

FARMER BROTHERS CO
Form 10-Q
May 08, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2012

OR

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

For the transition period from _____ to _____

Commission file number: 001-34249

FARMER BROS. CO.

(exact name of registrant as specified in its charter)

Delaware
(State of Incorporation)

95-0725980
(I.R.S. Employer Identification No.)

20333 South Normandie Avenue
Torrance, California

90502

(address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: (310) 787-5200

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 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). 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 definitions 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	☒
Non-accelerated filer	☐ (Do not check if a smaller reporting company)	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 ☐ NO ☒

On May 7, 2012, the registrant had 16,281,035 shares outstanding of its common stock, par value \$1.00 per share, which is the registrant's only class of common stock.

FARMER BROS. CO.
FORM 10-Q QUARTERLY REPORT
TABLE OF CONTENTS

	Page
<u>PART I – FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements</u>	<u>3</u>
<u>Consolidated Balance Sheets at March 31, 2012 (unaudited) and June 30, 2011</u>	<u>3</u>
<u>Consolidated Statements of Operations for the Three and Nine Months Ended March 31, 2012 and 2011 (unaudited)</u>	<u>4</u>
<u>Consolidated Statements of Cash Flows for the Nine Months Ended March 31, 2012 and 2011 (unaudited)</u>	<u>5</u>
<u>Notes to Consolidated Financial Statements (unaudited)</u>	<u>6</u>
<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>18</u>
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>22</u>
<u>Item 4. Controls and Procedures</u>	<u>24</u>
<u>PART II – OTHER INFORMATION</u>	
<u>Item 1A. Risk Factors</u>	<u>24</u>
<u>Item 6. Exhibits</u>	<u>32</u>
<u>SIGNATURES</u>	<u>33</u>
<u>EXHIBIT INDEX</u>	<u>34</u>

Table of Contents

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

FARMER BROS. CO.

CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

	March 31, 2012 (Unaudited)	June 30, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	\$3,463	\$6,081
Short-term investments	18,715	24,874
Accounts and notes receivable, net	41,685	43,501
Inventories	75,762	79,759
Income tax receivable	825	448
Prepaid expenses	2,792	2,747
Total current assets	143,242	157,410
Property, plant and equipment, net	106,622	114,107
Goodwill and other intangible assets, net	13,542	14,639
Other assets	2,766	2,892
Deferred income taxes	1,005	1,005
Total assets	\$267,177	\$290,053
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$31,688	\$42,473
Accrued payroll expenses	16,757	15,675
Short-term borrowings under revolving credit facility	28,702	31,362
Short-term obligations under capital leases	2,745	1,570
Deferred income taxes	500	500
Other current liabilities	12,005	11,882
Total current liabilities	92,397	103,462
Accrued postretirement benefits	24,715	23,585
Other long-term liabilities—capital leases	9,759	7,066
Accrued pension liabilities	21,231	22,371
Accrued workers' compensation liabilities	3,821	3,639
Deferred income taxes	1,815	1,815
Total liabilities	153,738	161,938
Commitments and contingencies (Note 10)		
Stockholders' equity:		
Preferred stock, \$1.00 par value, 500,000 shares authorized and none issued	—	—
Common stock, \$1.00 par value, 25,000,000 shares authorized; 16,281,035 and 16,186,372 shares issued and outstanding at March 31, 2012 and June 30, 2011, respectively	16,281	16,186
Additional paid-in capital	34,093	36,470
Retained earnings	112,589	129,784
Unearned ESOP shares	(25,636)	(30,437)
Less accumulated other comprehensive loss	(23,888)	(23,888)
Total stockholders' equity	113,439	128,115
Total liabilities and stockholders' equity	\$267,177	\$290,053

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

Table of Contents

FARMER BROS. CO.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except share and per share data)

(Unaudited)

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2012	2011	2012	2011
Net sales	\$121,527	\$116,732	\$374,494	\$344,702
Cost of goods sold	78,380	74,871	247,121	213,880
Gross profit	43,147	41,861	127,373	130,822
Selling expenses	37,909	43,311	110,361	130,098
General and administrative expenses	9,345	13,013	27,050	37,749
Pension withdrawal expense	—	—	4,348	—
Operating expenses	47,254	56,324	141,759	167,847
Loss from operations	(4,107)	) (14,463	) (14,386	) (37,025)
Other (expense) income :				
Dividend income	295	531	958	2,128
Interest income	63	32	99	144
Interest expense	(498)	) (529	) (1,579	) (1,412)
Other, net	(1,831)	) 1,289	(2,458)	) 4,690
Total other (expense) income	(1,971)	) 1,323	(2,980)	) 5,550
Loss before taxes	(6,078)	) (13,140	) (17,366	) (31,475)
Income tax (benefit) expense	(577)	) 56	(171)	) 506
Net loss	\$(5,501)	) \$(13,196	) \$(17,195	) \$(31,981)
Net loss per common share — basic and diluted	\$(0.35)	) \$(0.87	) \$(1.11	) \$(2.13)
Weighted average common shares outstanding — basic and diluted	15,592,291	15,101,746	15,448,622	15,035,759
Cash dividends declared per common share	\$—	\$—	\$—	\$0.175

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

Table of Contents

FARMER BROS. CO.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended March 31,	
	2012	2011
Cash flows from operating activities:		
Net loss	\$(17,195)	\$(31,981)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	23,831	23,627
Provision for doubtful accounts	880	1,306
Deferred income taxes	—	(1,772)
(Gain) loss on sales of assets	(1,161)	72
ESOP and share-based compensation expense	2,519	3,245
Net loss (gain) on derivatives and investments	5,131	(3,034)
Change in operating assets and liabilities:		
Short-term investments	1,027	27,078
Accounts and notes receivable	936	(2,613)
Inventories	3,533	(4,289)
Income tax receivable	(377)	5,781
Prepaid expenses and other assets	81	(1,546)
Accounts payable	(9,342)	3,613
Accrued payroll expenses and other liabilities	1,102	1,274
Accrued postretirement benefits	1,130	1,097
Other long-term liabilities	(1,083)	5,988
Net cash provided by operating activities	11,012	27,846
Cash flows from investing activities:		
Purchases of property, plant and equipment	(10,533)	(15,435)
Proceeds from sales of property, plant and equipment	2,112	1,315
Net cash used in investing activities	(8,421)	(14,120)
Cash flows from financing activities:		
Proceeds from revolving line of credit	13,700	27,850
Repayments on revolving line of credit	(17,700)	(36,470)
Payments on capital lease obligations	(1,209)	(913)
Dividends paid	—	(4,657)
Net cash used in financing activities	(5,209)	(14,190)
Net decrease in cash and cash equivalents	(2,618)	(464)
Cash and cash equivalents at beginning of period	6,081	4,149
Cash and cash equivalents at end of period	\$3,463	\$3,685
Non-cash investing activities:		
Additions to capital leases	\$5,203	\$5,546

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

Table of Contents

FARMER BROS. CO.

Notes to Consolidated Financial Statements
(Unaudited)

Note 1. Farmer Bros. Co. and Summary of Significant Accounting Policies

The Company

Farmer Bros. Co., a Delaware corporation (including its consolidated subsidiaries, unless the context otherwise requires, herein referred to as the “Company,” “we,” “our” or “Farmer Bros.”), is a manufacturer, wholesaler and distributor of coffee, tea and culinary products. The Company is a direct distributor of coffee to restaurants, hotels, casinos, hospitals and other food service providers, and is a provider of private brand coffee programs to grocery retailers, restaurant chains, convenience stores, and independent coffee houses, nationwide. The Company was founded in 1912, was incorporated in California in 1923, and reincorporated in Delaware in 2004. The Company operates in one business segment.

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 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 (“GAAP”) for complete consolidated financial statements. In the opinion of management, all adjustments (consisting only of normal recurring accruals, unless otherwise indicated) considered necessary for a fair presentation of the interim financial data have been included. Operating results for the three and nine months ended March 31, 2012 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2012. Events occurring subsequent to March 31, 2012 have been evaluated for potential recognition or disclosure in the unaudited consolidated financial statements for the three and nine months ended March 31, 2012.

The accompanying unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company’s Annual Report on Form 10-K for the fiscal year ended June 30, 2011, filed with the Securities and Exchange Commission (the “SEC”) on September 13, 2011.

Use of Estimates

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. We review our estimates on an ongoing basis using currently available information. Changes in facts and circumstances may result in revised estimates and actual results may differ from those estimates.

Reclassifications

Certain reclassifications have been made to prior year balances to conform to the current year presentation.

Fair Value Measurements

Fair value is the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants. The Company maximizes the use of observable market inputs, minimizes the use of unobservable market inputs and discloses in the form of an outlined hierarchy the details of such fair value measurements. See Note 2 for additional information.

Coffee Brewing Equipment and Service

The Company classifies certain expenses related to coffee brewing equipment provided to customers as cost of goods sold. These costs include the cost of equipment as well as the cost of servicing that equipment (including service employees’ salaries, cost of transportation and the cost of supplies and parts) and are considered directly attributable to the generation of revenues from the Company’s customers. Accordingly, such costs included in cost of goods sold in the accompanying unaudited consolidated financial statements for the three months ended March 31, 2012 and 2011 are \$6.7 million and \$5.4 million, respectively. Cost of coffee brewing equipment and service for the nine months ended March 31, 2012 and 2011 was \$19.1 million and \$19.4 million, respectively. The Company capitalized coffee brewing equipment in the amounts of \$9.9 million and \$10.1 million during the nine months ended March 31, 2012 and 2011, respectively. Depreciation expense related to capitalized coffee brewing equipment reported as cost of

goods sold was \$2.9 million and \$2.5 million in the three months ended March 31, 2012 and 2011, respectively. Depreciation expense related to capitalized coffee brewing equipment reported as cost of

Table of Contents

Farmer Bros. Co.

Notes to Consolidated Financial Statements (Unaudited)

goods sold was \$8.7 million and \$6.9 million in the nine months ended March 31, 2012 and 2011, respectively.

Revenue Recognition

Most product sales are made “off-truck” to the Company’s customers at their places of business by the Company’s sales representatives. Revenue is recognized at the time the Company’s sales representatives physically deliver products to customers and title passes or upon acceptance by the customer when shipped by third party delivery.

The Company sells roast and ground coffee and tea to The J.M. Smucker Company (“J.M. Smucker”) pursuant to a co packing agreement, which was assigned by Sara Lee Corporation (“Sara Lee”) to J.M. Smucker on February 17, 2012, as part of J.M. Smucker's acquisition of Sara Lee's coffee business. The Company recognizes revenue from this arrangement on a net basis, net of direct costs of revenue. As of March 31, 2012, the Company had \$2.7 million of receivables related to this arrangement, which are included in “Other receivables” (see Note 3).

Earnings (Loss) Per Common Share

Basic earnings (loss) per share (“EPS”) represents net earnings attributable to common stockholders divided by the weighted-average number of common shares outstanding for the period. Diluted EPS represents net earnings attributable to common stockholders divided by the weighted-average number of common shares outstanding, inclusive of the dilutive impact of common equivalent shares outstanding during the period. However, nonvested restricted stock awards (referred to as participating securities) are excluded from the dilutive impact of common equivalent shares outstanding in accordance with authoritative guidance under the two-class method since the nonvested restricted stockholders are entitled to participate in dividends declared on common stock as if the shares were fully vested and hence are deemed to be participating securities. Under the two-class method, earnings (loss) attributable to nonvested restricted stockholders are excluded from net earnings (loss) attributable to common stockholders for purposes of calculating basic and diluted EPS.

Computation of EPS for the three and nine months ended March 31, 2012 does not include the dilutive effect of 662,810 shares issuable under stock options since their inclusion would be anti-dilutive. Computation of EPS for the three and nine months ended March 31, 2011 does not include the dilutive effect of 531,760 shares issuable under stock options since their inclusion would be anti-dilutive. Accordingly, the unaudited consolidated financial statements present only basic net income (loss) per common share for all periods presented (see Note 9).

Dividends Declared

In the fourth quarter of fiscal 2011 and in the first three quarters of fiscal 2012, the Company’s Board of Directors voted to omit the payment of a quarterly dividend for the first, second, third and fourth quarters of fiscal 2012, respectively. The amount, if any, of dividends to be paid in the future will depend upon the Company’s then available cash, anticipated cash needs, overall financial condition, loan agreement restrictions, future prospects for earnings and cash flows, as well as other relevant factors.

Impairment of Goodwill and Intangible Assets

The Company performs its annual goodwill and indefinite-lived intangible assets impairment test as of June 30 of each fiscal year. Goodwill and other indefinite-lived intangible assets are not amortized but instead are reviewed for impairment annually and on an interim basis if events or changes in circumstances between annual tests indicate that an asset might be impaired. Indefinite-lived intangible assets are tested for impairment by comparing their fair values to their carrying values. Testing for impairment of goodwill is a two-step process. The first step requires the Company to compare the fair value of its reporting units to the carrying value of the net assets of the respective reporting units, including goodwill. If the fair value of the reporting unit is less than the carrying value, goodwill of the reporting unit is potentially impaired and the Company then completes step two to measure the impairment loss, if any. The second step requires the calculation of the implied fair value of goodwill by deducting the fair value of all tangible and intangible net assets of the reporting unit from the fair value of the reporting unit. If the implied fair value of goodwill is less than the carrying amount of goodwill, an impairment loss is recognized equal to the difference.

In addition to an annual test, goodwill and indefinite-lived intangible assets must also be tested on an interim basis if events or circumstances indicate that the estimated fair value of such assets has decreased below their carrying value.

There were no such events or circumstances during the three months ended March 31, 2012.

7

Table of Contents

Farmer Bros. Co.

