

CENTRAL GARDEN & PET CO  
Form 10-Q  
February 03, 2011  
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**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 25, 2010

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  
(State or other jurisdiction)

68-0275553  
(I.R.S. Employer

of incorporation or organization) Identification No.)  
1340 Treat Blvd., Suite 600, Walnut Creek, California 94597

(Address of principle executive offices)

(925) 948-4000

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(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.  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 definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer   
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  No

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

Common Stock Outstanding as of January 31, 2011	15,424,855
Class A Common Stock Outstanding as of January 31, 2011	42,037,132
Class B Stock Outstanding as of January 31, 2011	1,652,262

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

This Form 10-Q includes forward-looking statements. Forward-looking statements include statements concerning our plans, objectives, goals, strategies, future events, future revenues or performance, capital expenditures, plans or intentions relating to acquisitions, our competitive strengths and weaknesses, our business strategy, our ability to pass through grain and other raw material price increases and the trends we anticipate in the industries and economies in which we operate and other information that is not historical information. When used in this Form 10-Q, the words estimates, expects, anticipates, projects, plans, intends, believes and, variations of such words or similar expressions are intended to identify forward-looking statements. All forward-looking statements 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 25, 2010 including the factors described in the section entitled Risk Factors. If any of these risks or uncertainties materialize, or if any of our underlying assumptions are incorrect, our actual results may differ significantly from the results that we express in or imply by any of our forward-looking statements. We do not undertake any obligation to revise these forward-looking statements to reflect future events or circumstances. Presently known risk factors include, but are not limited to, the following factors:

seasonality and fluctuations in our operating results and cash flow;

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

declines in consumer spending during economic downturns;

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inflation, deflation and other adverse macro-economic conditions;

supply shortages in small animals and pet birds;

adverse weather conditions;

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fluctuations in energy prices, fuel and related petrochemical costs;

access to and cost of additional capital

dependence on a few customers for a significant portion of our business;

consolidation trends in the retail industry;

uncertainty about new product innovations and marketing programs;

competition in our industries;

risks associated with our acquisition strategy;

dependence upon our key executive officers;

implementation of a new enterprise resource planning information technology system;

potential environmental liabilities;

risk associated with international sourcing;

litigation and product liability claims;

the voting power associated with our Class B stock; and

potential dilution from issuance of authorized shares.

**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****CENTRAL GARDEN & PET COMPANY****CONDENSED CONSOLIDATED BALANCE SHEETS**

(in thousands, except share and per share amounts)

**Unaudited**

	December 26, 2009	December 25, 2010	September 25, 2010
			(See Note 1)
<b>ASSETS</b>			
Current assets:			
Cash and cash equivalents	\$ 91,791	\$ 75,317	\$ 91,460
Short term investments		15,320	15,320
Accounts receivable (less allowance for doubtful accounts of \$17,890, \$18,727 and \$21,564)	128,991	130,618	192,422
Inventories	327,403	341,621	285,964
Prepaid expenses and other	48,023	52,610	42,733
Total current assets	596,208	615,486	627,899
Land, buildings, improvements and equipment net	162,336	165,959	165,281
Goodwill	207,749	208,348	207,319
Other intangible assets net	102,236	85,768	86,798
Deferred income taxes and other assets	53,448	37,419	43,587
Total	\$ 1,121,977	\$ 1,112,980	\$ 1,130,884
<b>LIABILITIES AND EQUITY</b>			
Current liabilities:			
Accounts payable	\$ 117,635	\$ 115,651	\$ 112,611
Accrued expenses	83,091	84,931	81,418
Current portion of long-term debt	3,256	147	165
Total current liabilities	203,982	200,729	194,194
Long-term debt	404,007	400,141	400,106
Other long-term obligations	4,405	4,462	4,441
Equity:			
Common stock, \$.01 par value: 17,125,695, 15,733,655 and 16,258,704 shares outstanding at December 26, 2009, December 25, 2010 and September 25, 2010	171	157	163
Class A common stock, \$.01 par value: 45,745,191, 42,920,466 and 43,696,426 shares outstanding at December 26, 2009, December 25, 2010 and September 25, 2010	458	429	437
Class B stock, \$.01 par value: 1,652,262 shares outstanding	16	16	16
Additional paid-in capital	505,568	473,412	483,817
Accumulated earnings	2,309	33,053	45,319
Accumulated other comprehensive income	1,101	720	944

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Total Central Garden & Pet Company shareholders equity	509,623	507,787	530,696
Noncontrolling interest	(40)	(139)	1,447
Total equity	509,583	507,648	532,143
Total	\$ 1,121,977	\$ 1,112,980	\$ 1,130,884

See notes to condensed consolidated financial statements.

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

	<b>Three Months Ended</b>	
	<b>December 26, 2009</b>	<b>December 25, 2010</b>
Net sales	\$ 269,236	\$ 281,719
Cost of goods sold and occupancy	181,467	198,662
Gross profit	87,769	83,057
Selling, general and administrative expenses	87,248	89,540
Income (loss) from operations	521	(6,483)
Interest expense	(4,944)	(9,039)
Interest income	10	133
Other income (expense)	592	(406)
Loss before income taxes and noncontrolling interest	(3,821)	(15,795)
Income tax benefit	(1,402)	(6,117)
Loss including noncontrolling interest	(2,419)	(9,678)
Net income (loss) attributable to noncontrolling interest	475	(86)
Net loss attributable to Central Garden & Pet Company	\$ (2,894)	\$ (9,592)
Net loss per share attributable to Central Garden & Pet Company:		
Basic and diluted	\$ (0.04)	\$ (0.16)
Weighted average shares used in the computation of net income per share:		
Basic and diluted	66,828	60,941

See notes to condensed consolidated financial statements.



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	<b>Three Months Ended</b>	
	<b>December 26, 2009</b>	<b>December 25, 2010</b>
<b>Cash flows from operating activities:</b>		
Net loss	\$ (2,419)	\$ (9,678)
<b>Adjustments to reconcile net loss to net cash provided by operating activities:</b>		
Depreciation and amortization	7,231	7,045
Stock-based compensation	1,846	1,620
Excess tax benefits from stock-based awards	(196)	(115)
Deferred income taxes	(519)	(444)
Gain on termination of interest rate swap	(142)	
Loss (gain) on sale of property and equipment	112	(49)
<b>Change in assets and liabilities:</b>		
Accounts receivable	77,578	52,916
Inventories	(42,522)	(55,831)
Prepaid expenses and other assets	(2,948)	(3,284)
Accounts payable	7,946	10,869
Accrued expenses	(1,558)	1,628
Other long-term obligations	(121)	21
<b>Net cash provided by operating activities</b>	<b>44,288</b>	<b>4,698</b>
<b>Cash flows from investing activities:</b>		
Additions to property and equipment	(2,612)	(5,309)
Payments to acquire companies, net of cash acquired		(1,029)
<b>Net cash used in investing activities</b>	<b>(2,612)</b>	<b>(6,338)</b>
<b>Cash flows from financing activities:</b>		
Repayments of long-term debt	(823)	(78)
Proceeds from issuance of common stock	295	332
Repurchase of common stock	(32,450)	(13,281)
Distribution to noncontrolling interest	(2,761)	(1,500)
Excess tax benefits from stock-based awards	196	115
<b>Net cash used in financing activities</b>	<b>(35,543)</b>	<b>(14,412)</b>
<b>Effect of exchange rate changes on cash and cash equivalents</b>	<b>(10)</b>	<b>(91)</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>6,123</b>	<b>(16,143)</b>
<b>Cash and equivalents at beginning of period</b>	<b>85,668</b>	<b>91,460</b>
<b>Cash and equivalents at end of period</b>	<b>\$ 91,791</b>	<b>\$ 75,317</b>
<b>Supplemental information:</b>		
Cash paid for interest	\$ 1,586	\$ 897

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Cash paid for income taxes, net of refunds	\$ (44)	\$ 46
Non-cash investing activities:		
Capital expenditures incurred but not paid	\$ 409	\$ 1,116
Non-cash financing activities:		
Repurchased shares settled but not paid	\$ 2,494	\$ 1,879

See notes to condensed consolidated financial statements.

