

FARMER BROTHERS CO
Form 10-Q
February 09, 2011
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2010

OR

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

For the transition period from _____ to _____

Commission file number: 001-34249

FARMER BROS. CO.

(exact name of registrant as specified in its charter)

Edgar Filing: FARMER BROTHERS CO - Form 10-Q

Delaware
(State of Incorporation)

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

20333 South Normandie Avenue

Torrance, California
(address of principal executive offices)

90502
(Zip Code)

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

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

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

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

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

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

On February 8, 2011, the registrant had 16,207,927 shares outstanding of its common stock, par value \$1.00 per share, which is the registrant's only class of common stock.

Table of Contents

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

	Page
<u>PART I FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements</u>	
<u>Consolidated Balance Sheets at December 31, 2010 (unaudited) and June 30, 2010</u>	1
<u>Consolidated Statements of Operations for the Three and Six Months Ended December 31, 2010 and 2009 (unaudited)</u>	2
<u>Consolidated Statements of Cash Flows for the Six Months Ended December 31, 2010 and 2009 (unaudited)</u>	3
<u>Notes to Consolidated Financial Statements (unaudited)</u>	4
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	13
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	15
<u>Item 4. Controls and Procedures</u>	16
<u>PART II OTHER INFORMATION</u>	
<u>Item 1A. Risk Factors</u>	17
<u>Item 6. Exhibits</u>	25
<u>SIGNATURES</u>	26
<u>EXHIBIT INDEX</u>	27

Table of Contents**PART I - FINANCIAL INFORMATION****Item 1. Financial Statements****FARMER BROS. CO.****CONSOLIDATED BALANCE SHEETS**

(Dollars in thousands, except share and per share data)

	December 31, 2010 (Unaudited)	June 30, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 3,619	\$ 4,149
Short term investments	34,492	50,942
Accounts and notes receivable, net	42,804	42,596
Inventories	89,241	83,712
Income tax receivable	77	5,840
Deferred income taxes	4	4
Prepaid expenses	3,772	2,713
Total current assets	174,009	189,956
Property, plant and equipment, net	121,269	120,372
Goodwill and other intangible assets, net	23,357	25,242
Other assets	2,395	2,492
Deferred income taxes	1,059	1,059
Total assets	322,089	339,121
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	34,186	34,053
Accrued payroll expenses	13,819	14,661
Short-term borrowings under revolving credit facility	30,322	37,163
Short-term obligations under capital leases	1,410	724
Deferred income taxes	265	264
Other current liabilities	10,988	11,681
Total current liabilities	90,990	98,546
Accrued postretirement benefits	23,044	22,185
Long-term obligations under capital leases	7,364	3,137
Accrued pension liabilities	48,331	43,497
Accrued workers compensation liabilities	4,320	4,388
Deferred income taxes	1,773	1,773
Total liabilities	175,822	173,526
Commitments and contingencies		

Edgar Filing: FARMER BROTHERS CO - Form 10-Q

Stockholders' equity:

Preferred stock, \$1.00 par value, 500,000 shares authorized and none issued			
Common stock, \$1.00 par value, 25,000,000 shares authorized; 16,210,456 and 16,164,179 shares issued and outstanding at December 31, 2010 and June 30, 2010, respectively		16,210	16,164
Additional paid-in capital		34,880	37,468
Retained earnings		165,313	186,900
Unearned ESOP shares		(30,437)	(35,238)
Less accumulated other comprehensive loss		(39,699)	(39,699)
Total stockholders' equity		146,267	165,595
Total liabilities and stockholders' equity	\$	322,089	\$ 339,121

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

Table of Contents**FARMER BROS. CO.****CONSOLIDATED STATEMENTS OF OPERATIONS****(Dollars in thousands, except share and per share data)****(Unaudited)**

	Three Months Ended December 31,		Six Months Ended December 31,	
	2010	2009	2010	2009
Net sales	\$ 119,227	\$ 120,225	\$ 227,970	\$ 232,352
Cost of goods sold	74,211	69,133	139,009	126,956
Gross profit	45,016	51,092	88,961	105,396
Selling expenses	43,624	44,668	86,787	88,966
General and administrative expenses	11,935	11,526	24,736	24,031
Operating expenses	55,559	56,194	111,523	112,997
Loss from operations	(10,543)	(5,102)	(22,562)	(7,601)
Other income (expense):				
Dividend income	918	854	1,597	1,533
Interest income	38	92	112	185
Interest expense	(481)	(183)	(883)	(322)
Other income	1,245	2,905	3,401	7,366
Total other income, net	1,720	3,668	4,227	8,762
(Loss) income before taxes	(8,823)	(1,434)	(18,335)	1,161
Income tax expense (benefit)	89	(2,851)	450	(2,455)
Net (loss) income	\$ (8,912)	\$ 1,417	\$ (18,785)	\$ 3,616
Basic net (loss) income per common share	\$ (0.59)	\$ 0.10	\$ (1.25)	\$ 0.25
Diluted net (loss) income per common share	\$ (0.59)	\$ 0.10	\$ (1.25)	\$ 0.25
Weighted average common shares outstanding basic	15,078,026	14,721,740	15,050,644	14,692,164
Weighted average common shares outstanding diluted	15,078,026	14,723,380	15,050,644	14,694,059
Cash dividends declared per common share	\$ 0.060	\$ 0.115	\$ 0.175	\$ 0.230

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

Table of Contents**FARMER BROS. CO.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(Dollars in thousands)****(Unaudited)**

	Six Months Ended December 31,	
	2010	2009
Cash flows from operating activities:		
Net (loss) income	\$ (18,785)	\$ 3,616
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:		
Depreciation and amortization	15,416	12,385
Loss on sales of assets	445	339
Share-based compensation expense	2,259	2,753
Net gain on investments	(2,651)	(7,007)
Change in operating assets and liabilities:		
Short-term investments	19,101	(2,741)
Accounts and notes receivable	(208)	(5,011)
Inventories	(5,529)	(10,973)
Income tax receivable	5,762	(2,386)
Prepaid expenses and other assets	(961)	(1,794)
Accounts payable	913	316
Accrued payroll expenses and other liabilities	226	151
Accrued postretirement benefits	859	(87)
Other long-term liabilities	4,425	4,392
Net cash provided by (used in) operating activities	21,272	(6,047)
Cash flows from investing activities:		
Purchases of property, plant and equipment	(10,401)	(14,753)
Proceeds from sales of property, plant and equipment	495	127
Net cash used in investing activities	(9,906)	(14,626)
Cash flows from financing activities:		
Proceeds from revolving line of credit	18,550	21,495
Repayments on revolving line of credit	(26,150)	(15,267)
Payments on capital lease obligations	(609)	(386)
Dividends paid	(3,687)	(3,416)
Net cash (used in) provided by financing activities	(11,896)	2,426
Net decrease in cash and cash equivalents	(530)	(18,247)
Cash and cash equivalents at beginning of period	4,149	20,038
Cash and cash equivalents at end of period	\$ 3,619	\$ 1,791

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

Table of Contents

FARMER BROS. CO.

Notes to Consolidated Financial Statements

(Unaudited)

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

The Company

Farmer Bros. Co. (including its consolidated subsidiaries, unless the context requires otherwise, herein referred to as the Company, we, or our) is a manufacturer, wholesaler and distributor of coffee, tea and culinary products to institutional food service establishments including restaurants, hotels, casinos, hospitals and food service providers, as well as retailers such as convenience stores, coffee houses, general merchandisers, private-label retailers and grocery stores. The Company was incorporated in California in 1923, and reincorporated in Delaware in 2004.

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States (GAAP) for complete consolidated financial statements. In the opinion of management, all adjustments (consisting only of normal recurring accruals, unless otherwise indicated) considered necessary for a fair presentation of the interim financial data have been included. Operating results for the three and six months ended December 31, 2010 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2011. Events occurring subsequent to December 31, 2010 have been evaluated for potential recognition or disclosure in the unaudited consolidated financial statements for the three and six months ended December 31, 2010.

The accompanying unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company s Annual Report on Form 10-K, as amended, for the fiscal year ended June 30, 2010, filed with the Securities and Exchange Commission (the SEC) on September 14, 2010.

Use of Estimates

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results may differ from those estimates.

Fair Value Measurements

Effective July 1, 2009, the Company implemented the requirements of Accounting Standards Codification (ASC) 820, Fair Value Measurements and Disclosures (ASC 820), of the Financial Accounting Standards Board (the FASB) for its financial assets and liabilities. Fair value is the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants. The Company maximizes the use of observable market inputs, minimizes the use of unobservable market inputs and discloses in the form of an outlined hierarchy the details of such fair value measurements. See Note 2 for additional information.

