CENTRAL GARDEN & PET CO
Form 10-Q
September 09, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 28, 2008

or

¨ **TRANSITION REPORT PURSUANT OF SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _________ to _________

Commission File Number: 001-33268

CENTRAL GARDEN & PET COMPANY

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

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

(Address of principle executive offices)

(925) 948-4000

(Registrant s telephone number, including area code)

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

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

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

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

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

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

Common Stock Outstanding as of August 31, 2008	21,006,884
Class A Common Stock Outstanding as of August 31, 2008	48,462,453
Class B Stock Outstanding as of August 31, 2008	1,652,262

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PART I. FINANCIAL INFORMATION

PART II. OTHER INFORMATION

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

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

There are a number of risks and uncertainties that could cause our actual results to differ materially from the forward-looking statements contained in this Form 10-Q. Important factors that could cause our actual results to differ materially from the forward-looking statements we make in this Form 10-Q are set forth in our Form 10-K for the fiscal year ended September 29, 2007, including the factors described in the section entitled Risk Factors and in Part II Item 1A below. If any of these risks or uncertainties materialize, or if any of our underlying assumptions are incorrect, our actual results may differ significantly from the results that we express in or imply by any of our forward-looking statements. We do not undertake any obligation to revise these forward-looking statements to reflect future events or circumstances. Presently known risk factors include, but are not limited to, the following factors:

- seasonality and fluctuations in our operating results and cash flow;
- fluctuations in market prices for seeds and grains;

supply shortages in small animals and pet birds;

adverse weather conditions;

declines in consumer spending during economic downturns;

inability to comply with the terms of our indebtedness;

- limitations in our debt capacity as a result of deterioration in operating results coupled with our current outstanding indebtedness and seasonal borrowing needs;
- dependence on a few customers for a significant portion of our business;
- consolidation trends in the retail industry;
- uncertainties about new product innovations and our marketing programs;
- competition in our industries;
- risks associated with our acquisition strategy;
- dependence upon our key executive officers;
- rising energy prices, fuel and related petrochemical costs;
- implementation of a new enterprise resource planning information technology system over the next several years;
- potential environmental liabilities;
- risk associated with international sourcing;
- litigation and product liability claims; and
- the voting power associated with our Class B stock.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CENTRAL GARDEN & PET COMPANY

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share amounts)

(unaudited)

	September 29, 2007	June 28, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 21,055	$ 8,522
Accounts receivable (less allowance for doubtful accounts of $13,803 and $14,581)	247,429	292,746
Inventories	378,365	371,052
Prepaid expenses and other	38,659	36,767
Total current assets	685,508	709,087
Land, buildings, improvements and equipment net	201,609	194,064
Goodwill	598,758	201,624
Other intangible assets net	100,314	110,710
Deferred income taxes and other assets	60,633	119,016
Total	$ 1,646,822	$ 1,334,501
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 135,972	$ 118,611
Accrued expenses	75,968	102,014
Current portion of long-term debt	3,352	3,350
Total current liabilities	215,292	223,975
Long-term debt	607,171	580,494
Other long-term obligations	44,802	4,606
Convertible redeemable preferred stock	750	
Minority interest	1,834	2,741
Shareholders equity:		
Common stock, $.01 par value: 22,297,985 and 21,301,689 shares outstanding at September 29, 2007 and June 28, 2008	221	213
Class A common stock, $.01 par value: 47,860,603 and 48,232,340 shares outstanding at September 29, 2007 and June 28, 2008	478	482
Class B stock, $.01 par value: 1,652,262 shares outstanding	16	16
Additional paid-in capital	553,728	554,609
Retained earnings (accumulated deficit)	217,335	(36,553)
Accumulated other comprehensive income	5,195	3,918
Total shareholders equity	776,973	522,685

Total	$ 1,646,822	$ 1,334,501

See notes to condensed consolidated financial statements.

