

CENTRAL GARDEN & PET CO  
Form 10-Q  
February 02, 2006  
Table of Contents

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

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**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 December 24, 2005

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: 0-20242

**CENTRAL GARDEN & PET COMPANY**

**Delaware**  
(State or other jurisdiction  
of incorporation or organization)

**68-0275553**  
(I.R.S. Employer  
Identification No.)

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

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(Address of principle executive offices)

(925) 948-4000

(Registrant's telephone number, including area code)

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(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.  Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  Yes  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 January 15, 2006	19,808,769
Class B Stock Outstanding as of January 15, 2006	1,652,262

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**Table of Contents**

<b>PART I. FINANCIAL INFORMATION</b>		
Item 1.	<u>Financial Statements</u>	4
	<u>Condensed Consolidated Balance Sheets as of September 24, 2005 and December 24, 2005</u>	4
	<u>Condensed Consolidated Statements of Operations Three Months Ended December 25, 2004 and December 24, 2005</u>	5
	<u>Condensed Consolidated Statements of Cash Flows Three Months Ended December 25, 2004 and December 24, 2005</u>	6
	<u>Notes to Condensed Consolidated Financial Statements</u>	7
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	16
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	20
Item 4.	<u>Controls and Procedures</u>	20
<b>PART II. OTHER INFORMATION</b>		
Item 1.	<u>Legal Proceedings</u>	21
Item 1A.	<u>Risk Factors</u>	21
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	21
Item 3.	<u>Defaults Upon Senior Securities</u>	21
Item 4.	<u>Submission of Matters to a Vote of Security Holders</u>	21
Item 5.	<u>Other Information</u>	21
Item 6.	<u>Exhibits</u>	22

**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, 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 and economies in which we operate and other information that is not historical information. When used in this Form 10-Q, the words estimates, expects, anticipates, projects, plans, intends, believes and variations 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 24, 2005, including the factors described in the section entitled 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:

consolidation trends in the retail industry;

dependence on a few customers for a significant portion of each of our businesses;

uncertainty of our product innovations and marketing programs;

fluctuations in market prices for seeds and grains;

competition in our industries;

risks associated with our acquisition strategy;

adverse weather during the peak gardening season;

seasonality and fluctuations in our operating results and cash flows;

dependence upon our key executive officers;

rising energy prices;

**Table of Contents**

implementation of a new enterprise planning information system over the next several years;

potential environmental liabilities and product liability claims; and

pending litigation and claims;

**Table of Contents****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)

	September 24,	December 24,
	2005	2005
<b>ASSETS</b>		
Current assets:		
Cash and equivalents	\$ 28,792	\$ 12,913
Accounts receivable (less allowance for doubtful accounts of \$11,712 and \$10,357 )	184,896	155,908
Inventories	270,736	322,775
Prepaid expenses and other	25,853	28,201
	<u>510,277</u>	<u>519,797</u>
Total current assets	510,277	519,797
Land, buildings, improvements and equipment net	110,595	114,972
Goodwill	364,847	364,732
Deferred income taxes and other assets	70,630	83,434
	<u>1,056,349</u>	<u>1,082,935</u>
Total	\$ 1,056,349	\$ 1,082,935
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 96,455	\$ 119,837
Accrued expenses	68,152	66,187
Current portion of long-term debt	2,210	1,772
	<u>166,817</u>	<u>187,796</u>
Total current liabilities	166,817	187,796
Long-term debt	320,854	321,556
Other long-term obligations	18,500	19,411
Convertible redeemable preferred stock	3,000	3,000
Shareholders equity:		
Class B stock, \$.01 par value: 1,654,462 shares outstanding	16	16
Common stock, \$.01 par value: 33,419,556 shares issued and 19,659,691 shares outstanding at September 24, 2005 and 19,785,339 shares issued and outstanding at December 24, 2005	334	197
Additional paid-in capital	577,073	429,933
Retained earnings	119,497	122,057
Deferred compensation	(4,377)	
Treasury stock	(145,581)	
Accumulated other comprehensive income (loss)	216	(1,031)
	<u>547,178</u>	<u>551,172</u>
Total shareholders equity	547,178	551,172
Total	\$ 1,056,349	\$ 1,082,935

See notes to condensed consolidated financial statements.

**Table of Contents****CENTRAL GARDEN & PET COMPANY****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(in thousands, except per share amounts)****(unaudited)**

	<b>Three Months Ended</b>	
	<b>December 25, 2004</b>	<b>December 24, 2005</b>
Net sales	\$ 265,576	\$ 292,731
Cost of goods sold and occupancy	179,535	200,733
Gross profit	86,041	91,998
Selling, general and administrative expenses	76,525	82,223
Income from operations	9,516	9,775
Interest expense	(5,298)	(6,344)
Interest income	103	685
Other income (expense)	(320)	49
Income before income taxes	4,001	4,165
Income taxes	1,485	1,605
Net income	<u>\$ 2,516</u>	<u>\$ 2,560</u>
Income per common share:		
Basic	<u>\$ 0.12</u>	<u>\$ 0.12</u>
Diluted	<u>\$ 0.12</u>	<u>\$ 0.12</u>
Weighted average shares used in the computation of income per common share:		
Basic	20,539	21,335
Diluted	21,264	21,826

See notes to condensed consolidated financial statements.

**Table of Contents****CENTRAL GARDEN & PET COMPANY****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

(unaudited)

	Three Months Ended	
	December 25,	December 24,
	2004	2005
<b>Cash flows from operating activities:</b>		
Net income	\$ 2,516	\$ 2,560
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>		
Depreciation and amortization	4,479	5,185
Stock based compensation	235	1,020
Deferred income taxes		(273)
<b>Change in assets and liabilities (excluding effects of businesses acquired):</b>		
Receivables	40,323	28,850
Inventories	(50,279)	(52,371)
Prepaid expenses and other assets	(2,316)	(3,503)
Accounts payable	13,085	23,508
Accrued expenses	6,883	(1,821)
Other long-term obligations	247	911
<b>Net cash provided by operating activities</b>	<b>15,173</b>	<b>4,066</b>
<b>Cash flows from investing activities:</b>		
Additions to land, buildings, improvements and equipment	(5,563)	(8,757)
Assets acquired		(13,296)
Restricted investments	(130)	
<b>Net cash used in investing activities</b>	<b>(5,693)</b>	<b>(22,053)</b>
<b>Cash flows from financing activities:</b>		
Repayments on revolving line of credit	(63,000)	(1,000)
Borrowings on revolving line of credit	53,000	2,000
Repayments of long-term debt	(250)	(443)
Proceeds from issuance of stock	2,329	1,028
Excess tax benefits from stock based awards		633
Treasury stock repurchases	(528)	
<b>Net cash provided by (used in) financing activities</b>	<b>(8,449)</b>	<b>2,218</b>
<b>Effect of exchange rate changes on cash and equivalents</b>	<b>848</b>	<b>(110)</b>
<b>Net increase (decrease) in cash and equivalents</b>	<b>1,879</b>	<b>(15,879)</b>
Cash and equivalents at beginning of period	12,221	28,792
<b>Cash and equivalents at end of period</b>	<b>\$ 14,100</b>	<b>\$ 12,913</b>
<b>Supplemental information:</b>		
Cash paid for interest	\$ 1,576	\$ 2,938

Cash paid for income taxes net	<u>\$ (778)</u>	<u>\$ 683</u>
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See notes to condensed consolidated financial statements.