Coffee Brewing Equipment and Service

The Company classifies certain expenses related to coffee brewing equipment provided to customers as cost of goods sold. These costs include the cost of equipment as well as the cost of servicing that equipment (including service employees salaries, cost of transportation and the cost of supplies and parts) and are considered directly attributable to the generation of revenues from the Company s customers. Accordingly, such costs included in cost of goods sold in the accompanying unaudited consolidated financial statements for the three months ended December 31, 2010 and 2009 were \$6.7 million and \$4.8 million, respectively. Cost of coffee brewing equipment and service for the six months ended December 31, 2010 and 2009 was \$13.9 million and \$10.3 million, respectively. The Company capitalized coffee brewing equipment in the amounts of \$6.2 million and \$6.5 million during the six months ended December 31, 2010 and 2009, respectively. Depreciation expense related to capitalized coffee brewing equipment reported as cost of goods sold was \$2.3 million and \$1.4 million in the three months ended December 31, 2010 and 2009, respectively. Depreciation expense related to capitalized coffee brewing equipment reported as cost of goods sold was \$4.4 million and \$2.5 million in the six months ended December 31, 2010 and 2009, respectively.

Table of Contents**Revenue Recognition**

Most products are sold and delivered to the Company's customers at their places of business by the Company's route sales employees. Revenue is recognized at the time the Company's sales representatives physically deliver products to customers and title passes or upon acceptance by the customer when shipped by third party delivery.

In connection with the acquisition of the DSD Coffee Business in February 2009, the Company entered into an agreement with Sara Lee Corporation (Sara Lee) pursuant to which the Company performs co-packing services for Sara Lee as Sara Lee's agent. The Company recognizes revenue from this arrangement on a net basis, net of direct costs of revenue. As of December 31, 2010 and June 30, 2010, the Company had \$3.6 million and \$4.1 million of receivables from Sara Lee related to this arrangement, which are included in Other receivables (see Note 3).

Earnings (Loss) Per Common Share

Basic earnings (loss) per share (EPS) is computed by dividing net income (loss) by the weighted average common shares outstanding (see Note 9), excluding unallocated shares held by the Company's Employee Stock Ownership Plan. Diluted EPS includes the effect of any potential shares outstanding, which for the Company consists of dilutive stock options. The dilutive effect of stock options is calculated using the treasury stock method with an offset from expected proceeds upon exercise of the stock options and unrecognized compensation expense. Computation of EPS for the three months ended December 31, 2010 does not include the dilutive effect of 22,000 shares issuable under stock options since their inclusion would be anti-dilutive. In the computation of EPS for the six months ended December 31, 2010, 171,435 shares issuable under stock options were excluded since including them would be anti-dilutive. Accordingly the unaudited consolidated financial statements present only basic net income (loss) per common share for the three and six months ended December 31, 2010. Computation of EPS for the three and six months ended December 31, 2009 includes 1,640 and 1,895 dilutive shares, respectively, issuable under stock options.

Effective July 1, 2009, the Company began using the Two-Class Method to compute EPS. The Two-Class Method considers unvested restricted stock with a right to receive non-forfeitable dividends as participating securities and allocates earnings to participating securities in the computation of EPS. The Company computed EPS using the Two-Class Method for all periods presented. The effect for the three and six months ended December 31, 2010 and 2009 was not material.

Dividends Declared

The following dividends were declared in the first six months of fiscal 2011 on the dates indicated (in thousands, except per share amounts):

Record date	Payment date	Dividend amount	
		Total	Per share
October 22, 2010	November 8, 2010	\$ 1,858	\$ 0.115
January 28, 2011	February 14, 2011	\$ 969	\$ 0.06

Impairment of Goodwill and Intangible Assets

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

In addition to an annual test, goodwill and indefinite-lived intangible assets must also be tested on an interim basis if events or circumstances indicate that the estimated fair value of such assets has decreased below their carrying value. There were no such events or circumstances during the six months ended December 31, 2010.

Recently Adopted Accounting Standards

Edgar Filing: FARMER BROTHERS CO - Form 10-Q

In October 2009, the multiple-element arrangements guidance codified in ASC 605-25, Revenue Recognition Multiple Element Arrangements, was modified by the FASB as a result of the final consensus reached on EITF Issue No. 08-1, Revenue Arrangements with Multiple Deliverables, which was codified by ASU No. 2009-13. The guidance in ASU No. 2009-13 supersedes

Table of Contents

the existing guidance on such arrangements and is effective for the first annual reporting period after June 15, 2010 and was effective for the Company beginning on July 1, 2010. Adoption of ASU No. 2009-13 did not materially affect the results of operations, financial condition or cash flows of the Company.

New Accounting Pronouncements

No new accounting pronouncements were issued during the quarter ended December 31, 2010 and through the date of this filing that the Company believes are applicable or would have a material impact on the consolidated results of operations, financial condition or cash flows of the Company.

Note 2. Investments and Derivative Instruments

The Company purchases various derivative instruments as investments or to create economic hedges of its interest rate risk and commodity price risk. At December 31, 2010 and June 30, 2010, derivative instruments are not designated as accounting hedges. The fair value of derivative instruments is based upon broker quotes. The Company records unrealized gains and losses on trading securities and changes in the market value of certain coffee contracts meeting the definition of derivatives in Other income.

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

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

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

Level 3 Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability.

Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

The Company's investments have been grouped as follows at December 31, 2010 and June 30, 2010:

As of December 31, 2010 (In thousands)	Total	Level 1	Level 2	Level 3
		(Unaudited)		
Preferred stock	\$ 34,181	\$ 8,547	\$ 25,634	\$
Futures, options and other derivatives	\$ 311	\$ 311	\$	\$
As of June 30, 2010 (In thousands)	Total	Level 1	Level 2	Level 3
Preferred stock	\$ 50,684	\$ 11,946	\$ 38,738	\$
Futures, options and other derivatives	\$ 258	\$ 258	\$	\$

There were no significant transfers of securities between Level 1 and Level 2 as of December 31, 2010.

Investments, consisting of marketable debt and equity securities, money market instruments and various derivative instruments, are held for trading purposes and are stated at fair value. Investments are as follows:

(In thousands)	December 31, 2010	June 30, 2010
-----------------------	------------------------------------	--------------------------------

Edgar Filing: FARMER BROTHERS CO - Form 10-Q

	(Unaudited)	
Trading securities and derivatives at fair value		
Preferred stock	\$ 34,181	\$ 50,684
Futures, options and other derivatives	311	258
	\$ 34,492	\$ 50,942

Preferred stock investments as of December 31, 2010 consisted of securities with a fair value of \$23.2 million in an unrealized gain position and securities with a fair value of \$11.0 million in an unrealized loss position. Preferred stock investments as of June 30, 2010 consisted of securities with a fair value of \$36.3 million in an unrealized gain position and securities with a fair value of \$14.4 million in an unrealized loss position.

Table of Contents

The following tables show gross unrealized losses (although such losses have been recognized in the statements of operations) and fair value for those investments that were in an unrealized loss position as of December 31, 2010 and June 30, 2010, aggregated by the length of time those investments have been in a continuous loss position:

(In thousands)	December 31, 2010 (Unaudited)			
	Less than 12 Months		Fair Value	Total Unrealized Loss
	Fair Value	Unrealized Loss		
Preferred stock	\$ 507	\$ (13)	\$ 10,463	\$ (4,763)

(In thousands)	June 30, 2010			
	Less than 12 Months		Fair Value	Total Unrealized Loss
	Fair Value	Unrealized Loss		
Preferred stock	\$ 1,889	\$ (97)	\$ 14,358	\$ (6,044)

Gains and losses, both realized and unrealized, are included in Other income (expense). Net realized and unrealized gains and losses are as follows:

(In thousands)	Three Months Ended		Six Months Ended	
	December 31,		December 31,	
	2010	2009	2010	2009
Net realized gains	\$ 1,212	\$ 269	\$ 1,561	\$ 324
Net unrealized (losses) gains	(458)	2,509	1,090	6,683
Net realized and unrealized gains	\$ 754	\$ 2,778	\$ 2,651	\$ 7,007

Note 3. Accounts and Notes Receivable, net

(In thousands)	December 31, 2010 (Unaudited)	June 30, 2010
Trade receivables	\$ 41,658	\$ 39,600
Other receivables	4,496	6,289
Allowance for doubtful accounts	(3,350)	(3,293)
	\$ 42,804	\$ 42,596

Note 4. Inventories

December 31, 2010 (In thousands)	Processed	Unprocessed (Unaudited)	Total
Coffee	\$ 14,420	\$ 29,210	\$ 43,630
Tea and culinary products	29,210	3,164	32,374
Coffee brewing equipment	6,191	7,046	13,237
	\$ 49,821	\$ 39,420	\$ 89,241

Edgar Filing: FARMER BROTHERS CO - Form 10-Q

June 30, 2010 (In thousands)	Processed	Unprocessed	Total
Coffee	\$ 22,230	\$ 16,765	\$ 38,995
Tea and culinary products	28,833	3,145	31,978
Coffee brewing equipment	5,849	6,890	12,739
	\$ 56,912	\$ 26,800	\$ 83,712

Inventories are valued at the lower of cost or market. Costs of coffee, tea and culinary products are determined on the last in, first out (LIFO) basis. Costs of coffee brewing equipment manufactured are accounted for on the first in, first out (FIFO) basis. An actual valuation of inventory under the LIFO method is made only at the end of each fiscal year based on the inventory levels and costs at that time. Accordingly, interim LIFO calculations must necessarily be based on management's estimates of expected fiscal

Table of Contents

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

Note 5. Employee Benefit Plans

The Company provides pension plans for most full time employees. Generally the plans provide benefits based on years of service and/or a combination of years of service and earnings. Retirees are also eligible for medical, dental and vision benefits.

