on or after March 1, 2014 for 104.125%, after March 1, 2015 for 102.063% and after March 1, 2016 for 100%, plus accrued and unpaid interest. Additionally, at any time prior to March 1, 2013, the Company may redeem up to 35% of the 2018 Notes with any proceeds the Company receives from certain equity offerings at a redemption price of 108.25% of the principal amount, plus accrued and unpaid interest. The holders of the 2018 Notes have the right to require the Company to repurchase all or a portion of the 2018 Notes at a purchase price equal to 101% of the principal amount of the notes repurchased, plus accrued and unpaid interest through the repurchase date upon the occurrence of a change of control.

The 2018 Notes contain customary high yield covenants, including covenants limiting debt incurrence and restricted payments.

7. Supplemental Equity and Comprehensive Income Information

The following table summarizes the allocation of total comprehensive income between controlling and noncontrolling interests for the nine months ended June 23, 2012 and June 25, 2011:

	Nine Months Ended June 23, 2012		
(in thousands)	**Controlling Interest**	**Noncontrolling Interest**	**Total**
Net income	$ 31,232	$ 1,290	$ 32,522
Other comprehensive income:			
Foreign currency translation	108	0	108
Total comprehensive income	$ 31,340	$ 1,290	$ 32,630

	Nine Months Ended June 25, 2011		
(in thousands)	**Controlling Interest**	**Noncontrolling Interest**	**Total**
Net income	$ 39,255	$ 653	$ 39,908
Other comprehensive income:			
Foreign currency translation	442	0	442
Total comprehensive income	$ 39,697	$ 653	$ 40,350

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The following table provides a summary of the changes in the carrying amounts of equity attributable to controlling interest and noncontrolling interest for the nine months ended June 23, 2012 and June 25, 2011:

	Controlling Interest								
(in thousands)	Common Stock	Class A Common Stock	Class B Stock	Additional Paid In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total	Noncontrolling Interest	Total
Balance September 24, 2011	$ 129	$ 359	$ 16	$ 396,208	$ 59,045	$ 1,019	$ 456,776	$ 6	$ 456,782
Comprehensive income	0	0	0	0	31,232	108	31,340	1,290	32,630
Stock based compensation	0	0	0	3,782	0	0	3,782	0	3,782
Restricted share activity	0	1	0	379	0	0	380	0	380
Issuance of common stock	0	4	0	802	0	0	806	0	806
Repurchase of common stock	(7)	(19)	0	(20,358)	(500)	0	(20,884)	0	(20,884)
Tax benefit on stock option exercise	0	0	0	938	0	0	938	0	938
Balance June 23, 2012	$ 122	$ 345	$ 16	$ 381,751	$ 89,777	$ 1,127	$ 473,138	$ 1,296	$ 474,434

	Controlling Interest								
(in thousands)	Common Stock	Class A Common Stock	Class B Stock	Additional Paid In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total	Noncontrolling Interest	Total
Balance September 25, 2010	$ 163	$ 437	$ 16	$ 483,817	$ 45,319	$ 944	$ 530,696	$ 1,447	$ 532,143
Comprehensive income	0	0	0	0	39,255	442	39,697	653	40,350
Stock based compensation	0	0	0	4,143	0	0	4,143	0	4,143
Restricted share activity	0	4	0	(180)	0	0	(176)	0	(176)
Issuance of common stock	0	4	0	1,400	0	0	1,404	0	1,404
Repurchase of common stock	(26)	(63)	0	(68,620)	(15,340)	0	(84,049)	0	(84,049)
Distributions to noncontrolling interest	0	0	0	0	0	0	0	(1,500)	(1,500)
Tax benefit on stock option exercise	0	0	0	791	0	0	791	0	791
Balance June 25, 2011	$ 137	$ 382	$ 16	$ 421,351	$ 69,234	$ 1,386	$ 492,506	$ 600	$ 493,106

8. Stock-Based Compensation

The Company recognized share-based compensation expense of $5.3 million and $5.7 million for the nine month periods ended June 23, 2012 and June 25, 2011, respectively, as a component of selling, general and administrative expenses. The tax benefit associated with share-based compensation expense for the nine month periods ended June 23, 2012 and June 25, 2011 was $2.0 million and $2.1 million, respectively.

9. Earnings Per Share

The following is a reconciliation of the numerators and denominators of the basic and diluted per share computations for income from continuing operations.