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CENTRAL GARDEN & PET COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended		Nine Months Ended	
	June 30, 2007	June 28, 2008	June 30, 2007	June 28, 2008
Net sales	$ 466,778	$ 492,937	$ 1,269,836	$ 1,291,410
Cost of goods sold and occupancy	315,638	339,990	852,980	884,331
Gross profit	151,140	152,947	416,856	407,079
Selling, general and administrative expenses	113,948	119,079	327,509	319,175
Impairment of goodwill				400,000
Income (loss) from operations	37,192	33,868	89,347	(312,096)
Interest expense	(13,198)	(9,346)	(37,296)	(30,631)
Interest income	292	360	1,257	914
Other income	1,194	783	2,879	2,457
Income (loss) before income taxes (tax benefit) and minority interest	25,480	25,665	56,187	(339,356)
Income taxes (tax benefit)	9,495	9,574	20,904	(86,837)
Minority interest	470	443	1,284	906
Net income (loss)	$ 15,515	$ 15,648	$ 33,999	$ (253,425)
Net income (loss) per share:				
Basic	$ 0.22	$ 0.22	$ 0.48	$ (3.55)
Diluted	$ 0.22	$ 0.22	$ 0.47	$ (3.55)
Weighted average shares used in the computation of net income (loss) per share:				
Basic	70,910	71,493	70,730	71,367
Diluted	72,048	72,148	72,066	71,367

See notes to condensed consolidated financial statements.

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CENTRAL GARDEN & PET COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Nine Months Ended	
	June 30, 2007	June 28, 2008
Cash flows from operating activities:		
Net income (loss)	$ 33,999	$ (253,425)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	21,875	24,421
Stock-based compensation	3,723	9,107
Excess tax benefits from stock-based awards	(1,932)	(31)
Minority interest	1,284	906
Deferred income taxes	(1,423)	(110,624)
Gain on sales of property	(74)	(7,931)
Loss on sale of a business and equipment		1,713
Impairment of goodwill		400,000
Other impairments		2,000
Change in assets and liabilities (excluding businesses acquired):		
Accounts receivable	(37,232)	(44,974)
Inventories	(48,605)	8,545
Prepaid expenses and other assets	(6,514)	3,309
Accounts payable	16,943	(19,647)
Accrued expenses	15,787	16,152
Other long-term obligations	(730)	(1,382)
Net cash (used in) provided by operating activities	(2,899)	28,139
Cash flows from investing activities:		
Additions to property and equipment	(47,462)	(17,311)
Proceeds from property sales, net of expenses		12,053
Businesses acquired, net of cash acquired	(19,612)	(4,998)
Collection of note	3,340	
Restricted investments	292	(265)
Net cash used in investing activities	(63,442)	(10,521)
Cash flows from financing activities:		
Borrowings on revolving line of credit	665,000	595,000
Repayments of revolving line of credit	(615,000)	(621,000)
Repayments of long-term debt	(2,114)	(1,772)
Proceeds from issuance of common stock	4,258	1,430
Repurchase of common stock		(3,101)
Redemption of preferred stock		(750)
Excess tax benefits from stock-based awards	1,932	31
Payment of financing costs	(416)	(50)
Net cash provided by (used in) financing activities	53,660	(30,212)

Effect of exchange rate changes on cash and cash equivalents		90		61
Net decrease in cash and cash equivalents		(12,591)		(12,533)
Cash and equivalents at beginning of period		28,406		21,055
Cash and equivalents at end of period	$	15,815	$	8,522
Supplemental information:				
Cash paid for interest	$	34,566	$	28,258
Cash paid for income taxes net of refunds	$	2,954	$	8,333
Liabilities assumed in connection with acquisitions	$	3	$	1,505
Conversion of preferred stock to common stock	$	2,250	$	
Note receivable from sale of property	$		$	3,850
Repurchased shares settled but not paid	$		$	1,394

See notes to condensed consolidated financial statements.

CENTRAL GARDEN & PET COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Three and Nine Months Ended June 28, 2008

(unaudited)

1. Basis of Presentation

The condensed consolidated balance sheet of Central Garden & Pet Company and subsidiaries (the Company or Central) as of June 28, 2008, the condensed consolidated statements of operations for the three and nine months ended June 30, 2007 and June 28, 2008 and the condensed consolidated statements of cash flows for the nine months ended June 30, 2007 and June 28, 2008 have been prepared by the Company, without audit. In the opinion of management, all adjustments (which include only normal recurring adjustments, except as discussed in note 2) considered necessary to present fairly the financial position, results of operations and cash flows of the Company for the periods mentioned above, have been made.