Notes to Consolidated Financial Statements (Unaudited)

Long-lived Assets, Excluding Goodwill and Indefinite-lived Intangible Assets

The Company reviews the recoverability of its long-lived assets whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Long-lived assets evaluated for impairment are grouped with other assets to the lowest level for which identifiable cash flows are largely independent of the cash flows of other groups of assets and liabilities. The estimated future cash flows are based upon, among other things, assumptions about expected future operating performance, and may differ from actual cash flows. If the sum of the projected undiscounted cash flows (excluding interest) is less than the carrying value of the assets, the assets will be written down to the estimated fair value in the period in which the determination is made. There were no such events or circumstances during the three months ended March 31, 2012.

Recently Adopted Accounting Standards

No new accounting pronouncements were adopted during the quarter ended March 31, 2012.

New Accounting Pronouncements

In September 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2011-09, "Compensation—Retirement Benefits—Multiemployer Plans (Subtopic 715-80), Disclosures about an Employer's Participation in a Multiemployer Plan" ("ASU 2011-09"). ASU 2011-09 requires companies participating in multiemployer pension plans to disclose more information about the multiemployer plan(s), the employer's level of participation in the multiemployer plan(s), the financial health of the plan(s), and the nature of the employer's commitments to the plan(s). For public entities, the amendments are effective for fiscal years ending after December 15, 2011 and, for the Company, the amendments are effective for the fiscal year ending June 30, 2012. Since ASU 2011-09 does not change the accounting for an employer's participation in a multiemployer plan, the Company believes that adoption of ASU 2011-09 will not impact the results of operations, financial position or cash flows of the Company.

In September 2011, the FASB issued ASU No. 2011-08, "Goodwill and Other (Topic 350), Testing Goodwill for Impairment" ("ASU 2011-08"). Pursuant to ASU 2011-08 companies will have the option to first assess qualitative factors to determine whether it is more likely than not (a likelihood of more than 50%) that the fair value of a reporting unit is less than its carrying amount. If after considering the totality of events and circumstances an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, performing the two-step impairment test is unnecessary. The amendments include examples of events and circumstances that an entity should consider. ASU 2011-08 is effective for annual and interim impairment tests performed for fiscal years beginning after June 15, 2012 and is effective for the Company for fiscal 2013 beginning July 1, 2012. The Company believes that adoption of ASU 2011-08 will not impact the results of operations, financial position or cash flows of the Company.

In June 2011, the FASB issued ASU No. 2011-05, "Comprehensive Income (Topic 220), Presentation of Comprehensive Income" ("ASU 2011-05"). The new U.S. GAAP guidance gives companies two choices of how to present items of net income, items of other comprehensive income ("OCI") and total comprehensive income. Companies can create one continuous statement of comprehensive income or two separate consecutive statements. Companies will no longer be allowed to present OCI in the statement of stockholders' equity. EPS would continue to be based on net income. Although existing guidance related to items that must be presented in OCI has not changed, companies will be required to display reclassification adjustments for each component of OCI in both net income and OCI. Also, companies will need to present the components of OCI in their interim and annual financial statements. The amendments in the ASU should be applied retrospectively. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 and, for the Company, the amendments are effective beginning July 1, 2012. The Company believes that adoption of ASU 2011-05 will not impact the results of operations, financial position or cash flows of the Company. In December 2011, the FASB issued ASU No. 2011-12, "Comprehensive Income (Topic 220), Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards

Update No. 2011-05” (“ASU 2011-12”). ASU 2011-12 defers the ASU 2011-05 requirement that companies present reclassification adjustments out of accumulated other comprehensive income, until the FASB is able to address the concerns of stakeholders that the new presentation requirements would be difficult for preparers and may add unnecessary complexity to the financial statements.

In May 2011, the FASB issued ASU No. 2011-04, “Fair Value Measurement (Topic 820), Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs” (“ASU 2011-04”). ASU 2011-04 amends the fair value measurement and disclosure guidance in Accounting Standards Codification (“ASC”) 820, “Fair Value Measurements and Disclosures” (“ASC 820”), of the FASB for financial assets and liabilities to converge U.S. GAAP and

Table of Contents

Farmer Bros. Co.

Notes to Consolidated Financial Statements (Unaudited)

International Financial Reporting Standards requirements for measuring amounts at fair value as well as disclosures about these measurements. Many of the amendments clarify existing concepts and are generally not expected to result in significant changes to how many companies currently apply the fair value principles. In certain instances, however, the FASB changed a principle to achieve convergence, and while limited, these amendments have the potential to significantly change practice for some companies. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011 and, for the Company, the amendments are effective beginning July 1, 2012. The Company believes that adoption of ASU 2011-04 will not impact the results of operations, financial position or cash flows of the Company.

Note 2. Investments and Derivative Instruments

The Company purchases various derivative instruments as investments or to create economic hedges of its interest rate risk and commodity price risk. At March 31, 2012 and June 30, 2011, derivative instruments were not designated as accounting hedges as defined by ASC 815, "Accounting for Derivative Instruments and Hedging Activities." The fair value of derivative instruments is based upon broker quotes. The Company records unrealized gains and losses on trading securities and changes in the market value of certain coffee contracts meeting the definition of derivatives in "Other, net."

The Company groups its assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1 — Valuation is based upon quoted prices for identical instruments traded in active markets.

Level 2 — Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3 — Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

Assets and liabilities measured and recorded at fair value on a recurring basis were as follows:

As of March 31, 2012 (In thousands)	Total	Level 1 (Unaudited)	Level 2	Level 3
Preferred stock(1)	\$18,487	\$13,575	\$4,912	\$—
Futures, options and other derivative assets(1)	\$228	\$—	\$228	\$—
Derivative liabilities(2)	\$1,200	\$—	\$1,200	\$—
As of June 30, 2011 (In thousands)	Total	Level 1	Level 2	Level 3
Preferred stock(1)	\$24,407	\$7,181	\$17,226	\$—
Futures, options and other derivative assets(1)	\$467	\$—	\$467	\$—
Derivative liabilities(2)	\$1,647	\$—	\$1,647	\$—

(1)Included in "Short-term investments" on the consolidated balance sheet.

(2)Included in "Other current liabilities" on the consolidated balance sheet.

There were no significant transfers of securities between Level 1 and Level 2 in each of the periods presented.

Gains and losses, both realized and unrealized, are included in "Other, net." Net realized and unrealized gains and losses are as follows:

Three Months Ended

Nine Months Ended

Edgar Filing: FARMER BROTHERS CO - Form 10-Q

(In thousands)	March 31, 2012 (Unaudited)	2011	March 31, 2012	2011
Net realized (losses) gains	\$(5,006	) \$190	\$(4,925	) \$190
Net unrealized gains (losses)	2,125	254	(206	) 2,844
Net realized and unrealized (losses) gains	\$(2,881	) \$444	\$(5,131	) \$3,034

9

Table of Contents

Farmer Bros. Co.

Notes to Consolidated Financial Statements (Unaudited)

Preferred stock investments as of March 31, 2012 consisted of securities with a fair value of \$15.3 million in an unrealized gain position and securities with a fair value of \$3.2 million in an unrealized loss position. Preferred stock investments as of June 30, 2011 consisted of securities with a fair value of \$18.1 million in an unrealized gain position and securities with a fair value of \$6.3 million in an unrealized loss position. The following tables show gross unrealized losses (although such losses have been recognized in the statements of operations) and fair value for those investments that were in an unrealized loss position as of March 31, 2012 and June 30, 2011, aggregated by the length of time those investments have been in a continuous loss position:

(In thousands)	March 31, 2012 (Unaudited)			
	Less than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Preferred stock	\$1,516	\$(9)	\$1,671	\$(1,214)

(In thousands)	June 30, 2011			
	Less than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Preferred stock	\$319	\$(3)	\$6,326	\$(1,122)

Note 3. Accounts and Notes Receivable, net

(In thousands)	March 31, 2012 (Unaudited)	June 30, 2011
Trade receivables	\$40,043	\$40,716
Other receivables	3,613	5,637
Allowance for doubtful accounts	(1,971)	(2,852)
	\$41,685	\$43,501

Note 4. Inventories

March 31, 2012 (In thousands)	Processed (Unaudited)	Unprocessed	Total
Coffee	\$26,400	\$6,263	\$32,663
Tea and culinary products	28,886	4,656	33,542
Coffee brewing equipment	4,386	5,171	9,557
	\$59,672	\$16,090	\$75,762
June 30, 2011 (In thousands)	Processed	Unprocessed	Total
Coffee	\$22,464	\$17,220	\$39,684
Tea and culinary products	25,469	4,100	29,569
Coffee brewing equipment	3,930	6,576	10,506
	\$51,863	\$27,896	\$79,759

Inventories are valued at the lower of cost or market. Costs of coffee, tea and culinary products are accounted for on the last in, first out (LIFO) basis. Costs of coffee brewing equipment manufactured are accounted for on the first in, first out (FIFO) basis. The Company anticipates that certain inventory quantities will be reduced as of June 30, 2012 and expects the reduction to result in a liquidation of LIFO inventory quantities carried at lower costs prevailing in

prior years as compared to the estimated current year cost in fiscal 2012. The expected beneficial effect of this liquidation for fiscal 2012 is \$10.4 million of which the Company recorded \$2.2 million and \$7.8 million, respectively, in cost of goods sold for the three and nine months ended March 31, 2012. An actual valuation of inventory under the LIFO method is made only at the end of each fiscal 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 fiscal year-end inventory levels and costs. Because these estimates are subject to many

Table of Contents

Farmer Bros. Co.

Notes to Consolidated Financial Statements (Unaudited)

forces beyond management's control, interim results are subject to the final fiscal year-end LIFO inventory valuation. The Company routinely enters into specialized hedging transactions to purchase future coffee contracts to enable it to lock in green coffee prices within a pre-established range, and holds a mix of futures contracts and options to help hedge against volatility in green coffee prices. Gains and losses on these derivative instruments are realized immediately in "Other, net."

For the three and nine months ended March 31, 2012, the Company recorded \$(1.8) million and \$(4.9) million, respectively, in coffee-related net realized derivative losses. In each of the three and nine month periods ended March 31, 2011, the Company recorded \$0.8 million in coffee-related net realized derivative gains.

For the three and nine months ended March 31, 2012, the Company recorded \$(1.5) million and \$(2.6) million, respectively, in coffee-related net unrealized derivative losses. For the three and nine months ended March 31, 2011, the Company recorded \$(0.9) million in coffee-related net unrealized derivative losses and \$0.2 million in coffee-related net unrealized gains, respectively.

Note 5. Employee Benefit Plans

Single Employer Pension Plans

The Company has a defined benefit pension plan, the Farmer Bros. Salaried Employees Pension Plan, for the majority of its employees who are not covered under a collective bargaining agreement (the "Farmer Bros. Plan") and two defined benefit pension plans for certain hourly employees covered under a collective bargaining agreement (the "Brewmatic Plan" and the "Hourly Employees' Plan"). All assets and benefit obligations were determined using a measurement date of June 30.

The Company amended the Farmer Bros. Plan, freezing the benefit for all participants effective June 30, 2011. After the plan freeze, participants do not accrue any benefits under the plan, and new hires are not eligible to participate in the plan.

The net periodic benefit cost for the defined benefit pension plans is as follows:

Components of net periodic benefit cost

	Three Months Ended March 31, 2012		Nine Months Ended March 31, 2012	
	2011		2011	
(In thousands)	(Unaudited)			
Service cost	\$124	\$1,300	\$371	\$3,900
Interest cost	1,525	1,569	4,575	4,708
Expected return on plan assets	(1,703)	) (1,329	) (5,108	) (3,987
Amortization of net (gain) loss*	342	836	1,027	2,507
Amortization of prior service cost (credit)*	5	41	14	123
Net periodic benefit cost	\$293	\$2,417	\$879	\$7,251

These amounts represent the estimated portion of the net (gain) loss and net prior service cost (credit) remaining in
*accumulated other comprehensive income that is expected to be recognized as a component of net periodic benefit cost over the current fiscal year.

Weighted-average assumptions used to determine net periodic benefit cost

	Fiscal	
	2012	2011
Discount rate	5.60%	5.60%

Edgar Filing: FARMER BROTHERS CO - Form 10-Q

Expected long-term rate of return	8.25%	8.25%
Rate of compensation increase*	3.00%	3.00%

*For Hourly Employees' Plan only

Table of Contents

Farmer Bros. Co.

Notes to Consolidated Financial Statements (Unaudited)

Basis used to determine expected long-term return on plan assets

Historical and future expected rates of return of multiple asset classes were analyzed to develop a risk-free real rate of return and risk premiums for each asset class. The overall rate for each asset class was developed by combining a long-term inflation component, the risk-free real rate of return, and the associated risk premium. A weighted-average rate of return was developed based on those overall rates and the target asset allocation of the plans.

Multiemployer Pension Plans

During the nine months ended March 31, 2012, the Company withdrew from two multiemployer pension plans and recorded a charge of \$4.3 million associated with withdrawal from one of these plans, representing the present value of the estimated withdrawal liability expected to be paid in quarterly installments of \$0.1 million over 80 quarters. Installment payments will commence once the final determination of the amount of withdrawal liability is established, which determination may take up to 24 months from the date of withdrawal from the pension plan. Upon withdrawal, the employees covered under these multiemployer pension plans were included in the Company's 401(k) Plan. The \$4.3 million estimated withdrawal charge is included in the Company's statement of operations for the nine months ended March 31, 2012 as "Pension withdrawal expense" and in current and long-term liabilities on the Company's balance sheet at March 31, 2012. There is no anticipated withdrawal liability associated with the other multiemployer pension plan from which the Company withdrew.

The Company is currently in negotiations to withdraw from the remaining multiemployer pension plan in which it participates and, if successful, may incur a withdrawal liability, the amount of which could be material to the Company's results of operations and cash flows.