Company Pension Plans

The Company has a contributory defined benefit plan for the majority of its employees who are not covered under a collective bargaining agreement (Farmer Bros. Co. Plan) and two defined benefit pension plans for certain hourly employees covered under a collective bargaining agreement (Brewmatic Plan and Hourly Employees' Plan). The net periodic benefit costs for the defined benefit plans are as follows:

Components of net periodic benefit cost

(In thousands)	Three Months Ended December 31,		Six Months Ended December 31,	
	2010	2009	2010	2009
	(Unaudited)			
Service cost	\$ 1,300	\$ 1,097	\$ 2,600	\$ 2,195
Interest cost	1,569	1,527	3,139	3,054
Expected return on plan assets	(1,329)	(1,204)	(2,658)	(2,409)
Amortization of net (gain)/loss*	836	856	1,671	1,711
Amortization of prior service cost/(credit)*	41	41	82	83
Net periodic benefit cost	\$ 2,417	\$ 2,317	\$ 4,834	\$ 4,634

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

Weighted-average assumptions used to determine net periodic benefit cost

	Fiscal	
	2011	2010
Discount rate	5.60%	6.25%
Expected long-term rate of return	8.25%	8.25%
Rate of compensation increase	3.00%	3.00%

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

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

Postretirement Medical, Dental and Vision Benefits

The Company sponsors a defined benefit postretirement medical, dental and vision plan that covers qualified non-union retirees and certain qualified union retirees. The plan is not funded. Under this postretirement medical plan, the Company's contributions toward premiums for retiree medical, dental and vision coverage for participants and dependents are scaled based on length of service, with greater Company

Edgar Filing: FARMER BROTHERS CO - Form 10-Q

contributions for retirees with greater length of service. Additionally, the plan establishes a maximum Company contribution.

Table of Contents

The following table shows the components of net periodic postretirement benefit cost for the three and six months ended December 31, 2010 and 2009:

Components of net periodic postretirement benefit cost

(In thousands)	Three Months Ended December 31,		Six Months Ended December 31,	
	2010	2009 (Unaudited)	2010	2009
Service cost	\$ 474	\$ 373	\$ 948	\$ 746
Interest cost	314	310	628	620
Expected return on plan assets				
Amortization of net (gain) loss	(180)	(258)	(360)	(516)
Amortization of transition (asset)/obligation				
Amortization of prior service cost (credit)	(58)	(58)	(116)	(116)
Net periodic postretirement benefit cost	\$ 550	\$ 367	\$ 1,100	\$ 734

Weighted-average assumptions used to determine net periodic postretirement benefit cost

Discount rate	Fiscal	
	2011	2010
	5.52%	6.61%

Note 6. Bank Loan

On March 2, 2009, the Company and its wholly owned subsidiary, Coffee Bean International, Inc. (CBI), as Borrowers, entered into a Loan and Security Agreement (the Loan Agreement), with Wells Fargo Bank, National Association, successor by merger to Wachovia Bank, National Association (Wells Fargo), as Lender, providing for a \$50 million senior secured revolving credit facility expiring in February 2012 to help finance the DSD Coffee Business acquisition and for general corporate purposes.

All outstanding obligations under the Loan Agreement are collateralized by perfected security interests in the assets of the Borrowers, excluding the preferred stock held in investment accounts. The revolving line provides for advances of 85% of eligible accounts receivable and 65% of eligible inventory, as defined. The Loan Agreement has an unused commitment fee of 0.375%. The interest rate was 3.75% at December 31, 2010.

On August 31, 2010, the Company and its wholly owned subsidiaries entered into Amendment No. 4 to Loan and Security Agreement (the Amendment) with Wells Fargo pursuant to which effective March 31, 2010, certain collateral reporting, dividend payment, and financial covenants were modified. Effective September 1, 2010, the Amendment also amended the range of interest rates on the line usage based on modified Monthly Average Excess Availability levels. The range is PRIME + 0.25% to PRIME + 0.75% or Adjusted Eurodollar Rate + 2.5% to Adjusted Eurodollar Rate + 3.0%. As of December 31, 2010, the Company was in compliance with all restrictive covenants under the Loan Agreement.

On December 31, 2010, the Company was eligible to borrow up to a total of \$50.0 million under the credit facility. As of December 31, 2010, the Company had borrowed \$30.3 million of this amount, utilized \$3.2 million of its letters of credit sub-limit, and had excess availability of \$16.5 million under the credit facility.

Table of Contents**Note 7. Stock-Based Compensation****Stock Options**

On December 9, 2010, the Company granted 207,656 shares issuable upon the exercise of non-qualified stock options with an exercise price of \$18.03 per share to eligible employees, officers and directors under the Farmer Bros. Co. 2007 Omnibus Plan (the "Plan"). Shares under the options ratably vest over a three-year period. Following are the weighted average assumptions used in the Black-Scholes Merton valuation model for the grants issued during the six months ended December 31, 2010 and 2009:

	Six Months Ended December 31,	
	2010	2009
Weighted average fair value of options	\$ 8.17	\$ 6.14
Pre-vest forfeiture rate	6.50%	6.50%
Risk-free interest rate	2.80%	2.57%
Dividend yield	2.00%	2.50%
Average expected life	6.00 years	6.00 years
Expected stock price volatility	54.9%	41.20%

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

The following table summarizes stock option activity for the six months ended December 31, 2010:

(Unaudited)	Number of Stock Options	Weighted Average Exercise Price	Weighted Average Fair Value	Weighted Average Remaining Life (Years)	Aggregate Intrinsic Value (In thousands)
Outstanding at June 30, 2010	404,943	\$ 20.17	\$ 6.25	5.8	\$
Granted	207,656	\$ 18.03	\$ 8.17		\$
Cancelled/forfeited	(50,514)	\$ 20.14	\$ 6.21		\$
Outstanding at December 31, 2010	562,085	\$ 19.38	\$ 6.96	5.9	\$ 22
Vested and exercisable, December 31, 2010	171,435	\$ 21.05	\$ 6.34	5.0	\$
Vested and expected to vest, December 31, 2010	511,830	\$ 19.52	\$ 6.90	5.8	\$ 19

The aggregate intrinsic value in the table above represents the total pretax intrinsic value, based on the Company's closing stock price of \$17.80 at December 31, 2010, representing the last trading day of the quarter, which would have been received by award holders had all award holders exercised their awards that were in-the-money as of that date. As of December 31, 2010, there was approximately \$2.2 million of unrecognized compensation cost related to stock options and 80,617 shares vested during the six months ended December 31, 2010. Compensation expense recognized in general and administrative expenses in each of the three months ended December 31, 2010 and 2009 was \$0.2 million and \$0.1 million, respectively, and in each of the six months ended December 31, 2010 and 2009 was \$0.4 million and \$0.3 million, respectively.

Restricted Stock

Shares of restricted stock vest at the end of three years from the grant date for eligible employees and officers who are employees. Shares of restricted stock vest ratably over a period of three years for directors and officers who are not employees. Compensation expense is recognized on a straight-line basis over the service period based on the estimated fair value of the restricted stock that is ultimately expected to vest. Restricted stock based compensation expense recognized in general and administrative expenses in each of the three months ended December 31, 2010 and 2009 was \$0.1 million. Restricted stock based compensation expense recognized in general and administrative expenses

Edgar Filing: FARMER BROTHERS CO - Form 10-Q

in each of the six months ended December 31, 2010 and 2009 was \$0.3 million and \$0.2 million, respectively. As of December 31, 2010, there was approximately \$1.4 million of unrecognized compensation cost related to restricted stock. During the six months ended December 31, 2010, 7,870 shares of restricted stock vested.

Table of Contents

The following table summarizes restricted stock activity for the six months ended December 31, 2010:

(Unaudited)	Shares Awarded	Weighted Average Fair Value	Weighted Average Remaining Life (Years)	Aggregate Intrinsic Value (In thousands)
Outstanding at June 30, 2010	80,208	\$ 19.91	2.0	\$ 1,210
Granted	53,595	\$ 18.03		\$ 966
Vested	(7,870)	\$ 19.60		\$ 143
Cancelled/Forfeited	(7,318)	\$ 19.99		\$ 117
Outstanding at December 31, 2010	118,615	\$ 19.08	2.1	\$ 2,111
Expected to vest, December 31, 2010	105,546	\$ 19.20	2.0	\$ 1,879

Note 8. Income Taxes

The Company adjusts its effective tax rate each quarter based on its current estimated annual effective tax rate. The Company also records the tax impact of certain discrete items, unusual or infrequently occurring tax events and the effects of changes in tax laws or rates, in the interim period in which they occur. In addition, the Company evaluates its deferred tax assets quarterly to determine if a valuation allowance is required.

The Company considered whether a valuation allowance should be recorded against deferred tax assets based on the likelihood that the benefits of the deferred tax assets would or would not ultimately be realized in future periods. In making this assessment, significant weight was given to evidence that could be objectively verified such as recent operating results and less consideration was given to less objective indicators such as future earnings projections.