**Table of Contents**

**CENTRAL GARDEN & PET COMPANY**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**Three Months Ended December 24, 2005**

**(unaudited)**

**1. Basis of Presentation**

The condensed consolidated balance sheets of Central Garden & Pet Company and subsidiaries (the Company or Central ) as of December 24, 2005, the condensed consolidated statements of operations for the three months ended December 25, 2004 and December 24, 2005 and the condensed consolidated statements of cash flows for the three months ended December 25, 2004 and December 24, 2005 have been prepared by the Company, without audit. In the opinion of management, all adjustments (which include only normal recurring adjustments) considered necessary to present fairly the financial position, results of operations and cash flows of the Company for the periods mentioned above, have been made.

For the Company's foreign business in the UK, the local currency is the functional currency. Assets and liabilities are translated using the exchange rate in effect at the balance sheet date. Income and expenses are translated at the average exchange rate for the period. Comprehensive income was \$1.3 million for the three month period ended December 24, 2005 and includes net earnings of \$2.6 million and foreign currency translation adjustments of \$1.3 million that are excluded from net earnings but reported in accumulated other comprehensive income (loss), a separate component of shareholders' equity. 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.

Due to the seasonal nature of the Company's garden business, the results of operations for the three months ended December 24, 2005 and December 25, 2004 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 2005 Annual Report on Form 10-K, which has previously been filed with the Securities and Exchange Commission.

**2. Stock Based Compensation**

The Company has various non-qualified stock-based compensation programs, which provide for stock option grants and restricted stock awards. The fair value of restricted stock awards is recognized as deferred compensation at the time of the grant as a separate component of shareholders' equity with amortization over the vesting period. Stock options may be granted to officers, key employees and directors. Stock options granted are generally exercisable with a 30 month cliff vesting and 42 month expiration or in increments of 20% per year beginning three years from the date of grant and expiring 8 years from the date of grant. Prior to fiscal 2006, the Company accounted for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations and provided the required pro forma disclosures of SFAS No. 123, *Accounting for Stock-Based Compensation*.

Beginning in fiscal 2006, the Company adopted SFAS No. 123(R), *Share-Based Payment*, and elected to adopt the standard using the modified prospective transition method. Under this transition method, compensation cost in 2006 includes vested awards for (1) all share based payments granted prior to, but not vested as of September 24, 2005, based on the grant date fair value estimated in accordance with the original pro forma footnote disclosure provisions of FASB Statement No. 123 and (2) all share based payments granted subsequent to September 24, 2005, based on the grant date fair value estimated in accordance with the provisions of FASB Statement No. 123 (R). Accordingly, stock compensation award expense is recognized over the requisite service period using the straight-line attribution method. Previously reported amounts have not been restated.

The Company recognized share based compensation expense of \$1.0 million in the quarter ended December 24, 2005 as a component of selling, general and administrative expenses. Stock compensation cost in the first quarter of fiscal 2006 consisted of \$0.7 million for stock options and \$0.3 million for restricted stock awards.

**Table of Contents**

Had compensation expense for the Company's various stock option plans been determined based upon the projected fair values at the grant dates for awards under those plans in accordance with SFAS No. 123, the Company's pro-forma net earnings, basic and diluted earnings per common share for the three months ended December 25, 2004 would have been as follows:

	<b>Three Months Ended</b>	
	<b>December 25,</b>	
	<b>2004</b>	
	<b>(in thousands)</b>	
Net income, as reported	\$	2,516
Deduct: Total stock-based employee compensation expense determined under fair value based method for awards, net of related tax effects		(356)
<b>Pro forma net income</b>	<b>\$</b>	<b>2,160</b>
<b>Net income per common equivalent share:</b>		
Basic as reported	\$	0.12
Basic pro forma	\$	0.11
Diluted as reported	\$	0.12
Diluted pro forma	\$	0.10

The fair value of each option award is estimated on the date of grant using the Black-Scholes option valuation model. Expected stock price volatilities are estimated based on the Company's implied historical volatility. The expected term of options granted is based on analyses of historical employee termination rates and option exercises. The risk-free rates are based on U.S. Treasury yields, for notes with comparable terms as the option grants, in effect at the time of the grant. For purposes of this valuation model, no dividends have been assumed. Assumptions used in the Black-Scholes model are presented below:

	<b>Quarter ended</b>	
	<b>December 24,</b>	<b>December 25,</b>
	<b>2005</b>	<b>2004</b>
<b>Stock plans:</b>		
Average expected life in years	3 or 6	3 - 5
Expected volatility	29%	31%
Risk-free interest rate	4.3%	3.3%

The following table summarizes option activity during the quarter ended December 24, 2005:

	<b>Number of</b>	<b>Weighted</b>	<b>Weighted average</b>	<b>Aggregate</b>
	<b>shares</b>	<b>average exercise</b>	<b>remaining</b>	<b>intrinsic value</b>
	<b>(in thousands)</b>	<b>price per</b>	<b>contractual life</b>	<b>(in thousands)</b>
		<b>share</b>	<b>(in years)</b>	
		<b>price per</b>		
		<b>share</b>		
Outstanding at September 24, 2005	1,640	\$ 27.01		

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Granted	525	45.37		
Exercised	(60)	16.36		
Cancelled or expired	(6)	31.78		
	<u>          </u>			
Outstanding at December 24, 2005	2,099	31.89	3.5	\$ 66,940
	<u>          </u>			
Exercisable at December 24, 2005	267	\$ 21.53	0.7	\$ 5,752
	<u>          </u>			

The weighted average fair value of options granted during the first quarter of fiscal 2006 and fiscal 2005 was \$13.74 and \$8.54, respectively. The total intrinsic value of options exercised during the first quarter of fiscal 2006 and fiscal 2005 was \$1.6 million and \$8.5 million, respectively.