401(k) Plan

The Company's 401(k) Plan is available to all eligible employees who have worked more than 1,000 hours during a calendar year and were employed at the end of the calendar year. Participants in the 401(k) Plan may choose to contribute 1% to 15% of their annual pay subject to the maximum contribution allowed by the Internal Revenue Service. The Company's matching contribution is discretionary based on approval by the Company's Board of Directors. For the calendar years 2011 and 2012, the Company's Board of Directors approved a Company matching contribution of 50% of an employee's annual contribution to the 401(k) Plan, up to 6% of the employee's eligible income. The matching contributions (and any earnings thereon) vest at the rate of 20% for each of the participant's first five years of vesting service, so that a participant is fully vested in his or her matching contribution account after five years of vesting service. A participant is automatically vested in the event of death, disability or attainment of age 65 while employed by the Company. Employees are 100% vested in their contributions. For employees subject to a collective bargaining agreement, the match is only available if so provided in the labor agreement.

For the calendar year ended December 31, 2011, the Company's matching contribution was \$0.7 million which has been recorded in operating expenses as of March 31, 2012. The Company accrued \$0.4 million in operating expenses as of March 31, 2012, towards matching contributions for the calendar year ended December 31, 2012.

Postretirement Benefits

The Company sponsors an unfunded postretirement medical, dental and vision plan that covers qualified non-union retirees and certain qualified union retirees. Under this postretirement plan, the Company's contributions toward premiums for retiree medical, dental and vision coverage for participants and dependents are scaled based on length of service, with greater Company contributions for retirees with greater length of service, but subject to a maximum monthly Company contribution.

Table of Contents

Farmer Bros. Co.

Notes to Consolidated Financial Statements (Unaudited)

The following table shows the components of net periodic postretirement benefit cost for the three and nine months ended March 31, 2012 and 2011.

Components of net periodic postretirement benefit cost

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2012	2011	2012	2011
(In thousands)	(Unaudited)			
Service cost	\$409	\$474	\$1,227	\$1,422
Interest cost	330	314	990	942
Expected return on plan assets	—	—	—	—
Amortization of net (gain) loss	(199)	) (180	) (597	) (540
Amortization of transition (asset) obligation	—	—	—	—
Amortization of prior service cost (credit)	(58	) (58	) (174	) (174
Net periodic postretirement benefit cost	\$482	\$550	\$1,446	\$1,650
Weighted-average assumptions used to determine net periodic postretirement benefit cost				

	Fiscal 2012	2011
Discount rate	5.46%	5.52%

The fiscal 2012 estimate of net periodic postretirement benefit cost is based on July 1, 2010 census data assuming there were no demographic actuarial gains or losses during the fiscal year ended June 30, 2011.

Note 6. Bank Loan

On September 12, 2011, the Company entered into an Amended and Restated Loan and Security Agreement (the “New Loan Agreement”) among the Company and Coffee Bean International, Inc. (“CBI”), as Borrowers, certain of the Company’s other subsidiaries, as Guarantors, the Lenders party thereto, and Wells Fargo Bank, National Association (“Wells Fargo”), as Agent. The New Loan Agreement provides for a senior secured revolving credit facility of up to \$85 million, with a letter of credit sublimit of \$20 million. The new revolving line of credit provides for advances of 85% of eligible accounts receivable and 75% of eligible inventory (subject to a \$60 million inventory loan limit), as defined. The New Loan Agreement provides for a range of interest rates based on modified Monthly Average Excess Availability levels with a range of PRIME + 0.25% to PRIME + 0.75% or Adjusted Eurodollar Rate + 2.0% to Adjusted Eurodollar Rate + 2.5%. The New Loan Agreement has an amendment fee of 0.375% and an unused line fee of 0.25%. Outstanding obligations under the New Loan Agreement are collateralized by all of the Borrowers’ assets, including the Company’s preferred stock portfolio. The term of the New Loan Agreement expires on March 2, 2015. The New Loan Agreement contains a variety of affirmative and negative covenants of types customary in an asset-based lending facility, including those relating to reporting requirements, maintenance of records, properties and corporate existence, compliance with laws, incurrence of other indebtedness and liens, limitations on certain payments, including the payment of dividends and capital expenditures, and transactions and extraordinary corporate events. The New Loan Agreement allows the Company to pay dividends, subject to certain liquidity requirements. The New Loan Agreement also contains financial covenants requiring the Borrowers to maintain minimum Excess Availability and Total Liquidity levels. The New Loan Agreement allows the Lender to establish reserve requirements, which may reduce the amount of credit otherwise available to the Company, to reflect events, conditions, or risks that would have a reasonable likelihood of adversely affecting the Lender’s collateral or the Company’s assets, including the Company’s green coffee inventory.

On January 9, 2012, the New Loan Agreement was amended (“Amendment No. 1”) in connection with JPMorgan Chase Bank, N.A. (“JPMorgan Chase”), becoming an additional Lender thereunder. Pursuant to Amendment No. 1, Wells Fargo will provide a commitment of \$60 million and JPMorgan Chase will provide a commitment of \$25 million.

Table of Contents

Farmer Bros. Co.

Notes to Consolidated Financial Statements (Unaudited)

On March 31, 2012, the Company was eligible to borrow up to a total of \$80.2 million under the credit facility. As of March 31, 2012, the Company had borrowed \$28.7 million of this amount, excluding \$0.2 million in loan extension fees, utilized \$10.3 million of its letters of credit sublimit, and had excess availability of \$41.0 million under the credit facility. As of March 31, 2012, the interest rate on the Company's outstanding borrowings under the credit facility was 3.5%. The Company was in compliance with all restrictive covenants under the credit facility as of March 31, 2012.

Note 7. Share-Based Compensation

The Company measures and recognizes compensation expense for all share-based payment awards made under the Farmer Bros. Co. 2007 Omnibus Plan (the "Omnibus Plan") based on estimated fair values.

Stock Options

On December 8, 2011, the Company granted 96,834 shares issuable upon the exercise of non-qualified stock options with an exercise price of \$7.32 per share to eligible employees and officers under the Omnibus Plan. Shares issuable under the options ratably vest over a three-year period.

On February 13, 2012, pursuant to agreements with each of Jeffrey A. Wahba, Treasurer and Chief Financial Officer and then Interim Co-Chief Executive Officer; Patrick G. Criteser, then Interim-Co-Chief Executive Officer; and Mark A. Harding, Senior Vice President of Operations, the Company granted 65,000 shares, 85,000 shares and 20,000 shares, respectively, issuable upon the exercise of non-qualified stock options with an exercise price of \$10.82 per share. Shares issuable under these options vest on the first anniversary of the grant date, subject to accelerated vesting in the case of death, permanent incapacity and certain events relating to termination of employment as provided in the applicable employment agreement or arrangement and the award agreement.

Following are the weighted average assumptions used in the Black-Scholes Merton valuation model for the grants issued during the nine months ended March 31, 2012 and 2011:

	Nine Months Ended March 31,		
	2012	2011	
Weighted average fair value of options	\$4.74	\$8.17	
Pre-vest forfeiture rate	6.5	% 6.5	%
Risk-free interest rate	1.1	% 2.8	%
Dividend yield	—	% 2.0	%
Average expected life	6 years	6 years	
Expected stock price volatility	52.5	% 54.9	%

The Company estimates the fair value of share-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service period in the Company's consolidated statement of operations. The Company estimates forfeitures based on its historical pre-vest forfeiture rate and will revise those estimates in subsequent periods if actual forfeitures differ from those estimates. The Company's assumption regarding expected stock price volatility is based on the historical volatility of its stock price. The risk-free interest rate is based on U.S. Treasury zero-coupon issues at the date of grant with a remaining term equal to the expected life of the stock options.

Table of Contents

Farmer Bros. Co.

Notes to Consolidated Financial Statements (Unaudited)

The following table summarizes stock option activity for the nine months ended March 31, 2012:

(Unaudited)	Number of Stock Options	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value	Weighted Average Remaining Life (Years)	Aggregate Intrinsic Value (In thousands)
Outstanding at June 30, 2011	497,810	\$17.19	\$6.44	5.7	\$61
Granted	266,834	\$9.55	\$4.74	6.8	\$358
Cancelled/forfeited	(101,834)	\$20.84	\$6.35	—	\$—
Outstanding at March 31, 2012	662,810	\$13.55	\$5.77	5.8	\$506
Vested and exercisable, March 31, 2012	162,702	\$19.89	\$6.74	4.3	\$—
Vested and expected to vest, March 31, 2012	635,476	\$13.64	\$5.79	5.8	\$467

The aggregate intrinsic value in the table above represents the total pretax intrinsic value, based on the Company's closing stock price of \$10.89 at March 30, 2012, representing the last trading day of the quarter, which would have been received by award holders had all award holders exercised their awards that were in-the-money as of that date. As of March 31, 2012, there was approximately \$1.9 million of unrecognized compensation cost related to stock options and 73,852 shares vested during the nine months ended March 31, 2012. Compensation expense recognized in general and administrative expenses in each of the three months ended March 31, 2012 and 2011 was \$0.4 million and \$0.3 million, respectively. Compensation expense recognized in general and administrative expenses in each of the nine months ended March 31, 2012 and 2011 was \$1.0 million and \$0.6 million, respectively.

Restricted Stock

On December 8, 2011, the Company granted 78,756 shares of restricted stock with a grant date fair value of \$7.32 per share to eligible employees, officers and directors under the Omnibus Plan. Shares of restricted stock generally vest at the end of three years from the grant date for eligible employees and officers who are employees, with the exception of 10,384 shares of restricted stock granted in May 2011 to Patrick G. Criteser, then Interim Co-Chief Executive Officer, and 20,000 shares of restricted stock granted in February 2012 to Jeffrey A. Wahba, Treasurer and Chief Financial Officer and then Interim Co-Chief Executive Officer, which shares vest on the first anniversary of the grant date. Shares of restricted stock vest ratably over a period of three years for directors and officers who are not employees. Compensation expense is recognized on a straight-line basis over the service period based on the estimated fair value of the restricted stock that is ultimately expected to vest. Restricted stock based compensation expense recognized in general and administrative expenses in each of the three months ended March 31, 2012 and 2011 was \$0.2 million. Restricted stock based compensation expense recognized in general and administrative expenses in each of the nine months ended March 31, 2012 and 2011 was \$0.4 million. As of March 31, 2012, there was approximately \$1.3 million of unrecognized compensation cost related to restricted stock. During the nine months ended March 31, 2012, 16,843 shares of restricted stock vested.

The following table summarizes restricted stock activity for the nine months ended March 31, 2012:

(Unaudited)	Shares Awarded	Weighted Average Grant Date Fair Value	Weighted Average Remaining Life (Years)	Aggregate Intrinsic Value (In thousands)
Outstanding at June 30, 2011	80,687	\$17.31	2.6	\$818
Granted	98,756	\$8.03	2.3	\$793
Vested	(16,843)	\$19.61	—	\$127

Edgar Filing: FARMER BROTHERS CO - Form 10-Q

Cancelled/Forfeited	(4,093	) \$17.21	—	\$—
Outstanding at March 31, 2012	158,507	\$11.29	1.9	\$1,726
Expected to vest, March 31, 2012	129,564	\$11.29	1.9	\$1,411

Note 8. Income Taxes

The Company adjusts its effective tax rate each quarter based on its current estimated annual effective tax rate. The Company also records the tax impact of certain discrete items, unusual or infrequently occurring tax events and the effects of

Table of Contents

Farmer Bros. Co.

Notes to Consolidated Financial Statements (Unaudited)

changes in tax laws or rates, in the interim period in which they occur. In addition, the Company evaluates its deferred tax assets quarterly to determine if a valuation allowance is required.

The Company considered whether a valuation allowance should be recorded against deferred tax assets based on the likelihood that the benefits of the deferred tax assets would or would not ultimately be realized in future periods. In making this assessment, significant weight was given to evidence that could be objectively verified such as recent operating results and less consideration was given to less objective indicators such as future earnings projections. After consideration of positive and negative evidence, including the recent history of losses, the Company cannot conclude that it is more likely than not that it will generate future earnings sufficient to realize the Company's deferred tax assets. Accordingly, the Company increased its valuation allowance by \$2.8 million in the three months ended March 31, 2012 to \$67.9 million. The valuation allowance as of June 30, 2011 was \$60.4 million.

In January 2012, the State of California completed an audit of the Company's June 30, 2006 and June 30, 2007 tax returns, and the Company also reached a settlement agreement with the State of California regarding its audit of the Company's June 30, 2002 to June 30, 2005 R&D tax credit claims. As a result of these decisions, the Company released \$0.7 million related to uncertain tax positions during the three months ended March 31, 2012, which resulted in an income tax benefit of \$0.6 million, excluding interest and penalties.

A summary of the income tax (benefit) expense recorded in the three and nine months ended March 31, 2012 and 2011 is as follows:

(In thousands)	Three Months Ended		Nine Months Ended	
	March 31, 2012 (Unaudited)	2011	March 31, 2012	2011
Loss before taxes	\$ (6,078	) \$ (13,140	) \$ (17,366	) \$ (31,475
Income tax expense at federal statutory rate	(2,066	) (4,467	) (5,904	) (10,701
State income taxes and credits	(238	) (522	) (687	) (1,305
Dividends received deduction	(79	) (4	) (137	) (500
Valuation allowance	2,794	5,047	7,478	12,943
ESOP dividend	(464	) —	(464	) —
Changes in uncertain tax positions	(673	) —	(673	) —
Other permanent items	149	2	216	69
Income tax (benefit) expense	\$ (577	) \$ 56	\$ (171	) \$ 506

As of March 31, 2012 and June 30, 2011 the Company had not recognized the following tax benefits in its consolidated financial statements:

(In thousands)	As of March 31, 2012 (Unaudited)	June 30, 2011
Total unrecognized tax benefits*	\$3,211	\$3,902
Unrecognized benefits that, if recognized, would affect the Company's effective tax rate, subject to the valuation allowance*	\$3,064	\$3,637

*Excluding interest and penalties

The Company believes it is reasonably possible that \$40,000 of its total unrecognized tax benefits could be released in the next twelve months.