	Three Months Ended June 23, 2012			Nine Months Ended June 23, 2012		
	Income	Shares	Per Share	Income	Shares	Per Share
	(in thousands, except per share amounts)					
Basic EPS:						
Net income available to common shareholders	$ 22,699	47,661	$ 0.48	$ 31,232	47,580	$ 0.66
Effect of dilutive securities:						
Options to purchase common stock	0	476	(0.01)	0	455	(0.01)
Restricted shares	0	251	0	0	218	0
Diluted EPS:						
Net income available to common shareholders	$ 22,699	48,388	$ 0.47	$ 31,232	48,253	$ 0.65

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	Three Months Ended June 25, 2011			Nine Months Ended June 25, 2011		
	Income	Shares	Per Share	Income (Loss)	Shares	Per Share
	(in thousands, except per share amounts)					
Basic EPS:						
Net income available to common shareholders	$ 17,081	54,020	$ 0.32	$ 39,255	57,635	$ 0.68
Effect of dilutive securities:						
Options to purchase common stock	0	300	(0.01)	0	329	0
Restricted shares	0	178	0	0	151	0
Diluted EPS:						
Net income available to common shareholders	$ 17,081	54,498	$ 0.31	$ 39,255	58,115	$ 0.68

Options to purchase 12.8 million shares of common stock at prices ranging from $4.60 to $17.99 per share were outstanding at June 23, 2012 and options to purchase 12.6 million shares of common stock at prices ranging from $4.26 to $17.99 per share were outstanding at June 25, 2011.

For the three month periods ended June 23, 2012 and June 25, 2011, options to purchase 10.8 million and 9.4 million shares of common stock, respectively, were outstanding but were not included in the computation of diluted earnings per share because the option exercise prices were greater than the average market price of the common shares and, therefore, the effect would be anti-dilutive.

For the nine month period ended June 23, 2012 and June 25, 2011, options to purchase 9.9 million and 8.0 million shares of common stock, respectively, were outstanding but were not included in the computation of diluted earnings per share because the option exercise prices were greater than the average market price of the common shares and, therefore, the effect would be anti-dilutive.

10. Segment Information

Management has determined that the Company has two operating segments which are also reportable segments based on the level at which the Chief Operating Decision Maker reviews the results of operations to make decisions regarding performance assessment and resource allocation. These operating segments are Pet Products and Garden Products and are presented in the table below (in thousands).

	Three Months Ended		Nine Months Ended	
	June 25, 2011	June 23, 2012	June 25, 2011	June 23, 2012
Net sales:				
Pet Products	$ 227,256	$ 271,345	$ 639,464	$ 693,114
Garden Products	257,047	262,463	612,282	609,663
Total net sales	$ 484,303	$ 533,808	$ 1,251,746	$ 1,302,777
Income from operations:				
Pet Products	$ 27,214	$ 40,454	$ 61,978	$ 71,153
Garden Products	17,962	22,581	56,900	48,111
Corporate	(8,582)	(14,066)	(29,137)	(36,353)
Total income from operations	36,594	48,969	89,741	82,911
Interest expense net	(9,808)	(10,695)	(27,997)	(30,654)
Other income (expense)	318	102	116	(19)
Income taxes	9,879	14,554	21,952	19,716
Income including noncontrolling interest	17,225	23,822	39,908	32,522
Net income attributable to noncontrolling interest	144	1,123	653	1,290
Net income attributable to Central Garden & Pet Company	$ 17,081	$ 22,699	$ 39,255	$ 31,232
Depreciation and amortization:				
Pet Products	$ 3,576	$ 3,702	$ 10,917	$ 10,904
Garden Products	1,552	1,920	4,475	5,058
Corporate	1,978	2,402	5,924	7,114
Total depreciation and amortization	$ 7,106	$ 8,024	$ 21,316	$ 23,076

	June 25, 2011	June 23, 2012	September 24, 2011
Assets:			
Pet Products	$ 422,364	$ 432,342	$ 396,637
Garden Products	404,523	384,502	350,234
Corporate	328,845	362,874	346,132
Total assets	$ 1,155,732	$ 1,179,718	$ 1,093,003
Goodwill (included in corporate assets above):			
Pet Products	$ 201,639	$ 202,514	$ 202,514
Garden Products	7,709	7,709	7,709
Total goodwill	$ 209,348	$ 210,223	$ 210,223

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11. Consolidating Condensed Financial Information of Guarantor Subsidiaries

Certain 100% wholly-owned subsidiaries of the Company (as listed below, collectively the Guarantor Subsidiaries) have guaranteed fully and unconditionally, on a joint and several basis, the obligation to pay principal and interest on the Company s $450 million 8.25% Senior Subordinated Notes (the Notes) due March 1, 2018. Certain subsidiaries and operating divisions are not guarantors of the Notes and have been included in the financial results of the Parent in the information below. These Non-Guarantor entities are not material to the Parent. Those subsidiaries that are guarantors and co-obligors of the Notes are as follows:

Farnam Companies, Inc.