For the Company s foreign business in the UK, the local currency is the functional currency. Assets and liabilities are translated using the exchange rate in effect at the balance sheet date. Income and expenses are translated at the average exchange rate for the period. For the nine month period ended June 28, 2008, there was a comprehensive loss of $254.7 million, which includes a net loss of $253.4 million and foreign currency translation losses of $1.3 million that are excluded from net earnings but reported in accumulated other comprehensive income, a separate component of shareholders equity. For the nine month period ended June 30, 2007, comprehensive income was $36.7 million, which included net income of $34.0 million and foreign currency translation gains of $2.7 million. Deferred taxes are not provided on translation gains and losses, because the Company expects earnings of its foreign subsidiary to be permanently reinvested. Transaction gains and losses are included in results of operations.

Due to the seasonal nature of the Company s garden business, the results of operations for the three and nine month periods ended June 28, 2008 are not indicative of the operating results that may be expected for the entire fiscal year. These interim financial statements should be read in conjunction with the annual audited financial statements, accounting policies and financial notes thereto, included in the Company s 2007 Annual Report on Form 10-K, which has previously been filed with the Securities and Exchange Commission.

Minority Interest

Minority interest in the Company s condensed consolidated financial statements represents the 20% interest not owned by Central in a consolidated subsidiary. Since the Company controls this subsidiary, its financial statements are fully consolidated with those of the Company, and the minority owner s 20% share of the subsidiary s net assets and results of operations is deducted and reported as minority interest.

Repurchase of Company Stock

During the quarter ended June 28, 2008, we repurchased 977,000 shares of our voting common stock at an aggregate cost of approximately $4.5 million, or approximately $4.60 per share. Subsequent to quarter-end, we repurchased an additional 302,200 shares during the first week of July 2008 for approximately $1.4 million.

Recent Accounting Pronouncements Effective September 30, 2007, the Company adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109 (FIN 48). As a result of the implementation of FIN 48, the Company recognized a $0.5 million increase in its reserve for uncertain tax positions and a cumulative effect adjustment to decrease retained earnings. At the adoption date, the Company had $1.6 million of unrecognized tax benefits, $0.8 million of which would affect the effective tax rate if recognized. The Company has not recorded any significant changes to the unrecognized tax benefits during the current fiscal year and does not anticipate that there will be any significant changes to these unrecognized tax benefits within the next twelve months.

Interest and penalties related to uncertain tax positions are recognized in income tax expense. As of the adoption date, the Company had approximately $0.4 million of accrued interest and penalties related to uncertain tax positions.

The Company s major taxing jurisdictions are the United States and various states. Tax years 2004 through 2007 for the Internal Revenue Service and 2002 through 2007 for various states remain open to examination. The Company does not believe that the outcome of any examination will have a material impact on the Company s financial statements.

In March 2008, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 161, Disclosures about Derivative Instruments and Hedging Activities an Amendment of FASB Statement 133. SFAS No. 161 enhances required disclosures regarding derivatives and hedging activities, including enhanced disclosures regarding how: (a) an entity uses derivative instruments; (b) derivative instruments and related hedged items are accounted for under SFAS No. 133, Accounting for Derivatives and Hedging Activities; and (c) derivative instruments and related hedged items affect an entity s financial position, financial performance and cash flows. SFAS No. 161 is effective for the Company in its fiscal year beginning September 27, 2009. The Company is currently evaluating the impact of SFAS No. 161 on its consolidated financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 141(R) Business Combinations, which establishes accounting principles and disclosure requirements for all transactions in which a company obtains control over another business. This accounting pronouncement is effective prospectively for businesses acquired by the Company in its fiscal year beginning September 27, 2009. The Company is currently evaluating the impact of SFAS No. 141(R) on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements, an amendment to ARB No. 51. This standard prescribes the accounting by a parent company for minority interests held by other parties in a subsidiary of the parent company. SFAS No. 160 is effective for the Company in its fiscal year beginning September 27, 2009. The Company is currently evaluating the impact of SFAS No. 160 on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, which provides companies an option to report selected financial assets and liabilities at fair value. SFAS No. 159 requires companies to provide information to assist financial statement users to understand the effect of a company s choice to use fair value on its earnings, as well as to display on the face of the balance sheet the fair value of assets and liabilities chosen by the company for fair value accounting. Additionally, SFAS No. 159 establishes presentation and disclosure requirements designed to simplify comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 is effective for the Company in its fiscal year beginning September 28, 2008. The Company is currently evaluating the impact of SFAS No. 159 on its consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. SFAS No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The standard also establishes a framework for measuring fair value and provides for expanded disclosures about fair value measurements. SFAS No. 157 is effective for the Company s fiscal year beginning September 28, 2008. The Company is currently evaluating the impact of SFAS No. 157 on its consolidated financial statements.