The Company is currently appealing a decision reached by the Internal Revenue Service in connection with the audit of the Company's June 30, 2003 through June 30, 2008 tax returns. Based on the preliminary indication of the Appeals Officer in January 2012, the Company expects that the audit results will be upheld.

Table of Contents

Farmer Bros. Co.

Notes to Consolidated Financial Statements (Unaudited)

Note 9. Earnings (Loss) Per Common Share

The following table sets forth the calculation of basic and diluted net loss per common share:

(In thousands, except share and per share data)	Three Months Ended March 31,		Nine Months Ended March 31,	
	2012	2011	2012	2011
	(Unaudited)			
Net loss attributable to common stockholders - basic	\$ (5,445	) \$ (13,116	) \$ (17,019	) \$ (31,746)
Net loss attributable to holders of nonvested restricted stock	(56	) (80	) (176	) (235)
Total net loss	\$ (5,501	) \$ (13,196	) \$ (17,195	) \$ (31,981)
Weighted average common shares outstanding basic	15,592,291	15,101,746	15,448,622	15,035,759
Effect of dilutive securities:				
Shares issuable under stock options	—	—	—	—
Weighted average common shares outstanding diluted	15,592,291	15,101,746	15,448,622	15,035,759
Net loss per common share — basic	\$ (0.35	) \$ (0.87	) \$ (1.11	) \$ (2.13)
Net loss per common share — diluted	\$ (0.35	) \$ (0.87	) \$ (1.11	) \$ (2.13)

Note 10. Commitments and Contingencies

Contractual obligations for the remainder of fiscal 2012 and future fiscal years are as follows:

(In thousands)	Contractual Obligations (Unaudited)		
	Capital Lease Obligations	Operating Lease Obligations	Pension Plan Obligations
Three months ending June 30, 2012	\$882	\$2,285	\$6,025
Year ending June 30, 2013	3,326	4,755	6,589
Year ending June 30, 2014	2,912	3,886	6,746
Year ending June 30, 2015	2,864	3,108	7,101
Year ending June 30, 2016	2,642	2,056	7,462
Thereafter	1,775	3,414	43,753
		\$ 19,504	\$ 77,676
Total minimum lease payments	\$ 14,401		
Less: imputed interest (3.5% to 10.7%)	(1,897	)	
Present value of future minimum lease payments	12,504		
Less: current portion	2,745		
Long-term capital lease obligations	\$ 9,759		

The Company is a party to various pending legal and administrative proceedings. It is management's opinion that the outcome of such proceedings will not have a material impact on the Company's financial position, results of operations or cash flows.

Table of Contents

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

Forward-Looking Statements

The following discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of many factors. The results of operations for the three and nine months ended March 31, 2012 are not necessarily indicative of the results that may be expected for any future period. The following discussion should be read in combination with the consolidated financial statements and the notes thereto included in Part I, Item 1 of this report and with the "Risk Factors" described in Part II, Item 1A of this report.

Liquidity and Capital Resources

Credit Facility

On September 12, 2011, we entered into an Amended and Restated Loan and Security Agreement (the "New Loan Agreement") among the Company and CBI, as Borrowers, certain of the Company's other subsidiaries, as Guarantors, the Lenders party thereto, and Wells Fargo Bank, National Association ("Wells Fargo"), as Agent. Capitalized terms used below are defined in the New Loan Agreement.

The New Loan Agreement provides for a senior secured revolving credit facility of up to \$85 million with a letter of credit sublimit of \$20 million. The new revolving line of credit provides for advances of 85% of eligible accounts receivable and 75% of eligible inventory, as defined. The New Loan Agreement provides for a range of interest rates based on modified Monthly Average Excess Availability levels with a range of PRIME + 0.25% to PRIME + 0.75% or Adjusted Eurodollar Rate + 2.0% to Adjusted Eurodollar Rate + 2.5%. The New Loan Agreement has an amendment fee of 0.375% and an unused line fee of 0.25%. Outstanding obligations under the New Loan Agreement are collateralized by all of the Borrowers' assets, including the Company's preferred stock portfolio. The term of the New Loan Agreement expires on March 2, 2015.

The New Loan Agreement contains a variety of affirmative and negative covenants of types customary in an asset-based lending facility, including those relating to reporting requirements, maintenance of records, properties and corporate existence, compliance with laws, incurrence of other indebtedness and liens, limitations on certain payments, including the payment of dividends and capital expenditures, and transactions and extraordinary corporate events. The New Loan Agreement allows us to pay dividends, subject to certain liquidity requirements. The New Loan Agreement also contains financial covenants requiring the Borrowers to maintain minimum Excess Availability and Total Liquidity levels. The New Loan Agreement allows the Lender to establish reserve requirements, which may reduce the amount of credit otherwise available to us, to reflect events, conditions, or risks that would have a reasonable likelihood of adversely affecting the Lender's collateral or our assets, including our green coffee inventory. The New Loan Agreement provides that an event of default includes, among other things, subject to certain grace periods: (i) payment defaults; (ii) failure by any guarantor to perform any guarantee in favor of Lender; (iii) failure to abide by loan covenants; (iv) default with respect to other material indebtedness; (v) final judgment in a material amount not discharged or stayed; (vi) any change of control; (vii) bankruptcy or insolvency; and (viii) the failure of the Farmer Bros. Co. Employee Stock Ownership Benefit Trust, created by the Company to implement the ESOP, to be duly qualified under Section 401(a) of the Code or exempt from federal income taxation, or if the ESOP engages in a material non-exempt prohibited transaction.

On January 9, 2012, the New Loan Agreement was amended ("Amendment No. 1") in connection with JPMorgan Chase Bank, N.A. ("JPMorgan Chase"), becoming an additional Lender thereunder. Pursuant to Amendment No. 1, Wells Fargo will provide a commitment of \$60 million and JPMorgan Chase will provide a commitment of \$25 million. The New Loan Agreement replaces our previously existing Loan and Security Agreement, dated March 2, 2009, as amended (the "Original Loan Agreement"), among the Borrowers, Guarantors and Wells Fargo, as Lender. The Original Loan Agreement provided for a senior secured revolving credit facility of up to \$50 million, with a letter of credit sublimit of \$10 million. The original revolving line of credit provided for advances of 85% of eligible accounts receivable and 65% of eligible inventory, as defined. The Original Loan Agreement had an unused commitment fee of 0.375%. The Original Loan Agreement provided for a range of interest rates based on modified Monthly Average Excess Availability levels (as defined) with a range of PRIME + 0.25% to PRIME + 0.75% or Adjusted Eurodollar Rate + 2.5% to Adjusted Eurodollar Rate + 3.0%. All outstanding obligations under the Original Loan Agreement

were collateralized by the Company's assets, excluding the preferred stock held in investment accounts. On September 12, 2011, the Lender and the Company amended the Original Loan Agreement to reduce required minimum excess availability and required minimum total liquidity for the period from July 1, 2011 through September 30, 2011.

The interest rate on our outstanding borrowings under the New Loan Agreement was 3.5% at March 31, 2012. As of

Table of Contents

March 31, 2012, we were eligible to borrow up to a total of \$80.2 million under the credit facility, had outstanding borrowings of \$28.7 million, excluding \$0.2 million in loan extension fees, utilized \$10.3 million of the letters of credit sublimit, and had excess availability of \$41.0 million under the credit facility. Due to the short-term nature of the credit facility and the variable interest rate, fair value of the balance outstanding approximates carrying value. As of March 31, 2012, we were in compliance with all restrictive covenants under the New Loan Agreement. There can be no assurance that the Lender will issue a waiver or grant an amendment to the covenants in future periods, if the Company required one. As of April 30, 2012, we estimate that we were eligible to borrow up to a total of \$78.8 million, had outstanding borrowings of \$30.2 million, excluding \$0.2 million in loan extension fees, utilized \$10.3 million of the letters of credit sublimit, and had an estimated excess availability under the credit facility of \$38.1 million.

Liquidity

We generally finance our operations through cash flows from operations and borrowings under our revolving credit facility described above. As of March 31, 2012, we had \$3.5 million in cash and cash equivalents and \$18.7 million in short-term investments. We believe our revolving credit facility, to the extent available, in addition to our cash flows from operations and other liquid assets are sufficient to fund our working capital and capital expenditure requirements for the next 12 months.

We generate cash from operating activities primarily from cash collections related to the sale of our products. Net cash provided by operating activities was \$11.0 million in the first nine months of fiscal 2012, compared with net cash provided by operating activities of \$27.8 million in the first nine months of fiscal 2011. Net cash provided by operating activities in the first nine months of fiscal 2012 was primarily due to a decrease in inventory levels and collection of outstanding receivables. Net cash provided by operating activities during the comparable period in the prior fiscal year was primarily due to proceeds from the sale of investments.

Net cash used in investing activities decreased to \$8.4 million in the first nine months of fiscal 2012 compared to \$14.1 million in the first nine months of fiscal 2011 primarily due to reduced levels of capital expenditures.

Net cash used in financing activities was \$5.2 million in the first nine months of fiscal 2012 compared to net cash used in financing activities of \$14.2 million in the first nine months of fiscal 2011. Cash flows related to financing activities included net repayments on our revolving line of credit of \$4.0 million in the first nine months of fiscal 2012 compared to net repayments of \$8.5 million and a dividend payment of \$4.7 million in the first nine months of fiscal 2011.

Our expected capital expenditures for fiscal 2012 include expenditures to purchase coffee brewing equipment, vehicles, and machinery and equipment, and overall are not expected to deviate significantly from fiscal 2011 levels. In the first nine months of fiscal 2012, we capitalized \$10.5 million in property and equipment purchases, which included \$9.9 million in expenditures to purchase coffee brewing equipment. As of March 31, 2012, we have committed to \$5.2 million in vehicle leases, exceeding our planned lease commitments for fiscal 2012 by \$1.8 million. During the nine months ended March 31, 2012, we withdrew from two multiemployer pension plans and recorded a charge of \$4.3 million associated with withdrawal from one of the plans, representing the present value of the estimated withdrawal liability expected to be paid in quarterly installments of \$0.1 million over 80 quarters. There is no anticipated withdrawal liability associated with the other multiemployer pension plan from which we withdrew. We are currently in negotiations to withdraw from the remaining multiemployer pension plan in which we participate and, if successful, may incur a withdrawal liability, the amount of which could be material to our results of operations and cash flows.

Our working capital is comprised of the following:

(In thousands)	As of March 31, 2012	As of June 30, 2011
	(Unaudited)	
Current assets	\$ 143,242	\$ 157,410
Current liabilities	92,397	103,462
Working capital	\$ 50,845	\$ 53,948

Table of Contents

Liquidity Information:

(In thousands)

	Nine Months Ended	
	March 31, 2012	March 31, 2011
	(Unaudited)	
Capital expenditures	\$ 10,533	\$ 15,435
Dividends paid	\$ —	\$ 4,657

Results of Operations

Our net sales in the three months ended March 31, 2012 increased \$4.8 million, or 4%, to \$121.5 million, as compared to \$116.7 million in the three months ended March 31, 2011. Our net sales in the first nine months of fiscal 2012 increased \$29.8 million, or 9%, to \$374.5 million as compared to \$344.7 million in the first nine months of fiscal 2011, primarily due to the increases in list prices of our coffee, cappuccino, cocoa and selected spice products.

Gross profit in the three months ended March 31, 2012 increased \$1.2 million, or 3%, to \$43.1 million, as compared to \$41.9 million in the three months ended March 31, 2011. Gross profit in the three months ended March 31, 2012 includes the expected beneficial effect of the liquidation of LIFO inventory quantities in the amount of \$2.2 million (see Note 4 to the consolidated financial statements), as compared to the same period in fiscal 2011. In fiscal 2011, no such beneficial effect of liquidation of LIFO inventory quantities was recorded because year-end inventory levels were expected to be equal to or greater than the prior fiscal year and no liquidation of LIFO inventory quantities was anticipated. Gross margin was flat at 36% in the three months ended March 31, 2012, as compared to the same period in the prior fiscal year.

Gross profit in the nine months ended March 31, 2012 decreased \$3.4 million, or 3%, to \$127.4 million, as compared to \$130.8 million in the nine months ended March 31, 2011. Gross profit in the nine months ended March 31, 2012 includes the expected beneficial effect of the liquidation of LIFO inventory quantities in the amount of \$7.8 million (see Note 4 to the consolidated financial statements) as compared to the same period in fiscal 2011. In fiscal 2011, no such beneficial effect of liquidation of LIFO inventory quantities was recorded because year-end inventory levels were expected to be equal to or greater than the prior fiscal year and no liquidation of LIFO inventory quantities was anticipated. Gross margin decreased to 34% in the nine months ended March 31, 2012 from 38% in the comparable period of the prior fiscal year. The decrease in gross margin is primarily due to higher raw material costs, including a 33% increase in the average cost of green coffee beans compared to the same period in the prior fiscal year, and changes in the mix of our customers and the products we sell to them. The decrease in gross margin was partly offset by price increases for finished goods and the expected effect of the liquidation of LIFO inventory quantities recorded in the consolidated statements of operations.

