

CENTRAL GARDEN & PET CO  
Form 10-Q  
May 07, 2009  
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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 March 28, 2009

or

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

Commission File Number: 001-33268

**CENTRAL GARDEN & PET COMPANY**

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

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

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

(Address of principle executive offices)

**(925) 948-4000**

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant 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 April 30, 2009         | 19,684,899 |
| Class A Common Stock Outstanding as of April 30, 2009 | 48,446,286 |
| Class B Stock Outstanding as of April 30, 2009        | 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, 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, 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 27, 2008 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;

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declines in consumer spending during economic downturns;

inflation and adverse macro-economic conditions;

supply shortages in small animals and pet birds;

adverse weather conditions;

fluctuations in energy prices, fuel and related petrochemical costs;

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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;

impact of stock price decline on raising capital and dilution;

access to 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           |                     | (See Note 1)          |
|--|---------------------|---------------------|-----------------------|
|  | March 29,<br>2008   | March 28,<br>2009   | September 27,<br>2008 |
| <b>ASSETS</b>  |                     |                     |                       |
| Current assets:  |                     |                     |                       |
| Cash and cash equivalents  | \$ 7,577            | \$ 8,545            | \$ 26,929             |
| Accounts receivable (less allowance for doubtful accounts of \$14,420, \$13,393 and \$15,181)  | 342,528             | 317,713             | 260,639               |
| Inventories  | 416,848             | 380,156             | 349,499               |
| Prepaid expenses and other   | 33,953              | 40,030              | 34,686                |
| <b>Total current assets</b>  | <b>800,906</b>      | <b>746,444</b>      | <b>671,753</b>        |
| Land, buildings, improvements and equipment net  | 196,204             | 168,536             | 174,013               |
| Goodwill   | 204,562             | 207,173             | 201,499               |
| Other intangible assets net  | 98,797              | 105,520             | 107,404               |
| Deferred income taxes and other assets   | 131,827             | 84,505              | 104,649               |
| <b>Total</b>   | <b>\$ 1,432,296</b> | <b>\$ 1,312,178</b> | <b>\$ 1,259,318</b>   |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>   |                     |                     |                       |
| Current liabilities:   |                     |                     |                       |
| Accounts payable   | \$ 126,946          | \$ 137,558          | \$ 133,364            |
| Accrued expenses   | 92,510              | 94,571              | 84,345                |
| Current portion of long-term debt  | 3,350               | 3,322               | 3,340                 |
| <b>Total current liabilities</b>   | <b>222,806</b>      | <b>235,451</b>      | <b>221,049</b>        |
| Long-term debt   | 692,141             | 543,629             | 519,807               |
| Other long-term obligations  | 4,740               | 6,379               | 7,037                 |
| Minority interest  | 2,297               | 1,003               | 2,667                 |
| Shareholders' equity:  |                     |                     |                       |
| Common stock, \$.01 par value: 22,280,305, 19,683,660 and 21,008,384 shares outstanding at March 29, 2008, March 28, 2009 and September 27, 2008         | 221                 | 197                 | 210                   |
| Class A common stock, \$.01 par value: 48,221,552, 48,381,234 and 48,466,999 shares outstanding at March 29, 2008, March 28, 2009 and September 27, 2008 | 482                 | 484                 | 485                   |
| Class B stock, \$.01 par value: 1,652,262 shares outstanding   | 16                  | 16                  | 16                    |
| Additional paid-in capital   | 557,541             | 548,955             | 555,310               |
| Accumulated deficit  | (52,201)            | (23,627)            | (50,463)              |
| Accumulated other comprehensive income (loss)  | 4,253               | (309)               | 3,200                 |
| <b>Total shareholders' equity</b>  | <b>510,312</b>      | <b>525,716</b>      | <b>508,758</b>        |
| <b>Total</b>   | <b>\$ 1,432,296</b> | <b>\$ 1,312,178</b> | <b>\$ 1,259,318</b>   |

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>Six Months Ended</b>   |                           |
|---|---------------------------|---------------------------|---------------------------|---------------------------|
|   | <b>March 29,<br/>2008</b> | <b>March 28,<br/>2009</b> | <b>March 29,<br/>2008</b> | <b>March 28,<br/>2009</b> |
| Net sales   | \$ 484,688                | \$ 476,425                | \$ 798,473                | \$ 768,967                |
| Cost of goods sold and occupancy  | 324,878                   | 315,872                   | 544,341                   | 522,933                   |
| Gross profit  | 159,810                   | 160,553                   | 254,132                   | 246,034                   |
| Selling, general and administrative expenses                                    | 115,160                   | 103,397                   | 200,096                   | 191,544                   |
| Goodwill and other impairments  |                           |                           | 400,000                   |                           |
| Income (loss) from operations   | 44,650                    | 57,156                    | (345,964)                 | 54,490                    |
| Interest expense  | (9,780)                   | (5,751)                   | (21,285)                  | (12,635)                  |
| Interest income   | 266                       | 270                       | 554                       | 602                       |
| Other income (expense)  | 1,191                     | (131)                     | 1,674                     | (1,081)                   |
| Income (loss) before income taxes (tax benefit) and minority interest           | 36,327                    | 51,544                    | (365,021)                 | 41,376                    |
| Income taxes (tax benefit)  | 15,403                    | 17,980                    | (96,411)                  | 14,127                    |
| Minority interest   | 471                       | 544                       | 463                       | 413                       |
| Net income (loss)   | \$ 20,453                 | \$ 33,020                 | \$ (269,073)              | \$ 26,836                 |
| Net income (loss) per share:  |                           |                           |                           |                           |
| Basic   | \$ 0.29                   | \$ 0.48                   | \$ (3.77)                 | \$ 0.38                   |
| Diluted   | \$ 0.28                   | \$ 0.47                   | \$ (3.77)                 | \$ 0.38                   |
| Weighted average shares used in the computation of net income (loss) per share: |                           |                           |                           |                           |
| Basic   | 71,427                    | 69,122                    | 71,295                    | 70,122                    |
| Diluted   | 72,035                    | 69,872                    | 71,295                    | 70,588                    |

See notes to condensed consolidated financial statements.