**Table of Contents**

Changes in the Company's nonvested options for the first quarter of fiscal 2006 are summarized as follows:

	Number of shares (in thousands)	Weighted average grant date fair value per share
Nonvested at September 24, 2005	1,319	\$ 8.00
Granted	525	13.74
Vested	(6)	6.77
Cancelled	(6)	8.12
Nonvested at December 24, 2005	1,832	\$ 9.65

As of December 24, 2005, there was \$8.8 million of total unrecognized compensation cost related to nonvested stock options, which is expected to be recognized over a weighted-average period of 2.3 years.

**Restricted Stock Awards:** As of December 24, 2005, there were 0.2 million shares of restricted stock awards outstanding. The awards generally vest in 20% or 25% increments over a seven year period of employment after the grant date.

Restricted stock award activity during the first quarter of fiscal 2006 is summarized as follows:

	Number of shares (in thousands)
Outstanding at September 24, 2005	141
Granted	64
Exercised	(0)
Cancelled or expired	(0)
Outstanding at December 24, 2005	205

The weighted average grant-date fair value of restricted stock awards granted during the first quarters of fiscal 2006 and fiscal 2005 was \$41.92 and \$38.78, respectively.

As of December 24, 2005, there was \$6.8 million of unrecognized compensation cost related to nonvested restricted stock awards, which is expected to be recognized over a weighted-average period of 3.6 years.

**3. 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			Three Months Ended		
	December 25, 2004			December 24, 2005		
	Income	Shares	Per Share	Income	Shares	Per Share
(in thousands, except per share amounts)						
<b>Basic EPS:</b>						
Net income	\$ 2,516	20,539	\$ 0.12	\$ 2,560	21,335	\$ 0.12
<b>Effect of dilutive securities:</b>						
Options to purchase common stock		572			370	
Restricted shares		67			35	
Convertible preferred stock		86			86	
<b>Diluted EPS:</b>						
Net income attributable to common shareholders	\$ 2,516	21,264	\$ 0.12	\$ 2,560	21,826	\$ 0.12

**Table of Contents**

For the three month periods ended December 24, 2005 and December 25, 2004, options to purchase 513,985 and 438,225 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.

Shares of common stock from the assumed conversion of the Company's convertible preferred stock, issued in February 2004, were also included in the computation of diluted EPS for the three month periods ended December 24, 2005 and December 25, 2004.

**4. Shareholders' Equity**

Effective December 14, 2005, the Company retired all of its treasury stock, which consisted of 13,759,865 common shares. Upon retirement, the excess of the aggregate treasury stock purchase price over par value was allocated to additional paid-in capital.

**5. Assets Acquired**

In December 2005, the Company acquired certain intellectual property assets from Shirlo, Inc. for cash of approximately \$10 million. The assets acquired from Shirlo, Inc. include the company's exclusive marketing rights to etofenprox, an insect adulticide approved for on-animal use. The acquired assets will be combined with Wellmark International, a wholly owned subsidiary of Central. The Company has not yet finalized its allocation of the purchase price to the fair value of assets acquired.

**6. Segment Information**

Management has determined that the reportable segments of the Company are Garden Products and Pet Products, based on the level at which the chief operating decision making group reviews the results of operations to make decisions regarding performance assessment and resource allocation.

	Three Months Ended	
	December 25,	December 24,
	2004	2005
(in thousands)		
Net sales:		
Garden Products	\$ 108,817	\$ 125,584
Pet Products	156,759	167,147
Total net sales	\$ 265,576	\$ 292,731
Income (loss) from operations:		
Garden Products	\$ (811)	\$ (510)
Pet Products	18,097	18,551
Corporate	(7,770)	(8,266)
Total income from operations	9,516	9,775

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Interest expense net	(5,195)	(5,659)
Other income	(320)	49
Income taxes	(1,485)	(1,605)
	<u>          </u>	<u>          </u>
Net income	\$ 2,516	\$ 2,560
	<u>          </u>	<u>          </u>
Depreciation and amortization:		
Garden Products	\$ 1,457	\$ 1,542
Pet Products	2,788	3,332
Corporate	234	311
	<u>          </u>	<u>          </u>
Total depreciation and amortization	\$ 4,479	\$ 5,185
	<u>          </u>	<u>          </u>

**Table of Contents**

	September 24,	December 24,
	2005	2005
	(in thousands)	
<b>Assets:</b>		
Garden Products	\$ 330,884	\$ 348,773
Pet Products	273,481	279,103
Corporate	451,984	455,059
<b>Total assets</b>	<b>\$ 1,056,349</b>	<b>\$ 1,082,935</b>
<b>Goodwill (included in corporate assets):</b>		
Garden Products	\$ 169,456	\$ 169,484
Pet Products	195,391	195,248
<b>Total goodwill</b>	<b>\$ 364,847</b>	<b>\$ 364,732</b>

**7. Contingencies**

*TFH Litigation.* In December 1997, Central acquired all of the stock of TFH Publications, Inc. ( TFH ) from Herbert and Evelyn Axelrod (the Axelrods ). In connection with the transaction, Central made a \$10 million loan to the Axelrods (the Axelrod Loan ), which was evidenced by a Promissory Note. In September 1998, the Axelrods brought suit against Central and certain executives of Central for damages and relief from their obligations under the Promissory Note, alleging, among other things, that Central's failure to properly supervise the TFH management team had jeopardized their prospects of achieving certain earnouts. Central denied those allegations and counterclaimed against the Axelrods for enforcement of the Promissory Note, damages and other relief, alleging, among other things, fraud and breaches of warranties. These actions, *Herbert R. Axelrod and Evelyn Axelrod v. Central Garden & Pet Company; Glen S. Axelrod; Gary Hersch; William E. Brown; Robert B. Jones; Glenn Novotny; and Neill Hines*, Docket No. MON-L-5100-99, and *TFH Publications, Inc. v. Herbert Axelrod et al.*, Docket No. L-2127-99 (consolidated cases), are in the New Jersey Superior Court.

On September 1, 2005, a civil jury returned its verdict in the TFH litigation following a five-month trial. The jury returned an overall verdict in favor of Central. With regard to Central's claims against the Axelrods, the jury found: (1) Central was entitled to be repaid the Axelrod Loan, which was evidenced by the Promissory Note; (2) the Axelrods had breached four separate representations and warranties in the Stock Purchase Agreement, under which the Axelrods sold TFH to Central; (3) the Axelrods were not justified in starting a competing company in violation of their non-competition agreements; and (4) Herbert Axelrod had engaged in fraud. The jury awarded Central \$20,340,000.

The jury rejected most of the Axelrods' claims against Central. In that regard, the jury denied the Axelrods' claims for breach of contract, fraud, tortious interference and civil conspiracy. The jury did find that Central had breached Consulting Agreements with the Axelrods and awarded \$3.7 million in damages. In addition, before the trial, there had been an arbitration to determine whether the Axelrods were entitled to a purchase price adjustment. The Axelrods maintained that as a result of that arbitration determination, the Axelrods are entitled to an additional approximately \$2.6 million in purchase price.