2. Goodwill

The Company accounts for goodwill in accordance with SFAS No. 142, Goodwill and Other Intangible Assets, and tests goodwill for impairment annually, or whenever events occur or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. This assessment involves the use of significant accounting judgments and estimates as to future operating results and discount rates. Changes in estimates or use of different assumptions could produce significantly different results. An impairment loss is generally recognized when the carrying amount of the reporting unit s net assets exceeds the estimated fair value of the reporting unit. The Company uses discounted cash flow analysis to estimate the fair value of its reporting units. Current accounting convention also requires a comparison of current market capitalization to book value.

Based on the Company s most recent annual impairment test as of July 1, 2007, the Company determined that there was no goodwill impairment as of September 29, 2007. However, due to the continuing depressed stock price, as of December 29, 2007, shareholders equity (book value) was approximately $775 million and the market capitalization was approximately $390 million. As a result, the Company concluded there was an indicator of possible goodwill impairment as of December 29, 2007.

Accordingly, the Company updated its analysis and evaluation of goodwill for possible impairment as of December 29, 2007, which included a comparison of market capitalization to the combined fair values of the Company s four reporting units. Based on the Company s updated analysis and sustained decline in market capitalization, the Company determined that it was required to take a non-cash charge of $400 million in the first fiscal quarter to recognize the impairment of goodwill, comprised of $202 million relating to the Garden Segment and $198 million relating to the Pet Segment. This non-cash charge of $400 million reduced the Company s net earnings for the nine months ended June 28, 2008 by $290.4 million, or $4.07 per share.

The Company will perform its annual goodwill impairment test as of June 29, 2008, the first day of the fourth quarter of fiscal 2008.

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3. Long-Term Debt

As of June 28, 2008, the Company had $650 million in senior secured credit facilities consisting of a $350 million revolving credit facility maturing in February 2011 and a $300 million term loan maturing in September 2012. Interest on the revolving credit facility is based on a rate equal to prime plus a margin, which fluctuates from 0% to 0.375%, or LIBOR plus a margin, which fluctuates from 0.75% to 1.50%, determined quarterly based on consolidated total debt to consolidated EBITDA for the most recent trailing 12-month period. Interest on the term loan is based on a rate equal to LIBOR plus a margin, which fluctuates from 1.50% to 1.75% or the prime rate plus a margin, which fluctuates from 0.50% to 0.75%, at the Company s option. The August 2007 amendment provides that the margin on loans increases when the leverage ratio exceeds 4.5 to 1.0. The term loan is payable in quarterly installments of $750,000 with the balance payable in September 2012. These facilities are secured by substantially all of the Company s assets and contain certain financial covenants which require the Company to maintain minimum levels of interest coverage and maximum levels of total debt to EBITDA and that restrict the Company s ability to repurchase stock, make investments in or acquisitions of other businesses and pay dividends above certain levels over the life of the facilities.

The Company was in compliance with all financial covenants as of June 28, 2008. There was $138.0 million outstanding at June 28, 2008 under the $350 million revolving credit facility plus $15.8 million outstanding under certain letters of credit. The remaining potential available borrowing capacity was up to $196.2 million. The Company s borrowing capacity is also subject to compliance with the financial covenants in these credit agreements. As of June 28, 2008, our interest coverage ratio was 3.4 to 1.0 and our leverage ratio was 4.1 to 1.0, and we were in compliance with all financial covenants.