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|  | <b>Six Months Ended</b>   |                           |
|--|---------------------------|---------------------------|
|  | <b>March 29,<br/>2008</b> | <b>March 28,<br/>2009</b> |
| <b>Cash flows from operating activities:</b>   |                           |                           |
| Net income (loss)  | \$ (269,073)              | \$ 26,836                 |
| <b>Adjustments to reconcile net loss to net cash provided by (used in) operating activities:</b> |                           |                           |
| Depreciation and amortization  | 16,069                    | 14,696                    |
| Stock-based compensation   | 6,767                     | 6,383                     |
| Excess tax benefits from stock-based awards  | (24)                      | (74)                      |
| Minority interest  | 463                       | 413                       |
| Deferred income taxes  | (113,419)                 | (682)                     |
| Gain on sales of property  | (7,931)                   |                           |
| Loss on sale of a business and equipment   | 1,592                     | 435                       |
| Goodwill impairment  | 400,000                   |                           |
| Other impairments  | 2,000                     |                           |
| Proceeds from interest rate swap termination, net of amounts reclassified into earnings          |                           | 2,186                     |
| <b>Change in assets and liabilities (excluding businesses acquired):</b>                         |                           |                           |
| Accounts receivable  | (94,975)                  | (58,301)                  |
| Inventories  | (37,116)                  | (33,454)                  |
| Prepaid expenses and other assets  | 7,747                     | 1,273                     |
| Accounts payable   | (10,621)                  | 3,607                     |
| Accrued expenses   | 11,192                    | 10,526                    |
| Other long-term obligations  | (1,248)                   | (658)                     |
| <b>Net cash used in operating activities</b>   | <b>(88,577)</b>           | <b>(26,814)</b>           |
| <b>Cash flows from investing activities:</b>   |                           |                           |
| Additions to property and equipment  | (13,132)                  | (7,110)                   |
| Proceeds from property sales, net of expenses  | 12,053                    |                           |
| Businesses acquired, net of cash acquired  | (4,998)                   | (4,799)                   |
| Restricted investments   | (39)                      |                           |
| <b>Net cash used in investing activities</b>   | <b>(6,116)</b>            | <b>(11,909)</b>           |
| <b>Cash flows from financing activities:</b>   |                           |                           |
| Borrowings on revolving line of credit   | 385,000                   | 374,000                   |
| Repayments of revolving line of credit   | (302,000)                 | (315,000)                 |
| Repayments of long-term debt   | (934)                     | (23,321)                  |
| Proceeds from issuance of common stock   | 61                        | 109                       |
| Repurchase of common stock   | (138)                     | (12,812)                  |
| Redemption of preferred stock  | (750)                     |                           |
| Distribution to minority interest  |                           | (2,082)                   |
| Excess tax benefits from stock-based awards  | 24                        | 74                        |
| Payment of financing costs   | (125)                     | (75)                      |
| <b>Net cash provided by financing activities</b>   | <b>81,138</b>             | <b>20,893</b>             |

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|  |           |           |
|--|-----------|-----------|
| Effect of exchange rate changes on cash and cash equivalents | 77        | (554)     |
| Net decrease in cash and cash equivalents                    | (13,478)  | (18,384)  |
| Cash and equivalents at beginning of period                  | 21,055    | 26,929    |
| Cash and equivalents at end of period                        | \$ 7,577  | \$ 8,545  |
| Supplemental information:                                    |           |           |
| Cash paid for interest                                       | \$ 22,307 | \$ 12,899 |
| Cash paid for income taxes net of refunds                    | \$ 77     | \$ 423    |
| Non-cash investing activities:                               |           |           |
| Liabilities assumed in connection with acquisitions          | \$ 1,396  | \$        |
| Note receivable from sale of property                        | \$ 3,850  | \$        |
| Capital expenditures incurred but not paid                   | \$        | \$ 329    |
| Non-cash financing activities                                |           |           |
| Offset of subordinated notes with escrow                     | \$        | \$ 12,825 |
| Restricted share stock bonus                                 | \$ 1,549  | \$ 3,877  |

See notes to condensed consolidated financial statements.

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**CENTRAL GARDEN & PET COMPANY**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**Three and Six Months Ended March 28, 2009**

**(unaudited)**

**1. Basis of Presentation**

The condensed consolidated balance sheets of Central Garden & Pet Company and subsidiaries (the Company or Central ) as of March 29, 2008 and March 28, 2009, the condensed consolidated statements of operations for the three and six months ended March 29, 2008 and March 28, 2009 and the condensed consolidated statements of cash flows for the six months ended March 29, 2008 and March 28, 2009 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 3) 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 six month period ended March 28, 2009, there was comprehensive income of \$23.3 million, which includes net income of \$26.8 million and foreign currency translation adjustments of \$3.5 million that are excluded from net earnings but reported in accumulated other comprehensive income, a separate component of shareholders' equity. Deferred taxes are not provided on translation gains and losses, because the Company expects earnings of its foreign subsidiary to be permanently reinvested. Transaction gains and losses are included in results of operations.

Due to the seasonal nature of the Company's garden business, the results of operations for the three and six month periods ended March 28, 2009 and March 29, 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 2008 Annual Report on Form 10-K, which has previously been filed with the Securities and Exchange Commission. The September 27, 2008 balance sheet presented herein was derived from the audited statements.

***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 March 28, 2009, we repurchased 1,070,000 shares of our voting common stock at an aggregate cost of approximately \$7.1 million, or approximately \$6.66 per share, and 335,000 shares of our non-voting Class A common stock at an aggregate cost of approximately \$2.1 million, or approximately \$6.21 per share. During the six months ended March 28, 2009, we repurchased 1,291,925 shares of our voting common stock in the open market at an aggregate cost of approximately \$8.2 million, or approximately \$6.33 per share, and 847,168 shares of our non-voting Class A common stock in the open market at an aggregate cost of approximately \$4.4 million, or approximately \$5.27 per share.

***Recent Accounting Pronouncements***

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. In February 2008, the FASB issued FASB Staff Position ( FSP ) No. FAS 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13* and FSP No. FAS 157-2, *Effective Date of FASB Statement No. 157*. FSP 157-1 amends SFAS No. 157 to remove certain leasing transactions from its scope. FSP 157-2 delays the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008 for all non-financial

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assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually) and will be adopted by the Company beginning in the first quarter of fiscal 2010. In October 2008, the FASB issued FSP No. 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active*, to clarify the application of SFAS No. 157 in inactive markets for financial assets. FSP 157-3 became effective upon issuance and SFAS No. 157 is effective for fiscal years beginning after November 15, 2007.

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The Company elected to partially adopt SFAS No. 157 as of the beginning of fiscal 2009, as permitted by FSP 157-2 (see Note 2). The Company does not expect the adoption of the remaining provisions of SFAS No. 157 (delayed by FSP 157-2) to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

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. The Company adopted SFAS No. 159 as of the beginning of fiscal 2009 but elected not to record additional financial assets and liabilities at fair value. As a result, the adoption of SFAS No. 159 did not impact the Company's consolidated financial position, results of operations or cash flows.

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. In April 2009, the FASB issued FSP No. 141(R)-1 (FSP 141(R)-1), *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination that Arise from Contingencies*. FSP 141(R)-1 requires an acquirer to recognize at fair value an asset acquired or a liability assumed in a business combination that arises from a contingency if the acquisition-date fair value of an asset or liability can be determined during the measurement period. If the acquisition-date fair value cannot be determined, then the acquirer follows the recognition criteria in FASB Statement No. 5, *Accounting for Contingencies* and FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss* as an interpretation of FASB Statement No. 5 to determine whether the contingency should be recognized as of the acquisition date or after it. This FSP is effective prospectively for businesses acquired by the Company in its fiscal year beginning September 27, 2009.

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 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 April 2008, the FASB issued FSP No. 142-3 (FSP 142-3) *Determination of the Useful Life of Intangible Assets*. FSP 142-3 amends the factors an entity should consider in developing renewal or extension assumptions used in determining the useful life of recognized intangible assets under FASB Statement No. 142, *Goodwill and Other Intangible Assets*. This new guidance applies prospectively to intangible assets that are acquired individually or with a group of other assets in business combinations and asset acquisitions. FSP 142-3 is effective for the Company in its fiscal year beginning September 27, 2009. Early adoption is prohibited. Since this guidance will be applied prospectively, on adoption, there will be no impact to our current consolidated financial statements.

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

SFAS No. 157 establishes a single authoritative definition of fair value, a framework for measuring fair value and expands disclosure of fair value measurements. SFAS No. 157 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).



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In February 2009, the Company's \$75 million pay-floating interest rate swap was terminated prior to its maturity by the counterparty in accordance with the terms of the interest rate swap agreement. As a result of this swap termination, the Company received cash proceeds and realized a settlement gain of \$2.3 million that was recorded as an adjustment to the carrying amount of the related debt. The settlement gain is being amortized as an offset to interest expense over the remaining term of the debt, which expires February 2013.