Operating expenses in the three months ended March 31, 2012 decreased \$9.1 million, or 16%, to \$47.3 million, or 39% of sales, from \$56.3 million, or 48% of sales, in the comparable period of the prior fiscal year. During the nine months ended March 31, 2012, operating expenses decreased \$26.0 million, or 16%, to \$141.8 million, or 38% of sales, from \$167.8 million, or 49% of sales, in the comparable period of the prior fiscal year. The reduction in operating expenses in the three and nine months ended March 31, 2012 is primarily due to lower payroll and related expenses resulting from decreased employee headcount, savings from employee benefit plan restructuring and ongoing cost control measures. The reduction in operating expenses was offset in part by higher freight and fuel costs. In addition, during the nine months ended March 31, 2012, we withdrew from two multiemployer pension plans and recorded a charge of \$4.3 million associated with withdrawal from one of these plans, representing the present value of the estimated withdrawal liability expected to be paid in quarterly installments of \$0.1 million over 80 quarters. Installment payments will commence once the final determination of the amount of withdrawal liability is established, which determination may take up to 24 months from the date of withdrawal from the pension plan. Upon withdrawal, the employees covered under these multiemployer pension plans were included in the Company's 401(k) Plan. This \$4.3 million charge is included in the Company's statement of operations for the nine months ended March 31, 2012 as "Pension withdrawal expense" and in current and long-term liabilities on the Company's balance sheet at March 31, 2012.

Loss from operations in the three and nine months ended March 31, 2012 decreased to \$(4.1) million and \$(14.4) million, respectively, from \$(14.5) million and \$(37.0) million, respectively, during the three and nine months ended March 31, 2011, primarily due to reduction in operating expenses.

Total other expense in the three months ended March 31, 2012 was \$(2.0) million, as compared to total other income of \$1.3 million for the same period in the prior fiscal year. Total other expense in the nine months ended March 31, 2012 was \$(3.0) million compared to total other income of \$5.6 million in the nine months ended March 31, 2011.

Total other expense in

Table of Contents

the nine months ended March 31, 2012 included \$(5.1) million in net realized and unrealized derivative losses recorded and higher interest expense compared to \$3.0 million in net realized and unrealized derivative gains recorded and lower interest expense in the nine months ended March 31, 2011.

During the three and nine months ended March 31, 2012, we recorded income tax benefit of \$0.6 million and \$0.2 million, respectively. During the three and nine months ended March 31, 2011, we recorded income tax expense of \$0.1 million and \$0.5 million, respectively.

As a result of the forgoing factors, net loss was \$(5.5) million, or \$(0.35) per common share, for the three months ended March 31, 2012, compared to net loss of \$(13.2) million, or \$(0.87) per common share, for the three months ended March 31, 2011. Net loss for the nine months ended March 31, 2012 was \$(17.2) million, or \$(1.11) per common share, as compared to \$(32.0) million, or \$(2.13) per common share, in the comparable period of the prior fiscal year.

Non-GAAP Financial Measures

In addition to net income (loss) determined in accordance with GAAP, we use certain non-GAAP financial measures, such as "Net income (loss) excluding LIFO impact," "EBITDAE" and "Adjusted EBITDAE," in assessing our operating performance. We believe these non-GAAP measures serve as appropriate measures to be used in evaluating the performance of our business.

We define "Net income (loss) excluding LIFO impact" as net income (loss) excluding the impact of LIFO charge or credit. LIFO charge or credit includes: (1) the expected effect of the liquidation of LIFO inventory quantities as of the upcoming fiscal year end, prorated for the reporting periods and recorded in cost of goods sold, and (2) an estimate of the difference between cost of goods sold recorded on a last in, first out ("LIFO") basis and cost of goods sold that would have been recorded if we had used the first in, first out ("FIFO") method of inventory valuation. We believe the use of the LIFO method of inventory valuation for coffee, tea and culinary products results in a better matching of costs and revenues.

We define "EBITDAE" as net income (loss) excluding the impact of income taxes, interest expense, depreciation and amortization expense, ESOP and share-based compensation expense, non-cash impairment losses, non-cash pension withdrawal expense and net gains and losses from derivatives and investments. We reference this particular non-GAAP financial measure frequently in our decision-making because it provides supplemental information that facilitates internal comparisons to the historical operating performance of prior periods. In addition, incentive compensation is based on EBITDAE and we base certain of our forward-looking estimates on EBITDAE to facilitate quantification of planned business activities and enhance subsequent follow-up with comparisons of actual to planned EBITDAE. We define "Adjusted EBITDAE" as EBITDAE excluding the impact of LIFO charge or credit.

Net income (loss) excluding LIFO impact, EBITDAE and Adjusted EBITDAE as defined by us may not be comparable to similarly titled measures reported by other companies. We do not intend for non-GAAP financial measures to be considered in isolation or as a substitute for other measures prepared in accordance with GAAP. Set forth below is a reconciliation of reported net loss and reported basic and diluted net loss per common share to net loss excluding LIFO impact and basic and diluted net loss per common share excluding LIFO impact, respectively:

	Three Months Ended March 31,		Nine Months Ended March 31,	
(In thousands, except share and per share data)	2012	2011	2012	2011
Net loss, as reported	\$ (5,501)	\$ (13,196)	\$ (17,195)	\$ (31,981)
LIFO (credit) charge:				
Expected effect of liquidation of LIFO inventory quantities, net of taxes of zero (1)(2)(3)	(2,239)	—	(7,772)	—
Estimated difference in cost of goods sold—LIFO basis vs. FIFO basis, net of taxes of zero (1)	(3,096)	10,045	6,186	16,775
Net loss, excluding LIFO impact	(10,836)	(3,151)	(18,781)	(15,206)
Weighted average common shares outstanding—basic and diluted	15,592,291	15,101,746	15,448,622	15,035,759

Edgar Filing: FARMER BROTHERS CO - Form 10-Q

Net loss per common share, as reported—basic and diluted	\$ (0.35	)	\$ (0.87	)	\$ (1.11	)	\$ (2.13	)
Net loss per common share, excluding LIFO impact—basic and diluted	\$ (0.69	)	\$ (0.21	)	\$ (1.22	)	\$ (1.01	)

Table of Contents

Set forth below is a reconciliation of reported net loss to EBITDAE and Adjusted EBITDAE:

	Three Months Ended March 31,		Nine Months Ended March 31,	
(In thousands)	2012	2011	2012	2011
Net loss, as reported	\$(5,501	) \$(13,196	) \$(17,195	) \$(31,981
Income tax (benefit) expense	(577	) 56	(171	) 506
Interest expense	498	529	1,579	1,412
Depreciation and amortization expense	8,010	8,211	23,831	23,627
ESOP and share-based compensation expense	1,043	986	2,519	3,245
Pension withdrawal expense	—	—	4,348	—
Net loss (gain) on derivatives and investments	2,881	(444	) 5,131	(3,034
EBITDAE	\$6,354	\$(3,858	) \$20,042	(6,225
LIFO (credit) charge:				
Expected effect of liquidation of LIFO inventory quantities, net of taxes of zero (1)(2)(3)	(2,239	) —	(7,772	) —
Estimated difference in cost of goods sold—LIFO basis vs. FIFO basis (1)	(3,096	) 10,045	6,186	16,775
Adjusted EBITDAE	\$1,019	\$6,187	\$18,456	\$10,550

(1) There is no impact on income tax expense since we have recorded a 100% valuation allowance against deferred tax assets.

Actual valuation of inventory under the LIFO method is made only at the end of each fiscal year based on the inventory levels and costs at that time. Accordingly, interim LIFO calculations must necessarily be based on

(2) management's estimates of expected fiscal year-end inventory levels and costs. Because these estimates are subject to many forces beyond management's control, interim results are subject to the final fiscal year-end LIFO inventory valuation.

In the interim periods of fiscal 2011, the effect of liquidation of LIFO inventory quantities was zero because

(3) year-end inventory levels were expected to be equal to or greater than the prior fiscal year and no liquidation of LIFO inventory quantities was anticipated.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk

We are exposed to market value risk arising from changes in interest rates on our securities portfolio. Our portfolio of preferred securities has sometimes included investments in derivatives that provide a natural economic hedge of interest rate risk. We review the interest rate sensitivity of these securities and (a) may enter into "short positions" in futures contracts on U.S. Treasury securities or (b) may 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 number and type of futures and options 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 U.S. Treasury yields, and the costs of using futures and/or options.

The following table demonstrates the impact of varying interest rate changes based on the preferred stock holdings and market yield and price relationships at March 31, 2012. 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. At March 31, 2012, we had no futures contracts or put options designated as interest rate risk hedges.

Table of Contents

Interest Rate Changes	Market Value of Preferred Securities at March 31, 2012 (In thousands)	Change in Market Value
-150 basis points	\$ 19,203	\$ 716
-100 basis points	\$ 18,997	\$ 510
Unchanged	\$ 18,487	\$ —
+100 basis points	\$ 17,847	\$ (640)
+150 basis points	\$ 17,544	\$ (943)

Our revolving line of credit with Wells Fargo is at a variable rate. The interest rate varies based upon line usage, borrowing base availability and market conditions. As of March 31, 2012, we had outstanding borrowings of \$28.7 million, excluding \$0.2 million in loan extension fees, utilized \$10.3 million of our letters of credit sublimit, and had excess availability of \$41.0 million under the credit facility. The interest rate on the Company's outstanding borrowings at March 31, 2012 was 3.5%. The New Loan Agreement entered on September 12, 2011, provides for a senior secured revolving credit facility of up to \$85 million, with a letter of credit sublimit of \$20 million. The New Loan Agreement provides for a range of interest rates based on modified Monthly Average Excess Availability levels with a range of PRIME+0.25% to PRIME+0.75% or Adjusted Eurodollar Rate+2.0% to Adjusted Eurodollar Rate+2.5%. The term of the New Loan Agreement expires on March 2, 2015.

The following table demonstrates the impact of interest rate changes on our interest expense under the revolving credit facility for a full year based on the outstanding balance, including loan extension fees, and interest rate as of March 31, 2012:

Interest Rate Changes	Interest Rate	Annual Interest Expense (In thousands)
-150 basis points	2.00	% \$ 577
-100 basis points	2.50	% \$ 722
Unchanged	3.50	% \$ 1,010
+100 basis points	4.50	% \$ 1,299
+150 basis points	5.00	% \$ 1,443

Commodity Price Risk

We are exposed to commodity price risk arising from changes in the market price of green coffee. We account for green coffee inventory on the LIFO basis. In the normal course of business we hold a large green coffee inventory and enter into forward commodity purchase agreements with suppliers. We are subject to price risk resulting from the volatility of green coffee prices. Due to competition and market conditions, volatile price increases cannot always be passed on to our customers.

We routinely enter into specialized hedging transactions to purchase future coffee contracts to enable us to lock in green coffee prices within a pre-established range, and hold a mix of futures contracts and options to help hedge against volatility in green coffee prices. Gains and losses on these derivative instruments are realized immediately in "Other, net."

For the three and nine months ended March 31, 2012, we recorded \$(1.8) million and \$(4.9) million, respectively, in coffee-related net realized derivative losses. In each of the three and nine month periods ended March 31, 2011, we recorded \$0.8 million in coffee-related net realized derivative gains.

For the three and nine months ended March 31, 2012, we recorded \$(1.5) million and \$(2.6) million in coffee-related net unrealized derivative losses. For the three and nine months ended March 31, 2011, we recorded \$(0.9) million in coffee-related net unrealized derivative losses and \$0.2 million in coffee-related net unrealized gains.

Table of Contents

The following table demonstrates the impact of hypothetical changes in the market value of coffee cost on the market value of our coffee inventory and coffee forward purchase contracts as of March 31, 2012:

Coffee Cost Change	Market Value			(Decrease) Increase in Market Value	
	Coffee Inventory (In thousands)	Futures & Options	Total	Derivatives	Inventory
-10%	\$29,000	\$(386	) \$28,614	\$(386	) \$(3,663
Unchanged	\$32,663	\$228	\$32,891	\$—	\$—
10%	\$36,000	\$386	\$36,386	\$386	\$3,337

Item 4. Controls and Procedures

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934, as amended

(the “Exchange Act”), is recorded, processed, summarized and reported, within the time periods specified in the rules and forms of the SEC. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information we are required to disclose in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosures. In January 2010, we adopted Disclosure Controls and Procedures that included the organization of a Disclosure Committee designed to enhance our process of documenting our compliance with Rule 13a-15(e) promulgated under the Exchange Act. The Disclosure Committee performed its duties as prescribed by our Disclosure Controls and Procedures in preparing this Quarterly Report on Form 10-Q for the fiscal period ended March 31, 2012. As of March 31, 2012, our management, with the participation of our principal executive and principal financial officers, or persons performing similar functions, carried out an evaluation of the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15(e) promulgated under the Exchange Act. Based upon this evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that, as of March 31, 2012, our disclosure controls and procedures were effective.

Changes in Internal Control over Financial Reporting

Management has determined that there has been no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) promulgated under the Exchange Act) during our fiscal quarter ended March 31, 2012 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1A. Risk Factors

Certain statements contained in this quarterly report on Form 10-Q are not based on historical fact and are forward-looking statements within the meaning of federal securities laws and regulations. These statements are based on management’s current expectations, assumptions, estimates and observations of future events and include any statements that do not directly relate to any historical or current fact. These forward-looking statements can be identified by the use of words like “anticipates,” “estimates,” “projects,” “expects,” “plans,” “believes,” “intends,” “will,” “assumes,” and other words of similar meaning. Owing to the uncertainties inherent in forward-looking statements, actual results could differ materially from those set forth in forward-looking statements. We intend these forward-looking statements to speak only at the time of this report and do not undertake to update or revise these statements as more information becomes available except as required under federal securities laws and the rules and regulations of the SEC. Factors that could cause actual results to differ materially from those in forward-looking statements include, but are not limited to, fluctuations in availability and cost of green coffee, competition, organizational changes, the impact of a weaker economy, business conditions in the coffee industry and food industry in general, our continued success in attracting new customers, variances from budgeted sales mix and growth rates, weather and special or unusual events,

changes in the quality or dividend stream of third parties' securities and other investment vehicles in which we have invested our assets, as well as other risks described in this report and other factors described from time to time in our filings with the SEC.

You should consider each of the following factors as well as the other information in this report and in our Annual Report on Form 10-K for the fiscal year ended June 30, 2011, including our financial statements and the related notes, in evaluating our business and our prospects. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently consider immaterial may also negatively affect our business operations. If any of the following risks actually occurs, our business and financial results could be harmed. In that case, the trading price of our common stock could decline.

