CENTRAL GARDEN & PET CO
Form 10-Q
August 07, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 28, 2014

or

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

For the transition period from __________ to __________

Commission File Number: 001-33268

CENTRAL GARDEN & PET COMPANY

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

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

(Address of principle executive offices)

(925) 948-4000

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. x Yes ¨ No

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

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

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

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

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

Common Stock Outstanding as of July 31, 2014	12,308,802
Class A Common Stock Outstanding as of July 31, 2014	36,470,848
Class B Stock Outstanding as of July 31, 2014	1,652,262

PART I. FINANCIAL INFORMATION

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

This Form 10-Q includes forward-looking statements. Forward-looking statements include statements concerning our plans, objectives, goals, strategies, future events, future revenues or performance, projected cost savings, capital expenditures, financing needs, plans or intentions relating to acquisitions, our competitive strengths and weaknesses, our business strategy and the trends we anticipate in the industries in which we operate and other information that is not historical information. When used in this Form 10-Q, the words estimates, expects, anticipates, projects, plans intends, believes and variations of such words or similar expressions are intended to identify forward-looking statements. All forward-looking statements, including, without limitation, our examination of historical operating trends, are based upon our current expectations and various assumptions. Our expectations, beliefs and projections are expressed in good faith, and we believe there is a reasonable basis for them, but we cannot assure you that our expectations, beliefs and projections will be realized.

There are a number of risks and uncertainties that could cause our actual results to differ materially from the forward-looking statements contained in this Form 10-Q. Important factors that could cause our actual results to differ materially from the forward-looking statements we make in this Form 10-Q are set forth in our Form 10-K for the fiscal year ended September 28, 2013, including the factors described in the section entitled Item 1A Risk Factors. If any of these risks or uncertainties materialize, or if any of our underlying assumptions are incorrect, our actual results may differ significantly from the results that we express in or imply by any of our forward-looking statements. We do not undertake any obligation to revise these forward-looking statements to reflect future events or circumstances. Presently known risk factors include, but are not limited to, the following factors:

- seasonality and fluctuations in our operating results and cash flow;

fluctuations in market prices for seeds and grains and other raw materials;

our inability to pass through cost increases in a timely manner;

risks associated with new product introductions, including the risk that our new products will not produce sufficient sales to recoup our investment;

the impact on our financial results of costs incurred to consider and respond to the unsolicited Harbinger proposal, and the impact of the Harbinger proposal on our business, employees and customer relationships;

declines in consumer spending during economic downturns;

inflation, deflation and other adverse macro-economic conditions;

supply shortages in small animals and pet birds;

adverse weather conditions;

fluctuations in energy prices, fuel and related petrochemical costs;

access to and cost of additional capital;

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

disruptions in our business arising from the implementation of our change initiatives and the resulting consequences to our business and results of operations;

increased costs and expenses associated with our change initiatives;

consolidation trends in the retail industry;

competition in our industries;

risks associated with our acquisition strategy;

potential goodwill or intangible asset impairment;

dependence upon our key executives;

implementation of a new enterprise resource planning information technology system;

our ability to protect our intellectual property rights;

potential environmental liabilities;

risk associated with international sourcing;

litigation and product liability claims;

regulatory issues;

the impact of product recalls;

potential costs and risks associated with actual or anticipated cyber attacks;

the voting power associated with our Class B stock; and

potential dilution from issuance of authorized shares.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CENTRAL GARDEN & PET COMPANY

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share amounts)

Unaudited

	June 28, 2014	June 29, 2013	September 28, 2013
ASSETS			
Current assets:			
Cash and cash equivalents	$ 31,846	$ 20,482	$ 15,156
Short term investments	14,220	17,820	17,820
Accounts receivable (less allowance for doubtful accounts of $29,221, $23,355 and $21,158)	214,120	243,650	194,260
Inventories	365,035	413,070	391,934
Prepaid expenses and other	53,689	53,751	53,484
Total current assets	678,910	748,773	672,654
Land, buildings, improvements and equipment net	177,660	190,921	188,913
Goodwill	205,756	210,223	205,756
Other intangible assets net	76,923	75,670	79,868
Deferred income taxes and other assets	26,689	19,049	13,969
Total	$ 1,165,938	$ 1,244,636	$ 1,161,160
LIABILITIES AND EQUITY			
Current liabilities:			
Accounts payable	$ 89,959	$ 112,313	$ 103,569
Accrued expenses	89,521	93,213	78,618
Current portion of long-term debt	296	205	142
Total current liabilities	179,776	205,731	182,329
Long-term debt	449,994	509,430	472,445
Other long-term obligations	43,236	37,845	36,362
Equity:			
Common stock, $.01 par value: 12,308,802, 12,246,751, and 12,246,751 shares outstanding at June 28, 2014, June 29, 2013 and September 28, 2013	123	122	122

Class A common stock, $.01 par value: 36,479,590, 35,240,576 and 35,291,001 shares outstanding at June 28, 2014, June 29, 2013 and September 28, 2013	365	352	353
Class B stock, $.01 par value: 1,652,262 shares outstanding	16	16	16
Additional paid-in capital	398,244	388,443	389,153
Accumulated earnings	90,466	100,173	77,592
Accumulated other comprehensive income	1,868	840	1,442
Total Central Garden & Pet Company shareholders equity	491,082	489,946	468,678
Noncontrolling interest	1,850	1,684	1,346
Total equity	492,932	491,630	470,024
Total	$ 1,165,938	$ 1,244,636	$ 1,161,160

See notes to condensed consolidated financial statements.