### **3. 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 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.

In the first fiscal quarter of fiscal 2008, the Company recorded a non-cash charge of \$400 million to recognize the impairment of goodwill and other intangible assets, comprised of \$202 million relating to its Garden Products segment and \$198 million relating to its Pet Products segment. This non-cash charge of \$400 million reduced net earnings for the six months ended March 29, 2008 by \$290.4 million net of taxes.

In connection with the Company's purchase of an additional 60% equity interest in Tech Pac L.L.C. in March 2006, it deposited approximately \$15.5 million into an escrow account for possible contingent performance-based payments. In fiscal 2009, a net amount of \$4.8 million in cash was paid in performance-based payments which the Company recognized as additional goodwill.

### **4. Long-Term Debt**

As of March 28, 2009, 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. As of March 28, 2009, the applicable interest rate on the revolving credit facility related to base rate borrowings was 3.38%, and the applicable interest rate related to LIBOR rate borrowings was 1.78%. 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. As of March 28, 2009, the applicable interest rate on the term loan related to base rate borrowings was 3.75%, and the applicable interest rate related to LIBOR rate borrowings was 2.03%. 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 its stock, make investments in or acquisitions of other businesses and pay dividends above certain levels over the life of the facilities. Under the terms of the Company's senior secured credit facilities, it may make restricted payments, including cash dividends, in an aggregate amount not to exceed \$75,000,000 over the life of the facilities; if the total leverage ratio for the fiscal quarter most recently ended is less than 3.00 to 1.00, the maximum restricted payment amount will be increased to \$100,000,000 over the life of the facilities. Apart from the covenants limiting restricted payments and capital expenditures, the facilities do not restrict the use of retained earnings or net income.

The Company was in compliance with all financial covenants as of March 28, 2009. There was a \$137.0 million outstanding balance at March 28, 2009 under the \$350 million revolving credit facility plus \$15.8 million of outstanding letters of credit. After giving effect to the financial covenants in the credit agreement, the remaining borrowing capacity was \$170 million.

The Company's credit facility contains mandatory prepayment provisions when the Company has excess cash flow, as defined in the credit agreement, during the fiscal year. Accordingly, in December 2008, the Company repaid \$21.6 million of the term loan per this provision.

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The Company also has outstanding \$150 million of 9-1/8% senior subordinated notes due 2013 ( senior subordinated notes ). In October 2003, the Company entered into a \$75 million pay-floating interest rate swap effectively converting half of its \$150 million fixed rate 9-1/8 % senior subordinated notes to a floating rate of LIBOR + 4.04%. In February 2009, the swap was terminated prior to its maturity by the counterparty in accordance with the terms of the interest rate swap agreement. As a result of this swap termination, the Company received cash proceeds and realized a settlement gain of \$2.3 million that was recorded as an adjustment to the carrying amount of the related debt. The settlement gain is being amortized as an offset to interest expense over the remaining term of the debt, which expires in February 2013.

In connection with Gulfstream s purchase of an additional 60% equity interest in Tech Pac L.L.C. in March 2006, the Company deposited approximately \$15.5 million into an escrow for possible contingent performance-based payments. In March 2009, a net amount of \$4.8 million in cash was paid in performance-based payments, which the Company recognized as additional goodwill. There are no remaining contingent performance-based payments due to the seller. As part of the resolution of the contingent payments, the Company became the beneficiary of the remaining funds in the escrow, which are comprised primarily of \$12.8 million of aggregate principal amount of the senior subordinated notes. Under the requirements of SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, the senior subordinated notes contained within the escrow accounts have been recorded as a reduction of debt for accounting purposes against our outstanding senior subordinated notes balance as of March 28, 2009. The senior subordinated notes continue to be held in the escrow and have not been retired.

**5. 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 for non-performance based options.

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, 3.7 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. In fiscal 2009, approximately 78% of the performance options granted in fiscal 2008 that were eligible to vest in 2009, vested. To the extent Company goals are not achieved, the amount of stock-based compensation recognized in the future will be adjusted.

The Company recognized share-based compensation expense of \$5.3 million and \$5.8 million for the three month periods ended March 28, 2009 and March 29, 2008, respectively, and \$6.4 million and \$6.8 million for the six month periods ended March 28, 2009 and March 29, 2008, respectively, as a component of selling, general and administrative expenses.

The following table summarizes option activity for the six months ended March 28, 2009:

|                                   | Number of<br>Shares<br>(in thousands) |
|-----------------------------------|---------------------------------------|
| Outstanding at September 27, 2008 | 7,599                                 |
| Granted                           | 213                                   |
| Exercised                         | (46)                                  |
| Cancelled or Expired              | (374)                                 |
| Outstanding at March 28, 2009     | 7,392                                 |
| Exercisable at March 28, 2009     | 2,194                                 |



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As of March 28, 2009, there was approximately \$5.1 million of total unrecognized compensation cost related to non-vested stock options, which is expected to be recognized over a remaining weighted-average vesting period of four years.

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**Restricted Stock Awards:** As of March 28, 2009, there were 0.4 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 six months ended March 28, 2009:

|                                 | Number of<br>Shares<br>(in thousands) |
|---------------------------------|---------------------------------------|
| Nonvested at September 27, 2008 | 563                                   |
| Granted                         | 737                                   |
| Vested                          | (729)                                 |
| Forfeited                       | (172)                                 |
| <br>Nonvested at March 28, 2009 | <br>399                               |

The weighted average per share grant-date fair value of restricted stock awards granted during the first six months of fiscal 2009 and fiscal 2008 was \$6.18 and \$4.29, respectively.

During the six months ended March 28, 2009, the Company awarded approximately 621,000 shares, or \$6.2 million, of its non-voting common stock as bonus compensation in lieu of cash payment. The shares granted during the period as bonus compensation vested immediately.

As of March 28, 2009, there was approximately \$3.1 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.

**6. 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<br>March 28, 2009     |        |           | Six Months Ended<br>March 28, 2009 |        |           |
|---|--|--------|-----------|------------------------------------|--------|-----------|
|   | Income                                   | Shares | Per Share | Income                             | Shares | Per Share |
|   | (in thousands, except per share amounts) |        |           |                                    |        |           |
| <b>Basic EPS:</b>                           |  |        |           |                                    |        |           |
| Net income available to common shareholders | \$ 33,020                                | 69,122 | \$ 0.48   | \$ 26,836                          | 70,122 | \$ 0.38   |
| <b>Effect of dilutive securities:</b>       |  |        |           |                                    |        |           |
| Options to purchase common stock            |  | 335    |           |                                    | 41     |           |
| Restricted shares                           |  | 415    | (0.01)    |                                    | 425    |           |
| <b>Diluted EPS:</b>                         |  |        |           |                                    |        |           |
| Net income available to common shareholders | \$ 33,020                                | 69,872 | \$ 0.47   | \$ 26,836                          | 70,588 | \$ 0.38   |

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|  | Three Months Ended<br>March 29, 2008 |        |           | Six Months Ended<br>March 29, 2008 |        |           |
|--|--------------------------------------|--------|-----------|------------------------------------|--------|-----------|
|  | Income                               | Shares | Per Share | Income (Loss)                      | Shares | Per Share |
| (in thousands, except per share amounts)           |                                      |        |           |                                    |        |           |
| <b>Basic EPS:</b>                                  |                                      |        |           |                                    |        |           |
| Net income (loss) available to common shareholders | \$ 20,453                            | 71,427 | \$ 0.29   | \$ (269,073)                       | 71,295 | \$ (3.77) |
| <b>Effect of dilutive securities:</b>              |                                      |        |           |                                    |        |           |
| Options to purchase common stock                   |                                      | 18     |           |                                    |        |           |
| Restricted shares                                  |                                      | 582    | (0.01)    |                                    |        |           |
| Convertible preferred stock                        |                                      | 8      |           |                                    |        |           |
| <b>Diluted EPS:</b>                                |                                      |        |           |                                    |        |           |
| Net income (loss) available to common shareholders | \$ 20,453                            | 72,035 | \$ 0.28   | \$ (269,073)                       | 71,295 | \$ (3.77) |

Options to purchase 7.4 million shares of common stock at prices ranging from \$4.26 to \$17.99 per share were outstanding at March 28, 2009 and options to purchase 6.4 million shares of common stock at prices ranging from \$4.26 to \$17.99 per share were outstanding at March 29, 2008.