After consideration of positive and negative evidence, including the recent history of losses, the Company cannot conclude that it is more likely than not to generate future earnings sufficient to realize the Company's deferred tax assets. Accordingly, the Company increased its valuation allowance by \$3.5 million in the fiscal quarter ended December 31, 2010 to \$51.8 million.

A summary of the income tax expense (benefit) recorded in the three and six months ended December 31, 2010 and 2009 is as follows:

(In thousands)	Three Months Ended December 31,		Six Months Ended December 31,	
	2010	2009	2010	2009
	(Unaudited)			
(Loss) income before taxes	\$ (8,823)	\$ (1,434)	\$ (18,335)	\$ 1,161
Income tax provision at federal statutory rate	(3,000)	(488)	(6,234)	395
State income taxes and credits	(378)	91	(783)	222
Dividends received deduction	(81)	34	(496)	(345)
Valuation allowance	3,531	269	7,896	(176)
Change in valuation allowance from refund as a result of tax law change		(2,504)		(2,504)
Other permanent items	17	(253)	67	(47)
Income tax expense (benefit)	\$ 89	\$ (2,851)	\$ 450	\$ (2,455)

As of December 31, 2010 and June 30, 2010, the Company had not recognized the following tax benefits in its consolidated financial statements:

As of

Edgar Filing: FARMER BROTHERS CO - Form 10-Q

(In thousands)	December 31, 2010 (Unaudited)	June 30, 2010
Total unrecognized tax benefits*	\$ 5,218	\$ 5,218
Unrecognized benefits that, if recognized, would affect the Company's effective tax rate*	\$ 4,953	\$ 4,953

* Excluding interest and penalties

Table of Contents

The Internal Revenue Service is currently conducting an audit of the Company's amended federal returns filed in September 2009, and the State of California is conducting a state examination of the Company's open tax years. The Company believes it is reasonably possible that a portion of its total unrecognized tax benefits will decrease in the next twelve months upon the conclusion of these examinations.

Note 9. Net Income (Loss) Per Common Share

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

(In thousands, except per share data)	Three Months Ended December 31,		Six Months Ended December 31,	
	2010	2009 (Unaudited)	2010	2009
Net (loss) income attributable to common stockholders - basic	\$ (8,862)	\$ 1,409	\$ (18,681)	\$ 3,596
Effect of dilutive securities:				
Net (loss) income attributable to unvested restricted stockholders	(50)	8	(104)	20
Total net (loss) income	\$ (8,912)	\$ 1,417	\$ (18,785)	\$ 3,616
Weighted average common shares outstanding - basic	15,078,026	14,721,740	15,050,644	14,692,164
Effect of dilutive securities:				
Shares issuable under stock options		1,640		1,895
Weighted average common shares outstanding - diluted	15,078,026	14,723,380	15,050,644	14,694,059
Basic net (loss) income per common share	\$ (0.59)	\$ 0.10	\$ (1.25)	\$ 0.25
Diluted net (loss) income per common share	\$ (0.59)	\$ 0.10	\$ (1.25)	\$ 0.25

Note 10. Commitments and Contingencies

Contractual obligations for the remainder of the current fiscal year ending June 30, 2011 and future fiscal years are as follows (in thousands):

	Contractual Obligations (Unaudited)		
	Capital Lease Obligations	Operating Lease Obligations	Pension Plan Obligations
Six months ending June 30, 2011	\$ 1,098	\$ 2,531	\$ 2,643
Year ending June 30, 2012	1,995	4,471	5,449
Year ending June 30, 2013	1,957	3,546	5,759
Year ending June 30, 2014	1,929	3,003	5,987
Year ending June 30, 2015	1,901	2,286	6,410
Thereafter	1,959	4,708	39,900
		\$ 20,545	\$ 66,148

Total minimum lease payments \$ 10,839

Edgar Filing: FARMER BROTHERS CO - Form 10-Q

Less: imputed interest (1.74% to 13.6%)	(2,065)
Present value of future minimum lease payments	\$ 8,774
Less: current portion	1,410
Long-term capital lease obligations	\$ 7,364

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

Table of Contents

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

Forward-Looking Statements

The following discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of many factors. The results of operations for the three and six months ended December 31, 2010 and 2009 are not necessarily indicative of the results that may be expected for any future period. The following discussion should be read in combination with the consolidated financial statements and the notes thereto included in Part I Item 1 of this report and with the Risk Factors described in Part II Item 1A of this report.

Liquidity and Capital Resources

Credit Facility

On March 2, 2009, we entered into a Loan Agreement with Wells Fargo, as Lender, providing for a \$50 million senior secured revolving credit facility expiring in February 2012 to help finance the DSD Coffee Business acquisition and for general corporate purposes. The Loan Agreement contains a variety of restrictive covenants customary in an asset based lending facility, including a minimum excess availability requirement and a minimum total liquidity requirement, and it places limits on dividends. The Loan Agreement allows us to pay dividends at the current rate, subject to certain liquidity requirements.

All outstanding obligations under the Loan Agreement are collateralized by perfected security interests in our assets, excluding the preferred stock held in investment accounts. The revolving line provides for advances of 85% of eligible accounts receivable and 65% of eligible inventory, as defined. The Loan Agreement has an unused commitment fee of 0.375%. The interest rate varies based upon line usage, borrowing base availability and market conditions. The interest rate on the Company's outstanding borrowings was 3.75% at December 31, 2010. Due to the short-term nature of the credit facility and the variable interest rate, fair value of the balance outstanding approximates carrying value.

On August 31, 2010, we entered into Amendment No. 4 to Loan and Security Agreement with Wells Fargo (the Amendment) pursuant to which effective March 31, 2010, certain collateral reporting, dividend payment, and financial covenants were modified. Effective September 1, 2010, the Amendment also amended the range of interest rates on the line usage based on modified Monthly Average Excess Availability levels. The range is PRIME + 0.25% to PRIME + 0.75% or Adjusted Eurodollar Rate + 2.5% to Adjusted Eurodollar Rate + 3.0%. As of December 31, 2010, we were in compliance with all restrictive covenants under the Loan Agreement.

On December 31, 2010, we were eligible to borrow up to a total of \$50.0 million under the credit facility. As of December 31, 2010, we had borrowed \$30.3 million, utilized \$3.2 million of our letters of credit sub-limit, and had excess availability under the credit facility of \$16.5 million. As of January 15, 2011, approximately \$31.8 million was outstanding under this credit facility.

Liquidity

In fiscal 2011, we continue to focus on streamlining our operations including, where appropriate, expense reductions, asset redeployment and improvements in operating efficiencies and automation intended to improve our operating results. We expect to continue to increase our selling prices in response to substantial increases in the cost of raw materials for coffee, tea and culinary products to the extent possible without negatively impacting our market share. In addition, we have implemented a number of initiatives intended to reduce the cost of our operations, including initiatives to reduce inventory levels and tighten our management of accounts receivables, cost-share measures to address increases in employee healthcare costs, automation of certain functions including the centralization of certain IT functions, and initiatives to reduce the use of outside services. We also intend to continue to sell our excess real estate where appropriate and have renegotiated lease arrangements on real estate on more favorable terms in light of current market conditions. In the first half of fiscal 2011, we sold a portion of our investments in preferred stock in order to diversify our liquid assets and to pay down a portion of the outstanding balance on our revolving line of credit.

During the six months ended December 31, 2010, we capitalized \$10.4 million in property and equipment purchases which included \$6.2 million in expenditures to replace normal wear and tear of coffee brewing equipment, \$2.9 million in building and facility

Table of Contents

improvements, \$0.8 million in expenditures for vehicles, and machinery and equipment, and \$0.4 million in information technology related expenditures.

Our expected capital expenditures for fiscal 2011 included completion of the installation of the two roasters and other production equipment at our Torrance facility and expenditures to replace normal wear and tear of coffee brewing equipment, vehicles, and machinery and equipment. As of December 31, 2010, we have substantially completed all capital expenditures associated with installation of the two roasters.

As described above, we maintain a \$50 million senior secured revolving line of credit with Wells Fargo. Although we expect further synergies from integrating the DSD Coffee Business with our operations, and additional operational cost reduction, the realization and timing of these improvements are uncertain. Based on our current operations and anticipated cost management and operating improvements, we believe this credit facility, to the extent available, in addition to our cash flow from operations and other liquid assets, will be adequate to meet our liquidity needs through the current term of our credit facility. However, there can be no assurance that our business will generate sufficient cash flow from operations or that anticipated cost savings and operating improvements will be realized or that future borrowings will be available to us in an amount sufficient to enable us to pay our indebtedness or to fund our other liquidity needs. Our credit facility will expire in February 2012. We cannot provide assurances that we will be able to refinance any of our indebtedness on commercially reasonable terms or at all.

Our working capital is comprised of the following:

(In thousands)	As of December 31, 2010 (Unaudited)	As of June 30, 2010
Current assets	\$ 174,009	\$ 189,956
Current liabilities	90,990	98,546
Working capital	\$ 83,019	\$ 91,410

Liquidity Information

(In thousands)	For the Six Months Ended December 31, 2010 (Unaudited)	For the Twelve Months Ended June 30, 2010
Capital expenditures	\$ 10,401	\$ 28,484
Dividends paid	\$ 3,687	\$ 6,939

(In thousands)	As of December 31, 2010 (Unaudited)	As of June 30, 2010
Dividends payable	\$ 969	\$ 1,849

As of December 31, 2010, we had no material commitments for capital expenditures other than those described above.