4. Stock-Based Compensation

The Company has various non-qualified stock-based compensation programs, which provide for stock option grants and restricted stock awards. The grant date fair values of stock options and restricted stock awards are amortized over the vesting period. Stock options may be granted to officers, key employees and directors. The Company accounts for stock-based awards in accordance with SFAS No. 123(R), Share-Based Payment. Stock compensation expense is recognized over the requisite service period using the straight-line attribution method.

Stock options are generally granted with 30 month cliff vesting and 42 month expiration, but are also granted with graded vesting increments of 20% or 25% per year and expiring up to eight years from the date of grant. In fiscal 2008, 5.1 million performance options were granted that vest based on pre-determined Company goals for each of the next five years and expire at the end of the sixth year. Of the options granted in fiscal 2008, approximately 216,000 options scheduled to possibly vest in each of fiscal year 2009 and 2010 were amended and are now only subject to service vesting conditions. We currently estimate the performance-based options are probable of achievement and are recording the related expense over the estimated service period using the accelerated method. To the extent Company goals are not achieved, the amount of stock-based compensation recognized in the future will be adjusted.

During 2004 and 2005, respectively, the Company granted service-based nonvested stock option awards that were due to expire in June 2008 and June 2009. The grant price of the option awards were approximately $12 to $15 per share, significantly in excess of the current market price. In 2008, the Company modified options to purchase 1.4 million of these shares held by non-executive employees to extend the expiration date of these awards by three years. The primary purpose of the extended expiration was to encourage retention. The change to the expiration terms will result in an increase in stock-based compensation expense of approximately $0.1 million in fiscal 2008.

The Company recognized share-based compensation expense of $2.3 million and $1.4 million for the three month periods ended June 28, 2008 and June 30, 2007, respectively, and $9.1 million and $3.7 million for the nine month periods ended June 28, 2008 and June 30, 2007, respectively as a component of selling, general and administrative expenses.

The fair value of each option award is estimated on the date of grant using the Black-Scholes option valuation model. Expected stock price volatilities are estimated based on the Company s historical volatility. The expected term of options granted is based on analyses of historical employee termination rates and option exercises. The risk-free rates are based on U.S. Treasury yields, for notes with comparable terms as the option grants, in effect at the time of the grant. For purposes of this valuation model, no dividends have been assumed. Assumptions for the nine month periods ended June 28, 2008 and June 30, 2007 used in the Black-Scholes model are presented below:

	June 28, 2008	June 30, 2007
Stock plans:		
Average expected life in years	4 years	4 years

Expected volatility	31%	28%
Risk-free interest rate	2.7%	4.6%

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The following table summarizes option activity for the nine months ended June 28, 2008:

	Number of Shares (in thousands)	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding at September 29, 2007	4,724	$ 12.89	3 years	$ 32
Granted	5,325	$ 9.02		
Exercised	(42)	$ 4.60		
Cancelled or expired	(561)	$ 13.46		
Outstanding at June 28, 2008	9,446	$ 10.71	5 years	$ 30
Exercisable at June 28, 2008	1,646	$ 13.81	3 years	$ 1
Expected to vest after June 28, 2008	7,448	$ 10.06	5 years	$ 29

The weighted average per share fair value of options granted during the nine months ended June 28, 2008 and June 30, 2007 was $0.63 and $4.12, respectively. The total intrinsic value of options exercised during the nine months ended June 28, 2008 and June 30, 2007 was $0.1 million and $6.5 million, respectively.

As of June 28, 2008, there was approximately $7.4 million of total unrecognized compensation cost related to nonvested stock options, which is expected to be recognized over a remaining weighted-average vesting period of three years.

Restricted Stock Awards: As of June 28, 2008, there were 0.6 million shares of restricted stock awards outstanding. The awards generally vest in 20% or 25% annual increments beginning two or three years from the date of grant.