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**CENTRAL GARDEN & PET COMPANY**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**Three Months Ended December 25, 2010**

**(unaudited)**

**1. Basis of Presentation**

The condensed consolidated balance sheets of Central Garden & Pet Company and subsidiaries (the Company or Central ) as of December 26, 2009 and December 25, 2010, the condensed consolidated statements of operations for the three months ended December 26, 2009 and December 25, 2010, and the condensed consolidated statements of cash flows for the three months ended December 26, 2009 and December 25, 2010 have been prepared by the Company, without audit. In the opinion of management, all adjustments (which include only normal recurring adjustments) considered necessary to present fairly the financial position, results of operations and cash flows of the Company for the periods mentioned above, have been made.

For the Company's foreign business in the UK, the local currency is the functional currency. Assets and liabilities are translated using the exchange rate in effect at the balance sheet date. Income and expenses are translated at the average exchange rate for the period. Deferred taxes are not provided on translation gains and losses, because the Company expects earnings of its foreign subsidiary to be permanently reinvested. Transaction gains and losses are included in results of operations. See Note 7, Supplemental Equity and Comprehensive Income Information, for further detail.

Due to the seasonal nature of the Company's garden business, the results of operations for the three month periods ended December 26, 2009 and December 25, 2010 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 2010 Annual Report on Form 10-K, which has previously been filed with the Securities and Exchange Commission. The September 25, 2010 balance sheet presented herein was derived from the audited statements.

***Noncontrolling Interest***

Noncontrolling interest in the Company's condensed consolidated financial statements represents the 20% interest not owned by Central in a consolidated subsidiary. Since the Company controls this subsidiary, its financial statements are fully consolidated with those of the Company, and the noncontrolling owner's 20% share of the subsidiary's net assets and results of operations is deducted and reported as noncontrolling interest on the consolidated balance sheets and as net income (loss) attributable to noncontrolling interest in the consolidated statements of operations. See Note 7, Supplemental Equity and Comprehensive Income Information, for additional information.

***Derivative Instruments***

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

The Company does not perform the assessments required to achieve hedge accounting for commodity derivative positions. Accordingly, the changes in the values of these derivatives are recorded currently in cost of sales in its condensed consolidated statements of operations. As of December 25, 2010, the notional amount of these contracts was not significant.

***Recent Accounting Pronouncements***

On September 26, 2010, the Company adopted provisions of ASU No. 2009-17, *Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities (VIEs)*. This ASU amends the guidance for consolidation of VIEs primarily related to the determination of the primary beneficiary of the VIE. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

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In January 2010, the FASB issued ASU No. 2010-6, Improving Disclosures about Fair Value Measurements. This ASU requires new disclosures regarding transfers in and out of Level 1 and Level 2 fair value measurements, as well as requiring presentation on a

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gross basis information about purchases, sales, issuances and settlements in Level 3 fair value measurements. The ASU also clarifies existing disclosures regarding level of disaggregation, inputs and valuation techniques. The ASU is effective for interim and annual reporting periods beginning after December 15, 2009 and became effective for the Company on December 27, 2009. Disclosures about purchases, sales, issuances and settlements in the roll forward of activity in Level 3 fair value measurements are effective for fiscal years beginning after December 15, 2010 and will be effective for the Company on September 25, 2011.

### **2. Fair Value Measurements**

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

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

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

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

#### ***Assets and Liabilities Measured at Fair Value on a Recurring Basis***

The Company had short term investments, consisting of a bank certificate of deposit, measured at fair value under Level 1 inputs in the fair value hierarchy as of December 25, 2010. The Company had no other significant financial assets or liabilities on the balance sheet that were measured at fair value as of December 25, 2010.

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

The Company measures certain non-financial assets and liabilities, including long-lived assets, goodwill and intangible assets, at fair value on a non-recurring basis. Fair value measurements of non-financial assets and non-financial liabilities are used primarily in the impairment analyses of long-lived assets, goodwill and other intangible assets. During the period ended December 25, 2010, the Company was not required to measure any significant non-financial assets and liabilities at fair value.

### **3. Financial Instruments**

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

The estimated fair value of the Company's \$400 million 8.25 % senior subordinated notes due 2018 as of December 25, 2010 was \$405.0 million, compared to a carrying value of \$400.0 million. The estimated fair value is based on quoted market prices for these notes.

### **4. Goodwill**

The Company accounts for goodwill in accordance with ASC 350, Intangibles—Goodwill and Other, and tests goodwill for impairment annually, or whenever events occur or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. This assessment involves the use of significant accounting judgments and estimates as to future operating results and discount rates. Changes in estimates or use of different assumptions could produce significantly different results. An impairment loss is generally recognized when the carrying amount of the reporting unit's net assets exceeds the estimated fair value of the reporting unit. The Company uses discounted cash flow analysis to estimate the fair value of our reporting units. The Company's goodwill impairment analysis also includes a comparison of the aggregate estimated fair value of all four reporting units to the Company's total market capitalization.

Contingent performance payments of \$1.0 million were paid during the period ended December 25, 2010 for previous acquisitions and were recorded as goodwill.



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

		Gross	Accumulated Amortization (in millions)	Impairment	Net Carrying Value
<b>December 25, 2010</b>					
Marketing-related intangible assets	amortizable	\$ 12.3	\$ (5.3)	\$	\$ 7.0
Marketing-related intangible assets	nonamortizable	59.6		(16.9)	42.7
Total		71.9	(5.3)	(16.9)	49.7
Customer-related intangible assets	amortizable	41.6	(11.3)		30.3
Other acquired intangible assets	amortizable	9.2	(3.4)		5.8
Other acquired intangible assets	nonamortizable	1.2		(1.2)	
Total		10.4	(3.4)	(1.2)	5.8
Total other intangible assets		\$ 123.9	\$ (20.0)	\$ (18.1)	\$ 85.8
<b>December 26, 2009</b>					
Marketing-related intangible assets	amortizable	\$ 12.4	\$ (4.2)	\$	\$ 8.2
Marketing-related intangible assets	nonamortizable	59.6		(4.9)	54.7
Total		72.0	(4.2)	(4.9)	62.9
Customer-related intangible assets	amortizable	41.6	(9.2)		32.4
Other acquired intangible assets	amortizable	9.2	(2.3)		6.9
Other acquired intangible assets	nonamortizable	1.2		(1.2)	
Total		10.4	(2.3)	(1.2)	6.9
Total other intangible assets		\$ 124.0	\$ (15.7)	\$ (6.1)	\$ 102.2
<b>September 25, 2010</b>					
Marketing-related intangible assets	amortizable	\$ 12.3	\$ (5.0)	\$	\$ 7.3
Marketing-related intangible assets	nonamortizable	59.6		(16.9)	42.7
Total		71.9	(5.0)	(16.9)	50.0
Customer-related intangible assets	amortizable	41.6	(10.8)		30.8
Other acquired intangible assets	amortizable	9.2	(3.2)		6.0
Other acquired intangible assets	nonamortizable	1.2		(1.2)	
Total		10.4	(3.2)	(1.2)	6.0

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Total other intangible assets	\$ 123.9	\$ (19.0)	\$ (18.1)	\$ 86.8
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Other intangible assets acquired include contract-based and technology-based intangible assets.