Table of Contents

INCREASES IN THE COST OF GREEN COFFEE COULD REDUCE OUR GROSS MARGIN AND PROFIT.

Our primary raw material is green coffee, an agricultural commodity. Green coffee is mainly grown outside the United States and can be subject to volatile price fluctuations. Weather, real or perceived supply shortages, speculation in the commodity markets, political unrest, labor actions, currency fluctuations, armed conflict in coffee producing nations, and government actions, including treaties and trade controls between the U.S. and coffee producing nations, can affect the price of green coffee. In fiscal 2011, the market for green Arabica coffee increased approximately 80% per pound compared to the prior fiscal year. Additionally, green specialty coffees sell at a premium to other green coffees due to the inability of producers to increase supply in the short run to meet rising demand. As a result, the price spread between specialty coffee and non-specialty coffee is likely to widen as demand for specialty coffee continues to increase.

Green coffee prices can also be affected by the actions of producer organizations. The most prominent of these are the Colombian Coffee Federation, Inc. (CCF) and the International Coffee Organization (ICO). These organizations seek to increase green coffee prices largely by attempting to restrict supplies, thereby limiting the availability of green coffee to coffee consuming nations. As a result, these organizations or others may succeed in raising green coffee prices.

There can be no assurance that we will be successful in passing commodity price fluctuations on to our customers without losses in sales volume or gross margin in the future. Similarly, rapid, sharp decreases in the cost of green coffee could also force us to lower sales prices before realizing cost reductions in our green coffee inventory.

Additionally, if green coffee beans from a region become unavailable or prohibitively expensive, we could be forced to use alternative coffee beans or discontinue certain blends, which could adversely impact our sales.

Some of the Arabica coffee beans of the quality we purchase do not trade directly on the commodity markets. Rather, we purchase the high-end Arabica coffee beans that we use on a negotiated basis. We depend on our relationships with coffee brokers, exporters and growers for the supply of our primary raw material, high quality Arabica coffee beans. If any of our relationships with coffee brokers, exporters or growers deteriorate, we may be unable to procure a sufficient quantity of high quality coffee beans at prices acceptable to us or at all. In such case, we may not be able to fulfill the demand of our existing customers, supply new customers or expand other channels of distribution. A raw material shortage could result in a deterioration of our relationship with our customers, decreased revenues or could impair our ability to expand our business.

OUR EFFORTS TO SECURE AN ADEQUATE SUPPLY OF QUALITY COFFEES MAY BE UNSUCCESSFUL AND EXPOSE US TO COMMODITY PRICE RISK.

Maintaining a steady supply of green coffee is essential to keep inventory levels low and secure sufficient stock to meet customer needs. To help ensure future supplies, we may purchase coffee on forward contracts for delivery up to twelve months in the future. Non-performance by suppliers could expose us to credit and supply risk. Additionally, entering into such future commitments exposes us to purchase price risk. Because we are not always able to pass price changes through to our customers due to competitive pressures, unpredictable price changes can have an immediate effect on operating results that cannot be corrected in the short run. To reduce our potential price risk exposure we have, from time to time, entered into futures contracts to hedge coffee purchase commitments. Open contracts associated with these hedging activities are described in Part I, Item 3 of this report.

WE FACE EXPOSURE TO OTHER COMMODITY COST FLUCTUATIONS, WHICH COULD IMPAIR OUR PROFITABILITY.

We are exposed to cost fluctuations in other commodities, including, without limitation, milk, spices, natural gas and gasoline. In addition, an increase in the cost of fuel could indirectly lead to higher electricity costs, transportation costs and other commodity costs. Much like green coffee costs, the costs of these commodities depend on various factors beyond our control, including economic and political conditions, foreign currency fluctuations, and global weather patterns. To the extent we are unable to pass along such costs to our customers through price increases, our margins and profitability will decrease.

IMPAIRMENT CHARGES RELATED TO OUR GOODWILL OR LONG-LIVED ASSETS COULD ADVERSELY AFFECT OUR FUTURE OPERATING RESULTS.

We perform an analysis on our goodwill balances to test for impairment on an annual basis or whenever events occur that may indicate impairment possibly exists. Goodwill is deemed to be impaired if the net book value of a reporting unit exceeds the estimated fair value. A long-lived intangible asset (other than goodwill) is only deemed to have become impaired if the sum of the forecasted undiscounted future cash flows related to the asset is less than the asset's carrying value. If the sum of the forecasted cash flows is less than the carrying value, then we must write down the carrying value to its estimated fair value.

For the purposes of analysis of our goodwill balances, our estimates of fair value were based on a combination of the income approach, which estimates the fair value of our reporting units based on the future discounted cash flows, and the market

Table of Contents

approach, which estimates the fair value of our reporting units based on comparable market prices. Our estimates of future cash flows included estimated growth rates and assumptions about the extent and duration of the current economic downturn and operating results of our subsidiary, CBI.

As of March 31, 2012, we had a goodwill balance of \$5.3 million. Goodwill impairment analysis and measurement is a process that requires significant judgment and the use of significant estimates related to valuation such as discount rates, long-term growth rates and the level and timing of future cash flows. As a result, several factors could indicate potential impairment of our goodwill balance, including, but not limited to:

- a decline in our stock price and resulting market capitalization, if we determine that the decline is sustained and is indicative of a reduction in the fair value of CBI below its carrying value; and
- further weakening of the economy or the failure of CBI to reach our internal forecasts thereby impacting our ability to achieve our forecasted levels of cash flows and reducing the estimated discounted cash flow value of CBI.

We will continue to review our goodwill and other intangible assets for possible impairment. We cannot be certain that a future downturn in CBI's business, changes in market conditions or a longer-term decline in the quoted market price of our stock will not result in an impairment of goodwill and the recognition of resulting expenses in future periods, which could adversely affect our results of operations for those periods.

We also test our other long-lived assets for impairment annually and whenever events or changes in circumstances indicate that their carrying amount may be impaired. In the fourth quarter of fiscal 2011, we determined that the customer relationships acquired, and the distribution agreement and co-pack agreement that we entered into, in connection with the DSD Coffee Business acquisition were impaired and wrote these intangible assets off in their entirety. The total impairment charge of \$7.8 million was included in operating expenses in fiscal 2011. Failure to achieve our forecasted operating results, due to further weakness in the economic environment or other factors, and further declines in our market capitalization, among other things, could result in further impairment of our long-lived assets.

OUR LEVEL OF INDEBTEDNESS COULD ADVERSELY AFFECT OUR ABILITY TO RAISE ADDITIONAL CAPITAL TO FUND OUR OPERATIONS, AND LIMIT OUR ABILITY TO REACT TO CHANGES IN THE ECONOMY OR OUR INDUSTRY.

We have an \$85 million senior secured revolving credit facility and as of April 30, 2012, we estimate that we were eligible to borrow up to \$78.8 million under this credit facility. As of April 30, 2012, we had outstanding borrowings of \$30.2 million, excluding \$0.2 million in loan extension fees, utilized \$10.3 million of the letters of credit sublimit, and had an estimated excess availability under the credit facility of \$38.1 million. Maintaining a large loan balance under our credit facility could adversely affect our business and limit our ability to plan for or respond to changes in our business. Additionally, our borrowings under the credit facility are at variable rates of interest, exposing us to the risk of interest rate volatility, which could lead to an increase in our net loss. Our debt obligations could also:

- increase our vulnerability to general adverse economic and industry conditions;
- require us to dedicate a portion of our cash flow from operations to payments on our indebtedness, thereby reducing the availability of our cash flow for other purposes, including the payment of dividends, funding daily operations, investing in future business opportunities and capital expenditures;
- limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate thereby placing us at a competitive disadvantage compared to our competitors that may have less debt or debt with less restrictive debt covenants;
- limit, by the financial and other restrictive covenants in our loan agreement, our ability to borrow additional funds; and
- have a material adverse effect on us if we fail to comply with the covenants in our loan agreement because such failure could result in an event of default which, if not cured or waived, could result in our indebtedness becoming immediately due and payable.

RESTRICTIVE COVENANTS IN OUR CREDIT FACILITY MAY RESTRICT OUR ABILITY TO PURSUE OUR BUSINESS STRATEGIES.

Our revolving credit facility contains various covenants that limit our ability and/or our subsidiaries' ability to, among other things:

incur additional indebtedness;

pay dividends on or make distributions in respect of capital stock or make certain other restricted payments or

Table of Contents

investments;

•sell assets;

•create liens on certain assets to secure debt; and

•consolidate, merge, sell or otherwise dispose of all or substantially all of our assets.

Our credit facility also contains restrictive covenants that require the Company and its subsidiaries to satisfy financial condition and liquidity tests. Our ability to meet those tests may be affected by events beyond our control, and there can be no assurance that we will meet those tests. The breach of any of these covenants or our failure to meet the financial condition or liquidity tests could result in a default under the credit facility, and the lender could elect to declare all amounts borrowed thereunder, together with accrued interest, to be due and payable and could proceed against the collateral securing that indebtedness.

OUR BUSINESS IS SUBJECT TO RISKS ASSOCIATED WITH THE CURRENT ECONOMIC CLIMATE.

Our success depends to a significant extent on a number of factors that affect discretionary consumer spending, including economic conditions, disposable consumer income and consumer confidence, which have deteriorated due to current economic conditions. In a slow economy, businesses and individuals scale back their discretionary spending on travel and entertainment, including “dining out” as well as the purchase of high-end consumables like specialty coffee. Economic conditions may also cause businesses to reduce travel and entertainment expenses, and may even cause office coffee benefits to be eliminated. The current economic downturn and decrease in consumer spending may continue to adversely impact our revenues, and may affect our ability to market our products or otherwise implement our business strategy. Additionally, many of the effects and consequences of the global financial crisis and a broader global economic downturn are currently unknown; any one or all of them could potentially have a material adverse effect on our liquidity and capital resources, including our ability to sell third party securities in which we have invested some of our short-term assets or raise additional capital, if needed, or the ability of our lender to honor draws on our credit facility, or otherwise negatively affect our business, financial condition, operating results and cash flows.

WE RELY ON INFORMATION TECHNOLOGY AND ARE DEPENDENT ON ENTERPRISE RESOURCE PLANNING SOFTWARE IN OUR OPERATIONS. ANY MATERIAL FAILURE, INADEQUACY, INTERRUPTION OR SECURITY FAILURE OF THAT TECHNOLOGY COULD AFFECT OUR ABILITY TO EFFECTIVELY OPERATE OUR BUSINESS.

We rely on information technology systems across our operations, including management of our supply chain, point-of-sale processing, and various other processes and transactions. Our ability to effectively manage our business and coordinate the production, distribution and sale of our products depends significantly on the reliability and capacity of these systems. The failure of these systems to operate effectively, problems with transitioning to upgraded or replacement systems, or a breach in security of these systems could result in delays in processing replenishment orders from our branches, our inability to record product sales and reduced operational efficiency. Significant capital investments could be required to remediate any potential problems.

VOLATILITY IN THE EQUITY MARKETS COULD REDUCE THE VALUE OF OUR INVESTMENT PORTFOLIO.

We maintain a portfolio of fixed-income based investments disclosed as cash equivalents and short-term investments on our consolidated balance sheet. The value of our investments may be adversely affected by interest rate fluctuations, downgrades in credit ratings, illiquidity in the capital markets and other factors which may result in other than temporary declines in the value of our investments. Any of these events could cause us to record impairment charges with respect to our investment portfolio or to realize losses on the sale of investments. If the Company’s operating losses continue, a portion or this entire investment portfolio may be liquidated to fund those losses.

WE ARE LARGELY RELIANT ON MAJOR FACILITIES IN CALIFORNIA, TEXAS AND OREGON FOR PRODUCTION OF OUR PRODUCT LINE.

A significant interruption in operations at our manufacturing facilities in Torrance, California (our largest facility); Houston, Texas; or Portland, Oregon, whether as a result of an earthquake, hurricane, natural disaster, terrorism or other causes, could significantly impair our ability to operate our business. The majority of our green coffee comes through the Ports of Los Angeles, Long Beach, Houston, San Francisco and Portland. Any interruption to port operations, highway arteries, gas mains or electrical service in these areas could restrict our ability to supply our

branches with product and would adversely impact our business.

Table of Contents

INCREASED SEVERE WEATHER PATTERNS MAY INCREASE COMMODITY COSTS, DAMAGE OUR FACILITIES, AND IMPACT OR DISRUPT OUR PRODUCTION CAPABILITIES AND SUPPLY CHAIN.

There is increasing concern that a gradual increase in global average temperatures due to increased concentration of carbon dioxide and other greenhouse gases in the atmosphere have caused and will continue to cause significant changes in weather patterns around the globe and an increase in the frequency and severity of extreme weather events. Major weather phenomena like El Niño and La Niña are dramatically affecting coffee growing countries. The wet and dry seasons are becoming unpredictable in timing and duration causing improper development of the coffee cherries. Decreased agricultural productivity in certain regions as a result of changing weather patterns may affect the quality, limit availability or increase the cost of key agricultural commodities, such as green coffee, sugar and tea, which are important ingredients for our products. Increased frequency or duration of extreme weather conditions could also damage our facilities, impair production capabilities, disrupt our supply chain or impact demand for our products. As a result, the effects of climate change could have a long-term adverse impact on our business and results of operations. **OUR INDUSTRY IS HIGHLY COMPETITIVE AND WE MAY NOT HAVE THE RESOURCES TO COMPETE EFFECTIVELY.**

We primarily compete with other coffee companies, including multi-national firms with substantially greater financial, marketing and operating resources than the Company. We face competition from many sources including the foodservice divisions of multi-national manufacturers of retail products such as The J.M. Smucker Company (Folgers Coffee) and Kraft Foods Inc. (Maxwell House Coffee), wholesale grocery distributors such as Sysco Corporation and U.S. Foods, regional coffee roasters such as S & D Coffee, Inc. and Boyd Coffee Company, and specialty coffee suppliers such as Green Mountain Coffee Roasters, Inc. and Peet's Coffee & Tea, Inc. If we do not succeed in differentiating ourselves from our competitors or our competitors adopt our strategies, then our competitive position may be weakened. In addition, from time to time, we may need to reduce our prices in response to competitive and customer pressures and to maintain our market share. Competition and customer pressures, however, also may restrict our ability to increase prices in response to commodity and other cost increases. Our results of operations will be adversely affected if our profit margins decrease, as a result of a reduction in prices or an increase in costs, and if we are unable to increase sales volumes to offset those profit margin decreases.