CENTRAL GARDEN & PET COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended		Nine Months Ended	
	June 28, 2014	June 29, 2013	June 28, 2014	June 29, 2013
Net sales	$ 437,987	$ 494,130	$ 1,230,119	$ 1,284,796
Cost of goods sold and occupancy	318,856	341,664	883,651	902,201
Gross profit	119,131	152,466	346,468	382,595
Selling, general and administrative expenses	100,705	119,574	291,628	316,051
Income from operations	18,426	32,892	54,840	66,544
Interest expense	(10,429)	(11,347)	(33,051)	(32,599)
Interest income	14	28	43	120
Other income (expense)	456	353	396	(676)
Income before income taxes and noncontrolling interest	8,467	21,926	22,228	33,389
Income taxes	3,133	7,520	8,217	11,370
Income including noncontrolling interest	5,334	14,406	14,011	22,019
Net income attributable to noncontrolling interest	647	681	1,137	1,367
Net income attributable to Central Garden & Pet Company	$ 4,687	$ 13,725	$ 12,874	$ 20,652
Net income per share attributable to Central Garden & Pet Company:				
Basic	$ 0.10	$ 0.28	$ 0.26	$ 0.43
Diluted	$ 0.09	$ 0.28	$ 0.26	$ 0.42
Weighted average shares used in the computation of net income per share:				
Basic	49,148	48,173	48,732	48,037
Diluted	49,841	48,822	49,201	48,766

See notes to condensed consolidated financial statements.

CENTRAL GARDEN & PET COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended		Nine Months Ended	
	June 28, 2014	June 29, 2013	June 28, 2014	June 29, 2013
Net income	$ 5,334	$ 14,406	$ 14,011	$ 22,019
Other comprehensive income (loss):				
Foreign currency translation, net of tax	339	(92)	426	(699)
Total comprehensive income	5,673	14,314	14,437	21,320
Comprehensive income attributable to noncontrolling interests	647	681	1,137	1,367
Comprehensive income attributable to Central Garden & Pet Company	$ 5,026	$ 13,633	$ 13,300	$ 19,953

See notes to condensed consolidated financial statements.

CENTRAL GARDEN & PET COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Nine Months Ended	
	June 28, 2014	**June 29, 2013**
Cash flows from operating activities:		
Net income	$ 14,011	$ 22,019
Adjustments to reconcile net loss to net cash provided (used) by operating activities:		
Depreciation and amortization	26,683	24,158
Stock-based compensation	6,365	12,491
Excess tax benefits from stock-based awards	(422)	(345)
Deferred income taxes	7,420	9,252
Write-off of deferred financing costs	1,731	0
Unrealized losses on derivative financial instruments	0	412
Gain on sale of property and equipment	(1,996)	0
Loss on disposal of property and equipment	587	412
Change in assets and liabilities:		
Accounts receivable	(17,399)	(41,240)
Inventories	31,356	(83,181)
Prepaid expenses and other assets	3,525	(149)
Accounts payable	(14,687)	(15,545)
Accrued expenses	13,597	8,624
Other long-term obligations	(1,920)	(2,366)
Net cash provided (used) by operating activities	68,851	(65,458)
Cash flows from investing activities:		
Additions to property and equipment	(13,707)	(19,534)
Proceeds from sale of property and equipment, net of expenses	5,171	0
Payments to acquire companies, net of cash acquired	(20,262)	(4,835)
Proceeds from short term investments	3,600	4,885
Net cash used in investing activities	(25,198)	(19,484)
Cash flows from financing activities:		
Repayments of long-term debt	(282)	(257)
Proceeds from issuance of common stock	594	560
Borrowings under revolving line of credit	278,000	281,000
Repayments under revolving line of credit	(301,000)	(221,000)
Repurchase of common stock	(1,190)	(2,625)
Distribution to noncontrolling interest	(633)	(629)
Payment of financing costs	(3,090)	0

Excess tax benefits from stock-based awards	422	345
Net cash (used) provided by financing activities	(27,179)	57,394
Effect of exchange rate changes on cash and cash equivalents	216	(445)
Net increase (decrease) in cash and cash equivalents	16,690	(27,993)
Cash and equivalents at beginning of period	15,156	48,475
Cash and equivalents at end of period	$ 31,846	$ 20,482
Supplemental information:		
Cash paid for interest	$ 22,067	$ 22,894

See notes to condensed consolidated financial statements.