The Company evaluates long-lived assets, including amortizable and indefinite-lived intangible assets, for impairment whenever events or changes in circumstances indicate the carrying value may not be recoverable. The Company evaluates indefinite-lived intangible assets on an annual basis. In fiscal 2010, the Company recognized a non-cash \$12.0 million impairment charge to its indefinite-lived intangible assets as a result of the continuing challenging economic environment. The fair value of the remaining \$27.8 million of indefinite-lived intangible assets exceeded their carrying value at September 25, 2010. In fiscal 2009, the Company tested its indefinite-lived intangible assets and no impairment was indicated.

The Company is currently amortizing its acquired intangible assets with definite lives over periods ranging from 1 to 25 years; over weighted average remaining lives of eight years for marketing-related intangibles, 18 years for customer-related intangibles and six years for other acquired intangibles. Amortization expense for intangibles subject to amortization was approximately \$1.0 million and \$1.2 million for the three months ended December 25, 2010 and the three months ended December 26, 2009, respectively, and is classified within operating expenses in the condensed consolidated statements of operations. Estimated annual amortization expense related to acquired intangible assets in each of the succeeding five years is estimated to be approximately \$4 million per year from fiscal 2012 through fiscal 2016.



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Long-term debt consists of the following:

	December 25, 2010	September 25, 2010
	(in thousands)	
Senior subordinated notes, interest at 8.25%, payable semi-annually, principal due March 2018	\$ 400,000	\$ 400,000
Other notes payable	288	271
<b>Total</b>	<b>400,288</b>	<b>400,271</b>
Less current portion	(147)	(165)
<b>Long-term portion</b>	<b>\$ 400,141</b>	<b>\$ 400,106</b>

**Senior Credit Facility**

On June 25, 2010, the Company entered into an Amended and Restated Credit Agreement (the "Credit Agreement") with respect to a five-year senior secured revolving credit facility (the "Credit Facility") in an aggregate principal amount of \$275 million. The Company has the option to increase the size of the Facility by an additional \$200 million of incremental term loans and/or revolving loans should it exercise its option and one or more lenders are willing to make such increased amounts available to it. There was no outstanding balance at December 25, 2010 under the Credit Facility. There were \$0.2 million of letters of credit outstanding. After giving effect to the financial covenants in the Credit Agreement, the remaining potential borrowing capacity was \$274.8 million.

Interest on the Credit Facility is based, at the Company's option, on a rate equal to the Alternate Base Rate (ABR), which is the greatest of the prime rate, the Federal Funds rate plus  $\frac{1}{2}$  of 1% or one month LIBOR plus 1%, plus a margin, which fluctuates from 1.5% to 2.5%, or LIBOR plus a margin, which fluctuates from 2.5% to 3.5% and commitment fees that range from 0.35% to 0.75%, determined quarterly based on consolidated total debt to consolidated EBITDA for the most recent trailing 12-month period. As of December 25, 2010, had the Company borrowed under the Credit Facility, the applicable interest rate on the Credit Facility related to alternate base rate borrowings would have been 5.25%, and the applicable interest rate related to LIBOR rate borrowings would have been 3.26%.

The Credit Facility is guaranteed by the Company's material subsidiaries and is secured by the Company's assets, excluding real property but including substantially all of the capital stock of the Company's subsidiaries. The Credit Agreement contains certain financial and other covenants which require the Company to maintain minimum levels of interest coverage and maximum levels of senior debt to EBITDA and that restrict the Company's ability to repurchase its stock, make investments in or acquisitions of other businesses and pay dividends above certain levels over the life of the Credit Facility. Under the terms of the Company's Credit Facility, it may make restricted payments, including cash dividends and stock repurchases, in an aggregate amount initially not to exceed \$200 million over the life of the Credit Facility, subject to qualifications and baskets as defined in the Credit Agreement. As of December 25, 2010, the Company's total Leverage Ratio as defined in the Credit Agreement, was 2.7 to 1.0. Apart from the covenants limiting restricted payments and capital expenditures, the Credit Facility does not restrict the use of retained earnings or net income. The Company was in compliance with all financial covenants as of December 25, 2010.

**Senior Subordinated Notes and Debt Refinancing**

On March 8, 2010, the Company issued \$400 million aggregate principal amount of 8.25% senior subordinated notes due March 1, 2018 (the "2018 Notes"). The Company used the proceeds together with available cash to purchase its outstanding \$150 million aggregate principal amount of 9.125% senior subordinated notes due February 1, 2013 (the "2013 Notes"), including accrued interest, to repay the \$267.1 million outstanding under its senior term loan maturing February 2012 and pay fees and expenses related to the offering. The Company received tenders and consents from the holders of \$150 million of its 2013 Notes, including \$12.8 million held in escrow for the benefit of the Company, which was previously recorded as a reduction of debt for accounting purposes against the Company's 2013 Notes.

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

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and future domestic restricted subsidiaries with certain exceptions. The guarantees are general unsecured senior subordinated obligations of the guarantors and are subordinated to all existing and future senior debt of the guarantors.

The Company may redeem some or all of the 2018 Notes at any time prior to March 1, 2014 at the principal amount plus a make whole premium. The Company may redeem some or all of the 2018 Notes at any time on or after March 1, 2014 for 104.125%, after March 1, 2015 for 102.063% and after March 1, 2016 for 100%, plus accrued and unpaid interest. Additionally, at any time prior to

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March 1, 2013, the Company may redeem up to 35% of the 2018 Notes with any proceeds the Company receives from certain equity offerings at a redemption price of 108.25% of the principal amount, plus accrued and unpaid interest. The holders of the 2018 Notes have the right to require the Company to repurchase all or a portion of the 2018 Notes at a purchase price equal to 101% of the principal amount of the notes repurchased, plus accrued and unpaid interest through the repurchase date upon the occurrence of a change of control.

The 2018 Notes contain customary high yield covenants, including covenants limiting debt incurrence and restricted payments, subject to certain baskets and exceptions.