The Court has also awarded pre-judgment interest in post verdict rulings. In that regard, the Court set-off the Axelrods' \$2.6 million arbitration award against the \$10 million Promissory Note owed to Central and awarded Central pre-judgment interest on the remainder of what was owed to Central. The Court also granted pre-judgment interest on Central's fraud award and the Axelrods Consulting Agreement award. The net effect of the jury award and the post-verdict Court rulings to date is that Central is entitled to receive over \$22.3 million. In addition, Central has applied for its costs, expenses and attorneys fees related to the enforcement and collection of the Promissory Note. That application is currently pending before the New Jersey Superior Court.

The New Jersey Superior Court is scheduled to enter a final judgment in the TFH litigation in early 2006. The Axelrods were required to place cash in an account with the New Jersey Superior Court as security for the anticipated judgment. The Axelrods have stated that they intend to appeal. If there is an appeal, the Axelrods will be required to post security for the judgment pending the appeal or Central could collect on the judgment. It is estimated that an appeal could take nine months to several years to resolve.

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**Table of Contents**

*Phoenix Fire.* On August 2, 2000, a fire destroyed Central's leased warehouse space in Phoenix, Arizona, and an adjoining warehouse space leased by a third party. On July 31, 2001, the adjoining warehouse tenant filed a lawsuit against Central and other parties in the Superior Court of Arizona, Maricopa County, seeking to recover \$47 million for property damage from the fire. See *Cardinal Health Inc., et al. v. Central Garden & Pet Company, et al.*, Civil Case No. CV2001-013152. Local residents also filed a purported class action lawsuit alleging claims for bodily injury and property damage as a result of the fire. This class action lawsuit has now been settled as to all parties, and has received Court approval. As part of the settlement, Central's liability insurers paid \$7,825,000 on behalf of Central in May 2004. The building owner and several nearby businesses also filed lawsuits for property damage and business interruption, which were coordinated with the remaining tenant lawsuit. Each of these lawsuits is currently pending in the Superior Court of Arizona, Maricopa County. The business interruption lawsuits have been dismissed, or settled for amounts paid by Central's insurers. The trial for the remaining cases filed by the adjoining tenant and the building owner is currently scheduled for March 2006. The overall amount of the damages to all parties caused by the fire, and the overall amount of damages which Central may sustain as a result of the fire, have not been quantified. At the time of the fire, Central maintained property insurance covering losses to the leased premises, Central's inventory and equipment, and loss of business income. Central also maintained insurance providing \$51 million of coverage (with no deductible) against third party liability. Central believes that this insurance coverage will be available with respect to third party claims against Central if parties other than Central are not found responsible. The precise amount of the damages sustained in the fire, the ultimate determination of the parties responsible and the availability of insurance coverage are likely to depend on the outcome of complex litigation, involving numerous claimants, defendants and insurance companies.

**8. Consolidating Condensed Financial Information of Guarantor Subsidiaries**

Certain wholly owned subsidiaries of the Company (as listed below, collectively the "Guarantor Subsidiaries") have guaranteed fully and unconditionally, on a joint and several basis, the obligation to pay principal and interest under the Company's \$150,000,000 9-1/8% Senior Subordinated Notes (the "Notes") issued on January 30, 2003. Certain subsidiaries and operating divisions are not guarantors of the Notes and have been included in the Parent financial results below. Those subsidiaries that are guarantors of the Notes are as follows:

Four Paws Products Ltd.

Grant Laboratories, Inc.

Gulfstream Home & Garden, Inc.

Interpet USA, LLC

Kaytee Products, Incorporated

Matthews Redwood & Nursery Supply, Inc.

New England Pottery LLC

Norcal Pottery Products, Inc.

Pennington Seed, Inc. (including Phaeton Corporation (dba Unicorn Labs), Pennington Seed, Inc. of Nebraska, Gro Tec, Inc., Seeds West, Inc., All-Glass Aquarium Co., Inc. (including Oceanic Systems, Inc.), and Cedar Works, LLC.)

Pets International, Ltd.

T.F.H. Publications, Inc.

Wellmark International

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

**CONSOLIDATING CONDENSED STATEMENT OF OPERATIONS**

**Three Months Ended December 24, 2005**

(in thousands)

(unaudited)

	Guarantor			Consolidated
	Parent	Subsidiaries	Eliminations	
Net sales	\$ 98,136	\$ 214,417	\$ (19,822)	\$ 292,731
Cost of products sold and occupancy	70,725	149,830	(19,822)	200,733
Gross profit	27,411	64,587		91,998
Selling, general and administrative expenses	28,452	53,771		82,223
Income (loss) from operations	(1,041)	10,816		9,775
Interest net	(5,740)	81		(5,659)
Other income (expense)	(253)	302		49
Income (loss) before income taxes	(7,034)	11,199		4,165
Income taxes	2,708	(4,318)	5	(1,605)
Net income (loss)	(4,326)	6,881	5	2,560
Equity in undistributed income of guarantor subsidiaries	6,886		(6,886)	
Net income (loss)	\$ 2,560	\$ 6,881	\$ (6,881)	\$ 2,560

**Table of Contents****CONSOLIDATING CONDENSED STATEMENT OF OPERATIONS**

Three Months Ended December 25, 2004

(in thousands)

(unaudited)

	Guarantor			Consolidated
	Parent	Subsidiaries	Eliminations	
Net sales	\$ 92,263	\$ 191,586	\$ (18,273)	\$ 265,576
Cost of products sold and occupancy	65,897	131,911	(18,273)	179,535
Gross profit	26,366	59,675		86,041
Selling, general and administrative expenses	25,798	50,727		76,525
Income from operations	568	8,948		9,516
Interest net	(5,309)	114		(5,195)
Other income (expense)	(405)	85		(320)
Income (loss) before income taxes	(5,146)	9,147		4,001
Income taxes	1,966	(3,451)		(1,485)
Net income (loss)	(3,180)	5,696		2,516
Equity in undistributed income of guarantor subsidiaries	5,706		(5,706)	
Net income (loss)	\$ 2,526	\$ 5,696	\$ (5,706)	\$ 2,516

**CONSOLIDATING CONDENSED BALANCE SHEET**

December 24, 2005

(in thousands)

(unaudited)

	Guarantor			Consolidated
	Parent	Subsidiaries	Eliminations	
<b>ASSETS</b>				
Cash and equivalents	\$ 4,888	\$ 8,025	\$	\$ 12,913
Accounts receivable	120,669	49,626	(14,387)	155,908
Inventories	234,061	88,714		322,775
Prepaid expenses and other	13,314	14,887		28,201
Total current assets	372,932	161,252	(14,387)	519,797
Land, buildings, improvements and equipment, net	98,347	16,625		114,972
Goodwill		364,732		364,732
Investment in guarantor subsidiaries		388,916	(388,916)	
Deferred income taxes and other assets	48,921	37,958	(3,445)	83,434
Total	\$ 520,200	\$ 969,483	\$ (406,748)	\$ 1,082,935