CENTRAL GARDEN & PET COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Three and Nine Months Ended June 28, 2014

(unaudited)

1. Basis of Presentation

The condensed consolidated balance sheets of Central Garden & Pet Company and subsidiaries (the Company or Central) as of June 28, 2014 and June 29, 2013, the condensed consolidated statements of operations for the three and nine months ended June 28, 2014 and June 29, 2013, the condensed consolidated statements of comprehensive income for the three and nine months ended June 28, 2014 and June 29, 2013 and the condensed consolidated statements of cash flows for the nine months ended June 28, 2014 and June 29, 2013 have been prepared by the Company, without audit. In the opinion of management, the interim financial statements include all normal recurring adjustments necessary for a fair statement of the results for the interim periods presented.

For the Company s foreign business in the UK, the local currency is the functional currency. Assets and liabilities are translated using the exchange rate in effect at the balance sheet date. Income and expenses are translated at the average exchange rate for the period. Deferred taxes are not provided on translation gains and losses because the Company expects earnings of its foreign subsidiary to be permanently reinvested. Transaction gains and losses are included in results of operations. See Note 9, Supplemental Equity Information, for further detail.

Due to the seasonal nature of the Company s garden business, the results of operations for the three and nine month periods ended June 28, 2014 are not indicative of the operating results that may be expected for the entire fiscal year. These interim financial statements should be read in conjunction with the annual audited financial statements, accounting policies and financial notes thereto, included in the Company s 2013 Annual Report on Form 10-K, which has previously been filed with the Securities and Exchange Commission. The September 28, 2013 balance sheet presented herein was derived from the audited statements.

Noncontrolling Interest

Noncontrolling interest in the Company s condensed consolidated financial statements represents the 20% interest not owned by Central in a consolidated subsidiary. Since the Company controls this subsidiary, its financial statements are consolidated with those of the Company, and the noncontrolling owner s 20% share of the subsidiary s net assets and results of operations is deducted and reported as noncontrolling interest on the consolidated balance sheets and as net income (loss) attributable to noncontrolling interest in the consolidated statements of operations. See Note 9, Supplemental Equity Information, for additional information.

Derivative Instruments

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

The Company does not perform the assessments required to achieve hedge accounting for commodity derivative positions. Accordingly, the changes in the values of these derivatives are recorded currently in other income (expense) in its condensed consolidated statements of operations. See Note 4, Derivative Instruments, for additional information.

Recent Accounting Pronouncements

Comprehensive Income

In February 2013, the FASB issued Accounting Standards Update No. 2013-02, *Comprehensive Income (Topic 220) Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income (ASU 2013-02)*. This guidance requires entities to disclose, either in the notes to the consolidated financial statements or parenthetically on the face of the statement that reports comprehensive income (loss), items reclassified out of accumulated other comprehensive income (loss) and into net earnings in their entirety and the effect of the reclassification on each affected statement of operations line item. In addition, for accumulated other comprehensive income (loss) reclassification items that are not reclassified in their entirety into net earnings, a cross reference to other required accounting standard disclosures is required. This guidance became effective for the Company on September 29, 2013. This new guidance did not have a material impact on the Company s condensed consolidated financial statements.

Discontinued Operations

In April 2014, the FASB issued Accounting Standards Update No. 2014-08 (ASU 2014-08), *Presentation of Financial Statements (Topic 205) and Property, Plant and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*. ASU 2014-08 provides amended guidance for reporting discontinued operations and disclosures of disposals of components. The amended guidance raises the threshold for disposals to qualify as discontinued operations and permits significant continuing involvement and continuing cash flows with the discontinued operation. In addition, the amended guidance requires additional disclosures for discontinued operations and new disclosures for individually material disposal transactions that do not meet the definition of a discontinued operation. The amended guidance is effective for the Company prospectively commencing in the first quarter of fiscal 2015. Early adoption is permitted. The adoption of the applicable sections of this ASC may have an impact on the accounting for any future discontinued operations the Company may have.

Revenue Recognition

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2014-09 (ASU 2014-09), *Revenue from Contracts with Customers*. This update was issued as Accounting Standards Codification Topic 606. The core principle of this amendment is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period, with earlier adoption not permitted. The guidance permits two implementation approaches, one requiring retrospective application of the new standard with restatement of prior years and one requiring prospective application of the new standard with disclosure of results under old standards. The adoption of this guidance is not expected to have a significant impact on the Company s consolidated financial statements.