**7. Supplemental Equity and Comprehensive Income (Loss) Information**

The following table summarizes the allocation of total comprehensive income (loss) between controlling and noncontrolling interests for the three months ended December 25, 2010 and December 26, 2009:

(in thousands)	Three Months Ended December 25, 2010		
	Controlling Interest	Noncontrolling Interest	Total
Net loss	\$ (9,592)	\$ (86)	\$ (9,678)
Other comprehensive loss:			
Foreign currency translation	(224)		(224)
Total comprehensive loss	\$ (9,816)	\$ (86)	\$ (9,902)

(in thousands)	Three Months Ended December 26, 2009		
	Controlling Interest	Noncontrolling Interest	Total
Net income (loss)	\$ (2,894)	\$ 475	\$ (2,419)
Other comprehensive gain (loss):			
Foreign currency translation	39		39
Total comprehensive gain (loss)	\$ (2,855)	\$ 475	\$ (2,380)

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The following table provides a summary of the changes in the carrying amounts of equity attributable to controlling interest and noncontrolling interest for the three months ended December 25, 2010 and December 26, 2009:

(in thousands)	Controlling Interest								
	Class			Additional	Retained	Accumulated		Noncontrolling	Total
	Common	Class	Class B			Other	Comprehensive		
Stock	A	Stock	Paid In	Earnings	Income	Total	Interest	Total	
<b>Balance September 25, 2010</b>	\$ 163	\$ 437	\$ 16	\$ 483,817	\$ 45,319	\$ 944	\$ 530,696	\$ 1,447	\$ 532,143
Comprehensive loss					(9,592)	(224)	(9,816)	(86)	(9,902)
Stock based compensation				1,165			1,165		1,165
Restricted share activity				(49)			(49)		(49)
Issuance of common stock		2		601			603		603
Repurchase of common stock	(6)	(10)		(12,237)	(2,674)		(14,927)		(14,927)
Distributions to noncontrolling interest								(1,500)	(1,500)
Tax benefit on stock option exercise				115			115		115
<b>Balance December 25, 2010</b>	\$ 157	\$ 429	\$ 16	\$ 473,412	\$ 33,053	\$ 720	\$ 507,787	\$ (139)	\$ 507,648

(in thousands)	Controlling Interest								
	Class			Additional	Retained	Accumulated		Noncontrolling	Total
	Common	Class	Class B			Other	Comprehensive		
Stock	A	Stock	Paid In	Earnings	Income	Total	Interest	Total	
<b>Balance September 26, 2009</b>	\$ 188	\$ 475	\$ 16	\$ 531,300	\$ 12,044	\$ 1,062	\$ 545,085	\$ 2,250	\$ 547,335
Comprehensive income (loss)					(2,894)	39	(2,855)	475	(2,380)
Stock based compensation				1,363			1,363		1,363
Restricted share activity				(46)			(46)		(46)
Issuance of common stock		2		604			606		606
Repurchase of common stock	(17)	(19)		(27,849)	(6,841)		(34,726)		(34,726)
Distributions to noncontrolling interest								(2,761)	(2,761)
Tax benefit on stock option exercise				196			196		196
Other								(4)	(4)
<b>Balance December 26, 2009</b>	\$ 171	\$ 458	\$ 16	\$ 505,568	\$ 2,309	\$ 1,101	\$ 509,623	\$ (40)	\$ 509,583

**8. Stock-Based Compensation**

The Company recognized share-based compensation expense of \$1.6 million and \$1.8 million for the three month periods ended December 25, 2010 and December 26, 2009, respectively, as a component of selling, general and administrative expenses. The tax benefit associated with share-based compensation expense for the three month periods ended December 25, 2010 and December 26, 2009 was \$0.6 million and \$0.7 million, respectively.

**9. Earnings Per Share**

The potential effects of stock awards were excluded from the diluted earnings per share calculation for the three month periods ended December 25, 2010 and December 26, 2009 because their inclusion in a net loss period would be anti-dilutive to the earnings per share calculation.



**Table of Contents****10. 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 and are presented in the table below (in thousands).

	<b>Three Months Ended</b>	
	<b>December 26, 2009</b>	<b>December 25, 2010</b>
<b>Net sales:</b>		
Pet Products	\$ 181,526	\$ 186,800
Garden Products	87,710	94,919
<b>Total net sales</b>	<b>\$ 269,236</b>	<b>\$ 281,719</b>
<b>Income (loss) from operations:</b>		
Pet Products	\$ 17,628	\$ 11,409
Garden Products	(6,331)	(7,983)
Corporate	(10,776)	(9,909)
<b>Total income from operations</b>	<b>521</b>	<b>(6,483)</b>
Interest expense net	(4,934)	(8,906)
Other income (expense)	592	(406)
Income tax benefit	(1,402)	(6,117)
Loss including noncontrolling interest	(2,419)	(9,678)
Net income (loss) attributable to noncontrolling interest	475	(86)
<b>Net loss attributable to Central Garden &amp; Pet Company</b>	<b>\$ (2,894)</b>	<b>\$ (9,592)</b>
<b>Depreciation and amortization:</b>		
Pet Products	\$ 3,994	\$ 3,668
Garden Products	1,408	1,430
Corporate	1,829	1,947
<b>Total depreciation and amortization</b>	<b>\$ 7,231</b>	<b>\$ 7,045</b>
	<b>September 25, 2010</b>	<b>December 25, 2010</b>
<b>Assets:</b>		
Pet Products	\$ 385,894	\$ 388,047
Garden Products	323,387	309,675
Corporate	421,603	415,258
<b>Total assets</b>	<b>\$ 1,130,884</b>	<b>\$ 1,112,980</b>
<b>Goodwill (included in corporate assets above):</b>		
Pet Products	\$ 201,639	\$ 201,639
Garden Products	5,680	6,709

Total goodwill	\$ 207,319	\$ 208,348
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**Table of Contents****11. 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 \$400 million 8.25% Senior Subordinated Notes issued on March 8, 2010 (the Notes). 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.

Four Paws Products Ltd.

Grant Laboratories, Inc.

Gulfstream Home & Garden, Inc.

Interpet USA, LLC

Kaytee Products, Inc.

Matthews Redwood & Nursery Supply, Inc.

Matson, LLC

New England Pottery, LLC

Pennington Seed, Inc. (including Pennington Seed, Inc. of Nebraska, Gro Tec, Inc., Seeds West, Inc., All-Glass Aquarium Co., Inc. and Cedar Works, LLC.)

Pets International, Ltd.

T.F.H. Publications, Inc.