For the three month periods ended March 28, 2009 and March 29, 2008, options to purchase 4.8 and 3.8 million shares of common stock, respectively, were outstanding but were not included in the computation of diluted earnings per share because the option exercise prices were greater than the average market price of the common shares and, therefore, the effect would be anti-dilutive. 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 March 29, 2008.

For the six month period ended March 28, 2009, options to purchase 4.9 million 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. 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 six month period ended March 29, 2008, because their inclusion in a net loss period would be anti-dilutive to the earnings per share calculation.

**Table of Contents****7. 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).

|   | Three Months Ended |                   | Six Months Ended            |                   |
|---|--------------------|-------------------|-----------------------------|-------------------|
|   | March 29,<br>2008  | March 28,<br>2009 | March 29,<br>2008           | March 28,<br>2009 |
| <b>Net sales:</b>                                     |                    |                   |                             |                   |
| Pet Products  | \$ 230,914         | \$ 228,840        | \$ 432,537                  | \$ 414,515        |
| Garden Products                                       | 253,774            | 247,585           | 365,936                     | 354,452           |
| Total net sales                                       | \$ 484,688         | \$ 476,425        | \$ 798,473                  | \$ 768,967        |
| <b>Income (loss) from operations:</b>                 |                    |                   |                             |                   |
| Pet Products  | \$ 28,195          | \$ 31,897         | \$ (152,571) <sup>(1)</sup> | \$ 44,772         |
| Garden Products                                       | 26,111             | 36,721            | (179,947) <sup>(2)</sup>    | 28,965            |
| Corporate   | (9,656)            | (11,462)          | (13,446)                    | (19,247)          |
| Total income (loss) from operations                   | 44,650             | 57,156            | (345,964)                   | 54,490            |
| Interest expense net                                  | (9,514)            | (5,481)           | (20,731)                    | (12,033)          |
| Other income (expense)                                | 1,191              | (131)             | 1,674                       | (1,081)           |
| Income taxes (tax benefit)                            | 15,403             | 17,980            | (96,411)                    | 14,127            |
| Minority interest                                     | 471                | 544               | 463                         | 413               |
| Net income (loss)                                     | \$ 20,453          | \$ 33,020         | \$ (269,073)                | \$ 26,836         |
| <b>Depreciation and amortization:</b>                 |                    |                   |                             |                   |
| Pet Products  | \$ 4,234           | \$ 3,943          | \$ 8,603                    | \$ 8,030          |
| Garden Products                                       | 2,155              | 1,618             | 4,325                       | 3,337             |
| Corporate   | 1,690              | 1,661             | 3,141                       | 3,329             |
| Total depreciation and amortization                   | \$ 8,079           | \$ 7,222          | \$ 16,069                   | \$ 14,696         |
| <b>Assets:</b>  |                    |                   |                             |                   |
| Pet Products  | \$ 472,415         | \$ 462,356        |                             |                   |
| Garden Products                                       | 409,646            | 509,884           |                             |                   |
| Corporate   | 377,257            | 339,938           |                             |                   |
| Total assets  | \$ 1,259,318       | \$ 1,312,178      |                             |                   |
| <b>Goodwill (included in corporate assets above):</b> |                    |                   |                             |                   |
| Pet Products  | \$ 201,499         | \$ 202,374        |                             |                   |
| Garden Products                                       |                    | 4,799             |                             |                   |
| Total goodwill  | \$ 201,499         | \$ 207,173        |                             |                   |

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- (1) Includes goodwill impairment of \$197,755
  
- (2) Includes goodwill and other intangible assets impairment of \$202,245

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**8. 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.

Matson, LLC

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)

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.

For the three months and six months ended March 28, 2009, goodwill and other intangible assets have been reported in the Guarantor Subsidiaries consolidating condensed financial statements below. In prior periods, such amounts were reported in the Parent consolidating condensed financial statements. The consolidating condensed financial statements for the three and six months ended March 29, 2008 have been restated to conform with the fiscal 2009 presentation.

**CONSOLIDATING CONDENSED STATEMENT OF OPERATIONS**

**Three Months Ended March 28, 2009**

(in thousands)  
(unaudited)

| Parent | Guarantor<br>Subsidiaries | Eliminations | Consolidated |
|--------|---------------------------|--------------|--------------|
|--------|---------------------------|--------------|--------------|

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|   |            |            |             |            |
|---|------------|------------|-------------|------------|
| Net sales   | \$ 142,028 | \$ 381,009 | \$ (46,612) | \$ 476,425 |
| Cost of products sold and occupancy   | 103,478    | 259,006    | (46,612)    | 315,872    |
| Gross profit  | 38,550     | 122,003    |             | 160,553    |
| Selling, general and administrative expenses                                  | 30,901     | 72,496     |             | 103,397    |
| Income from operations  | 7,649      | 49,507     |             | 57,156     |
| Interest net  | (5,619)    | 138        |             | (5,481)    |
| Other income (loss )  | (2,177)    | 2,046      |             | (131)      |
| Income (loss) before income taxes and minority interest                       | (147)      | 51,691     |             | 51,544     |
| Income taxes  | 233        | 17,747     |             | 17,980     |
| Minority interest   | 544        |            |             | 544        |
| Income (loss) before equity in undistributed income of guarantor subsidiaries | (924)      | 33,944     |             | 33,020     |
| Equity in undistributed income of guarantor subsidiaries                      | 33,944     |            | (33,944)    |            |
| Net income  | \$ 33,020  | \$ 33,944  | \$ (33,944) | \$ 33,020  |

**Table of Contents****CONSOLIDATING CONDENSED STATEMENT OF OPERATIONS****Three Months Ended March 29, 2008****(in thousands)  
(unaudited)**

|  | <b>Parent</b> | <b>Guarantor<br/>Subsidiaries</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|--|---------------|-----------------------------------|---------------------|---------------------|
| Net sales  | \$ 134,783    | \$ 383,470                        | \$ (33,565)         | \$ 484,688          |
| Cost of products sold and occupancy  | 94,023        | 264,420                           | (33,565)            | 324,878             |
| Gross profit   | 40,760        | 119,050                           |                     | 159,810             |
| Selling, general and administrative expenses   | 30,151        | 85,009                            |                     | 115,160             |
| Income from operations   | 10,609        | 34,041                            |                     | 44,650              |
| Interest net   | (9,667)       | 153                               |                     | (9,514)             |
| Other income (expense)   | (839)         | 2,030                             |                     | 1,191               |
| Income before income taxes and minority interest   | 103           | 36,224                            |                     | 36,327              |
| Income tax expense (tax benefit)   | (80,514)      | 95,917                            |                     | 15,403              |
| Minority interest  | 471           |                                   |                     | 471                 |
| Net income (loss) before equity in undistributed income (loss) of guarantor subsidiaries | 80,146        | (59,693)                          |                     | 20,453              |
| Equity in undistributed income (loss) of guarantor subsidiaries                          | (59,693)      |                                   | 59,693              |                     |
| Net income (loss)  | \$ 20,453     | \$ (59,693)                       | \$ 59,693           | \$ 20,453           |