The following table summarizes restricted stock award activity during the nine months ended June 28, 2008:

	Number of Shares (in thousands)
Nonvested at September 29, 2007	648
Granted	453
Vested	(446)
Forfeited	(60)
Nonvested at June 28, 2008	595

The weighted average per share grant-date fair value of restricted stock awards granted during the first nine months of fiscal 2008 and fiscal 2007 was $4.29 and $14.78, respectively.

As of June 28, 2008, there was approximately $5.3 million of unrecognized compensation cost related to nonvested restricted stock awards, which is expected to be recognized over a remaining weighted-average period of two years.

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5. Earnings per Share

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

	Three Months Ended June 28, 2008			Nine Months Ended June 28, 2008		
	Income	Shares	Per Share	Income (Loss)	Shares	Per Share
	(in thousands, except per share amounts)					
Basic EPS:						
Net income (loss) available to common shareholders	$ 15,648	71,493	$ 0.22	$ (253,425)	71,367	$ (3.55)
Effect of dilutive securities:						
Options to purchase common stock		63				
Restricted shares		592				
Diluted EPS:						
Net income (loss) available to common shareholders	$ 15,648	72,148	$ 0.22	$ (253,425)	71,367	$ (3.55)

	Three Months Ended June 30, 2007			Nine Months Ended June 30, 2007		
	Income	Shares	Per Share	Income	Shares	Per Share
	(in thousands, except per share amounts)					
Basic EPS:						
Net income available to common shareholders	$ 15,515	70,910	$ 0.22	$ 33,999	70,730	$ 0.48
Effect of dilutive securities:						
Options to purchase common stock		403			587	
Restricted Shares		670			684	(0.01)
Convertible preferred stock		65			65	
Diluted EPS:						
Net income available to common shareholders	$ 15,515	72,048	$ 0.22	$ 33,999	72,066	$ 0.47

Options to purchase 9,446,652 shares of common stock at prices ranging from $4.26 to $17.99 per share were outstanding at June 28, 2008 and options to purchase 4,891,000 shares of common stock at prices ranging from $4.26 to $17.99 per share were outstanding at June 30, 2007.

For the three month periods ended June 28, 2008 and June 30, 2007, options to purchase 6,750,788 and 2,713,000 shares of common stock, respectively, were outstanding but were not included in the computation of diluted earnings per share because the option exercise prices were greater than the average market price of the common shares and, therefore, the effect would be anti-dilutive. Shares of common stock from the assumed conversion of the Company s convertible preferred stock, issued in February 2004, were included in the computation of diluted EPS for the three month period ended June 30, 2007 but were not included in the computation for the three month period ended June 28, 2008 as they were not outstanding during the quarter.

The potential effects of stock awards and the assumed conversion of the Company s convertible preferred stock were excluded from the diluted earnings per share calculation for the nine month period ended June 28, 2008, because their inclusion in a net loss period would be anti-dilutive to the earnings per share calculation. For the nine month period ended June 30, 2007, options to purchase 1,308,000 shares of common stock were outstanding but were not included in the computation of diluted earnings per share because the option exercise prices were greater than the average market price of the common shares and, therefore, the effect would be anti-dilutive. Shares of common stock from the assumed conversion of the convertible preferred stock were included in the computation of diluted EPS for the nine month period ended June 30, 2007.

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6. Segment Information

Management has determined that the Company has two operating segments which are also reportable segments based on the level at which the Chief Executive Officer reviews the results of operations to make decisions regarding performance assessment and resource allocation. These operating segments are Pet Products and Garden Products.

	Three Months Ended		Nine Months Ended	
	June 30, 2007	June 28, 2008	June 30, 2007	June 28, 2008
Net sales:				
Pet Products	$ 239,715	$ 239,464	$ 671,804	$ 672,001
Garden Products	227,063	253,473	598,032	619,409
Total net sales	$ 466,778	$ 492,937	$ 1,269,836	$ 1,291,410
Income (loss) from operations:				
Pet Products	$ 29,949	$ 32,734	$ 77,041	$ (119,837)
Garden Products	16,119	12,561	42,828	(167,386)
Corporate	(8,876)	(11,427)	(30,522)	(24,873)
Total income (loss) from operations	37,192	33,868	89,347	(312,096)
Interest expense net	(12,906)	(8,986)	(36,039)	(29,717)
Other income	1,194	783	2,879	2,457
Income taxes (tax benefit)	9,495	9,574	20,904	(86,837)
Minority interest [(1)]	470	443	1,284	906
Net income (loss)	$ 15,515	$ 15,648	$ 33,999	$ (253,425)
Depreciation and amortization:				
Pet Products	$ 4,670	$ 4,554	$ 13,387	$ 13,157
Garden Products	1,856	2,130	5,756	6,455
Corporate	1,067	1,668	2,732	4,809
Total depreciation and amortization	$ 7,593	$ 8,352	$ 21,875	$ 24,421