2. Business Combinations

Four Star Microbial Products

In December 2012, the Company acquired the remaining majority interest in FourStar Microbial Products, LLC (Four Star Microbial) for approximately $4.8 million in cash and approximately $4.2 million of contingent future performance-based payments. The purchase price exceeded the estimated fair value of the tangible and intangible assets acquired by $3.2 million, which was recorded as goodwill. The operating results of FourStar Microbial had no material impact on the consolidated financial statements.

The following table summarizes the preliminary recording of the fair values of the assets acquired and liabilities assumed as of the acquisition date and subsequent adjustments:

(In thousands)	**Amounts Previously Recognized as of Acquisition Date[(1)]**	**Measurement Period Adjustments**	**Amounts Recognized as of Acquisition Date (as Adjusted)**

Current assets, net of cash and cash equivalents acquired	$	220	$	0	$	220
Fixed assets		40		0		40
Goodwill		0		3,243		3,243
Intangible assets		1,144		5,958		7,102
Other long-term assets		5,406		(5,406)		0
Current liabilities		(13)		0		(13)
Other long-term liabilities		0		(4,165)		(4,165)
		6,797		(370)(2)		6,427
Assets of aquiree recorded prior to purchase of majority interest		(1,962)		370		(1,592)
Net assets acquired, less cash and cash equivalents	$	4,835	$	0	$	4,835

(1) As previously reported in our Form 10-Q for the period ended December 29, 2012.

(2) The Company recognized a loss of approximately $370 on its prior ownership interest in the acquiree.

During fiscal 2013, the fair value measurements of assets acquired and liabilities assumed of FourStar Microbial as of the acquisition date were refined. This refinement did not have a significant impact on the Company s condensed consolidated statements of operations, balance sheets or cash flows in any period and, therefore, the Company has not retrospectively adjusted its financial statements. These fair value assessments were finalized and reflected in the Company s Form 10-K for the year ended September 28, 2013. Financial results for FourStar Microbial have been included in the results of operations within the Pet segment since the date of acquisition.

Envincio

On April 1, 2014, the Company purchased certain assets of Envincio LLC, including brands, EPA registrations, inventory and trade receivables, for approximately $20 million. The purchase price exceeded the fair value of the net tangible assets acquired by approximately $14 million, which is included in deferred taxes and other assets in our condensed consolidated balance sheets as of June 28, 2014, as the Company has not yet finalized the allocation of the purchase price to the fair value of the intangible assets acquired. The operating results of this acquisition did not have a material impact on the Company s consolidated financial statements. This acquisition is expected to enable the Company to be a key supplier and product innovator in the growing natural insecticides product market, often characterized as EPA-exempt products, and expand its offerings in traditional pesticides.

3. Fair Value Measurements

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

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

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

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

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

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following table presents the Company s financial assets and liabilities measured at fair value on a recurring basis based upon the level within the fair value hierarchy in which the fair value measurements fall, as of June 28, 2014 (in thousands):

	Level 1	Level 2	Level 3	Total
Assets:				
Certificates of deposit[(a)]	$ 0	$ 14,220	$ 0	$ 14,220

Total assets	$ 0	$ 14,220	$ 0	$ 14,220
Liabilities:				
Liability for contingent consideration[(c)]	$ 0	$ 0	$ 4,414	$ 4,414
Total liabilities	$ 0	$ 0	$ 4,414	$ 4,414

The following table presents the Company s financial assets and liabilities measured at fair value on a recurring basis based upon the level within the fair value hierarchy in which the fair value measurements fall, as of June 29, 2013:

	Level 1	Level 2	Level 3	Total
Assets:				
Certificates of deposit[a]	$ 0	$ 17,820	$ 0	$ 17,820
Total assets	$ 0	$ 17,820	$ 0	$ 17,820
Liabilities:				
Derivative liabilities[b]	$ 0	$ 197	$ 0	$ 197
Total liabilities	$ 0	$ 197	$ 0	$ 197

The following table presents our financial assets and liabilities at fair value on a recurring basis based upon the level within the fair value hierarchy in which the fair value measurements fall, as of September 28, 2013:

	Level 1	Level 2	Level 3	Total
Assets:				
Certificates of deposit[a]	$ 0	$ 17,820	$ 0	$ 17,820
Total assets	$ 0	$ 17,820	$ 0	$ 17,820
Liabilities:				
Liability for contingent consideration[c]	$ 0	$ 0	$ 4,165	$ 4,165
Total liabilities	$ 0	$ 0	$ 4,165	$ 4,165

(a) The fair value of our time deposits is based on the most recent observable inputs for similar instruments in active markets or quoted prices for identical or similar instruments in markets that are not active or are directly or indirectly observable. These are presented as short term investments in the condensed consolidated balance sheets.

(b) Derivative assets and liabilities were valued using quoted forward pricing from bank counterparties and are presented as other current assets and liabilities in the condensed consolidated balance sheets.