**CONSOLIDATING CONDENSED STATEMENT OF OPERATIONS****Six Months Ended March 28, 2009****(in thousands)  
(unaudited)**

|   | <b>Parent</b> | <b>Guarantor<br/>Subsidiaries</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|---|---------------|-----------------------------------|---------------------|---------------------|
| Net sales   | \$ 234,740    | \$ 615,238                        | \$ (81,011)         | \$ 768,967          |
| Cost of products sold and occupancy   | 172,657       | 431,287                           | (81,011)            | 522,933             |
| Gross profit  | 62,083        | 183,951                           |                     | 246,034             |
| Selling, general and administrative expenses                                      | 56,535        | 135,009                           |                     | 191,544             |
| Income from operations  | 5,548         | 48,942                            |                     | 54,490              |
| Interest net  | (12,355)      | 322                               |                     | (12,033)            |
| Other income (expense)  | (1,653)       | 572                               |                     | (1,081)             |
| Income (loss) before income taxes (tax benefit) and minority interest             | (8,460)       | 49,836                            |                     | 41,376              |
| Income taxes (tax benefit)  | (3,033)       | 17,160                            |                     | 14,127              |
| Minority interest   | 413           |                                   |                     | 413                 |
| Net income (loss) before equity in undistributed income of guarantor subsidiaries | (5,840)       | 32,676                            |                     | 26,836              |
| Equity in undistributed income of guarantor subsidiaries                          | 32,676        |                                   | (32,676)            |                     |
| Net income  | \$ 26,836     | \$ 32,676                         | \$ (32,676)         | \$ 26,836           |





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

Six Months Ended March 29, 2008

(in thousands)  
(unaudited)

|  | Parent       | Guarantor<br>Subsidiaries | Eliminations | Consolidated |
|--|--------------|---------------------------|--------------|--------------|
| Net sales  | \$ 230,369   | \$ 627,159                | \$ (59,055)  | \$ 798,473   |
| Cost of products sold and occupancy  | 163,592      | 439,804                   | (59,055)     | 544,341      |
| Gross profit   | 66,777       | 187,355                   |              | 254,132      |
| Selling, general and administrative expenses   | 56,420       | 143,676                   |              | 200,096      |
| Goodwill and other impairments   | 91,482       | 308,518                   |              | 400,000      |
| Loss from operations   | (81,125)     | (264,839)                 |              | (345,964)    |
| Interest net   | (21,015)     | 284                       |              | (20,731)     |
| Other income (expense)   | (802)        | 2,476                     |              | 1,674        |
| Loss before income taxes and minority interest   | (102,942)    | (262,079)                 |              | (365,021)    |
| Income tax expense (tax benefit)   | (109,211)    | 12,800                    |              | (96,411)     |
| Minority interest  | 463          |                           |              | 463          |
| Net income (loss) before equity in undistributed income (loss) of guarantor subsidiaries | 5,806        | (274,879)                 |              | (269,073)    |
| Equity in undistributed income (loss) of guarantor subsidiaries                          | (274,879)    |                           | 274,879      |              |
| Net loss   | \$ (269,073) | \$ (274,879)              | \$ 274,879   | \$ (269,073) |

**CONSOLIDATING CONDENSED BALANCE SHEET**

March 28, 2009

(in thousands)  
(unaudited)

|  | Parent       | Guarantor<br>Subsidiaries | Eliminations | Consolidated |
|--|--------------|---------------------------|--------------|--------------|
| <b>ASSETS</b>                                    |              |                           |              |              |
| Cash and cash equivalents                        | \$ 6,810     | \$ 1,735                  | \$           | \$ 8,545     |
| Accounts receivable, net                         | 82,513       | 252,016                   | (16,816)     | 317,713      |
| Inventories                                      | 119,238      | 260,918                   |              | 380,156      |
| Prepaid expenses and other assets                | 18,818       | 21,212                    |              | 40,030       |
| Total current assets                             | 227,379      | 535,881                   | (16,816)     | 746,444      |
| Land, buildings, improvements and equipment, net | 55,878       | 112,658                   |              | 168,536      |
| Goodwill   |              | 207,173                   |              | 207,173      |
| Investment in guarantors                         | 777,112      |                           | (777,112)    |              |
| Deferred income taxes and other assets           | 127,613      | 103,968                   | (41,556)     | 190,025      |
| Total  | \$ 1,187,982 | \$ 959,680                | \$ (835,484) | \$ 1,312,178 |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>       |              |                           |              |              |
| Accounts payable                                 | \$ 62,137    | \$ 92,237                 | \$ (16,816)  | \$ 137,558   |
| Accrued expenses and other current liabilities   | 51,719       | 46,174                    |              | 97,893       |
| Total current liabilities                        | 113,856      | 138,411                   | (16,816)     | 235,451      |
| Long-term debt                                   | 543,493      | 136                       |              | 543,629      |
| Other long-term obligations                      | 3,914        | 44,021                    | (41,556)     | 6,379        |

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|                     |              |            |              |              |
|---------------------|--------------|------------|--------------|--------------|
| Minority interest   | 1,003        |            |              | 1,003        |
| Shareholders equity | 525,716      | 777,112    | (777,112)    | 525,716      |
| Total               | \$ 1,187,982 | \$ 959,680 | \$ (835,484) | \$ 1,312,178 |

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

September 27, 2008

(in thousands)

(unaudited)

|  | Parent       | Guarantor<br>Subsidiaries | Eliminations | Consolidated |
|--|--------------|---------------------------|--------------|--------------|
| <b>ASSETS</b>                                    |              |                           |              |              |
| Cash and cash equivalents                        | \$ 22,866    | \$ 4,063                  | \$           | \$ 26,929    |
| Accounts receivable, net                         | 55,325       | 215,832                   | (10,518)     | 260,639      |
| Inventories                                      | 93,366       | 256,133                   |              | 349,499      |
| Prepaid expenses and other assets                | 17,929       | 16,757                    |              | 34,686       |
| Total current assets                             | 189,486      | 492,785                   | (10,518)     | 671,753      |
| Land, buildings, improvements and equipment, net | 56,693       | 117,320                   |              | 174,013      |
| Goodwill   |              | 201,499                   |              | 201,499      |
| Investment in guarantors                         | 724,868      |                           | (724,868)    |              |
| Other assets                                     | 145,977      | 107,632                   | (41,556)     | 212,053      |
| Total  | \$ 1,117,024 | \$ 919,236                | \$ (776,942) | \$ 1,259,318 |
| <b>LIABILITIES</b>                               |              |                           |              |              |
| Accounts payable                                 | \$ 42,954    | \$ 100,928                | \$ (10,518)  | \$ 133,364   |
| Accrued expenses and other liabilities           | 38,924       | 48,761                    |              | 87,685       |
| Total current liabilities                        | 81,878       | 149,689                   | (10,518)     | 221,049      |
| Long-term debt                                   | 519,583      | 224                       |              | 519,807      |
| Other long-term obligations                      | 4,138        | 44,455                    | (41,556)     | 7,037        |
| Minority interest                                | 2,667        |                           |              | 2,667        |
| Total shareholders' equity                       | 508,758      | 724,868                   | (724,868)    | 508,758      |
| Total  | \$ 1,117,024 | \$ 919,236                | \$ (776,942) | \$ 1,259,318 |