Wellmark International (including B2E Corporation and B2E Biotech 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 December 25, 2010****(in thousands)****(unaudited)**

	<b>Parent</b>	<b>Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
Net sales	\$ 93,503	\$ 215,656	\$ (27,440)	\$ 281,719
Cost of products sold and occupancy	71,453	154,649	(27,440)	198,662
Gross profit	22,050	61,007		83,057
Selling, general and administrative expenses	27,099	62,441		89,540



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Loss from operations	(5,049)	(1,434)	(6,483)
Interest net	(8,972)	66	(8,906)
Other income (loss )	346	(752)	(406)
Loss before income taxes	(13,675)	(2,120)	(15,795)
Income tax benefit	(5,289)	(828)	(6,117)
Loss including noncontrolling interest	(8,386)	(1,292)	(9,678)
Loss attributable to noncontrolling interest	(86)		(86)
Loss attributable to Central Garden & Pet Co. before equity in undistributed income of guarantor subsidiaries	(8,300)	(1,292)	(9,592)
Equity in undistributed income of guarantor subsidiaries	(1,292)		1,292
Net loss attributable to Central Garden & Pet Co.	\$ (9,592)	\$ (1,292)	\$ 1,292 \$ (9,592)

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

Three Months Ended December 26, 2009

(in thousands)  
(unaudited)

	Parent	Guarantor Subsidiaries	Eliminations	Consolidated
Net sales	\$ 90,525	\$ 207,463	\$ (28,752)	\$ 269,236
Cost of products sold and occupancy	64,583	145,636	(28,752)	181,467
Gross profit	25,942	61,827		87,769
Selling, general and administrative expenses	27,648	59,600		87,248
Income (loss) from operations	(1,706)	2,227		521
Interest net	(5,019)	85		(4,934)
Other income (expense)	(1,902)	2,494		592
Income (loss) before income taxes	(8,627)	4,806		(3,821)
Income taxes (tax benefit)	(3,265)	1,863		(1,402)
Income (loss) including noncontrolling interest	(5,362)	2,943		(2,419)
Income attributable to noncontrolling interest	475			475
Income (loss) attributable to Central Garden & Pet Co. before equity in undistributed income of guarantor subsidiaries	(5,837)	2,943		(2,894)
Equity in undistributed income of guarantor subsidiaries	2,943		(2,943)	
Net income (loss) attributable to Central Garden & Pet Co.	\$ (2,894)	\$ 2,943	\$ (2,943)	\$ (2,894)

**CONSOLIDATING CONDENSED BALANCE SHEET**

December 25, 2010

(in thousands)  
(unaudited)

	Parent	Guarantor Subsidiaries	Eliminations	Consolidated
<b>ASSETS</b>				
Cash and cash equivalents	\$ 73,569	\$ 1,748	\$	\$ 75,317
Short term investments	15,320			15,320
Accounts receivable, net	47,793	92,554	(9,729)	130,618
Inventories	106,501	235,120		341,621
Prepaid expenses and other assets	30,599	22,011		52,610
Total current assets	273,782	351,433	(9,729)	615,486
Land, buildings, improvements and equipment, net	64,242	101,717		165,959
Goodwill		208,348		208,348
Investment in guarantors	616,405		(616,405)	
Deferred income taxes and other assets	41,557	81,630		123,187
Total	\$ 995,986	\$ 743,128	\$ (626,134)	\$ 1,112,980
<b>LIABILITIES AND EQUITY</b>				
Accounts payable	\$ 42,036	\$ 83,344	\$ (9,729)	\$ 115,651
Accrued expenses and other current liabilities	43,528	41,550		85,078

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Total current liabilities	85,564	124,894	(9,729)	200,729
Long-term debt	400,072	69		400,141
Other long-term obligations	2,702	1,760		4,462
Shareholders' equity attributable to Central Garden & Pet Co.	507,787	616,405	(616,405)	507,787
Noncontrolling interest	(139)			(139)
<b>Total equity</b>	<b>507,648</b>	<b>616,405</b>	<b>(616,405)</b>	<b>507,648</b>
<b>Total</b>	<b>\$ 995,986</b>	<b>\$ 743,128</b>	<b>\$ (626,134)</b>	<b>\$ 1,112,980</b>

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

September 25, 2010

(in thousands)

(unaudited)

	Parent	Guarantor Subsidiaries	Eliminations	Consolidated
<b>ASSETS</b>				
Cash and cash equivalents	\$ 90,265	\$ 1,195	\$	\$ 91,460
Short term investments	15,320			15,320
Accounts receivable, net	47,001	150,838	(5,417)	192,422
Inventories	84,129	201,835		285,964
Prepaid expenses and other assets	23,447	19,286		42,733
<b>Total current assets</b>	<b>260,162</b>	<b>373,154</b>	<b>(5,417)</b>	<b>627,899</b>
Land, buildings, improvements and equipment, net	63,303	101,978		165,281
Goodwill		207,319		207,319
Investment in guarantors	633,908		(633,908)	
Other assets	47,327	83,058		130,385
<b>Total</b>	<b>\$ 1,004,700</b>	<b>\$ 765,509</b>	<b>\$ (639,325)</b>	<b>\$ 1,130,884</b>
<b>LIABILITIES AND EQUITY</b>				
Accounts payable	\$ 35,218	\$ 82,810	\$ (5,417)	\$ 112,611
Accrued expenses and other liabilities	34,692	46,891		81,583
<b>Total current liabilities</b>	<b>69,910</b>	<b>129,701</b>	<b>(5,417)</b>	<b>194,194</b>
Long-term debt	400,026	80		400,106
Other long-term obligations	2,621	1,820		4,441
Shareholders' equity attributable to Central Garden & Pet Co.	530,696	633,908	(633,908)	530,696
Noncontrolling interest	1,447			1,447
<b>Total equity</b>	<b>532,143</b>	<b>633,908</b>	<b>(633,908)</b>	<b>532,143</b>
<b>Total</b>	<b>\$ 1,004,700</b>	<b>\$ 765,509</b>	<b>\$ (639,325)</b>	<b>\$ 1,130,884</b>

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

Three Months Ended December 25, 2010

( in thousands)

(unaudited)

	Parent	Guarantor Subsidiaries	Eliminations	Consolidated
Net cash provided (used) by operating activities	\$ (17,362)	\$ 20,768	\$ 1,292	\$ 4,698
Additions to property and equipment	(2,402)	(2,907)		(5,309)
Businesses acquired, net of cash acquired		(1,029)		(1,029)
Investment in guarantor subsidiaries	17,503	(16,211)	(1,292)	
Net cash provided (used) by investing activities	15,101	(20,147)	(1,292)	(6,338)
Repayments of long-term debt	(20)	(58)		(78)
Repurchase of common stock	(13,281)			(13,281)
Proceeds from issuance of common stock	332			332
Excess tax benefits from stock-based awards	115			115
Distribution to noncontrolling interest	(1,500)			(1,500)
Net cash used by financing activities	(14,354)	(58)		(14,412)
Effect of exchange rate changes on cash	(81)	(10)		(91)
Net increase (decrease) in cash and cash equivalents	(16,696)	553		(16,143)
Cash and cash equivalents at beginning of period	90,265	1,195		91,460
Cash and cash equivalents at end of period	\$ 73,569	\$ 1,748	\$	\$ 75,317

**CONSOLIDATING CONDENSED STATEMENT OF CASH FLOWS**

Three Months Ended December 26, 2009

( in thousands)

(unaudited)

	Parent	Guarantor Subsidiaries	Eliminations	Consolidated
Net cash provided (used) by operating activities	\$ (753)	\$ 47,984	\$ (2,943)	\$ 44,288
Additions to property and equipment	(1,813)	(799)		(2,612)
Investment in guarantor subsidiaries	43,781	(46,724)	2,943	
Net cash provided (used) by investing activities	41,968	(47,523)	2,943	(2,612)
Repayments of long-term debt	(693)	(130)		(823)
Repurchase of common stock	(32,450)			(32,450)
Proceeds from issuance of common stock	295			295
Excess tax benefits from stock-based awards	196			196

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Distribution to noncontrolling interest	(2,761)			(2,761)
Net cash used by financing activities	(35,413)	(130)		(35,543)
Effect of exchange rate changes on cash		(10)		(10)
Net increase in cash and cash equivalents	5,802	321		6,123
Cash and cash equivalents at beginning of period	82,958	2,710		85,668
Cash and cash equivalents at end of period	\$ 88,760	\$ 3,031	\$	\$ 91,791

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**12. Legal Proceedings**

We may from time to time become involved in certain legal proceedings in the ordinary course of business. Currently, we are not a party to any legal proceedings that management believes would have a material adverse effect on our financial position or results of operations.