(c) The liability for contingent consideration relates to an earn-out for B2E, acquired in December 2012. The fair value of the contingent consideration arrangement is determined based on the Company s evaluation as to the probability and discounted amount of any earn-out that will be achieved based on expected future performance by the acquired entity. This is presented as part of accrued expenses and long-term liabilities in the condensed consolidated balance sheets.

The following table provides a summary of changes in fair value of our Level 3 financial instruments for the period ended September 28, 2013 and June 28, 2014 (in thousands):

	Amount
Balance as of September 28, 2013	$ 4,165
Changes in the fair value of contingent performance-based payments established at the time of acquisition	249
Balance as of June 28, 2014	$ 4,414

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

The Company measures certain non-financial assets and liabilities, including long-lived assets, goodwill and intangible assets, at fair value on a non-recurring basis. Fair value measurements of non-financial assets and non-financial liabilities are used primarily in the impairment analyses of long-lived assets, goodwill and other intangible assets. During the period ended June 28, 2014, the Company was not required to measure any significant non-financial assets and liabilities at fair value.

Fair Value of Other Financial Instruments

The estimated fair value of the Company s $450.0 million 8.25% senior subordinated notes due 2018 as of June 28, 2014, June 29, 2013 and September 28, 2013, was $469.1 million, $457.3 million and $449.5 million, respectively, compared to a carrying value of $449.5 million, $449.4 million and $449.4 million, respectively. The estimated fair value is based on quoted market prices for these notes, which are Level 2 inputs within the fair value hierarchy.

4. Derivative Instruments

Our operations are exposed to market risks from adverse changes in commodity prices affecting the cost of raw materials. In the normal course of business, these risks are managed through a variety of strategies, including the use of derivatives. The utilization of these financial transactions is governed by policies covering acceptable counterparty exposure, instrument types and other practices. The Company does not enter into derivative contracts for speculative purposes. The Company performs assessments of its counterparty credit risk regularly, including a review of credit ratings and potential nonperformance of the counterparty, and minimizes counterparty concentrations.

Commodity and commodity index futures, swaps and option contracts are used to economically hedge commodity input prices on grains and proteins. These derivative contracts are entered into for periods consistent with the related underlying exposures and do not constitute positions independent of those exposures. Generally, the Company economically hedges a portion of its anticipated consumption of commodity inputs for periods of up to 12 months. As of September 28, 2013 and June 28, 2014, the Company had no outstanding derivative instruments. As of June 29, 2013, the Company had economically hedged certain portions of its anticipated consumption of commodity inputs using derivative instruments with expiration dates through July 2013.

The Company recognizes all derivative instruments as either assets or liabilities at fair value in the condensed consolidated balance sheets, with the exception of normal purchases and normal sales expected to result in physical delivery. The Company s derivative financial instruments have not been designated as hedging instruments for accounting purposes. The Company recognizes realized and unrealized gains and losses from derivatives used to economically hedge anticipated commodity consumption in other income (expense) on the condensed consolidated statement of operations.

The following table presents the fair value of all derivative instruments outstanding in the condensed consolidated balance sheets (in thousands):

	June 28, 2014		June 29, 2013		September 28, 2013	
	Other Current Assets	Other Current Liabilities	Other Current Assets	Other Current Liabilities	Other Current Assets	Other Current Liabilities
Derivatives not designated as hedging instruments:						
Commodity contracts	$ 0	$ 0	$ 0	$ 197	$ 0	$ 0
Total derivative instruments	$ 0	$ 0	$ 0	$ 197	$ 0	$ 0

The following table presents the effect of derivative instruments recorded in other income (expense) on the condensed consolidated statements of operations (in thousands):

	Three Months Ended		Nine Months Ended	
Derivatives Not Designated as Hedging Instruments	**June 28, 2014**	**June 29, 2013**	**June 28, 2014**	**June 29, 2013**
Commodity contracts	$ 0	$ (185)	$ 0	$ (922)
Total derivative instruments	$ 0	$ (185)	$ 0	$ (922)

The following table presents the gross contract notional volume of outstanding derivative contracts:

Commodity	Metric	June 28, 2014	June 29, 2013	September 28, 2013
Corn	Bushels	0	366,000	0

5. Inventories, net

Inventories, net of allowance for obsolescence, consist of the following (in thousands):

	June 28, 2014	June 29, 2013	September 28, 2013
Raw materials	$ 93,922	$ 130,597	$ 121,695
Work in progress	17,592	19,848	19,856
Finished goods	240,337	255,112	236,322
Supplies	13,184	7,513	14,060
Total inventories, net	$ 365,035	$ 413,070	$ 391,934

6. Goodwill

The Company accounts for goodwill in accordance with ASC 350, Intangibles Goodwill and Other, and tests goodwill for impairment annually, or whenever events occur or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. This assessment involves the use of significant accounting judgments and estimates as to future operating results and discount rates. Changes in estimates or use of different assumptions could produce significantly different results. An impairment loss is generally recognized when the carrying amount of the reporting unit s net assets exceeds the estimated fair value of the reporting unit. The Company uses discounted cash flow analysis to estimate the fair value of our reporting units. The Company s goodwill impairment analysis also includes a comparison of the aggregate estimated fair value of its reporting units to the Company s total market capitalization. Based on the Company s annual analysis of goodwill performed during the fourth quarter of fiscal 2013, it concluded the carrying value of the Company s Garden segment goodwill was impaired, resulting in a non-cash goodwill impairment charge of $7.7 million.