Results of Operations

Our net sales in the three months ended December 31, 2010 decreased \$1.0 million, or 1%, to \$119.2 million as compared to \$120.2 million during the three months ended December 31, 2009. Our net sales in the first half of fiscal 2011 decreased \$4.4 million, or 1.9%, to \$228.0 million as compared to \$232.4 million in the first half of fiscal 2010. These decreases are primarily due to a modest reduction in the number of customers who purchased our products as compared to the same periods in the prior year. We expect that the ongoing weakness in the economy and reduced consumer spending will continue to impact our sales through the remainder of fiscal 2011.

Gross profit in the three months ended December 31, 2010 decreased \$6.1 million, or 12%, to \$45.0 million, as compared to \$51.1 million during the three months ended December 31, 2009. Gross margin decreased to 38% in the three months ended December 31, 2010 from 42% in the comparable period in the prior fiscal year. Gross profit during the first half of fiscal 2011 decreased \$16.4 million, or 15.6%, to \$89.0 million, as compared to \$105.4 million during the first half of fiscal 2010. Gross margin decreased to 39% in the first half of fiscal 2011 from

Edgar Filing: FARMER BROTHERS CO - Form 10-Q

45% in the first half of fiscal 2010. This decrease in gross margin is primarily due to higher total coffee brewing equipment and service costs included in cost of goods sold compared to the same period in the prior year, substantially increased raw material costs which included an increase since the beginning of the current fiscal year of approximately 45% in the cost of green coffee beans purchased, and changes in the mix of our customers and the products we sell to them.

Table of Contents

Operating expenses in the three months ended December 31, 2010 decreased \$0.6 million, or 1%, to \$55.6 million, or 47% of sales, from \$56.2 million, or 47% of sales, in the comparable period of fiscal 2010. During the first half of fiscal 2011, operating expenses decreased \$1.5 million, or 1.3%, to \$111.5 million, or 49% of sales, as compared to \$113.0 million, or 49% of sales, in the first half of fiscal 2010. The reduction in operating expenses in the three and six months ended December 31, 2010, as compared to the same periods in the prior year is primarily due to lower payroll and related expenses resulting from a reduction in number of employees offset in part by higher freight and fuel costs.

Loss from operations in the three and six months ended December 31, 2010 was \$(10.5) million and \$(22.6) million, respectively, as compared to \$(5.1) million and \$(7.6) million, respectively, during the three and six months ended December 31, 2009, primarily due to decline in gross profit.

Total other income in the three and six months ended December 31, 2010 was \$1.7 million and \$4.2 million, respectively, as compared to \$3.7 million and \$8.8 million, respectively, in the three and six months ended December 31, 2009. These changes were primarily due to higher interest expense and lower net realized and unrealized gains in the three and six months ended December 31, 2010, as compared to the three and six months ended December 31, 2009.

During the three and six months ended December 31, 2010, we recorded income tax expense of \$0.1 million and \$0.4 million compared to income tax benefit of \$2.9 million and \$2.5 million, respectively, recorded during the three and six months ended December 31, 2009. Income tax benefit for the three and six month periods ended December 31, 2009 was primarily attributable to federal legislation allowing a five year net operating loss carryback period for net operating losses incurred in tax years that ended in 2008 and 2009. This legislation allowed us to claim additional income tax receivable and record a corresponding decrease in our deferred tax assets relating to our net operating loss carryovers, thereby reducing the valuation allowance recorded as of June 30, 2009 and resulting in income tax benefit for the three and six months ended December 31, 2009.

As a result of the forgoing factors, we recorded a net loss of \$(8.9) million, or \$(0.59) per common share, for the three months ended December 31, 2010, compared to net income of \$1.4 million, or \$0.10 per common share, for the three months ended December 31, 2009. Net loss in the first half of fiscal 2011 was \$(18.8) million, or \$(1.25) per common share, as compared to net income of \$3.6 million, or \$0.25 per common share, in the first half of fiscal 2010.

Item 3. Qualitative and Quantitative Disclosures About Market Risk**Interest Rate Risk**

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

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

As of December 31, 2010 there were no futures or options contracts in place as an interest rate hedge. The following table demonstrates the impact of varying interest rate changes based on the preferred stock holdings, futures and options positions, and market yield and price relationships at December 31, 2010. This table is predicated on an instantaneous change in the general level of interest rates and assumes predictable relationships between the prices of preferred securities holdings, the yields on U.S. Treasury securities and related futures and options.

Interest Rate Changes	Market Value at December 31, 2010			Changes in Market Value of Total Portfolio
	Preferred Securities	Futures and Options	Total Portfolio	
150 basis points	\$ 34,936	\$	\$ 34,936	\$ 754

Edgar Filing: FARMER BROTHERS CO - Form 10-Q

100 basis points	\$ 34,848	\$	\$ 34,848	\$ 667
Unchanged	\$ 34,182	\$	\$ 34,182	\$
+100 basis points	\$ 32,642	\$	\$ 32,642	\$ (1,540)
+150 basis points	\$ 31,704	\$	\$ 31,704	\$ (2,478)

Our revolving line of credit with Wells Fargo is at a variable rate. The interest rate varies based upon line usage, borrowing base availability and market conditions. Effective September 1, 2010, the interest rate on the line usage was amended to a range of PRIME + 0.25% to PRIME + 0.75% or Adjusted Eurodollar Rate + 2.5% to Adjusted Eurodollar Rate + 3.0%, based on modified

Table of Contents

Monthly Average Excess Availability levels. As of December 31, 2010, we had borrowed \$30.3 million, utilized \$3.2 million of our letters of credit sub-limit, and had excess availability of \$16.5 million under the credit facility. The interest rate on the Company's outstanding borrowings at December 31, 2010 was 3.75%.

The following table demonstrates the impact of interest rate changes on our interest expense under the revolving credit facility for a full year based on the outstanding balance and interest rate as of December 31, 2010:

Interest Rate Changes	Interest Rate	Annual Interest Expense (In thousands)
150 basis points	2.25%	\$ 682
100 basis points	2.75%	\$ 834
Unchanged	3.75%	\$ 1,137
+100 basis points	4.75%	\$ 1,440
+150 basis points	5.25%	\$ 1,592

Commodity Price Risk

We are exposed to commodity price risk arising from changes in the market price of green coffee. We price green coffee inventory on the last-in, first-out (LIFO) basis. In the normal course of business we hold a large green coffee inventory and enter into forward commodity purchase agreements with suppliers. We are subject to price risk resulting from the volatility of green coffee prices. Due to competition and market conditions, volatile price increases cannot always be passed on to our customers. From time to time we may hold a mix of futures contracts and options to protect against volatile green coffee price changes. Gains and losses on these derivative instruments are realized immediately in Other income (expense).

The following table demonstrates the impact of hypothetical changes in the market value of coffee cost on the market value of our coffee inventory and coffee forward purchase contracts as of December 31, 2010:

Coffee Cost Change	Coffee Inventory	Market Value Futures & Options	Change in Market Value		
			Total	Derivatives	Inventory
			(In thousands)		
10%	\$ 39,000	\$ (397)	\$ 38,603	\$ (397)	\$ (4,630)
Unchanged	\$ 43,630	\$ 310	\$ 43,940	\$	\$
10%	\$ 48,000	\$ 397	\$ 48,397	\$ 397	\$ 4,370

Item 4. Controls and Procedures

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934, as amended (the Exchange Act), is recorded, processed, summarized and reported, within the time periods specified in the rules and forms of the SEC. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information we are required to disclose in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosures. In January 2010, we adopted Disclosure Controls and Procedures that included the organization of a Disclosure Committee designed to enhance our process of documenting our compliance with Rule 13a-15(e) promulgated under the Exchange Act. The Disclosure Committee performed its duties as prescribed by our Disclosure Controls and Procedures in preparing this Quarterly Report on Form 10-Q for the fiscal period ended December 31, 2010.

As of December 31, 2010, our management, with the participation of our principal executive and principal financial officers, or persons performing similar functions, carried out an evaluation of the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15(e) promulgated under the Exchange Act. Based upon this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of December 31, 2010, our disclosure controls and procedures were effective.

Changes in Internal Control over Financial Reporting

Management has determined that there has been no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) promulgated under the Exchange Act) during our fiscal quarter ended December 31, 2010 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents**PART II - OTHER INFORMATION****Item 1A. Risk Factors**

Certain statements contained in this quarterly report on Form 10-Q are not based on historical fact and are forward-looking statements within the meaning of federal securities laws and regulations. These statements are based on management's current expectations, assumptions, estimates and observations of future events and include any statements that do not directly relate to any historical or current fact. These forward-looking statements can be identified by the use of words like anticipates, estimates, projects, expects, plans, believes, intends, will, words of similar meaning. Owing to the uncertainties inherent in forward-looking statements, actual results could differ materially from those set forth in forward-looking statements. We intend these forward-looking statements to speak only at the time of this report and do not undertake to update or revise these statements as more information becomes available except as required under federal securities laws and the rules and regulations of the SEC. Factors that could cause actual results to differ materially from those in forward-looking statements include, but are not limited to, fluctuations in availability and cost of green coffee, competition, organizational changes, our failure to realize synergies from the integration of the CBI and DSD Coffee Business acquisitions, our ability to refinance or replace our existing credit facility upon its expiration, the impact of a weaker economy, business conditions in the coffee industry and food industry in general, our continued success in attracting new customers, variances from budgeted sales mix and growth rates, weather and special or unusual events, changes in the quality or dividend stream of third parties' securities and other investment vehicles in which we have invested our assets, as well as other risks described in this report and other factors described from time to time in our filings with the SEC.