**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**  
**Our Company**

Central Garden & Pet Company ( Central ) is a leading innovator, marketer and producer of quality branded products. We are one of the largest suppliers in the pet and lawn and garden supplies industries in the United States. The total pet industry is estimated to be approximately \$28 billion in annual retail sales. We estimate the annual retail sales of the pet supplies and ultra-premium pet food markets in the categories in which we participate to be approximately \$17 billion. As of 2010, the total lawn and garden industry in the United States is estimated to be approximately \$24 billion in annual retail sales. We estimate the annual retail sales of the lawn and garden supplies markets in the categories in which we participate to be approximately \$6 billion.

Our pet supplies products include products for dogs and cats, including edible bones, premium healthy edible and non-edible chews, ultra-premium dog and cat food and treats, leashes, collars, toys, pet carriers, grooming supplies and other accessories; products for birds, small animals and specialty pets, including food, cages and habitats, toys, chews and related accessories; animal and household health and insect control products; products for fish, reptiles and other aquarium-based pets, including aquariums, furniture and lighting fixtures, pumps, filters, water conditioners, food and supplements, and information and knowledge resources; and products for horses and livestock. These products are sold under a number of brand names including Adams™, Altosid, Aqueon®, Avoderm®, BioSpot®, Coralife®, Farnam®, Four Paws®, Interpet, Kaytee®, Kent Marine®, Nylabone®, Oceanic Systems®, Pet Select®, Pre-Strike®, Pinnacle®, Super Pet®, TFH®, Zilla® and Zodiac®.

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

**Recent Developments**

*Fiscal 2011 First Quarter Financial Performance* - In our first quarter of fiscal 2011, our net income decreased \$6.7 million from our first quarter of fiscal 2010. Our revenues increased \$12.5 million, with sales growth in both our operating segments, but we incurred a loss from operations of \$6.5 million, a decrease of \$7.0 million from the prior year quarter. The decrease in operating income was due primarily to increased grain and other raw material prices and increased marketing and brand building expenditures. Additionally, our interest expense increased \$4.0 million from the prior year quarter due to our issuance of \$400 million of 8.25% 2018 Notes in March 2010.

*Repurchase of Company Stock* - During the quarter ended December 25, 2010, we repurchased \$14.9 million of our common stock, which consisted of 0.5 million shares of our voting common stock (CENT) at an aggregate cost of approximately \$5.1 million, or approximately \$9.52 per share and 1.0 million shares of our non-voting Class A common stock (CENTA) at an aggregate cost of approximately \$9.8 million, or approximately \$9.61 per share. Under our current share repurchase program authorization, approximately \$66 million remains available for repurchases in 2011 and thereafter.

**Results of Operations****Three Months Ended December 25, 2010****Compared with Three Months Ended December 26, 2009***Net Sales*

Net sales for the three months ended December 25, 2010 increased \$12.5 million, or 4.6%, to \$281.7 million from \$269.2 million for the three months ended December 26, 2009. Our branded product sales increased \$10.4 million and sales of other manufacturers' products increased \$2.1 million.



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Pet Products net sales increased \$5.3 million, or 2.9%, to \$186.8 million for the three months ended December 25, 2010 from \$181.5 million in the comparable fiscal 2009 period. Pet branded product sales increased \$4.6 million, due primarily to a sales increase of \$3.5 million of bird feed products and a \$1.4 million increase in aquatic and reptile kits and aquarium tanks, from the prior year quarter. The increased sales were due primarily to increased brand building and marketing expenditures and expanded product distribution.

Garden Products net sales increased \$7.2 million, or 8.2%, to \$94.9 million for the three months ended December 25, 2010 from \$87.7 million in the comparable fiscal 2009 period. Garden branded product sales increased \$5.8 million due primarily to a \$9.5 million increase in grass seed, partially offset by a \$2.3 million decrease in garden chemicals and control products. The decrease in garden chemicals and control products was due primarily to a poor fall fire ant season.

**Gross Profit**

Gross profit for the three months ended December 25, 2010 decreased \$4.7 million, or 5.4%, to \$83.1 million from \$87.8 million for the three months ended December 26, 2009. Gross profit as a percentage of net sales declined from 32.6% for the three months ended December 26, 2009 to 29.5% for the three months ended December 25, 2010. Gross profit as a percentage of net sales decreased in both segments. The gross margin decrease in Pet Products was due primarily to increased grain prices (for example, milo, sunflower and corn). The gross margin in Garden Products was impacted by increased grain prices and by product mix with an increase in grass seed sales and a decline in garden chemicals and control products sales. We are in the process of implementing price increases during our second fiscal quarter to mitigate the impact of the increasing grain prices.

**Selling, General and Administrative Expenses**

Selling, general and administrative expenses increased \$2.3 million, or 2.6%, to \$89.5 million for the three months ended December 25, 2010 from \$87.2 million for the three months ended December 26, 2009. As a percentage of net sales, selling, general and administrative expenses decreased to 31.8% for the three months ended December 25, 2010, compared to 32.4% in the comparable prior year quarter due to the increase in net sales. The increase in selling, general and administrative expenses, discussed further below, was due to increased selling expenses.

Selling and delivery expense increased \$5.3 million, or 12.9%, from \$41.1 million for the three months ended December 26, 2009 to \$46.4 million for the three months ended December 25, 2010. The increased expense was due primarily to increased marketing costs, including brand building activities and increased variable compensation related to the increase in sales.

Facilities expense declined \$0.1 million to \$2.4 million in the quarter ended December 25, 2010 from \$2.5 million for the quarter ended December 26, 2009.

Warehouse and administrative expense decreased \$2.9 million to \$40.7 million for the quarter ended December 25, 2010 from \$43.6 million in the quarter ended December 26, 2009 due primarily to reduced compensation expense for fiscal 2010 and reduced legal and litigation costs.

**Net Interest Expense**

Net interest expense for the three months ended December 25, 2010 increased \$4.0 million or 80.5%, to \$8.9 million from \$4.9 million for the three months ended December 26, 2009. In March 2010, we issued \$400 million of 8.25% 2018 Notes, tendered for our outstanding 9.125% 2013 Notes and paid the outstanding indebtedness under our senior term loan. As a result of this refinancing, our average borrowing rate for the current quarter increased to 8.6% compared to 4.6% for the prior year quarter. Debt outstanding on December 25, 2010 was \$400.3 million compared to \$407.3 million as of December 26, 2009.

**Other Income**

Other income decreased \$1.0 million from earnings of \$0.6 million for the quarter ended December 26, 2009, to a \$0.4 million expense for the quarter ended December 25, 2010. The decrease was due primarily to investments accounted for under the equity method of accounting that generated income in the prior year quarter but losses in the current year quarter.