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LIABILITIES AND SHAREHOLDERS EQUITY				
Accounts payable	\$ 72,263	\$ 61,961	\$ (14,387)	\$ 119,837
Accrued expenses and other current liabilities	38,166	29,793		67,959
	<hr/>	<hr/>	<hr/>	<hr/>
Total current liabilities	110,429	91,754	(14,387)	187,796
Long-term debt	118	321,438		321,556
Other long-term obligations	20,737	2,119	(3,445)	19,411
Convertible redeemable preferred stock		3,000		3,000
Shareholders equity	388,916	551,172	(388,916)	551,172
	<hr/>	<hr/>	<hr/>	<hr/>
Total	\$ 520,200	\$ 969,483	\$ (406,748)	\$ 1,082,935
	<hr/>	<hr/>	<hr/>	<hr/>

**Table of Contents****CONSOLIDATING CONDENSED BALANCE SHEET**

September 24, 2005

(in thousands)

(unaudited)

	Guarantor			Consolidated
	Parent	Subsidiaries	Eliminations	
<b>ASSETS</b>				
Cash and equivalents	\$ 22,732	\$ 6,060	\$	\$ 28,792
Accounts receivable	50,804	147,517	(13,425)	184,896
Inventories	71,871	198,865		270,736
Prepaid expenses and other	12,903	12,950		25,853
<b>Total current assets</b>	<b>158,310</b>	<b>365,392</b>	<b>(13,425)</b>	<b>510,277</b>
Land, buildings, improvements and equipment, net	11,154	99,441		110,595
Goodwill	364,847			364,847
Investment in guarantor subsidiaries	371,249		(371,249)	
Deferred income taxes and other assets	38,338	35,737	(3,445)	70,630
<b>Total</b>	<b>\$ 943,898</b>	<b>\$ 500,570</b>	<b>\$ (388,119)</b>	<b>\$ 1,056,349</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>				
Accounts payable	\$ 43,383	\$ 66,497	\$ (13,425)	\$ 96,455
Accrued expenses and other current liabilities	28,402	41,960		70,362
<b>Total current liabilities</b>	<b>71,785</b>	<b>108,457</b>	<b>(13,425)</b>	<b>166,817</b>
Long-term debt	320,731	123		320,854
Other long-term obligations	1,204	20,741	(3,445)	18,500
Convertible redeemable preferred stock	3,000			3,000
Shareholders' equity	547,178	371,249	(371,249)	547,178
<b>Total</b>	<b>\$ 943,898</b>	<b>\$ 500,570</b>	<b>\$ (388,119)</b>	<b>\$ 1,056,349</b>

**CONSOLIDATING CONDENSED STATEMENT OF CASH FLOWS**

Three Months Ended December 24, 2005

(in thousands)

(unaudited)

	Guarantor			Consolidated
	Parent	Subsidiaries	Eliminations	
Net cash provided (used) by operating activities	\$ 21,369	\$ (10,409)	\$ (6,894)	\$ 4,066
Expenditures for land, buildings, improvements and equipment	(6,089)	(2,668)		(8,757)
Assets acquired	(13,296)			(13,296)
Investment in guarantor subsidiaries	(18,914)	12,020	6,894	
<b>Net cash provided (used) by investing activities</b>	<b>(38,299)</b>	<b>9,352</b>	<b>6,894</b>	<b>(22,053)</b>

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Repayments on revolving line of credit	(1,000)	.	(1,000)
Borrowings on revolving line of credit	2,000		2,000
Payments on long-term debt	(438)	(5)	(443)
Proceeds from issuance of stock	1,028		1,028
Tax benefits on options exercised	633		633
	<u>2,223</u>	<u>(5)</u>	<u>2,218</u>
Net cash provided (used) by financing activities			
Effect of exchange rate changes on cash		(110)	(110)
	<u>(14,707)</u>	<u>\$ (1,172)</u>	<u>(15,879)</u>
Net increase (decrease) in cash and equivalents			
Cash and equivalents at beginning of period	22,732	6,060	28,792
	<u>22,732</u>	<u>6,060</u>	<u>28,792</u>
Cash and equivalents at end of period	<u>\$ 8,025</u>	<u>\$ 4,888</u>	<u>\$ 12,913</u>

**Table of Contents****CONSOLIDATING CONDENSED STATEMENT OF CASH FLOWS**

Three Months Ended December 25, 2004

(in thousands)

(unaudited)

	<b>Guarantor</b>			<b>Consolidated</b>
	<b>Parent</b>	<b>Subsidiaries</b>	<b>Eliminations</b>	
Net cash provided (used) by operating activities	\$ 8,381	\$ 12,498	\$ (5,706)	\$ 15,173
Expenditures for land, buildings, improvements and equipment	(1,191)	(4,372)		(5,563)
Restricted investments	(130)			(130)
Investment in guarantor subsidiaries	5,393	(11,099)	5,706	
Net cash provided (used) by investing activities	4,072	(15,471)	5,706	(5,693)
Repayments under lines of credit, net	(10,000)			(10,000)
Payments on long-term debt	(250)			(250)
Proceeds from issuance of stock	2,329			2,329
Payments to reacquire stock	(528)			(528)
Net cash provided (used) by financing activities	(8,449)			(8,449)
Effect of exchange rate changes on cash	(1,672)	2,520		848
Net increase (decrease) in cash and equivalents	2,332	(453)		1,879
Cash and equivalents at beginning of period	5,028	7,193		12,221
Cash and equivalents at end of period	\$ 7,360	\$ 6,740	\$	\$ 14,100

## **Table of Contents**

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

#### **Overview**

Central Garden & Pet is a leading innovator, marketer and producer of quality branded products. We are one of the largest suppliers in the Lawn and Garden and Pet supplies industries. The total lawn and garden industry is estimated to be approximately \$51 billion in retail sales. We estimate the applicable portion of the lawn and garden supplies market to our business is approximately \$15 billion. The total pet industry is estimated to be approximately \$37 billion in retail sales. We estimate the applicable portion of the pet supplies market to be approximately \$8.5 billion.

Our lawn and garden supplies products include: proprietary and non-proprietary grass seed; wild bird feed, feeders, bird houses and other birding accessories; weed, grass, ant and other herbicide, insecticide and pesticide products; and decorative outdoor lifestyle and lighting products, including pottery, trellises and other wood products and holiday lighting. These products are sold under a number of brand names including Pennington, Rebels, Cedar Works, AMDRO, Grants, Lilly Miller, Sevin, Over n Out, Norcal Pottery, New England Pottery, GKI/Bethlehem Lighting and Matthews Four Seasons.