You should consider each of the following factors as well as the other information in this report and in our Annual Report on Form 10-K, as amended, for the fiscal year ended June 30, 2010, including our financial statements and the related notes, in evaluating our business and our prospects. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently consider immaterial may also negatively affect our business operations. In that case, the trading price of our common stock could decline.

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

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

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

In the past, we generally have been able to pass on increases in green coffee costs to our customers. However, there can be no assurance that we will be successful in passing such fluctuations on to our customers without losses in sales volume or gross margin in the future. Similarly, rapid, sharp decreases in the cost of green coffee could also force us to lower sales prices before realizing cost reductions in our green coffee inventory. Additionally, if green coffee beans from a region become unavailable or prohibitively expensive, we could be forced to use alternative coffee beans or discontinue certain blends, which could adversely impact our sales.

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

Table of Contents

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

Maintaining a steady supply of green coffee is essential to keep inventory levels low and secure sufficient stock to meet customer needs. To help ensure future supplies, we may purchase coffee on forward contracts for delivery as long as twelve months in the future. Non-performance by suppliers could expose us to credit and supply risk. Additionally, entering into such future commitments exposes us to purchase price risk. Because we are not always able to pass price changes through to our customers due to competitive pressures, unpredictable price changes can have an immediate effect on operating results that cannot be corrected in the short run. To reduce our potential price risk exposure we have, from time to time, entered into futures contracts to hedge coffee purchase commitments. Open contracts associated with these hedging activities are described in Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

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

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

OUR EXISTING CREDIT FACILITY EXPIRES IN FEBRUARY 2012. WE MAY BE UNABLE TO REPLACE OR RENEGOTIATE THIS CREDIT FACILITY ON ACCEPTABLE TERMS.

Our existing credit facility expires in February 2012. We may be unable to extend or replace this credit facility on terms acceptable to us, or at all, and there can be no assurance that additional lines-of-credit or financing instruments will be available in amounts or on terms acceptable to us, if at all. A lack or high cost of credit could limit our ability to obtain additional financing for working capital, capital expenditures, or other purposes in the future, as needed. If future cash flow from operations and other sources of funds are insufficient to fund our liquidity needs, we may be forced to reduce or delay our business activities and capital expenditures, sell assets, or obtain additional equity capital. A return to recent tight credit markets may make replacement financing more expensive and difficult to obtain. There can be no assurance that we will be able to refinance our credit facility on a timely basis or on satisfactory terms, if at all. The inability to obtain additional or replacement financing could have a material adverse effect on our liquidity.

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

We have a \$50 million senior secured revolving credit facility. As of January 15, 2011, approximately \$31.8 million was outstanding under this credit facility. Maintaining a large loan balance under our credit facility could adversely affect our business and limit our ability to plan for or respond to changes in our business. Additionally, our borrowings under the credit facility are at variable rates of interest, exposing us to the risk of interest rate volatility, which could lead to a decrease in our net income. Our debt obligations could also:

increase our vulnerability to general adverse economic and industry conditions;

require us to dedicate a portion of our cash flow from operations to payments on our indebtedness, thereby reducing the availability of our cash flow for other purposes, including the payment of dividends, funding daily operations, investing in future business opportunities and capital expenditures;

limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate thereby placing us at a competitive disadvantage compared to our competitors that may have less debt or debt with less restrictive debt covenants;

limit, by the financial and other restrictive covenants in our loan agreement, our ability to borrow additional funds; and

Table of Contents

have a material adverse effect on us if we fail to comply with the covenants in our loan agreement because such failure could result in an event of default which, if not cured or waived, could result in our indebtedness becoming immediately due and payable.

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

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

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

We maintain a significant portfolio of fixed-income based investments disclosed as cash equivalents and short term investments on our consolidated balance sheet. The value of our investments may be adversely affected by interest rate fluctuations, downgrades in credit ratings, illiquidity in the capital markets and other factors which may result in other than temporary declines in the value of our investments. Any of these events could cause us to record impairment charges with respect to our investment portfolio or to realize losses on the sale of investments. We seek to mitigate these risks with the help of our investment advisors by generally investing in high quality securities and continuously monitoring the overall risk of our portfolio. To date, we have not realized any material impairment within our investment portfolio. If the Company's operating losses continue, a portion or all of this investment portfolio may be liquidated to fund those losses.

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

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

WE MAY FAIL TO REALIZE THE EXPECTED SYNERGIES AND OTHER BENEFITS OF THE INTEGRATION OF THE DSD COFFEE BUSINESS, WHICH COULD ADVERSELY AFFECT OUR FUTURE RESULTS.

In fiscal 2010, we completed the integration of the DSD Coffee Business into our existing business. This was a complex, costly and time-consuming process which presented significant challenges and risks to our business, including:

distraction of management from ongoing business concerns;

assimilation and retention of employees and customers of the DSD Coffee Business;

differences in the culture of the DSD Coffee Business and the Company's culture;

unforeseen difficulties in integrating the DSD Coffee Business, including information systems and accounting controls;

Edgar Filing: FARMER BROTHERS CO - Form 10-Q

failure of the DSD Coffee Business to continue to generate income at the levels upon which we based our acquisition decision;

managing the DSD Coffee Business operations through offices in Downers Grove, Illinois, which is distant from the Company's headquarters in Torrance, California;

expansion into new geographical markets in which we have limited or no experience;

integration of technologies, services and products; and

achievement of appropriate internal control over financial reporting.

Table of Contents

We may fail to realize the operating efficiencies, synergies, economies of scale, cost savings and other benefits expected from the acquisition. We may fail to grow and build profits in the DSD Coffee Business or achieve sufficient cost savings through the integration of customers or administrative and other operational activities. Furthermore, we must achieve these objectives without adversely affecting our revenues. If we are not able to successfully achieve these objectives, the anticipated benefits of the acquisition may not be realized fully or at all, or it may take longer to realize them than expected, and our results of operations could be adversely affected.

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

There is increasing concern that a gradual increase in global average temperatures due to increased concentration of carbon dioxide and other greenhouse gases in the atmosphere have caused and will continue to cause significant changes in weather patterns around the globe and an increase in the frequency and severity of extreme weather events. Major weather phenomena like El Niño and La Niña are dramatically affecting coffee growing countries. The wet and dry seasons are becoming unpredictable in timing and duration causing improper development of the coffee cherries. Decreased agricultural productivity in certain regions as a result of changing weather patterns may affect the quality, limit availability or increase the cost of key agricultural commodities, such as green coffee, sugar and tea, which are important ingredients for our products. Increased frequency or duration of extreme weather conditions could also damage our facilities, impair production capabilities, disrupt our supply chain or impact demand for our products. As a result, the effects of climate change could have a long-term adverse impact on our business and results of operations.

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

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

incur additional indebtedness;

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

sell assets;

create liens on certain assets to secure debt; and

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

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

OUR INDUSTRY IS HIGHLY COMPETITIVE AND WE MAY NOT HAVE THE RESOURCES TO COMPETE EFFECTIVELY.

We primarily compete with other coffee companies, including multi-national firms with substantially greater financial, marketing and operating resources than the Company. We face competition from many sources including the food service divisions of multi-national manufacturers of retail products such as The J.M. Smucker Company (Folgers Coffee), Kraft Foods Inc. (Maxwell House Coffee) and Sara Lee Corporation, wholesale grocery distributors such as Sysco Corporation and U.S. Food Service, regional coffee roasters such as S & D Coffee, Inc. and Boyd Coffee Company, and specialty coffee suppliers such as Green Mountain Coffee Roasters, Inc. and Peet's Coffee & Tea, Inc. If we do not succeed in differentiating ourselves from our competitors or our competitors adopt our strategies, then our competitive position may be weakened. In addition, from time to time, we may need to reduce our prices in response to competitive and customer pressures and to maintain

our market share. Competition and customer pressures, however, also may restrict our ability to increase prices in response to commodity and other cost increases. Our results of operations will be adversely affected if our profit margins decrease, as a result of a reduction in prices or an increase in costs, and if we are unable to increase sales volumes to offset those profit margin decreases.

VOLATILITY IN THE EQUITY MARKETS OR INTEREST RATE FLUCTUATIONS COULD SUBSTANTIALLY INCREASE OUR PENSION COSTS AND NEGATIVELY IMPACT OUR OPERATING RESULTS.