**CONSOLIDATING CONDENSED STATEMENT OF CASH FLOWS**

Six Months Ended March 28, 2009

(in thousands)

(unaudited)

|  | Parent    | Guarantor<br>Subsidiaries | Eliminations | Consolidated |
|--|-----------|---------------------------|--------------|--------------|
| Net cash provided (used) by operating activities | \$ 22,082 | \$ (16,220)               | \$ (32,676)  | \$ (26,814)  |
| Additions to property and equipment              | (3,384)   | (3,726)                   |              | (7,110)      |
| Businesses acquired, net of cash                 |           | (4,799)                   |              | (4,799)      |
| Investment in guarantor subsidiaries             | (55,753)  | 23,077                    | 32,676       |              |
| Net cash provided (used) by investing activities | (59,137)  | 14,552                    | 32,676       | (11,909)     |
| Repayments on revolving line of credit           | (315,000) |                           |              | (315,000)    |
| Borrowings on revolving line of credit           | 374,000   |                           |              | 374,000      |
| Repayments of long-term debt                     | (23,215)  | (106)                     |              | (23,321)     |
| Repurchase of common stock                       | (12,812)  |                           |              | (12,812)     |
| Proceeds from issuance of stock                  | 109       |                           |              | 109          |
| Deferred financing costs                         | (75)      |                           |              | (75)         |
| Excess tax benefits from stock-based awards      | 74        |                           |              | 74           |
| Distribution to minority interest                | (2,082)   |                           |              | (2,082)      |

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|  |          |          |    |          |
|--|----------|----------|----|----------|
| Net cash provided (used) by financing activities | 20,999   | (106)    |    | 20,893   |
| Effect of exchange rate changes on cash          |          | (554)    |    | (554)    |
| Net decrease in cash and cash equivalents        | (16,056) | (2,328)  |    | (18,384) |
| Cash and cash equivalents at beginning of period | 22,866   | 4,063    |    | 26,929   |
| Cash and cash equivalents at end of period       | \$ 6,810 | \$ 1,735 | \$ | \$ 8,545 |

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

Six Months Ended March 29, 2008

(in thousands)

(unaudited)

|   | Parent       | Guarantor<br>Subsidiaries | Eliminations | Consolidated |
|---|--------------|---------------------------|--------------|--------------|
| Net cash provided (used) by operating activities    | \$ (237,517) | \$ (125,939)              | \$ 274,879   | \$ (88,577)  |
| Additions to property                               | (6,040)      | (7,092)                   |              | (13,132)     |
| Proceeds from property sales, net of expenses       |              | 12,053                    |              | 12,053       |
| Businesses acquired, net of cash                    | (4,998)      |                           |              | (4,998)      |
| Restricted investments                              | (39)         |                           |              | (39)         |
| Investment in guarantor subsidiaries                | 158,932      | 115,947                   | (274,879)    |              |
| Net cash provided (used) by investing activities    | 147,855      | 120,908                   | (274,879)    | (6,116)      |
| Repayments on revolving line of credit              | (302,000)    |                           |              | (302,000)    |
| Borrowings on revolving line of credit              | 385,000      |                           |              | 385,000      |
| Repayments of long-term debt                        | (829)        | (105)                     |              | (934)        |
| Repurchase of common stock                          | (138)        |                           |              | (138)        |
| Proceeds from issuance of stock                     | 61           |                           |              | 61           |
| Redemption of preferred stock                       | (750)        |                           |              | (750)        |
| Deferred financing costs                            | (125)        |                           |              | (125)        |
| Excess tax benefits from stock-based awards         | 24           |                           |              | 24           |
| Net cash provided by (used by) financing activities | 81,243       | (105)                     |              | 81,138       |
| Effect of exchange rate changes on cash             |              | 77                        |              | 77           |
| Net decrease in cash and cash equivalents           | (8,419)      | (5,059)                   |              | (13,478)     |
| Cash and cash equivalents at beginning of period    | 14,048       | 7,007                     |              | 21,055       |
| Cash and cash equivalents at end of period          | \$ 5,629     | \$ 1,948                  | \$           | \$ 7,577     |

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

Central Garden & Pet Company 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 \$36 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 \$15 billion. The total lawn and garden industry in the United States is estimated to be approximately \$95 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 \$7 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<sup>™</sup>, All-Glass Aquarium<sup>®</sup>, Altosid, Aqueon<sup>™</sup>, BioSpot<sup>®</sup>, Breeder's Choice<sup>®</sup>, Coralife<sup>®</sup>, Farnam<sup>®</sup>, Four Paws<sup>®</sup>, Interpet, Kaytee<sup>®</sup>, Kent Marine<sup>®</sup>, Nylabone<sup>®</sup>, Pet Select<sup>®</sup>, Pre Strike<sup>®</sup>, Oceanic Systems<sup>®</sup>, Super Pet<sup>®</sup>, TFH<sup>™</sup>, Zilla<sup>™</sup> and Zodiac<sup>®</sup>.

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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<sup>®</sup>, GKI/Bethlehem Lighting, Grants, Ironite<sup>®</sup>, Lilly Miller<sup>®</sup>, Matthews Four Seasons<sup>™</sup>, New England Pottery<sup>®</sup>, Norcal Pottery<sup>®</sup>, Pennington<sup>®</sup>, Over n Out<sup>®</sup>, Sevin<sup>®</sup>, The Rebels<sup>®</sup> and Smart Seed<sup>™</sup>.

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In fiscal 2008, our consolidated net sales were \$1.7 billion, of which our lawn and garden segment, or Garden Products, accounted for approximately \$807.6 million and our pet segment, or Pet Products, accounted for approximately \$897.8 million. In fiscal 2008, our loss from operations was \$324.4 million, of which Garden Products accounted for \$198.2 million and Pet Products accounted for \$88.2 million, before corporate expenses and eliminations of \$38.0 million.

### **Background**

We have transitioned our company to a leading marketer and producer of branded products from a traditional pet and lawn and garden supplies distributor. We made this transition because we recognized the opportunity to build a portfolio of leading brands and improve profitability by capitalizing on our knowledge of the pet and lawn and garden supplies sectors, strong relationships with retailers and nationwide sales and logistics network. Our goal was to diversify our business and improve operating margins by establishing a portfolio of leading brands. Since 1997, we have acquired numerous branded product companies and product lines, including: Wellmark and Four Paws in fiscal 1997; Kaytee Products, TFH and Pennington Seed in fiscal 1998; Norcal Pottery in fiscal 1999; AMDRO and All-Glass Aquarium in fiscal 2000; Lilly Miller in fiscal 2001; Alaska Fish Fertilizer in fiscal 2002; Kent Marine, New England Pottery, Interpet, KRB Seed Company, (dba Budd's Seed), and Energy Savers Unlimited in fiscal 2004; Pets International and Gulfstream Home & Garden in fiscal 2005; Farnam, Breeder's Choice, Tech Pac, Ironite and Shirlo in fiscal 2006 and B2E Corporation, B2E Biotech LLC and DLF Trifolium Oregon (dba ASP Research) in fiscal 2007.