Four Paws Products Ltd.

Grant Laboratories, Inc.

Gulfstream Home & Garden, Inc.

Interpet USA, LLC

Kaytee Products, Inc.

Matthews Redwood & Nursery Supply, Inc.

Matson, LLC

New England Pottery, LLC

Pennington Seed, Inc. (including Pennington Seed, Inc. of Nebraska, Gro Tec, Inc., Seeds West, Inc., All-Glass Aquarium Co., Inc. and Cedar Works, LLC.)

Pets International, Ltd.

T.F.H. Publications, Inc.

Wellmark International (including B2E Corporation and B2E Biotech LLC)

In lieu of providing separate audited financial statements for the Guarantor Subsidiaries, the Company has included the accompanying consolidating condensed financial statements based on the Company s understanding of the Securities and Exchange Commission s interpretation and application of Rule 3-10 of the Securities and Exchange Commission s Regulation S-X.

CONSOLIDATING CONDENSED STATEMENT OF OPERATIONS

Three Months Ended June 23, 2012

(in thousands)

(unaudited)

	Parent	Guarantor Subsidiaries	Eliminations	Consolidated
Net sales	$ 161,734	$ 398,615	$ (26,541)	$ 533,808
Cost of products sold and occupancy	111,510	268,187	(26,541)	353,156

Gross profit	50,224	130,428	0	180,652
Selling, general and administrative expenses	41,061	90,622	0	131,683
Income from operations	9,163	39,806	0	48,969
Interest net	(10,727)	32	0	(10,695)
Other income (loss)	(4,494)	4,596	0	102
Income (loss) before income taxes	(6,058)	44,434	0	38,376
Income taxes (tax benefit)	(2,361)	16,915	0	14,554
Income (loss) including noncontrolling interest	(3,697)	27,519	0	23,822
Income attributable to noncontrolling interest	1,123	0	0	1,123
Income (loss) attributable to Central Garden & Pet Co. before equity in undistributed income of guarantor subsidiaries	(4,820)	27,519	0	22,699
Equity in undistributed income of guarantor subsidiaries	27,519	0	(27,519)	0
Net income attributable to Central Garden & Pet Co.	$ 22,699	$ 27,519	$ (27,519)	$ 22,699

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CONSOLIDATING CONDENSED STATEMENT OF OPERATIONS

Three Months Ended June 25, 2011

(in thousands)

(unaudited)

	Parent	Guarantor Subsidiaries	Eliminations	Consolidated
Net sales	$ 157,449	$ 358,384	$ (31,530)	$ 484,303
Cost of products sold and occupancy	118,876	247,568	(31,530)	334,914
Gross profit	38,573	110,816	0	149,389
Selling, general and administrative expenses	38,002	74,793	0	112,795
Income from operations	571	36,023	0	36,594
Interest net	(9,947)	139	0	(9,808)
Other income (loss)	(576)	894	0	318
Income (loss) before income taxes	(9,952)	37,056	0	27,104
Income taxes (tax benefit)	(3,629)	13,508	0	9,879
Income (loss) including noncontrolling interest	(6,323)	23,548	0	17,225
Income attributable to noncontrolling interest	144	0	0	144
Income (loss) attributable to Central Garden & Pet Co. before equity in undistributed income of guarantor subsidiaries	(6,467)	23,548	0	17,081
Equity in undistributed income of guarantor subsidiaries	23,548	0	(23,548)	0
Net income attributable to Central Garden & Pet Co.	$ 17,081	$ 23,548	$ (23,548)	$ 17,081

CONSOLIDATING CONDENSED STATEMENT OF OPERATIONS

Nine Months Ended June 23, 2012

(in thousands)

(unaudited)

	Parent	Guarantor Subsidiaries	Eliminations	Consolidated
Net sales	$ 416,119	$ 952,470	$ (65,812)	$ 1,302,777
Cost of products sold and occupancy	298,413	661,090	(65,812)	893,691