At the end of fiscal 2010, the projected benefit obligation of our defined benefit pension plans was \$114.7 million and assets were \$66.0 million. The difference between plan obligations and assets, or the funded status of the plans, significantly affects the net periodic benefit costs of our pension plans and the ongoing funding requirements of those plans. Among other factors, changes in interest rates, mortality rates, early retirement rates, investment returns and the market value of plan assets can affect the level of plan funding, cause volatility in the net periodic pension costs, and increase our future funding requirements. We expect to make

Table of Contents

approximately \$4.9 million in contributions to our pension plans in fiscal 2011 and record an accrued expense of approximately \$9.8 million per year beginning in fiscal 2011. We have made approximately \$3.2 million in contributions to pension plans and recorded accrued pension expense of approximately \$4.8 million during the first half of fiscal 2011. These payments are expected to continue at this level for several years, and the current economic environment increases the risk that we may be required to make even larger contributions in the future.

OUR SALES AND DISTRIBUTION NETWORK IS COSTLY TO MAINTAIN.

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

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

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

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

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

For the purposes of analysis of our goodwill balances, our estimates of fair value were based on a combination of the income approach, which estimates the fair value of our reporting units based on the future discounted cash flows, and the market approach, which estimates the fair value of our reporting units based on comparable market prices. Our estimates of future cash flows included estimated growth rates and assumptions about the extent and duration of the current economic downturn and operating results of our subsidiary, CBI.

As of December 31, 2010, we had a goodwill balance of \$5.3 million. Goodwill impairment analysis and measurement is a process that requires significant judgment and the use of significant estimates related to valuation such as discount rates, long term growth rates and the level and timing of future cash flows. As a result, several factors could result in impairment of a material amount of our \$5.3 million goodwill balance in future periods, including, but not limited to:

a decline in our stock price and resulting market capitalization, if we determine that the decline is sustained and is indicative of a reduction in the fair value of any of our reporting units below its carrying value; and

further weakening of the economy or the failure of CBI to reach our internal forecasts thereby impacting our ability to achieve our forecasted levels of cash flows and reducing the estimated discounted cash flow value of our reporting units.

It is not possible at this time to determine if any such future impairment charge would result from these factors, or, if it does, whether such charge would be material. We will continue to review our goodwill and other intangible assets for possible impairment. We cannot be certain that a future downturn in CBI's business, changes in market conditions or a longer-term decline in the quoted market price of our stock will not result in an impairment of goodwill and the recognition of resulting expenses in future periods, which could adversely affect our results of operations for those periods.

We also test our other long-lived assets for impairment whenever events or changes in circumstances indicate that their carrying amount may be impaired. Failure to achieve our forecasted operating results, due to further weakness in the economic environment or other factors, could result

Edgar Filing: FARMER BROTHERS CO - Form 10-Q

in impairment of a significant amount of our long-lived intangible or tangible assets. As of December 31, 2010, we had \$23.4 million of long-lived intangible assets, including \$5.3 million of goodwill.

Table of Contents

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

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

CHANGES IN CONSUMER PREFERENCES COULD ADVERSELY AFFECT OUR BUSINESS.

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

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

We are self-insured for many risks up to significant deductible amounts. The premiums associated with our insurance continue to increase. General liability, fire, workers compensation, directors and officers liability, life, employee medical, dental and vision and automobile risks present a large potential liability. While we accrue for this liability based on historical experience, future claims may exceed claims we have incurred in the past. Should a different number of claims occur compared to what was estimated or the cost of the claims increase beyond what was anticipated, reserves recorded may not be sufficient and the accruals may need to be adjusted accordingly in future periods.

OUR ROASTING AND BLENDING METHODS ARE NOT PROPRIETARY, SO COMPETITORS MAY BE ABLE TO DUPLICATE THEM, WHICH COULD HARM OUR COMPETITIVE POSITION.

We consider our roasting and blending methods essential to the flavor and richness of our coffees and, therefore, essential to our brand. Because our roasting methods cannot be patented, we would be unable to prevent competitors from copying these methods if such methods became known. If our competitors copy our roasts or blends, the value of our brand may be diminished, and we may lose customers to our competitors. In addition, competitors may be able to develop roasting or blending methods that are more advanced than our production methods, which may also harm our competitive position.

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

Our operating results may fluctuate from period to period or within certain periods as a result of a number of factors, including fluctuations in the price and supply of green coffee, fluctuations in the selling prices of our products, the success of our hedging strategy, competition from existing or new competitors in our industry, changes in consumer preferences, and our ability to manage inventory and fulfillment operations and maintain gross margins. Fluctuations in our operating results as a result of these factors or for any other reason, could cause our stock price to decline. Accordingly, we believe that period-to-period comparisons of our operating results are not necessarily meaningful, and such comparisons should not be relied upon as indicators of future performance.

OPERATING LOSSES MAY CONTINUE AND, AS A RESULT, THE PRICE OF OUR STOCK MAY BE NEGATIVELY AFFECTED.

We have incurred an operating loss and a net loss for each of the prior three fiscal years. If our current strategies are unsuccessful we may not achieve the levels of sales and earnings we expect. As a result, we could suffer additional losses in future years and our stock price could decline.

Table of Contents

FUTURE FUNDING DEMANDS UNDER PENSION PLANS FOR CERTAIN UNION EMPLOYEES ARE UNKNOWN.

We participate in several multi-employer defined benefit plans for certain union employees. The management, funding status and future viability of these plans is not known at this time. The nature of the contract with these plans allows for future funding demands that are outside our control or ability to estimate.

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

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

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

As of February 8, 2011, members of the Farmer family or entities controlled by the Farmer family (including trusts and a family partnership) as a group beneficially owned approximately 40% of our outstanding common stock. As a result, these stockholders, acting together, may be able to influence the outcome of stockholder votes, including votes concerning the election and removal of directors and approval of significant corporate transactions. This level of concentrated ownership may have the effect of delaying or preventing a change in the management or voting control of the Company. In addition, this significant concentration of share ownership may adversely affect the trading price of our common stock if investors perceive disadvantages in owning stock in a company with such concentrated ownership.

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

All of our outstanding shares are eligible for sale in the public market, subject in certain cases to limitations under Rule 144 of the Securities Act of 1933, as amended (the Securities Act). Also, shares subject to outstanding options and restricted stock under the Farmer Bros. Co. 2007 Omnibus Plan (the Omnibus Plan) are eligible for sale in the public market to the extent permitted by the provisions of various vesting agreements, our stock ownership guidelines, and Rule 144 under the Securities Act. If these shares are sold, or if it is perceived that they will be sold in the public market, the trading price of our common stock could decline.

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

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

In addition, our Board of Directors has the authority to issue up to 500,000 shares of preferred stock (of which 200,000 shares have been designated as Series A Junior Participating Preferred Stock) and to determine the price, rights, preferences, privileges and restrictions, including voting rights, of those shares without any further vote or action by stockholders. The rights of the holders of our common stock may be subject to, and may be adversely affected by, the rights of the holders of any preferred stock that may be issued in the future. The issuance of preferred stock may have the effect of delaying, deterring or preventing a change of control of the Company without further action by stockholders and may adversely affect the voting and other rights of the holders of our common stock.

Further, certain provisions of our charter documents, including a classified board of directors, provisions eliminating the ability of stockholders to take action by written consent, and provisions limiting the ability of stockholders to raise matters at a meeting of stockholders without giving advance notice, may have the effect of delaying or preventing changes in control or management of the Company, which could have an adverse effect on the market price of our stock. In addition, our charter documents do not permit

Table of Contents

cumulative voting, which may make it more difficult for a third party to gain control of our Board of Directors. Further, we are subject to the anti-takeover provisions of Section 203 of the Delaware General Corporation Law, which will prohibit us from engaging in a business combination with an interested stockholder for a period of three years after the date of the transaction in which the person became an interested stockholder, even if such combination is favored by a majority of stockholders, unless the business combination is approved in a prescribed manner. The application of Section 203 also could have the effect of delaying or preventing a change of control or management.

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

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

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

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

Similarly, instances or reports, whether true or not, of unclean water supply, food-borne illnesses and food tampering have in the past severely injured the reputations of companies in the food processing sector and could in the future affect us as well. Any report linking us to the use of unclean water, food-borne illnesses or food tampering could damage the value of our brands, negatively impact sales of our products, and potentially lead to product liability claims. Clean water is critical to the preparation of coffee beverages. We have no ability to ensure that our customers use a clean water supply to prepare coffee beverages.

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

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

Table of Contents

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

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

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

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

Item 6. Exhibits

See Exhibit Index.