Virtually all of our sales before fiscal 1997 were derived from distributing other manufacturers' products. Since then, our branded product sales have grown to approximately \$1.4 billion, or approximately 85% of total sales, in fiscal 2008. During this same period, our sales of other manufacturers' products have declined to approximately 15% of total sales, and our gross profit margins have improved from 13.6% in fiscal 1996 to 30.6% in fiscal 2008.

### **Recent Developments**

#### *Swap Agreement Termination*

In February 2009, our \$75 million pay-floating interest rate swap was terminated prior to its maturity by the counterparty in accordance with the terms of the interest rate swap agreement. As a result of this swap termination, we received cash proceeds and realized a settlement gain of \$2.3 million that was recorded as an adjustment to the carrying amount of the related debt. The settlement gain is being amortized as an offset to interest expense over the remaining term of the debt, which expires February 2013.

#### *Repurchase of Company Stock*

During the quarter ended March 28, 2009, we repurchased 1,070,000 shares of our voting common stock at an aggregate cost of approximately \$7.1 million, or approximately \$6.66 per share, and 335,000 shares of our non-voting Class A common stock at an aggregate cost of approximately \$2.1 million, or approximately \$6.21 per share. During the six months ended March 28, 2009, we repurchased 1,291,925 shares of our voting common stock in the open market at an aggregate cost of approximately \$8.2 million, or approximately \$6.33 per share, and 847,168 shares of our non-voting Class A common stock in the open market at an aggregate cost of approximately \$4.4 million, or approximately \$5.27 per share.

### **Significant Prior Year Events**

#### *Goodwill*

We account for goodwill in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," and test 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. We use discounted cash flow analysis to estimate the fair value of our reporting units. Our goodwill impairment analysis also includes a comparison of the aggregate estimated fair value of all four reporting units to our total market capitalization.



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In the first fiscal quarter of fiscal 2008, we recorded a non-cash charge of \$400 million to recognize the impairment of goodwill and other intangible assets, comprised of \$202 million relating to our Garden segment and \$198 million relating to our Pet segment. This non-cash charge of \$400 million reduced our net earnings for the six months ended March 29, 2008 by \$290.4 million net of taxes.

### *Gain on Sale of Properties and Legal Settlement Proceeds*

The following transactions are included in selling, general and administrative expenses in the first six months of fiscal 2008:

In October 2007, we sold a facility for approximately \$7.9 million in cash. In connection with the sale, we are leasing back the property from the purchaser for a period of approximately two years. We are accounting for the leaseback as an operating lease. We recognized a gain of approximately \$3.1 million in the Pet Products segment in the first six months of fiscal 2008 and deferred approximately \$1.5 million to be recognized ratably over the term of the lease.

In December 2007, we sold a facility for approximately \$5.1 million. Proceeds were comprised of cash of \$1.3 million and a \$3.8 million recourse note payable to us. We are leasing back the property from the purchaser and are accounting for the leaseback as an operating lease. We recognized a gain of approximately \$4.6 million from this sale in the Garden Products segment in the first six months of fiscal 2008.

In December 2007, we received approximately \$5.0 million in cash related to the settlement of a legal matter that is included in Corporate.

In December 2007, we sold the net assets of our live bird business for approximately \$1.2 million in cash and recognized a loss of approximately \$1.6 million in the Pet Products segment.

### **New Accounting Pronouncements**

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. In February 2008, the FASB issued FASB Staff Position ( FSP ) No. FAS 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13* and FSP No. FAS 157-2, *Effective Date of FASB Statement No. 157*. FSP 157-1 amends SFAS No. 157 to remove certain leasing transactions from its scope. FSP 157-2 delays the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008 for all non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually) and will be adopted by the Company beginning in the first quarter of fiscal 2010. In October 2008, the FASB issued FSP No. 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active*, to clarify the application of SFAS No. 157 in inactive markets for financial assets. FSP 157-3 became effective upon issuance and SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. The Company elected to partially adopt SFAS No. 157 as of the beginning of fiscal 2009, as permitted by FSP 157-2 (see Note 2 to the condensed consolidated financial statements). The Company does not expect the adoption of the remaining provisions of SFAS No. 157 (delayed by FSP 157-2) to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

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. The Company adopted SFAS No. 159 as of the beginning of fiscal 2009 but elected not to record additional financial assets and liabilities at fair value. As a result, the adoption of SFAS No. 159 did not impact the Company's consolidated financial position, results of operations or cash flows.

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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. In April 2009, the FASB issued FSP No. 141(R)-1( FSP 141(R)-1 ), Accounting for Assets Acquired and Liabilities Assumed in a Business Combination that Arise from Contingencies. FSP 141(R)-1 requires an acquirer to

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recognize at fair value an asset acquired or a liability assumed in a business combination that arises from a contingency if the acquisition-date fair value of an asset or liability can be determined during the measurement period. If the acquisition-date fair value cannot be determined, then the acquirer follows the recognition criteria in FASB Statement No. 5, *Accounting for Contingencies* and FASB Interpretation No. 14,

*Reasonable Estimation of the Amount of a Loss* an interpretation of FASB Statement No. 5 to determine whether the contingency should be recognized as of the acquisition date or after it. This FSP is effective prospectively for businesses acquired by the Company in its fiscal year beginning September 27, 2009.

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 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 April 2008, the FASB issued FSP No. 142-3 ( FSP 142-3 ) *Determination of the Useful Life of Intangible Assets*. FSP 142-3 amends the factors an entity should consider in developing renewal or extension assumptions used in determining the useful life of recognized intangible assets under FASB Statement No. 142, *Goodwill and Other Intangible Assets*. This new guidance applies prospectively to intangible assets that are acquired individually or with a group of other assets in business combinations and asset acquisitions. FSP 142-3 is effective for the Company in its fiscal year beginning September 27, 2009. Early adoption is prohibited. Since this guidance will be applied prospectively, on adoption, there will be no impact to our current consolidated financial statements.

## **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 27, 2008.

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**Table of Contents****Results of Operations****Three Months Ended March 28, 2009****Compared with Three Months Ended March 29, 2008*****Net Sales***

Net sales for the three months ended March 28, 2009 decreased \$8.3 million, or 1.7%, to \$476.4 million from \$484.7 million for the three months ended March 29, 2008 due primarily to an overall softer retail market and continued inventory level reductions by retailers. Our branded product sales decreased \$5.0 million and sales of other manufacturers' products decreased \$3.3 million. Pet Products' net sales declined \$2.1 million, or 0.9%, to \$228.8 million for the three months ended March 28, 2009 from \$230.9 million in the comparable fiscal 2008 period. Pet branded product sales decreased \$2.8 million and sales of other manufacturers' products increased \$0.7 million from the prior year due primarily to continued softness in the aquatics category and the change in the foreign currency exchange rates for sales from our international subsidiary. Garden Products' net sales decreased \$6.2 million, or 2.4%, to \$247.6 million for the three months ended March 28, 2009 from \$253.8 million in the comparable fiscal 2008 period. The decreased garden sales were due primarily to lower grass seed sales, in what we believe was a later start to the garden season as a result of weather conditions, as compared to the prior year quarter, partially offset by increased sales of garden chemical and control products. Garden branded product sales decreased \$2.1 million and sales of other manufacturers' products decreased \$4.1 million.