7. Other Intangible Assets

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

	Gross	Accumulated Amortization	Impairment	Net Carrying Value
		(in millions)		
June 28, 2014				
Marketing-related intangible assets amortizable	$ 12.5	$ (9.6)	$ 0	$ 2.9
Marketing-related intangible assets nonamortizable	59.6	0	(16.9)	42.7
Total	72.1	(9.6)	(16.9)	45.6
Customer-related intangible assets amortizable	42.8	(19.6)	0	23.2
Other acquired intangible assets amortizable	16.6	(8.5)	0	8.1
Other acquired intangible assets nonamortizable	1.2	0	(1.2)	0

Total	17.8	(8.5)	(1.2)	8.1
Total other intangible assets	$ 132.7	$ (37.7)	$ (18.1)	$ 76.9

	Gross	Accumulated Amortization	Impairment	Net Carrying Value
		(in millions)		
June 29, 2013				
Marketing-related intangible assets amortizable	$ 12.3	$ (8.1)	$ 0	$ 4.2
Marketing-related intangible assets nonamortizable	59.6	0	(16.9)	42.7
Total	71.9	(8.1)	(16.9)	46.9
Customer-related intangible assets amortizable	42.7	(17.2)	0	25.5
Other acquired intangible assets amortizable	10.8	(7.5)	0	3.3
Other acquired intangible assets nonamortizable	1.2	0	(1.2)	0
Total	12.0	(7.5)	(1.2)	3.3
Total other intangible assets	$ 126.6	$ (32.8)	$ (18.1)	$ 75.7

	Gross	Accumulated Amortization	Impairment	Net Carrying Value
		(in millions)		
September 28, 2013				
Marketing-related intangible assets amortizable	$ 12.5	$ (8.9)	$ 0	$ 3.6
Marketing-related intangible assets nonamortizable	59.6	0	(16.9)	42.7
Total	72.1	(8.9)	(16.9)	46.3
Customer-related intangible assets amortizable	42.8	(17.9)	0	24.9
Other acquired intangible assets amortizable	16.6	(7.9)	0	8.7
Other acquired intangible assets nonamortizable	1.2	0	(1.2)	0
Total	17.8	(7.9)	(1.2)	8.7
Total other intangible assets	$ 132.7	$ (34.7)	$ (18.1)	$ 79.9

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

As part of its acquisition of the remaining majority interest in FourStar Microbial during the first quarter of fiscal 2013, the Company acquired approximately $0.1 million of marketing-related intangible assets, $0.1 million of customer-related intangible assets and $6.9 million of other intangible assets.

The Company evaluates long-lived assets, including amortizable and indefinite-lived intangible assets, for impairment whenever events or changes in circumstances indicate the carrying value may not be recoverable. The Company evaluates indefinite-lived intangible assets on an annual basis. In fiscal 2013, the Company tested its indefinite-lived intangible assets and no impairment was indicated. Other factors indicating the carrying value of the Company s amortizable intangible assets may not be recoverable were not present in fiscal 2013 or during the nine months ended June 28, 2014, and accordingly, no impairment testing was performed on these assets.

The Company is currently amortizing its acquired intangible assets with definite lives over periods ranging from 1 to 25 years; over weighted average remaining lives of six years for marketing-related intangibles, 15 years for customer-related intangibles and 15 years for other acquired intangibles. Amortization expense for intangibles subject to amortization was approximately $1.0 and $1.1 million for each of three month periods ended June 28, 2014 and June 29, 2013, respectively, and $3.0 million and $3.1 million for the nine months ended June 28, 2014 and June 29, 2013, respectively, and is classified within operating expenses in the condensed consolidated statements of operations. Estimated annual amortization expense related to acquired intangible assets in each of the succeeding five years is estimated to be approximately $5 million per year from fiscal 2014 through fiscal 2018.

8. Long-Term Debt

Long-term debt consists of the following:

	June 28, 2014	June 29, 2013	September 28, 2013

		(in thousands)	
Senior subordinated notes, net of unamortized discount[(1)], interest at 8.25%, payable semi-annually, principal due March 2018	$ 449,500	$ 449,390	$ 449,417
Asset-based revolving credit facility, interest at LIBOR plus a margin of 1.25% to 1.75% or Base Rate plus a margin of 0.25% to 0.75%, final maturity December 2018	0	0	0
Revolving credit facility, interest at Alternate Base Rate plus a margin of 0.75% to 1.75%, or LIBOR plus a margin of 1.75% to 2.75%, final maturity June 2016	0	60,000	23,000
Other notes payable	790	245	170
Total	450,290	509,635	472,587
Less current portion	(296)	(205)	(142)
Long-term portion	$ 449,994	$ 509,430	$ 472,445

(1) Represents unamortized original issue discount of $500, $610 and $583 as of June 28, 2014, June 29, 2013 and September 28, 2013, respectively.