Our pet supplies products include: products for dogs and cats, including bones, premium healthy edible and non-edible chews, leashes, collars, toys, pet carriers, grooming supplies and other accessories; products for birds, small animals and specialty pets, including food, cages and habitats, toys, chews and related accessories; animal and household health and insect control products; and products for fish, reptiles and other aquarium-based pets, including aquariums, furniture and lighting fixtures, pumps and filters and water conditioners and supplements, and information and knowledge resources. These products are sold under a number of brand names including All-Glass Aquarium, Oceanic, Energy Savers Unlimited, Kent Marine, Interpet, TFH, Nylabone, Four Paws, Pet Select, Kaytee, Super Pet, Zodiac, Pre Strike and Altosid.

In fiscal 2005, our consolidated net sales were \$1.4 billion, of which our lawn and garden segment, or Garden Products, accounted for approximately \$740 million and our pet segment, or Pet Products, accounted for approximately \$640 million. In fiscal 2005, our income from operations was \$100.1 million of which Garden Products accounted for \$47.1 million and Pet Products accounted for \$83.7 million, before corporate expenses and eliminations of \$30.7 million.

Central was incorporated in Delaware in June 1992 and is the successor to a California corporation which was incorporated in 1955. References to we, us, our, or Central mean Central Garden & Pet Company and its subsidiaries and divisions, and their predecessor companies and subsidiaries.

#### **Background**

We have transitioned our company to a leading marketer and producer of branded products from a traditional pet and lawn and garden supplies distributor. We made this transition because we recognized the opportunity to build a portfolio of leading brands and improve profitability by capitalizing on our knowledge of the pet and lawn and garden supplies sectors, our strong relationships with retailers, and our nationwide sales and logistics network. Our goal was to diversify our business and improve operating margins by establishing a portfolio of leading brands. Since 1997, we have acquired numerous branded product companies and product lines, including Wellmark and Four Paws in fiscal 1997; Kaytee Products, TFH and Pennington Seed in fiscal 1998; Norcal Pottery in fiscal 1999; AMDRO and All-Glass Aquarium in fiscal 2000; Lilly Miller in fiscal 2001; Alaska Fish Fertilizer in fiscal 2002; Kent Marine, New England Pottery, Interpet, KRB Seed Company, (dba Budd Seed), and Energy Savers Unlimited in fiscal 2004 and Pets International and Gulfstream Home & Garden in fiscal 2005.

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While expanding our branded products business, we experienced adverse events in our distribution business. From 1995 to 1999, we were the master distributor of Round Up and Ortho. In January 1999, The Scotts Company, one of our largest distribution suppliers at the time, acquired Ortho and became the marketing agent for Round Up. In July 2000, Scotts terminated its relationship with us. Subsequently, we downsized our distribution operations and integrated these sales and logistics networks into our pet and lawn and garden products businesses to allow us to focus resources and provide strategic sales support for our brands. Virtually all of our sales before fiscal 1997 were derived from distributing other manufacturers' products. Since then, our branded product sales have grown to approximately \$1.1 billion, or approximately 78% of total sales, in fiscal 2005. During this same period, our sales of other manufacturers' products have declined to approximately 22% of total sales, and our gross profit margins have improved from 13.6% in fiscal 1996 to 32.1% in fiscal 2005.

## **Table of Contents**

### **Recent Developments**

#### **Assets Acquired from Shirlo**

In December 2005, we acquired certain intellectual property assets from Shirlo, Inc. for cash of approximately \$10 million. The assets acquired from Shirlo, Inc. include the company's exclusive marketing rights to etofenprox, an insect adulticide approved for on-animal use. The acquired assets will be combined with Wellmark International, a wholly owned subsidiary of Central. We have not finalized the allocation of the purchase price to the fair value of assets acquired.

#### ***Announced Acquisition of Farnam***

In January 2006, we announced that we agreed to acquire the stock of Farnam Companies, Inc. for approximately \$287 million, plus \$4 million for the purchase of related real property. Farnam is a leading manufacturer and marketer of innovative health care products primarily for horses, household pets and livestock sold through over-the-counter and veterinary channels. In addition to the Farnam umbrella brand, Farnam's portfolio of industry leading brands includes Equicare<sup>®</sup>, ComboCare<sup>®</sup>, IverCare<sup>®</sup>, Endure<sup>®</sup>, and Repel-X<sup>®</sup> for horses; D-Worm<sup>®</sup>, BioSpot<sup>®</sup> and Scratchex<sup>®</sup> for household pets; and Adams<sup>®</sup> and Bite Free<sup>®</sup> insect controls for home and yard care. In its fiscal year ending November 30, 2005, Farnam generated net sales of approximately \$160 million. The transaction is expected to close in our second fiscal quarter ending March 2006 and is subject to satisfaction of regulatory requirements and other customary closing conditions. We anticipate that we will fund the acquisition with the proceeds from \$650 million in new senior secured financing consisting of a revolving bank facility and new term loan B notes. This new facility will also be used to retire our existing bank debt and term loan B notes.

### **New Accounting Pronouncements**

#### ***Accounting for Stock-Based Compensation***

Through 2005, we accounted for our stock plans using the intrinsic value method. Effective the beginning of fiscal 2006, we adopted Statement of Financial Accounting Standards (SFAS) No. 123(R), Share-Based Payment, and elected the modified prospective application method upon adoption. SFAS No. 123(R) requires us to use a fair-value based method in determining stock-based compensation. Accordingly, stock-based compensation cost is measured at the grant date, based on the fair value of the award, and expensed over the employees' requisite service period. Total compensation cost for our stock plans in the first quarter of 2006 was \$1 million.

### **Critical Accounting Policies, Estimates and Judgments**

There have been no material changes to our critical accounting policies, estimates and assumptions or the judgments affecting the application of those accounting policies since our Annual Report on Form 10-K for the fiscal year ended September 24, 2005.

**Stock-based compensation:** In fiscal 2006, we adopted SFAS No. 123(R) using the modified prospective transition method and began accounting for our stock-based compensation using a fair-valued based recognition method. Under the provisions of SFAS

No. 123(R), stock-based compensation cost is estimated at the grant date based on the fair-value of the award and is expensed ratably over the requisite service period of the award. Determining the appropriate fair-value model and calculating the fair value of stock-based awards at the grant date requires considerable judgment, including estimating stock price volatility, expected option life and forfeiture rates. We develop our estimates based on historical data and market information which can change significantly over time.

We use the Black-Scholes option valuation model to value employee stock awards. We estimate stock price volatility based on an average historical volatility of our stock. Estimated option life and forfeiture rate assumptions are also derived from historical data. We recognize compensation expense using the straight-line amortization method for stock based compensation awards with graded vesting. Had we used alternative valuation methodologies, the amount we expense for stock based payments could be significantly different.