**Income Taxes**

Our effective income tax benefit rate was 38.7% for the quarter ended December 25, 2010 and 36.7% for the quarter ended December 26, 2009. Our 2011 tax benefit rate increased due primarily to additional tax credits in fiscal 2011. We expect our effective income tax rate for fiscal year

2011 to be similar to the fiscal year 2010 rate.

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### **Inflation**

Our revenues and margins are dependent on various economic factors, including rates of inflation or deflation, energy costs, consumer attitudes toward discretionary spending, currency fluctuations, and other macro-economic factors which may impact levels of consumer spending. Historically, in certain fiscal periods, we have been adversely impacted by rising input costs related to domestic inflation, particularly relating to grain and seed prices, fuel prices and the ingredients used in our garden fertilizer and chemicals, and many of our other inputs. The rising costs made it difficult for us to increase prices to our retail customers at a pace to enable us to return to historical margins.

In fiscal 2009 and fiscal 2010, our business was negatively impacted by declining consumer confidence, as well as other macro-economic factors. In the first quarter of our fiscal year 2011, we were once again impacted by rising raw materials costs. We are in the process of implementing price increases during our second fiscal quarter to mitigate the impact of the increasing grain prices.

### **Weather and Seasonality**

Historically, our sales of lawn and garden products have been influenced by weather and climate conditions in the different markets we serve. Additionally, our Garden Products business has historically been highly seasonal. In fiscal 2010, approximately 68% of Garden Products net sales and 60% of our total net sales occurred in the second and third fiscal quarters. Substantially all of Garden Products operating income is typically generated in this period, which has historically offset the operating loss incurred during the first fiscal quarter of the year.

### **Liquidity and Capital Resources**

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

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

We service two broad markets: pet supplies and lawn and garden supplies. Our pet supplies businesses involve products that have a year round selling cycle with a slight degree of seasonality. As a result, it is not necessary to maintain large quantities of inventory to meet peak demands. On the other hand, our lawn and garden businesses are highly seasonal with approximately 68% of Garden Products net sales occurring during the second and third fiscal quarters. For many manufacturers of garden products, this seasonality requires them to ship large quantities of their product well ahead of the peak consumer buying periods. To encourage retailers and distributors to stock large quantities of inventory, industry practice has been for manufacturers to give extended credit terms and/or promotional discounts.

Net cash provided by operating activities decreased \$39.6 million, from \$44.3 million for the three months ended December 26, 2009, to \$4.7 million for the three months ended December 25, 2010. The decrease in cash provided by operating activities was due primarily to the working capital improvements in the first quarter of our fiscal year 2010, which generated large increases in cash, and to lower earnings in the first quarter of our fiscal year 2011. In the first quarter of fiscal 2011, our working capital accounts decreased approximately \$2.8 million from fiscal year end 2010, but increased by \$20.6 million as compared to the first quarter of fiscal year 2010, due primarily to increased inventory purchases since fiscal year end 2010.

Net cash used in investing activities increased \$3.7 million, from \$2.6 million for the three months ended December 26, 2009 to \$6.3 million during the three months ended December 25, 2010. The increase in cash used in investing activities was due to increases in capital expenditures in the current year as a result of the conversion of our legacy systems to an enterprise-wide information technology platform, as well as a contingent performance payment related to an acquired business that was not required in the prior year period.

Net cash used by financing activities decreased \$21.1 million, from \$35.5 million for the three months ended December 26, 2009, to \$14.4 million for the three months ended December 25, 2010. The decrease in cash used was due to higher repurchases of our common stock during the three months ended December 26, 2009. For the three month period ending December 25, 2010, we



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repurchased and retired 0.5 million shares of our voting common stock at an aggregate cost of approximately \$5.1 million, or approximately \$9.52 per share, and 1.0 million shares of our non-voting Class A common stock at an aggregate cost of approximately \$9.8 million, or approximately \$9.61 per share.

***Senior Credit Facility***

On June 25, 2010, we entered into an Amended and Restated Credit Agreement (the *Credit Agreement*) with respect to a five-year senior secured revolving credit facility (the *Credit Facility*) in an aggregate principal amount of \$275 million. We have the option to increase the size of the Facility by an additional \$200 million of incremental term loans and/or revolving loans should we exercise our option and one or more lenders are willing to make such increased amounts available to us. There was no outstanding balance at December 25, 2010 under the Credit Facility. There were \$0.2 million of letters of credit outstanding. After giving effect to the financial covenants in the Credit Agreement, the remaining potential borrowing capacity was \$274.8 million.

Interest on the Credit Facility is based, at our option, on a rate equal to the Alternate Base Rate ( *ABR* ), the greatest of the prime rate, the Federal Funds rate plus  $\frac{1}{2}$  of 1% or one month LIBOR plus 1%, plus a margin, which fluctuates from 1.5% to 2.5%, or LIBOR plus a margin, which fluctuates from 2.5% to 3.5% and commitment fees that range from 0.35% to 0.75%, determined quarterly based on consolidated total debt to consolidated EBITDA for the most recent trailing 12-month period. As of December 25, 2010, had we borrowed under the Credit Facility, the applicable interest rate on the Credit Facility related to alternate base rate borrowings would have been 5.25%, and the applicable interest rate related to LIBOR rate borrowings would have been 3.26%.

The Credit Facility is guaranteed by our material subsidiaries and is secured by our assets, excluding real property but including substantially all of the capital stock of our subsidiaries. The Credit Agreement contains certain financial and other covenants which require us to maintain minimum levels of interest coverage and maximum levels of senior debt to EBITDA and that restrict our ability to repurchase our stock, make investments in or acquisitions of other businesses and pay dividends above certain levels over the life of the Credit Facility. Under the terms of our Credit Facility, we may make restricted payments, including cash dividends and stock repurchases, in an aggregate amount initially not to exceed \$200 million over the life of the Credit Facility, subject to qualifications and baskets as defined in the Credit Agreement. As of December 25, 2010, our Total Leverage Ratio, as defined in the Credit Agreement, was 2.7 to 1.0. Apart from the covenants limiting restricted payments and capital expenditures, the Credit Facility does not restrict the use of retained earnings or net income. We were in compliance with all financial covenants as of December 25, 2010.

***Senior Subordinated Notes and Debt Refinancing***

On March 8, 2010, we issued \$400 million aggregate principal amount of 8.25% senior subordinated notes due March 1, 2018 (the *2018 Notes*). We used the proceeds together with available cash to purchase our outstanding \$150 million aggregate principal amount of 9.125% senior subordinated notes due February 1, 2013 (the *2013 Notes*), including accrued interest, to repay the \$267.1 million outstanding under our senior term loan maturing February 2012 and pay fees and expenses related to the offering. We received tenders and consents from the holders of \$150 million of our 2013 Notes, including \$12.8 million held in escrow for our benefit, which was previously recorded as a reduction of debt for accounting purposes against the 2013 Notes.

The estimated fair value of our \$400 million 2018 Notes as of December 25, 2010 was approximately \$405.0 million. The estimated fair value is based on quoted market prices for these notes.