	September 29, 2007	June 28, 2008
Assets:		
Pet Products	$ 478,714	$ 504,924
Garden Products	456,484	465,913
Corporate	711,624	363,664
Total assets	$ 1,646,822	$ 1,334,501
Goodwill (included in corporate assets above):		
Pet Products	$ 403,715	$ 200,824
Garden Products	195,043	800
Total goodwill	$ 598,758	$ 201,624

(1) Minority interest is associated with the Garden Products segment.

7. Consolidating Condensed Financial Information of Guarantor Subsidiaries

Certain 100% wholly-owned subsidiaries of the Company (as listed below, collectively the Guarantor Subsidiaries) have guaranteed fully and unconditionally, on a joint and several basis, the obligation to pay principal and interest on the Company s $150,000,000 9-1/8% Senior Subordinated Notes (the Notes) issued on January 30, 2003. Certain subsidiaries and operating divisions are not guarantors of the Notes and have been included in the financial results of the Parent in the information below. These Non-Guarantor entities are not material to the Parent. Those subsidiaries that are guarantors and co-obligors of the Notes are as follows:

Farnam Companies, Inc. (including Thompson s Veterinary Supply, Inc.)

Four Paws Products Ltd.

Grant Laboratories, Inc.

Gulfstream Home & Garden, Inc.

Interpet USA, LLC

Kaytee Products, Inc.

Matthews Redwood & Nursery Supply, Inc.

New England Pottery, LLC

Norcal Pottery Products, Inc.

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

Pets International, Ltd.

T.F.H. Publications, Inc.

Wellmark International (including B2E Corporation and B2E Biotech LLC)

Matson, LLC

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

CONSOLIDATING CONDENSED STATEMENT OF OPERATIONS

Three Months Ended June 28, 2008

(in thousands)

(unaudited)

	Parent	Guarantor Subsidiaries	Eliminations	Consolidated
Net sales	$ 138,480	$ 380,487	$ (26,030)	$ 492,937

Cost of products sold and occupancy	104,445	261,575	(26,030)	339,990
Gross profit	34,035	118,912		152,947
Selling, general and administrative expenses	33,744	85,335		119,079
Income from operations	291	33,577		33,868
Interest net	(9,104)	118		(8,986)
Other income (loss)	(1,778)	2,561		783
Income (loss) before income taxes and minority interest	(10,591)	36,256		25,665
Income taxes	623	8,951		9,574
Minority interest	443			443
Income (loss) before equity in undistributed income of guarantor subsidiaries	(11,657)	27,305		15,648
Equity in undistributed income of guarantor subsidiaries	27,305		(27,305)	
Net income (loss)	$ 15,648	$ 27,305	$ (27,305)	$ 15,648

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CONSOLIDATING CONDENSED STATEMENT OF OPERATIONS

Three Months Ended June 30, 2007

(in thousands)

(unaudited)

	Parent	Guarantor Subsidiaries	Eliminations	Consolidated
Net sales	$ 142,646	$ 348,038	$ (23,906)	$ 466,778
Cost of products sold and occupancy	100,234	239,310	(23,906)	315,638
Gross profit	42,412	108,728		151,140
Selling, general and administrative expenses	38,027	75,921		113,948
Income from operations	4,385	32,807		37,192
Interest net	(13,044)	138		(12,906)
Other income (loss)	(871)	2,065		1,194
Income (loss) before income taxes and minority interest	(9,530)	35,010		25,480
Income taxes (tax benefit)	(3,811)	13,306		9,495
Minority interest	470			470
Income (loss) before equity in undistributed income of guarantor subsidiaries	(6,189)	21,704		15,515
Equity in undistributed income of guarantor subsidiaries	21,704		(21,704)	
Net income (loss)	$ 15,515	$ 21,704	$ (21,704)	$ 15,515