**Table of Contents**

**Results of Operations**

**Three Months Ended December 24, 2005**

**Compared with Three Months Ended December 25, 2004**

Net sales for the three months ended December 24, 2005 increased \$27.1 million, or 10.2%, to \$292.7 million from \$265.6 million for the three months ended December 25, 2004. Pet Products' net sales increased \$10.3 million, or 6.6%, to \$167.1 million for the three months ended December 24, 2005 from \$156.8 million in the comparable fiscal 2005 period. Garden Products' net sales increased \$16.8 million, or 15.4%, to \$125.6 million for the three months ended December 24, 2005 from \$108.8 million in the comparable fiscal 2005 period. Our branded product sales increased \$23.3 million and sales of other manufacturers' products increased \$3.8 million. Our Pet Products' branded product sales increased \$9.6 million due primarily to recent acquisitions. Our Garden Products' branded product sales increased \$13.7 million due primarily to increased grass seed sales and \$4 million from fiscal year 2005 acquisitions.

Gross profit for the three months ended December 24, 2005 increased \$6.0 million, or 6.9%, to \$92.0 million from \$86.0 million for the three months ended December 25, 2004. Gross profit increased in both Garden Products and Pet Products. Gross profit as a percentage of net sales decreased from 32.4% for the three months ended December 25, 2004 to 31.4% for the three months ended December 24, 2005. While the Pet Products gross profit percentage remained relatively steady, the Garden Products percentage decreased 200 basis points. The decreased margin was due primarily to an unfavorable product mix shift within Garden's product portfolio. The sales increase experienced in Garden in the first quarter was primarily in our lower margin products. Additionally, price increases to offset increased raw material costs had not taken effect during the first quarter of fiscal 2006.

Selling, general and administrative expenses increased \$5.7 million, or 7.5%, from \$76.5 million for the three months ended December 25, 2004 to \$82.2 million for the three months ended December 24, 2005. All three components of selling, general and administrative expenses increased, as discussed further below. As a percentage of net sales, selling, general and administrative expenses decreased to 28.1% for the three months ended December 24, 2005, compared to 28.8% in the comparable prior year period.

Selling and delivery expense increased \$3.8 million, or 10.2%, from \$37.4 million for the three months ended December 25, 2004 to \$41.2 million for the three months ended December 24, 2005. The increase was due primarily to increased sales as selling and delivery costs as a percentage of net sales remained unchanged at 14%.

Facilities expense increased \$0.7 million to \$3.5 million for the three months ended December 24, 2005 from \$2.8 million for the three months ended December 25, 2004. The increase was due primarily to facility relocation costs incurred as part of our previously announced restructuring effort within the Garden Products segment.

Warehouse and administrative expense increased \$1.2 million, or 3.3%, from \$36.3 million for the three months ended December 25, 2004 to \$37.5 million for the three months ended December 24, 2005. The increase was due primarily to \$1 million for stock based compensation as a result of adopting SFAS 123(R). Decreased legal and litigation costs of \$0.4 million were offset by restructuring costs.

Net interest expense for the three months ended December 24, 2005 increased \$0.4 million, or 7.7%, to \$5.6 million from \$5.2 million for the three months ended December 25, 2004. The increase was due primarily to increased average long-term debt balances during the fiscal 2006 quarter as compared to the prior year quarter, as a result of acquisitions made in the last year and slightly higher interest

rates on our floating rate debt, partially offset by increased interest income of \$0.6 million.

Other income increased \$0.3 million to essentially break-even from \$0.3 million expense reported for the quarter ended December 25, 2004. Other income represents income from four equity method investments.

Our effective income tax rate for the quarter ended December 24, 2005 was 38.5% compared with 37.1% for the quarter ended December 25, 2004. The effective tax rate was lower in the prior year quarter due to estimated state tax decreases and a larger portion of income taxed at lower foreign rates.

### **Liquidity and Capital Resources**

We have financed our growth through a combination of bank borrowings, supplier credit, internally generated funds and sales of equity and debt securities to the public.

## **Table of Contents**

Historically, our business has been seasonal and our working capital requirements and capital resources tracked closely to this seasonal pattern. During the first fiscal quarter, accounts receivable reach their lowest level while inventory, accounts payable and short-term borrowings begin to increase. During the second fiscal quarter, receivables, accounts payable and short-term borrowings begin to increase, reflecting the build-up of inventory and related payables in anticipation of the peak lawn and garden selling season. During the third fiscal quarter, inventory levels remain relatively constant while accounts receivable peak and short-term borrowings start to decline as cash collections are received during the peak selling season. During the fourth fiscal quarter, inventory levels are at their lowest, and accounts receivable and payables are substantially reduced through conversion of receivables to cash. As a result of the reduction in sales of garden products manufactured by other parties as a percentage of overall sales, this seasonal pattern has become somewhat less significant.

We service two broad markets: pet supplies and lawn and garden supplies. Our pet supplies businesses involve products that have a year round selling cycle with very little change quarter to quarter. As a result, it is not necessary to maintain large quantities of inventory to meet peak demands. Additionally, this level sales cycle eliminates the need for manufacturers to give extended credit terms to either distributors or retailers. On the other hand, our lawn and garden businesses are highly seasonal with approximately 63% of Garden Products net sales occurring during the second and third fiscal quarters. For many manufacturers of garden products, this seasonality requires them to ship large quantities of their product well ahead of the peak consumer buying periods. To encourage distributors to stock large quantities of inventory, industry practice has been for manufacturers to give extended credit terms and/or promotional discounts.

The primary cash flows for the three months ended December 24, 2005 were \$22.1 million in cash used in investing activities (primarily for the acquisition of businesses) partially offset by \$2.2 million provided by financing activities and \$4.1 million of cash provided by operating activities. Net cash used in investing activities increased \$16.4 million from the prior year primarily due to cash used for acquisitions. Net cash provided by financing activities increased \$10.7 million as the prior period included \$10 million of repayments on our revolving line of credit.

At December 24, 2005, our total debt was \$323.3 million versus \$295.3 million at December 25, 2004, due to additional borrowings on our credit facility to finance our acquisitions since the first quarter of fiscal 2005.