VOLATILITY IN THE EQUITY MARKETS OR INTEREST RATE FLUCTUATIONS COULD SUBSTANTIALLY INCREASE OUR PENSION FUNDING REQUIREMENTS AND NEGATIVELY IMPACT OUR FINANCIAL POSITION.

At the end of fiscal 2011, the projected benefit obligation of our single employer defined benefit pension plans was \$111.8 million and assets were \$83.7 million. The difference between plan obligations and assets, or the funded status of the plans, significantly affects the net periodic benefit costs of our single employer pension plans and the ongoing funding requirements of those plans. Among other factors, changes in interest rates, mortality rates, early retirement rates, investment returns and the market value of plan assets can affect the level of plan funding, cause volatility in the net periodic pension costs, and increase our future funding requirements. We expect to make approximately \$7.5 million in contributions to our single employer pension plans in fiscal 2012 and record an accrued expense of approximately \$1.2 million per year beginning in fiscal 2012. As of March 31, 2012, we have made \$6.1 million in contributions to our single employer pension plans and accrued \$0.9 million in expense. These payments are expected to continue at this level for several years, and the current economic environment increases the risk that we may be required to make even larger contributions in the future.

OUR SALES AND DISTRIBUTION NETWORK IS COSTLY TO MAINTAIN.

Our sales and distribution network requires a large investment to maintain and operate. Costs include the fluctuating cost of gasoline, diesel and oil, costs associated with managing, purchasing, leasing, maintaining and insuring a fleet of delivery vehicles, the cost of maintaining distribution centers and branch warehouses throughout the country, and the cost of hiring, training and managing our route sales professionals. Many of these costs are beyond our control, and others are fixed rather than variable. Some competitors use alternate methods of distribution that eliminate many of the costs associated with our method of distribution.

EMPLOYEE STRIKES AND OTHER LABOR-RELATED DISRUPTIONS MAY ADVERSELY AFFECT OUR OPERATIONS.

We have union contracts relating to a significant portion of our workforce. Although we believe union relations have been amicable in the past, there is no assurance that this will continue in the future. There are potential adverse effects of labor disputes with our own employees or by others who provide transportation (shipping lines, truck drivers) or cargo handling (longshoremen), both domestic and foreign, of our raw materials or other products. These actions could restrict our ability to obtain, process and/or distribute our products.

Table of Contents

GOVERNMENT MANDATORY HEALTHCARE REQUIREMENTS COULD ADVERSELY AFFECT OUR PROFITS.

We offer healthcare benefits to all employees who work at least 40 hours a week and meet service eligibility requirements. In the past, some states, including California, have proposed legislation mandating that employers pay healthcare premiums into a state-run fund for all employees immediately upon hiring or pay a penalty for failing to do so. If legislation similar to this were to be enacted in California, or in the other states in which we do business, it could have an adverse effect on our results of operations. In addition, comprehensive health care legislation (the Patient Protection and Affordable Care Act and the Health Care and Education Affordability Reconciliation Act of 2010) was passed and signed into law in March 2010. Due to the breadth and complexity of this legislation, the phased-in nature of the implementation, and the lack of implementing regulations, it is difficult to predict the financial and operational impacts this legislation will have on us. Our expenses may significantly increase over the long-term as a result of this legislation.

POSSIBLE LEGISLATION OR REGULATION INTENDED TO ADDRESS CONCERNS ABOUT CLIMATE CHANGE COULD ADVERSELY AFFECT OUR RESULTS OF OPERATIONS, CASH FLOWS AND FINANCIAL CONDITION.

Governmental agencies are evaluating changes in laws to address concerns about the possible effects of greenhouse gas emissions on climate. Increased public awareness and concern over climate change may increase the likelihood of more proposals to reduce or mitigate the emission of greenhouse gases. Laws enacted that directly or indirectly affect our suppliers (through an increase in the cost of production or their ability to produce satisfactory products) or our business (through an impact on our inventory availability, cost of goods sold, operations or demand for the products we sell) could adversely affect our business, financial condition, results of operations and cash flows. Compliance with any new or more stringent laws or regulations, or stricter interpretations of existing laws, including increased government regulations to limit carbon dioxide and other greenhouse gas emissions as a result of concern over climate change, could require us to reduce emissions and to incur compliance costs which could affect our profitability or impede the production or distribution of our products, which could affect our results of operations, cash flows and financial condition. In addition, public expectations for reductions in greenhouse gas emissions could result in increased energy, transportation and raw material costs and may require us and to make additional investments in facilities and equipment.

CHANGES IN CONSUMER PREFERENCES COULD ADVERSELY AFFECT OUR BUSINESS.

Our continued success depends, in part, upon the demand for coffee. We believe that competition from other beverages continues to dilute the demand for coffee. Consumers who choose soft drinks, juices, bottled water, teas and other beverages all reduce spending on coffee. Consumer trends away from coffee could negatively impact our business.

WE ARE SELF-INSURED. OUR RESERVES MAY NOT BE SUFFICIENT TO COVER FUTURE CLAIMS.

We are self-insured for many risks up to significant deductible amounts. The premiums associated with our insurance continue to increase. General liability, fire, workers' compensation, directors and officers liability, life, employee medical, dental and vision and automobile risks present a large potential liability. While we accrue for this liability based on historical

experience, future claims may exceed claims we have incurred in the past. Should a different number of claims occur compared to what was estimated or the cost of the claims increase beyond what was anticipated, reserves recorded may not be sufficient and the accruals may need to be adjusted accordingly in future periods. In May 2011, we did not meet the minimum credit rating criteria for participation in the alternative security program for California self-insurers. As a result, we were required to post a \$5.9 million letter of credit as a security deposit to the State of California Department of Industrial Relations Self-Insurance Plans. We posted the security deposit in June 2011. **COMPETITORS MAY BE ABLE TO DUPLICATE OUR ROASTING AND BLENDING METHODS, WHICH COULD HARM OUR COMPETITIVE POSITION.**

We consider our roasting and blending methods essential to the flavor and richness of our coffees and, therefore, essential to our brand. Because our roasting methods cannot be patented, we would be unable to prevent competitors from copying these methods if such methods became known. If our competitors copy our roasts or blends, the value of

our brand may be diminished, and we may lose customers to our competitors. In addition, competitors may be able to develop roasting or blending methods that are more advanced than our production methods, which may also harm our competitive position.

OUR OPERATING RESULTS MAY HAVE SIGNIFICANT FLUCTUATIONS FROM QUARTER TO QUARTER WHICH COULD HAVE A NEGATIVE EFFECT ON OUR STOCK PRICE.

Our operating results may fluctuate from period to period or within certain periods as a result of a number of factors, including fluctuations in the price and supply of green coffee, fluctuations in the selling prices of our products, the success of our

Table of Contents

hedging strategy, competition from existing or new competitors in our industry, changes in consumer preferences, and our ability to manage inventory and fulfillment operations and maintain gross margins. During the quarters, we record the expected beneficial effect of liquidation of LIFO inventory quantities and record the actual impact at fiscal year end. Fluctuations in our operating results as a result of these factors or for any other reason, could cause our stock price to decline. Accordingly, we believe that period-to-period comparisons of our operating results are not necessarily meaningful, and such comparisons should not be relied upon as indicators of future performance.

OPERATING LOSSES MAY CONTINUE AND, AS A RESULT, COULD LEAD TO INCREASED LEVERAGE WHICH MAY HARM OUR FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

We have incurred operating losses and net losses for each of the prior three fiscal years. If our current strategies are unsuccessful we may not achieve the levels of sales and earnings we expect. As a result, we could suffer additional losses in future years and our stock price could decline leading to deterioration in our credit rating, which could limit the availability of additional financing and increase the cost of obtaining financing. In addition, an increase in leverage could raise the likelihood of a financial covenant breach which in turn could limit our access to existing funding under our revolving credit facility.

Our ability to satisfy our operating lease obligations and make payments of principal and interest on our indebtedness depends on our future performance. Should we experience deterioration in operating performance, we will have less cash flow available to meet these obligations. In addition, if such deterioration were to lead to the closure of warehouses or distribution centers, we would need to fund the costs of terminating those leases. If we are unable to generate sufficient cash flow from operations in the future to satisfy these financial obligations, we may be required to, among other things:

- seek additional financing in the debt or equity markets;
- refinance or restructure all or a portion of our indebtedness;
- sell selected assets; or
- reduce or delay planned capital or operating expenditures.

Such measures might not be sufficient to enable us to satisfy our financial obligations. In addition, any such financing, refinancing or sale of assets might not be available on economically favorable terms.

WE COULD FACE SIGNIFICANT WITHDRAWAL LIABILITY IF WE WITHDRAW FROM PARTICIPATION IN THE MULTIEMPLOYER PENSION PLAN IN WHICH WE PARTICIPATE.

We participate in a multiemployer pension plan administered by a labor union representing some of our employees. We make periodic contributions to this plan to allow it to meet its pension benefit obligations to its participants. In the event that we withdraw from participation in this plan, then applicable law could require us to make an additional lump-sum contribution to the plan, and we would have to reflect that as an expense in our consolidated statement of operations and as a liability on our consolidated balance sheet. Our withdrawal liability for any multiemployer plan would depend on the extent of the plan's funding of vested benefits. We are currently in negotiations to withdraw from this multiemployer plan and, if successful, may incur a withdrawal liability, the amount of which could be material to our results of operations and cash flows.

WE DEPEND ON THE EXPERTISE OF KEY PERSONNEL. THE UNEXPECTED LOSS OF ONE OR MORE OF THESE KEY EMPLOYEES COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR OPERATIONS AND COMPETITIVE POSITION.

Our continued success largely depends on the efforts and abilities of our executive officers and other key personnel. There is limited management depth in certain key positions throughout the Company. We must continue to recruit, retain and motivate management and other employees to maintain our current business and support our projected growth. The loss of key employees could adversely affect our operations and competitive position. We do not maintain key person life insurance policies on any of our executive officers.

CONCENTRATION OF OWNERSHIP AMONG OUR PRINCIPAL STOCKHOLDERS MAY PREVENT NEW INVESTORS FROM INFLUENCING SIGNIFICANT CORPORATE DECISIONS AND MAY RESULT IN A LOWER TRADING PRICE FOR OUR STOCK THAN IF OWNERSHIP OF OUR STOCK WAS LESS CONCENTRATED.

As of May 7, 2012, members of the Farmer family or entities controlled by the Farmer family (including trusts) as a group beneficially owned approximately 39.4% of our outstanding common stock. As a result, these stockholders, acting together, may be able to influence the outcome of stockholder votes, including votes concerning the election and removal of directors and approval of significant corporate transactions. This level of concentrated ownership may have the effect of delaying or preventing a change in the management or voting control of the Company. In addition, this significant concentration of share

Table of Contents

ownership may adversely affect the trading price of our common stock if investors perceive disadvantages in owning stock in a company with such concentrated ownership.

FUTURE SALES OF SHARES BY EXISTING STOCKHOLDERS COULD CAUSE OUR STOCK PRICE TO DECLINE.

All of our outstanding shares are eligible for sale in the public market, subject in certain cases to limitations under Rule 144 of the Securities Act of 1933, as amended (the “Securities Act”). Also, shares subject to outstanding options and restricted stock under the Omnibus Plan are eligible for sale in the public market to the extent permitted by the provisions of various vesting agreements, our stock ownership guidelines, and Rule 144 under the Securities Act. If these shares are sold, or if it is perceived that they will be sold in the public market, the trading price of our common stock could decline.

ANTI-TAKEOVER PROVISIONS COULD MAKE IT MORE DIFFICULT FOR A THIRD PARTY TO ACQUIRE US.

We have adopted a stockholder rights plan (the “Rights Plan”) pursuant to which each share of our outstanding common stock is accompanied by one preferred share purchase right (a “Right”). Each Right, when exercisable, will entitle the registered holder to purchase from the Company one one-hundredth of a share of Series A Junior Participating Preferred Stock, \$1.00 par value per share, at a purchase price of \$112.50, subject to adjustment. The Rights expire on March 28, 2015, unless they are earlier redeemed, exchanged or terminated as provided in the Rights Plan. Because the Rights may substantially dilute the stock ownership of a person or group attempting to take us over without the approval of our Board of Directors, our Rights Plan could make it more difficult for a third party to acquire us (or a significant percentage of our outstanding capital stock) without first negotiating with our Board of Directors regarding such acquisition.

In addition, our Board of Directors has the authority to issue up to 500,000 shares of preferred stock (of which 200,000 shares have been designated as Series A Junior Participating Preferred Stock) and to determine the price, rights, preferences, privileges and restrictions, including voting rights, of those shares without any further vote or action by stockholders. The rights of the holders of our common stock may be subject to, and may be adversely affected by, the rights of the holders of any preferred stock that may be issued in the future. The issuance of preferred stock may have the effect of delaying, deterring or preventing a change of control of the Company without further action by stockholders and may adversely affect the voting and other rights of the holders of our common stock. Further, certain provisions of our charter documents, including a classified board of directors, provisions eliminating the ability of stockholders to take action by written consent, and provisions limiting the ability of stockholders to raise matters at a meeting of stockholders without giving advance notice, may have the effect of delaying or preventing changes in control or management of the Company, which could have an adverse effect on the market price of our stock. In addition, our charter documents do not permit cumulative voting, which may make it more difficult for a third party to gain control of our Board of Directors. Further, we are subject to the anti-takeover provisions of Section 203 of the Delaware General Corporation Law, which will prohibit us from engaging in a “business combination” with an “interested stockholder” for a period of three years after the date of the transaction in which the person became an interested stockholder, even if such combination is favored by a majority of stockholders, unless the business combination is approved in a prescribed manner. The application of Section 203 also could have the effect of delaying or preventing a change of control or management.