CONSOLIDATING CONDENSED STATEMENT OF OPERATIONS

Nine Months Ended June 28, 2008

(in thousands)

(unaudited)

	Parent	Guarantor Subsidiaries	Eliminations	Consolidated
Net sales	$ 373,574	$ 1,002,921	$ (85,085)	$ 1,291,410
Cost of products sold and occupancy	270,684	698,732	(85,085)	884,331
Gross profit	102,890	304,189		407,079
Selling, general and administrative expenses	93,065	226,110		319,175
Goodwill Impairment	400,000			400,000
Income (loss) from operations	(390,175)	78,079		(312,096)
Interest net	(30,119)	402		(29,717)
Other income (loss)	(2,576)	5,033		2,457

Income (loss) before income taxes and minority interest	(422,870)	83,514		(339,356)
Income taxes (tax benefit)	(108,276)	21,439		(86,837)
Minority interest	906			906
Income (loss) before equity in undistributed income of guarantor subsidiaries	(315,500)	62,075		(253,425)
Equity in undistributed income of guarantor subsidiaries	62,075		(62,075)	
Net income (loss)	$ (253,425)	$ 62,075	$ (62,075)	$ (253,425)

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CONSOLIDATING CONDENSED STATEMENT OF OPERATIONS

Nine Months Ended June 30, 2007

(in thousands)

(unaudited)

	Parent	Guarantor Subsidiaries	Eliminations	Consolidated
Net sales	$ 387,822	$ 969,411	$ (87,397)	$ 1,269,836
Cost of products sold and occupancy	269,385	670,992	(87,397)	852,980
Gross profit	118,437	298,419		416,856
Selling, general and administrative expenses	101,875	225,634		327,509
Income from operations	16,562	72,785		89,347
Interest net	(36,412)	373		(36,039)
Other income (loss)	(3,323)	6,202		2,879
Income (loss) before income taxes and minority interest	(23,173)	79,360		56,187
Income taxes (tax benefit)	(9,324)	30,228		20,904
Minority interest	1,284			1,284
Income (loss) before equity in undistributed income of guarantor subsidiaries	(15,133)	49,132		33,999
Equity in undistributed income of guarantor subsidiaries	49,132		(49,132)	
Net income (loss)	$ 33,999	$ 49,132	$ (49,132)	$ 33,999

CONSOLIDATING CONDENSED BALANCE SHEET

June 28, 2008

(in thousands)

(unaudited)

	Parent	Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS				
Cash and cash equivalents	$ 9,550	$ (1,028)	$	$ 8,522
Accounts receivable, net	76,352	229,364	(12,970)	292,746
Inventories	104,563	266,489		371,052
Prepaid expenses and other assets	13,619	23,148		36,767
Total current assets	204,084	517,973	(12,970)	709,087
Land, buildings, improvements and equipment, net	56,436	137,628		194,064
Goodwill	201,624			201,624
Investment in guarantors	664,518		(664,518)	
Deferred income taxes and other assets	84,495	145,231		229,726

Total	$ 1,211,157	$ 800,832	$ (677,488)	$ 1,334,501
LIABILITIES AND SHAREHOLDERS EQUITY				
Accounts payable	$ 49,633	$ 81,948	$ (12,970)	$ 118,611
Accrued expenses and other current liabilities	53,843	51,521		105,364
Total current liabilities	103,476	133,469	(12,970)	223,975
Long-term debt	580,217	277		580,494
Other long-term obligations	2,038	2,568		4,606
Minority interest	2,741			2,741
Shareholders equity	522,685	664,518	(664,518)	522,685
Total	$ 1,211,157	$ 800,832	$ (677,488)	$ 1,334,501

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CONSOLIDATING CONDENSED BALANCE SHEET

September 29, 2007

(in thousands)

(unaudited)

	Parent	Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS				
Cash and cash equivalents	$ 14,706	$ 6,349&nb		