We currently maintain a \$300 million senior secured credit facility consisting of a \$125 million revolving credit facility maturing in May 2008 and a \$175 million term loan maturing in May 2009. Interest on the term loan is based on a rate equal to LIBOR + 1.75% or the prime rate plus 0.25%, at our option. Interest on the revolving credit facility is based on a rate equal to prime plus a margin, which fluctuates from (0.25)% to 0.75% or LIBOR plus a margin which fluctuates from 1.25% to 2.25%, determined quarterly based on consolidated total debt to consolidated EBITDA for the most recent trailing 12-month period. In February 2005, we exercised an option contained in our credit agreement to borrow an additional \$75 million under our six year term loan. The total outstanding borrowings after the draw down under the term loan was approximately \$173.5 million and at December 24, 2005 was \$172.2 million. The term loan is payable in quarterly installments of \$437,500 with the balance payable in May 2009. This facility is secured by essentially all of our assets, contains certain financial covenants requiring maintenance of minimum levels of interest coverage and maximum levels of senior debt to EBITDA and total debt to EBITDA, and restricts our ability to make treasury stock purchases, investments in or acquisitions of a business and pay dividends above certain levels over the life of the facility. We were in compliance with all financial covenants as of December 24, 2005. The balance outstanding at December 24, 2005 under the \$125 million revolving credit facility was \$1.0 million, and the remaining available borrowing capacity was \$114.7 million, with \$9.3 million outstanding under certain letters of credit.

In October 2003, we entered into a \$75 million pay-floating interest rate swap effectively converting half of our \$150 million fixed rate 9-1/8 % senior subordinated notes to a floating rate of LIBOR + 4.04%.

We believe that cash flows from operating activities, funds available under our credit facility, and arrangements with suppliers will be adequate to fund our presently anticipated working capital requirements for the foreseeable future. We anticipate that our capital expenditures will not exceed \$40 million for the next 12 months. The increased expected capital expenditures, compared to our

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historical rate, are due to our implementation of a scalable enterprise-wide information technology platform to support future growth and to enable us to take advantage of new applications and technologies. We have selected SAP as our software provider and anticipate investing approximately \$30 million over the next four years to implement our new information technology strategy. This initiative, when complete, will combine our numerous information systems into one enterprise system and create a common business model and common data which will create greater efficiency and effectiveness. We have embarked upon an enterprise-wide information technology initiative to provide a common ERP platform that will enable many of our strategic initiatives and enhance our operating efficiency.

In January 2006, we agreed to acquire the stock of Farnam Companies, Inc. for approximately \$287 million, plus \$4 million for the purchase of related real property. The transaction is expected to close in our second fiscal quarter ending March 2006 and is subject to satisfaction of regulatory requirements and other customary closing conditions. We anticipate that we will fund the

## **Table of Contents**

acquisition with the proceeds from \$650 million in new senior secured financing consisting of a revolving bank facility and new term loan B notes. This new facility will also be used to retire our existing bank debt and term loan B notes.

As part of our growth strategy, we have engaged in acquisition discussions with a number of companies in the past, and we anticipate that we will continue to evaluate potential acquisition candidates. If one or more potential acquisition opportunities, including those that would be material, become available in the near future, we may require additional external capital. In addition, such acquisitions would subject us to the general risks associated with acquiring companies, particularly if the acquisitions are relatively large.

## **Off-Balance Sheet Arrangements**

There have been no material changes to the information provided in our Annual Report on Form 10-K for the fiscal year ended September 24, 2005 regarding off-balance sheet arrangements.

## **Contractual Obligations**

There have been no material changes outside the ordinary course of business in our contractual obligations set forth in the Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources in our Annual Report on Form 10-K for the fiscal year ended September 24, 2005.

## **Weather and Seasonality**

Historically, our sales of lawn and garden products have been influenced by weather and climate conditions in the markets we serve. Additionally, Garden Products' business has been highly seasonal. In fiscal 2005, approximately 63% of Garden Products' net sales and 57% of our total net sales occurred in the Company's second and third fiscal quarters. Substantially all of Garden Products' operating income is typically generated in this period, which has historically offset the operating loss incurred during the first fiscal quarter of the year.

## **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

We believe there has been no material change in our exposure to market risk from that discussed in our fiscal 2005 Annual Report filed on Form 10-K.

## **Item 4. Controls and Procedures**

(a) Our Chief Executive Officer and Chief Financial Officer have reviewed, as of the end of the period covered by this report, the disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) that ensure that information relating to the Company required to be disclosed by us in the reports that we file or submit under the Exchange Act, is recorded, processed, summarized and reported in a timely and proper manner. Based upon this review, we believe that the controls and procedures in place are effective to ensure that information relating to the Company that is required to be disclosed by us in the reports that we file or submit under the Exchange Act is properly disclosed as required by the Exchange Act and related regulations.

(b) *Changes in internal controls.* There were no significant changes in our internal controls during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents****PART II. OTHER INFORMATION****Item 1. Legal Proceedings**

For information on our material legal proceedings, you should read Note 7 Contingencies to the unaudited condensed consolidated financial statements in Part I Item 1 of this report.

**Item 1A. Risk Factors**

There have been no material changes from the risk factors previously disclosed in our Form 10-K in response to Item AA. to Part I of Form 10-K.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

Except as set forth in the table below, we did not repurchase any of our equity securities during the quarter ended December 24, 2005.

<u>Period</u>	<u>Total Number of Shares (or Units) Purchased</u>	<u>Average Price Paid per Share</u>	<u>Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs</u>	<u>Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs</u>
September 25 – October 29, 2005		\$		
October 30 – November 26, 2005				
November 27 – December 24, 2005				\$ 100,000,000
<b>Total</b>				<b>\$ 100,000,000</b>

**Item 3. Defaults Upon Senior Securities**

Not applicable

**Item 4. Submission of Matters to a Vote of Security Holders**

Not applicable

**Item 5. Other Information**

Not applicable

**Table of Contents**

**Item 6. Exhibits**

- 10.9\* Form of Agreement to Protect Confidential Information, Intellectual Property and Business Relationships (Incorporated by reference from Exhibit 10.1 to the Company's current report on Form 8-K filed October 14, 2005).
- 10.10\* Form of Post-Termination Consulting Agreement (Incorporated by reference from Exhibit 10.2 to the Company's current report on Form 8-K filed October 14, 2005).
- 10.11\* Employment Agreement between Central Garden & Pet Company and Bradley P. Johnson, dated September 30, 2005 (Incorporated by reference from Exhibit 10.1 to the Company's current report on Form 8-K filed October 17, 2005).
- 10.12\* Deferred Compensation Plan of the Company dated as of December 14, 2005 (Incorporated by reference from Exhibit 10.1 to the Company's current report on Form 8-K filed December 20, 2005).
- 31.1 Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350.
- 32.2 Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350.

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\* Management contract or compensatory plan or arrangement.

**Table of Contents**

**SIGNATURES**

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

CENTRAL GARDEN & PET COMPANY  
Registrant

Dated: February 2, 2006

/s/ GLENN W. NOVOTNY  
Glenn W. Novotny  
President and Chief Executive Officer

/s/ STUART W. BOOTH  
Stuart W. Booth  
Executive Vice President and Chief Financial Officer