Asset Backed Loan Facility

On December 5, 2013, the Company entered into a credit agreement which provides up to a $390 million principal amount senior secured asset-based revolving credit facility, with up to an additional $200 million principal amount available with the consent of the Lenders if the Company exercises the accordion feature set forth therein (collectively, the Credit Facility). The Credit Facility matures on December 5, 2018 and replaced the Company s prior revolving credit facility. The Company may borrow, repay and reborrow amounts under the Credit Facility until its maturity date, at which time all amounts outstanding under the Credit Facility must be repaid in full. As of June 28, 2014, there were no borrowings outstanding under the Credit Facility. There were no letters of credit outstanding under the Credit Facility as of June 28, 2014. There were other letters of credit of $14.2 million outstanding as of June 28, 2014.

The Credit Facility is subject to a borrowing base, calculated using a formula based upon eligible receivables and inventory, minus certain reserves and subject to restrictions. The borrowing availability as of June 28, 2014 was $390 million, the maximum amount available under the credit facility. Borrowings under the Credit Facility will bear interest at an index based on LIBOR or, at the option of the Company, the Base Rate (defined as the highest of (a) the SunTrust prime rate, (b) the Federal Funds Rate plus 0.5% and (c) one-month LIBOR plus 1.00%), plus, in either case, an applicable margin based on the Company s total outstanding borrowings. Such applicable margin for LIBOR-based borrowings fluctuates between 1.25%-1.75% (and was 1.25% at June 28, 2014) and such applicable margin for Base Rate borrowings fluctuates between 0.25%-0.75% (and was 0.25% at June 28, 2014). As of June 28, 2014, the applicable interest rate related to Base Rate borrowings was 3.5%, and the applicable interest rate related to LIBOR-based borrowings was 1.4%.

The Credit Facility contains customary covenants, including financial covenants which require the Company to maintain a minimum fixed charge coverage ratio of 1.00:1.00 upon reaching certain borrowing levels. The Credit Facility is secured by substantially all assets of the Company. The Company was in compliance with all covenants under the Credit Facility during the period ended June 28, 2014.

The Company incurred approximately $3.1 million of costs in conjunction with this transaction, which included banking fees and legal expenses. These costs will be amortized over the term of the Credit Facility.

The Company recorded a non-cash charge of $1.7 million for the three month period ended December 28, 2013 as part of interest expense, related to the write-off of unamortized deferred financing costs under the prior revolving credit facility.

Senior Subordinated Notes

On March 8, 2010, the Company issued $400 million aggregate principal amount of 8.25% senior subordinated notes due March 1, 2018 (the 2018 Notes). On February 13, 2012, the Company issued an additional $50 million aggregate principal amount of its 2018 Notes at a price of 98.501%, plus accrued interest from September 1, 2011, in a private placement. The Company used the net proceeds from the offering to pay a portion of the outstanding balance under its prior revolving credit facility.

The estimated fair value of our $450 million of 2018 Notes as of June 28, 2014 was approximately $469.1 million. The estimated fair value is based on quoted market prices for these notes.

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

The Company may redeem some or all of the 2018 Notes at any time after March 1, 2014 for 104.125%, after March 1, 2015 for 102.063% and after March 1, 2016 for 100%, plus accrued and unpaid interest. The holders of the 2018 Notes have the right to require the Company to repurchase all or a portion of the 2018 Notes at a purchase price equal to 101% of the principal amount of the notes repurchased, plus accrued and unpaid interest upon the occurrence of a change of control.

The 2018 Notes contain customary high yield covenants, including covenants limiting debt incurrence and restricted payments, subject to certain baskets and exceptions. The Company was in compliance with all financial covenants in the 2018 Notes indenture as of June 28, 2014.