QUALITY CONTROL PROBLEMS MAY ADVERSELY AFFECT OUR BRANDS THEREBY NEGATIVELY IMPACTING OUR SALES.

Our success depends on our ability to provide customers with high quality products and service. Although we take measures to ensure that we sell only fresh coffee, tea and culinary products, we have no control over our products once they are purchased by our customers. Accordingly, customers may store our products for longer periods of time, potentially affecting product quality. If consumers do not perceive our products and service to be of high quality, then the value of our brands may be diminished and, consequently, our operating results and sales may be adversely affected.

ADVERSE PUBLIC OR MEDICAL OPINIONS ABOUT CAFFEINE AND REPORTS OF INCIDENTS INVOLVING FOOD BORNE ILLNESS AND TAMPERING MAY HARM OUR BUSINESS.

Coffee contains significant amounts of caffeine and other active compounds, the health effects of some of which are not fully understood. A number of research studies conclude or suggest that excessive consumption of caffeine may lead to increased adverse health effects. An unfavorable report on the health effects of caffeine or other compounds present in coffee could significantly reduce the demand for coffee which could harm our business and reduce our sales.

Similarly, instances or reports, whether true or not, of unclean water supply, food-borne illnesses and food tampering have in the past severely injured the reputations of companies in the food processing sector and could in the future affect us as well.

Table of Contents

Any report linking us to the use of unclean water, food-borne illnesses or food tampering could damage the value of our brands, negatively impact sales of our products, and potentially lead to product liability claims. Clean water is critical to the preparation of coffee beverages. We have no ability to ensure that our customers use a clean water supply to prepare coffee beverages.

PRODUCT RECALLS AND INJURIES CAUSED BY PRODUCTS COULD REDUCE OUR SALES AND HARM OUR BUSINESS.

Selling products for human consumption involves inherent legal risks. We could be required to recall products due to product contamination, spoilage or other adulteration, product misbranding or product tampering. We may also suffer losses if our products or operations violate applicable laws or regulations, or if our products cause injury, illness or death. A significant product liability claim against us, whether or not successful, or a widespread product recall may reduce our sales and harm our business.

GOVERNMENT REGULATIONS COULD RESULT IN ADDITIONAL COSTS THEREBY AFFECTING OUR PROFITABILITY.

New laws and regulations may be introduced that could result in additional compliance costs, seizures, confiscations, recalls or monetary fines, any of which could prevent or inhibit the development, distribution and sale of our products. We continually monitor and modify our packaging to be in compliance with applicable laws and regulations. Any change in labeling requirements for our products may lead to an increase in packaging costs or interruptions or delays in packaging deliveries. If we fail to comply with applicable laws and regulations, we may be subject to civil remedies, including fines, injunctions, recalls or seizures, as well as potential criminal sanctions, which could have a material adverse effect on our results of operations.

FAILURE TO MAINTAIN EFFECTIVE INTERNAL CONTROLS IN ACCORDANCE WITH SECTION 404 OF THE SARBANES OXLEY ACT OF 2002 COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR BUSINESS AND STOCK PRICE.

As directed by Section 404 of the Sarbanes Oxley Act of 2002 ("SOX"), the SEC adopted rules requiring us, as a public company, to include a report of management on our internal controls over financial reporting in our annual report on Form 10-K and quarterly reports on Form 10-Q that contains an assessment by management of the effectiveness of our internal controls over financial reporting. In addition, our independent auditors must attest to and report on management's assessment of the effectiveness of our internal controls over financial reporting as of the end of the fiscal year. Compliance with SOX Section 404 has been a challenge for many companies. Our ability to continue to comply is uncertain as we expect that our internal controls will continue to evolve as our business activities change. If, during any year, our independent auditors are not satisfied with our internal controls over financial reporting or the level at which these controls are designed, documented, operated, tested or assessed, or if the independent auditors interpret the requirements, rules or regulations differently than we do, then they may decline to attest to management's assessment or may issue a report that is qualified. In addition, if we fail to maintain the adequacy of our internal controls, we may not be able to ensure that we can conclude on an ongoing basis that we have effective internal controls over financial reporting in accordance with SOX Section 404. Failure to maintain an effective internal control environment could have a material adverse effect on our stock price. In addition, there can be no assurance that we will be able to remediate material weaknesses, if any, which may be identified in future periods.

Item 6. Exhibits

See Exhibit Index.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

FARMER BROS. CO.

By: /S/ MICHAEL H. KEOWN
Michael H. Keown
President and Chief Executive Officer
(principal executive officer)

Date: May 8, 2012

By: /S/ JEFFREY A. WAHBA
Jeffrey A. Wahba
Treasurer and Chief Financial Officer
(principal financial officer)

Date: May 8, 2012

Table of Contents

EXHIBIT INDEX

- 3.1 Certificate of Incorporation (filed as Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2009 filed with the SEC on May 11, 2009 and incorporated herein by reference).
- 3.2 Amended and Restated Bylaws (filed as Exhibit 3.2 to the Company's Current Report on Form 8-K filed with the SEC on April 25, 2011 and incorporated herein by reference).
- 4.1 Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock (filed as Exhibit 4.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2010 filed with the SEC on May 10, 2010 and incorporated herein by reference).
- 4.2 Rights Agreement, dated March 17, 2005, by and between Farmer Bros. Co. and Wells Fargo Bank, N.A., as Rights Agent (filed as Exhibit 4.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2010 filed with the SEC on May 10, 2010 and incorporated herein by reference).
- 4.3 Specimen Stock Certificate (filed as Exhibit 4.1 to the Company's Form 8-A/A filed with the SEC on February 6, 2009 and incorporated herein by reference).
- 10.1 Amended and Restated Loan and Security Agreement, dated September 12, 2011, by and among Farmer Bros. Co. and Coffee Bean International, Inc., as Borrowers, Coffee Bean Holding Co., Inc. and FBC Finance Company, as Guarantors, the Lenders party thereto, and Wells Fargo Bank, National Association, as Agent (filed as Exhibit 10.12 to the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2011 filed with the SEC on September 13, 2011 and incorporated herein by reference).
- 10.2 Amendment No. 1 to Amended and Restated Loan and Security Agreement, effective January 9, 2012, by and among Farmer Bros. Co. and Coffee Bean International, Inc., as Borrowers, Coffee Bean Holding Co., Inc. and FBC Finance Company, as Guarantors, the Lenders party thereto, and Wells Fargo Bank, National Association, as Agent (filed as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2011 filed with the SEC on February 8, 2012 and incorporated herein by reference).
- 10.3 Farmer Bros. Co. Pension Plan for Salaried Employees (filed as Exhibit 10.1 to the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2007 filed with the SEC on September 13, 2007 and incorporated herein by reference).*
- 10.4 Amendment No. 1 to Farmer Bros. Co. Retirement Plan effective June 30, 2011 (filed as Exhibit 10.14 to the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2011 filed with the SEC on September 13, 2011 and incorporated herein by reference).*
- 10.5 Farmer Bros. Co. 2005 Incentive Compensation Plan (Amended and Restated as of December 31, 2008) (filed as Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2008 filed with the SEC on February 10, 2009 and incorporated herein by reference).*
- 10.6

Edgar Filing: FARMER BROTHERS CO - Form 10-Q

Farmer Bros. Co. Amended and Restated Employee Stock Ownership Plan, as adopted by the Board of Directors on December 9, 2010 and effective as of January 1, 2010 (filed as Exhibit 10.12 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2010 filed with the SEC on February 9, 2011 and incorporated herein by reference).*

10.7 ESOP Loan Agreement including ESOP Pledge Agreement and Promissory Note, dated March 28, 2000, between Farmer Bros. Co. and Wells Fargo Bank, N.A., Trustee for the Farmer Bros Co. Employee Stock Ownership Plan (filed as Exhibit 10.13 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2010 filed with the SEC on February 9, 2011 and incorporated herein by reference).

10.8 Amendment No. 1 to ESOP Loan Agreement, dated June 30, 2003, between Farmer Bros. Co. and Wells Fargo Bank, N.A., Trustee for the Farmer Bros Co. Employee Stock Ownership Plan (filed as Exhibit 10.14 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2010 filed with the SEC on February 9, 2011 and incorporated herein by reference).

10.9 ESOP Loan Agreement No. 2 including ESOP Pledge Agreement and Promissory Note, dated July 21, 2003 between Farmer Bros. Co. and Wells Fargo Bank, N.A., Trustee for the Farmer Bros Co. Employee Stock Ownership Plan (filed as Exhibit 10.15 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2010 filed with the SEC on February 9, 2011 and incorporated herein by reference).

10.10 Separation Agreement, dated as of April 1, 2011, by and between Farmer Bros. Co. and Roger M. Lavery III (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on April 6, 2011 and incorporated herein by reference).*

Table of Contents

- 10.11 Employment Agreement, dated March 9, 2012, by and between Farmer Bros. Co. and Michael H. Keown (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on March 13, 2012 and incorporated herein by reference).*
- 10.12 Amended and Restated Employment Agreement, effective as of April 19, 2011, by and between Farmer Bros. Co. and Jeffrey A. Wahba (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on May 23, 2011 and incorporated herein by reference).*
- 10.13 Amendment No. 1 to Amended and Restated Employment Agreement, dated as of August 30, 2011, by and between Farmer Bros. Co. and Jeffrey A. Wahba (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on September 2, 2011 and incorporated herein by reference).*
- 10.14 Second Amended and Restated Employment Agreement, effective as of February 13, 2012, by and between Farmer Bros. Co. and Jeffrey A. Wahba (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on February 17, 2012 and incorporated herein by reference).*
- 10.15 Letter Agreement, effective as of April 19, 2011, by and between Farmer Bros. Co. and Mark A. Harding (filed as Exhibit 10.3 to the Company's Current Report on Form 8-K filed with the SEC on May 23, 2011 and incorporated herein by reference).*
- 10.16 Employment Agreement, dated as of April 4, 2012, by and between Farmer Bros. Co. and Thomas W. Mortensen (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K/A filed with the SEC on April 10, 2012 and incorporated herein by reference).*
- 10.17 Employment Agreement, effective as of April 19, 2011, by and between Farmer Bros. Co. and Patrick G. Criteser (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the SEC on May 23, 2011 and incorporated herein by reference).*
- 10.18 Amended and Restated Employment Agreement, effective as of February 13, 2012, by and between Farmer Bros. Co. and Patrick G. Criteser (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the SEC on February 17, 2012 and incorporated herein by reference).*
- 10.19 Employment Agreement, dated as of December 1, 2010, by and between Farmer Bros. Co. and Larry B. Garrett (filed as Exhibit 10.29 to the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2011 filed with the SEC on September 13, 2011 and incorporated herein by reference).*
- 10.20 2007 Omnibus Plan (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on August 29, 2007 and incorporated herein by reference).*
- 10.21 Form of 2007 Omnibus Plan Stock Option Grant Notice and Stock Option Agreement (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on February 26, 2008 and incorporated herein by reference).*
- 10.22 Form of 2007 Omnibus Plan Restricted Stock Award Grant Notice and Restricted Stock Award Agreement (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the SEC on February 26, 2008 and incorporated herein by reference).*

Edgar Filing: FARMER BROTHERS CO - Form 10-Q

- 10.23 Stock Ownership Guidelines for Directors and Executive Officers (filed as Exhibit 10.3 to the Company's Current Report on Form 8-K filed with the SEC on February 26, 2008 and incorporated herein by reference).*
- 10.24 Form of Target Award Notification Letter (Fiscal 2012) under Farmer Bros. Co. 2005 Incentive Compensation Plan (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on September 21, 2011 and incorporated herein by reference).*
- 10.25 Form of Target Award Notification Letter (Fiscal 2011) under Farmer Bros. Co. 2005 Incentive Compensation Plan (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on September 30, 2010 and incorporated herein by reference).*
- 10.26 Form of Target Award Notification Letter (Fiscal 2010) under Farmer Bros. Co. 2005 Incentive Compensation Plan (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the SEC on December 16, 2009 and incorporated herein by reference).*
- 10.27 Form of Change in Control Severance Agreement for Executive Officers of the Company (with schedule of executive officers attached) (filed as Exhibit 10.3 to the Company's Current Report on Form 8-K/A filed with the SEC on April 10, 2012 and incorporated herein by reference).*

Table of Contents

10.28	Form of Indemnification Agreement for Directors and Officers of the Company, as adopted on May 18, 2006 and as amended on December 31, 2008 (with schedule of indemnitees attached) (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K/A filed with the SEC on April 10, 2012 and incorporated herein by reference).*
31.1	Principal Executive Officer Certification Pursuant to Securities Exchange Act Rules 13a-14 and 15d-14 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
31.2	Principal Financial and Accounting Officer Certification Pursuant to Securities Exchange Act Rules 13a-14 and 15d-14 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
32.1	Principal Executive Officer Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).
32.2	Principal Financial and Accounting Officer Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).
101	The following materials from Farmer Bros. Co.'s Quarterly Report on Form 10-Q for the quarter ended March 31, 2012, formatted in XBRL (eXtensible Business Reporting Language): (i) consolidated balance sheets, (ii) consolidated statements of operations, (iii) consolidated statements of cash flows and (iv) the notes to the consolidated financial statements, tagged as block of text.**

* Management contract or compensatory plan or arrangement.

** Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.