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

We may redeem some or all of the 2018 Notes at any time prior to March 1, 2014 at the principal amount plus a *make whole* premium. We may redeem some or all of the 2018 Notes at any time on or after March 1, 2014 for 104.125%, after March 1, 2015 for 102.063% and after March 1, 2016 for 100%, plus accrued and unpaid interest. Additionally, at any time prior to March 1, 2013 we may redeem up to 35% of the 2018 Notes with any proceeds we receive from certain equity offerings at a redemption price of 108.25% of the principal amount, plus accrued and unpaid interest. The holders of the 2018 Notes have the right to require us to repurchase all or a portion of the 2018 Notes at a purchase price equal to 101% of the principal amount of the notes repurchased, plus accrued and unpaid interest through the repurchase date upon the occurrence of a change of control.

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The 2018 Notes contain customary high yield covenants, including covenants limiting debt incurrence and restricted payments, subject to certain baskets and exceptions.

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At December 25, 2010, our total debt outstanding was \$400.3 million versus \$407.3 million at December 26, 2009 and cash and short term investment balances for the same periods were \$90.6 million and \$91.8 million, respectively.

In 2010, our Board of Directors authorized the repurchase of up to a total of \$100 million of our common stock, of which approximately \$33.8 million has been repurchased to date. We expect to continue our repurchases from time to time depending on market conditions.

We believe that cash flows from operating activities, funds available under our Credit Facility and arrangements with suppliers will be adequate to fund our presently anticipated working capital requirements for the foreseeable future. We anticipate that our capital expenditures will not exceed \$30 million for fiscal 2011, which are related primarily to replacements and upgrades to plant and equipment and investment in our implementation of a scalable enterprise-wide information technology platform. We are investing in this information technology platform to improve existing operations, to support future growth, and enable us to take advantage of new applications and technologies. We have invested approximately \$51 million from fiscal 2005 through fiscal 2010 in this initiative and plan to invest up to an additional \$10 million in fiscal 2011 for planned implementations. Capital expenditures for 2012 and beyond will depend upon the pace of conversion of those remaining legacy systems. This initiative, when complete, will combine our numerous information systems into one enterprise system which should create greater efficiency and effectiveness.

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

## **Off-Balance Sheet Arrangements**

There have been no material changes to the information provided in our Annual Report on Form 10-K for the fiscal year ended September 25, 2010 regarding off-balance sheet arrangements.

## **Contractual Obligations**

There have been no material changes outside the ordinary course of business in our contractual obligations set forth in the Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources in our Annual Report on Form 10-K for the fiscal year ended September 25, 2010.

## **New Accounting Pronouncements**

Refer to Footnote 1 in the notes to the condensed consolidated financial statements for new accounting pronouncements.

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

There have been no material changes to our critical accounting policies, estimates and assumptions or the judgments affecting the application of those accounting policies since our Annual Report on Form 10-K for the fiscal year ended September 25, 2010.

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

We believe there has been no material change in our exposure to market risk from that discussed in our fiscal 2010 Annual Report filed on Form 10-K except as follows:

*Commodity Prices.* We are exposed to fluctuations in market prices for grains, grass seed and pet food ingredients. To mitigate risk associated with increases in market prices and commodity availability, we enter into contracts for purchases, primarily to ensure commodity availability to us in the future. As of September 25, 2010, we had entered into fixed purchase commitments for commodities totaling approximately \$157.6 million. A 10% change in the market price for these commodities would have resulted in an additional pretax gain or loss of \$15.8 million related to the contracts outstanding as of September 25, 2010. During the first quarter of fiscal 2011, prices for some of our key crops have increased substantially. During the first quarter of fiscal 2011, our weighted average cost per pound increased approximately 15% from the fourth quarter of fiscal 2010. We are currently negotiating price increases with our retailers; however we can provide no assurance as to the timing or extent of our ability to implement additional price adjustments in the context of rising costs or in the event of increased costs in the

future.



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**Item 4. Controls and Procedures**

(a) *Evaluation of Disclosure Controls and Procedures.* Our Chief Executive Officer and Chief Financial Officer have reviewed, as of the end of the period covered by this report, the disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) that ensure that information relating to the Company required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported in a timely and proper manner and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Based upon this review, such officers concluded that our disclosure controls and procedures were effective as of December 25, 2010.

(b) *Changes in Internal Control Over Financial Reporting.* Central's management, with the participation of Central's Chief Executive Officer and Chief Financial Officer, has evaluated whether any change in Central's internal control over financial reporting occurred during the first quarter of fiscal 2011. Based on that evaluation, management concluded that there has been no change in Central's internal control over financial reporting during the first quarter of fiscal 2011 that has materially affected, or is reasonably likely to materially affect, Central's internal control over financial reporting.

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

From time to time, we are involved in certain legal proceedings in the ordinary course of business. Currently, we are not a party to any legal proceedings that management believes would have a material adverse effect on our financial position or results of operations.

**Item 1A. Risk Factors**

There have been no material changes from the risk factors previously disclosed in Item 1A. to Part I of our Form 10-K for the fiscal year ended September 25, 2010.

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The following table sets forth the repurchases of any equity securities during the fiscal quarter ended December 25, 2010 and the dollar amount of authorized share repurchases remaining under our stock repurchase program.

Period	Total Number of Shares (or Units) Purchased	Average Price Paid per Share (or Units)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs (1)
September 26, 2010 – October 30, 2010	11,834 <sup>(2)</sup>	\$ 10.26	7,500	\$ 81,077,000
October 31, 2010 – November 27, 2010	274,803 <sup>(3)</sup>	\$ 9.03	272,100	\$ 78,620,000
November 28, 2010 – December 25, 2010	1,283,070 <sup>(4)</sup>	\$ 9.69	1,278,676	\$ 66,225,000
Total	1,569,707	\$ 9.58	1,558,276	\$ 66,225,000

- (1) On July 15, 2010, the Board of Directors authorized a new \$100 million share repurchase program. The program has no expiration date and expires when the amount authorized has been used or the Board withdraws its authorization.
- (2) Includes 4,334 shares purchased during the period indicated that represent withholding of a portion of shares to cover taxes in connection with the vesting of restricted stock and the exercise of stock options.
- (3) Includes 2,703 shares purchased during the period indicated that represent withholding of a portion of shares to cover taxes in connection with the vesting of restricted stock and the exercise of stock options.
- (4) Includes 4,394 shares purchased during the period indicated that represent withholding of a portion of shares to cover taxes in connection with the vesting of restricted stock and the exercise of stock options.

**Item 3. Defaults Upon Senior Securities**

Not applicable

**Item 4. Reserved****Item 5. Other Information**

Not applicable

**Item 6. Exhibits**

- 10.1 Employment Offer Letter Between Lori Varlas and the Company dated November 5, 2010 (Incorporated by reference from Exhibit 10.1 to the Company's Form 8-K filed December 1, 2010).
- 31.1 Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

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- 31.2 Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350.
- 32.2 Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350.

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**SIGNATURES**

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

CENTRAL GARDEN & PET COMPANY

Registrant

Dated: February 3, 2011

/s/ WILLIAM E. BROWN

William E. Brown

Chairman and Chief Executive Officer

*(Principal Executive Officer)*

/s/ LORI A. VARLAS

Lori A. Varlas

Chief Financial Officer

*(Principal Financial Officer)*