9. Supplemental Equity Information

The following table provides a summary of the changes in the carrying amounts of equity attributable to controlling interest and noncontrolling interest for the nine months ended June 28, 2014 and June 29, 2013:

	Controlling Interest								
(in thousands)	Common Stock	Class A Common Stock	Class B Stock	Additional Paid In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total	Noncontrolling Interest	Total
Balance September 28, 2013	$ 122	$ 353	$ 16	$ 389,153	$ 77,592	$ 1,442	$ 468,678	$ 1,346	$ 470,024
Comprehensive income					12,874	426	13,300	1,137	14,437
Stock based compensation				3,734			3,734		3,734
Restricted share activity	1	9		3,940			3,950		3,950
Issuance of common stock		3		995			998		998
Tax benefit on stock option exercise				422			422		422
Distribution to Noncontrolling interest								(633)	(633)
Balance June 28, 2014	$ 123	$ 365	$ 16	$ 398,244	$ 90,466	$ 1,868	$ 491,082	$ 1,850	$ 492,932

	Controlling Interest								
(in thousands)	Common Stock	Class A Common Stock	Class B Stock	Additional Paid In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total	Noncontrolling Interest	Total
Balance September 29, 2012	$ 122	$ 347	$ 16	$ 382,195	$ 79,718	$ 1,539	$ 463,937	$ 946	$ 464,883
Comprehensive income					20,652	(699)	19,953	1,367	21,320

Stock based compensation				3,489			3,489		3,489
Restricted share activity		4		2,478			2,482		2,482
Issuance of common stock		1		1,240			1,241		1,241
Repurchase of common stock				(1,304)	(197)		(1,501)		(1,501)
Tax benefit on stock option exercise				345			345		345
Distribution to Noncontrolling interest								(629)	(629)
Balance June 29, 2013	$ 122	$ 352	$ 16	$ 388,443	$ 100,173	$ 840	$ 489,946	$ 1,684	$ 491,630

10. Stock-Based Compensation

The Company recognized share-based compensation expense of $6.4 million and $12.5 million for the nine month periods ended June 28, 2014 and June 29, 2013, respectively, as a component of selling, general and administrative expenses. The tax benefit associated with share-based compensation expense for the nine month periods ended June 28, 2014 and June 29, 2013 was $2.3 million and $4.8 million, respectively.

11. Earnings Per Share

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

	Three Months Ended June 28, 2014			Nine Months Ended June 28, 2014		
	Income	Shares	Per Share	Income	Shares	Per Share
	(in thousands, except per share amounts)					
Basic EPS:						
Net income available to common shareholders	$ 4,687	49,148	$ 0.10	$ 12,874	48,732	$ 0.26
Effect of dilutive securities:						
Options to purchase common stock		154	0		35	0
Restricted shares		539	(0.01)		434	0
Diluted EPS:						
Net income available to common shareholders	$ 4,687	49,841	$ 0.09	$ 12,874	49,201	$ 0.26

	Three Months Ended June 29, 2013			Nine Months Ended June 29, 2013		
	Income	Shares	Per Share	Income	Shares	Per Share
	(in thousands, except per share amounts)					
Basic EPS:						
Net income available to common shareholders	$ 13,725	48,173	$ 0.28	$ 20,652	48,037	$ 0.43
Effect of dilutive securities:						
Options to purchase common stock		141	0		284	0
Restricted shares		508	0		445	(0.01)
Diluted EPS:						
Net income available to common shareholders	$ 13,725	48,822	$ 0.28	$ 20,652	48,766	$ 0.42

Options to purchase 11.2 million shares of common stock at prices ranging from $6.43 to $16.23 per share were outstanding at June 28, 2014 and options to purchase 11.6 million shares of common stock at prices ranging from $4.60 to $16.23 per share were outstanding at June 29, 2013.

For the three month periods ended June 28, 2014 and June 29, 2013, options to purchase 9.5 million and 10.7 million shares of common stock, respectively, were outstanding but were not included in the computation of diluted earnings per share because the option exercise prices were greater than the average market price of the common shares and, therefore, the effect would be anti-dilutive.

For the nine month periods ended June 28, 2014 and June 29, 2013, options to purchase 10.3 million and 7.5 million shares of common stock, respectively, were outstanding but were not included in the computation of diluted earnings per share because the option exercise prices were greater than the average market price of the common shares and, therefore, the effect would be anti-dilutive.

12. Segment Information

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

	Three Months Ended		Nine Months Ended	
	June 28, 2014	June 29, 2013	June 28, 2014	June 29, 2013
Net sales:				
Pet segment	$ 227,082	$ 237,851	$ 628,431	$ 667,781
Garden segment	210,905	256,279	601,688	617,015
Total net sales	$ 437,987	$ 494,130	$ 1,230,119	$ 1,284,796
Income (loss) from operations:				
Pet segment	28,435	$ 33,144	67,014	$ 70,782
Garden segment	4,011	13,668	34,579	39,090
Corporate	(14,020)	(13,920)	(46,753)	(43,328)
Total income from operations	18,426	32,892	54,840	66,544
Interest expense net	(10,415)	(11,319)	(33,008)	(32,479)
Other income (expense)	456	353	396	(676)
Income taxes	3,133	7,520	8,217	11,370
Income including noncontrolling interest	5,334	14,406	14,011	22,019
Net income attributable to noncontrolling interest	647	681	1,137	1,367
Net income attributable to Central Garden & Pet Company	$ 4,687	$ 13,725	$ 12,874	$ 20,652