Table of Contents**SIGNATURES**

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

Name	Title	Date
/s/ ROGER M. LAVERTY III	President and Chief Executive Officer	February 9, 2011
Roger M. Lavery III	(principal executive officer)	
/s/ JEFFREY A. WAHBA	Treasurer and Chief Financial Officer	February 9, 2011
Jeffrey A. Wahba	(principal financial officer)	

Table of Contents

EXHIBIT INDEX

- 3.1 Certificate of Incorporation (filed as Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2009 filed with the SEC on May 11, 2009 and incorporated herein by reference).
- 3.2 Amended and Restated Bylaws (filed as Exhibit 3.2 to the Company's Current Report on Form 8-K filed with the SEC on June 8, 2006 and incorporated herein by reference).
- 4.1 Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock (filed as Exhibit 4.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2010 filed with the SEC on May 10, 2010 and incorporated herein by reference).
- 4.2 Rights Agreement, dated March 17, 2005, by and between Farmer Bros. Co. and Wells Fargo Bank, N.A., as Rights Agent (filed as Exhibit 4.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2010 filed with the SEC on May 10, 2010 and incorporated herein by reference).
- 4.3 Specimen Stock Certificate (filed as Exhibit 4.1 to the Company's Form 8-A/A filed with the SEC on February 6, 2009 and incorporated herein by reference).
- 10.1 Asset Purchase Agreement dated as of December 2, 2008, by and among Sara Lee Corporation, Samar, LLC and Farmer Bros. Co. (filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2008 filed with the SEC on February 10, 2009 and incorporated herein by reference).
- 10.2 Amendment No. 1 to Asset Purchase Agreement, dated February 27, 2009, by and among Sara Lee Corporation, Samar, LLC and Farmer Bros. Co. (filed as Exhibit 10.2 to the Company's Annual Report on Form 10-K/A for the fiscal year ended June 30, 2009 filed with the SEC on September 15, 2009 and incorporated herein by reference).
- 10.3 Second Amendment to Asset Purchase Agreement, dated December 17, 2009, by and among Sara Lee Corporation, Samar, LLC and Farmer Bros. Co. (filed as Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2009 and incorporated herein by reference).
- 10.4 Stock Purchase Agreement, dated April 27, 2007, by and among Farmer Bros. Co., Coffee Bean Holding Co., Inc., and the Stockholders of Coffee Bean Holding Co., Inc. (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on May 1, 2007 and incorporated herein by reference).
- 10.5 Loan and Security Agreement, dated March 2, 2009, by and among Farmer Bros. Co. and Coffee Bean International, Inc., as Borrowers, Coffee Bean Holding Co., Inc., FBC Finance Company and SL Realty, LLC, as Guarantors, and Wells Fargo Bank, National Association, successor by merger to Wachovia Bank, National Association, as Lender (filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2008 filed with the SEC on February 10, 2009 and incorporated herein by reference).
- 10.6 Amendment No. 1 to Loan and Security Agreement and Consent, dated March 2, 2009, by and among Farmer Bros. Co. and Coffee Bean International, Inc., as Borrowers, Coffee Bean Holding Co., Inc. and FBC Finance Company, as Guarantors, and Wells Fargo Bank, National Association, successor by merger to Wachovia Bank, National Association, as Lender (filed as Exhibit 10.5 to the Company's Annual Report on Form 10-K/A for the fiscal year ended June 30, 2009 filed with the SEC on September 15, 2009 and incorporated herein by reference).
- 10.7 Amendment No. 2 to Loan and Security Agreement and Consent, dated July 27, 2009, by and among Farmer Bros. Co. and Coffee Bean International, Inc., as Borrowers, Coffee Bean Holding Co., Inc. and FBC Finance Company, as Guarantors, and Wells Fargo Bank, National Association, successor by merger to Wachovia Bank, National Association, as Lender (filed as Exhibit 10.6 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2009 filed with the SEC on November 9, 2009 and incorporated herein by reference).
- 10.8 Amendment No. 3 to Loan and Security Agreement, dated November 20, 2009, by and among Farmer Bros. Co. and Coffee Bean International, Inc., as Borrowers, Coffee Bean Holding Co., Inc. and FBC Finance Company, as Guarantors, and Wells Fargo Bank, National Association, successor by merger to Wachovia Bank, National Association, as Lender (filed as

Table of Contents

- Exhibit 10.8 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2009 filed with the SEC on February 9, 2010 and incorporated herein by reference).
- 10.9 Amendment No. 4 to Loan and Security Agreement and Consent, dated August 31, 2010, by and among Farmer Bros. Co. and Coffee Bean International, Inc., as Borrowers, Coffee Bean Holding Co., Inc. and FBC Finance Company, as Guarantors, and Wells Fargo Bank, National Association, successor by merger to Wachovia Bank, National Association, as Lender (filed as Exhibit 10.9 to the Company's Annual Report on Form 10-K/A for the year ended June 30, 2010 filed with the SEC on September 14, 2010 and incorporated herein by reference).
- 10.10 Letter Agreement regarding Waiver of Event of Default dated May 7, 2010, by and among Farmer Bros. Co. and Coffee Bean International, Inc., as Borrowers, Coffee Bean Holding Co., Inc. and FBC Finance Company, as Guarantors, and Wells Fargo Bank, National Association, successor by merger to Wachovia Bank, National Association, as Lender (filed as Exhibit 10.9 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2010 filed with the SEC on May 10, 2010 and incorporated herein by reference).
- 10.11 Farmer Bros. Co. 2005 Incentive Compensation Plan (Amended and Restated as of December 31, 2008) (filed as Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2008 filed with the SEC on February 10, 2009 and incorporated herein by reference).*
- 10.12 Farmer Bros. Co. Amended and Restated Employee Stock Ownership Plan, as adopted by the Board of Directors on December 9, 2010 and effective as of January 1, 2010 (filed herewith).*
- 10.13 ESOP Loan Agreement including ESOP Pledge Agreement and Promissory Note, dated March 28, 2000, between Farmer Bros. Co. and Wells Fargo Bank, N.A., Trustee for the Farmer Bros Co. Employee Stock Ownership Plan (filed herewith).
- 10.14 Amendment No. 1 to ESOP Loan Agreement, dated June 30, 2003, between Farmer Bros. Co. and Wells Fargo Bank, N.A., Trustee for the Farmer Bros Co. Employee Stock Ownership Plan (filed herewith).
- 10.15 ESOP Loan Agreement No. 2 including ESOP Pledge Agreement and Promissory Note, dated July 21, 2003 between Farmer Bros. Co. and Wells Fargo Bank, N.A., Trustee for the Farmer Bros Co. Employee Stock Ownership Plan (filed herewith).
- 10.16 Employment Agreement, dated as of June 2, 2006, by and between Farmer Bros. Co. and Roger M. Lavery III (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on June 8, 2006 and incorporated herein by reference).*
- 10.17 Amendment No. 1 to Employment Agreement, dated as of December 5, 2007, by and between Farmer Bros. Co. and Roger M. Lavery III (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K/A filed with the SEC on December 11, 2007 and incorporated herein by reference).*
- 10.18 Amendment No. 2 to Employment Agreement, dated as of December 31, 2008, by and between Farmer Bros. Co. and Roger M. Lavery III (filed as Exhibit 10.13 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2008 filed with the SEC on February 10, 2009 and incorporated herein by reference).*
- 10.19 Employment Agreement, dated as of March 14, 2009, by and between Farmer Bros. Co. and Heidi L. Modaro (filed as Exhibit 10.15 to the Company's Annual Report on Form 10-K/A for the fiscal year ended June 30, 2009 filed with the SEC on September 15, 2009 and incorporated herein by reference).*
- 10.20 Employment Agreement, dated as of February 25, 2010, by and between Farmer Bros. Co. and Jeffrey A. Wahba (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on March 3, 2010 and incorporated herein by reference).*
- 10.21 Consulting Agreement, dated as of March 2, 2009, by and between Farmer Bros. Co. and Michael J. King (filed as Exhibit 10.16 to the Company's Annual Report on Form 10-K/A for the fiscal year ended June 30, 2009 filed with the SEC on September 15, 2009 and incorporated herein by reference).*

Table of Contents

- 10.22 Interim Services Agreement, dated as of December 17, 2009, by and between Farmer Bros. Co. and Tatum, LLC (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on February 10, 2010 and incorporated herein by reference).*
- 10.23 2007 Omnibus Plan (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on August 29, 2007 and incorporated herein by reference).*
- 10.24 Form of 2007 Omnibus Plan Stock Option Grant Notice and Stock Option Agreement (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on February 26, 2008 and incorporated herein by reference).*
- 10.25 Form of 2007 Omnibus Plan Restricted Stock Award Grant Notice and Restricted Stock Award Agreement (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the SEC on February 26, 2008 and incorporated herein by reference).*
- 10.26 Stock Ownership Guidelines for Directors and Executive Officers (filed as Exhibit 10.3 to the Company's Current Report on Form 8-K filed with the SEC on February 26, 2008 and incorporated herein by reference).*
- 10.27 Form of Target Award Notification Letter (Fiscal 2011) under Farmer Bros. Co. 2005 Incentive Compensation Plan (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on September 30, 2010 and incorporated herein by reference).*
- 10.28 Form of Target Award Notification Letter (Fiscal 2010) under Farmer Bros. Co. 2005 Incentive Compensation Plan (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the SEC on December 16, 2009 and incorporated herein by reference).*
- 10.29 Form of Change in Control Severance Agreement for Executive Officers of the Company (with schedule of executive officers attached) (filed herewith).*
- 10.30 Form of Indemnification Agreement for Directors and Officers of the Company, as adopted on May 18, 2006 and as amended on December 31, 2008 (with schedules of indemnitees attached) (filed herewith).*
- 31.1 Principal Executive Officer Certification Pursuant to Securities Exchange Act Rules 13a-14 and 15d-14 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
- 31.2 Principal Financial and Accounting Officer Certification Pursuant to Securities Exchange Act Rules 13a-14 and 15d-14 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
- 32.1 Principal Executive Officer Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).
- 32.2 Principal Financial and Accounting Officer Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).

* Management contract or compensatory plan or arrangement.