***Gross Profit***

Gross profit for the three months ended March 28, 2009 increased \$0.7 million, or 0.5%, to \$160.5 million from \$159.8 million for the three months ended March 29, 2008. Gross profit as a percentage of net sales increased from 33.0% for the three months ended March 29, 2008 to 33.7% for the three months ended March 28, 2009. Gross profit decreased \$4.2 million in Pet Products due primarily to adverse changes in product mix and, secondarily, to the segment's sales decrease. Gross profit increased \$4.9 million in Garden Products due primarily to margin increases in garden chemicals and control products and wild bird feed products.

***Selling, General and Administrative Expenses***

Selling, general and administrative expenses decreased \$11.8 million, or 10.2%, to \$103.4 million for the three months ended March 28, 2009 from \$115.2 million for the three months ended March 29, 2008. As a percentage of net sales, selling, general and administrative expenses decreased to 21.7% for the three months ended March 28, 2009, compared to 23.8% in the comparable prior year quarter. The change in selling, general and administrative expenses is discussed further below.

Selling and delivery expense decreased \$5.2 million, or 9.1%, from \$57.3 million for the three months ended March 29, 2008 to \$52.1 million for the three months ended March 28, 2009. The decreased expense was due primarily to lower fuel costs, lower employee related costs, and consolidation within our west coast distribution operations. As a percentage of net sales, selling and delivery expense decreased to 10.9% for the current quarter from 11.8% for the prior year quarter.

Facilities expense decreased \$1.0 million to \$2.8 million in the quarter ended March 28, 2009 from \$3.8 million for the quarter ended March 29, 2008. The decrease was due primarily to cost savings from consolidation of our west coast facilities.

Warehouse and administrative expense decreased \$5.6 million to \$48.5 million for the quarter ended March 28, 2009 from \$54.1 million in the quarter ended March 29, 2008. The decrease was due primarily to a non-cash impairment charge of \$2.0 million taken against trade credits in the prior year quarter and reduced employee related costs in the current year quarter.

***Net Interest Expense***

Net interest expense for the three months ended March 28, 2009 decreased \$4.0 million or 42.4%, to \$5.5 million from \$9.5 million for the three months ended March 29, 2008. The decrease was due primarily to lower average borrowings and secondarily to lower interest rates on our floating rate debt. Our borrowing rate for the quarter was approximately 3.9% compared to 5.6% for the prior year quarter.

***Other Income***

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Other income decreased \$1.3 million from earnings of \$1.2 million for the quarter ended March 29, 2008, to \$0.1 million loss for the quarter ended March 28, 2009. The decrease was due primarily to income recorded in the prior year quarter for an investment no longer accounted for under the equity method of accounting.

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### ***Income Taxes***

Our effective income tax rate was 34.9% for the quarter ended March 28, 2009 and 42.4% for the quarter ended March 29, 2008. The 2009 tax expense rate is lower than the statutory rate primarily as a result of a \$1.1 million reduction in state valuation allowances. The 2008 tax expense rate is higher than the statutory rate primarily due to a \$1.7 million increase in state valuation allowances.

### **Six Months Ended March 28, 2009**

### **Compared with Six Months Ended March 29, 2008**

### ***Net Sales***

Net sales for the six months ended March 28, 2009 decreased \$29.5 million, or 3.7%, to \$769.0 million from \$798.5 million for the six months ended March 29, 2008. Pet Products net sales decreased \$18.0 million, or 4.2%, to \$414.6 million for the six months ended March 28, 2009 from \$432.6 million in the comparable fiscal 2008 period. Garden Products net sales decreased \$11.5 million, or 3.1%, to \$354.4 million for the six months ended March 28, 2009 from \$365.9 million in the comparable fiscal 2008 period. Our branded product sales decreased \$24.1 million and sales of other manufacturers products decreased \$5.4 million. The sales decrease was primarily in our grass seed category, in what we believe to be a late start to the garden season, and in our aquatic products due to softness in the category.

### ***Gross Profit***

Gross profit for the six months ended March 28, 2009 decreased \$8.1 million, or 3.2%, to \$246.0 million from \$254.1 million for the six months ended March 29, 2008. Pet Products gross profit decreased \$10.8 million and Garden Products gross profit increased \$2.7 million. Gross profit as a percentage of net sales increased from 31.8% for the six months ended March 29, 2008 to 32.0% for the six months ended March 29, 2008. The margin increase was due primarily to reduced input costs as the prior year period was one of continued rising grain input costs. This increase was partially offset by a decrease in pet product margin due primarily to decreased sales.

### ***Selling, General and Administrative Expenses***

Selling, general and administrative expenses decreased \$8.6 million, or 4.3%, to \$191.5 million for the six months ended March 28, 2009 from \$200.1 million for the six months ended March 29, 2008. As a percentage of net sales, selling, general and administrative expenses decreased from 25.1% for the six months ended March 29, 2008 to 24.9% for the six months ended March 28, 2009. The decrease in selling, general and administrative expenses is discussed below.

Selling and delivery expense decreased \$9.0 million, or 8.6%, from \$105.1 million for the six months ended March 29, 2008 to \$96.1 million for the six months ended March 28, 2009. As a percentage of net sales, selling and delivery expense decreased to 12.5% from 13.2% of net sales due primarily to lower employee related, freight and fuel related costs.

Facilities decreased \$1.9 million, or 25.3%, from \$7.5 million for the six months ended March 29, 2008 to \$5.6 million for the six months ended March 28, 2009 due primarily to cost savings from the consolidation of our west coast distribution facilities.

Warehouse and administrative expense increased \$2.3 million to \$89.8 million in the six month period ended March 28, 2009. The increase was due to net gains of \$9.0 million from the sale of assets and a legal settlement partially offset by a non-cash impairment charge taken against trade credits in the six month period ended March 29, 2008. Absent the net gains in the prior year period, expenses decreased due primarily to lower employee related costs.

### ***Goodwill Impairment***

We updated our analysis and evaluation of goodwill for possible impairment as of December 29, 2007. Applicable accounting standards require a comparison of the sum of the fair values of the reporting units to the current market capitalization when assessing goodwill for possible impairment. As a result, we recorded an impairment charge related to goodwill of approximately \$400 million, comprised of \$202 million in the Garden Products segment and \$198 million in the Pet Products segment, in the first quarter of fiscal 2008.

### ***Net Interest Expense***

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Net interest expense for the six months ended March 28, 2009 decreased \$8.7 million, or 42.0%, to \$12.0 million from \$20.7 million for the six months ended March 29, 2008. The decrease was due primarily to lower interest rates on our floating rate debt and decreased average borrowings. Our borrowing rate for the six months ended March 28, 2009 was approximately 4.5% compared to 6.3% a year ago.

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### ***Other Income (Expense)***

Other expense was \$1.1 million for the six months ended March 28, 2009 compared to other income of \$1.7 million for the six months ended March 29, 2008. The decrease was due primarily to income recorded in the prior year quarter for an investment no longer accounted for under the equity method of accounting.

### ***Income Taxes***

Our effective income tax rate was 34.1% for the six months ended March 28, 2009 compared to 26.4% for the six months ended March 29, 2008. The 2009 tax expense rate is lower than the statutory rate primarily as the result of a \$1.1 million reduction in state valuation allowances. The 2008 tax benefit rate was lower than the statutory rate due primarily to the nondeductible portion of the non-cash goodwill impairment charge.

### ***Inflation***

The results of operations and financial condition are presented based upon historical cost. While it is difficult to accurately measure the impact of inflation, we believe that the effects of inflation on our operations could be significant.

### ***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, Garden Products' business has historically been highly seasonal. In fiscal 2008, approximately 63% of Garden Products' net sales and 57% 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 bank borrowings, supplier credit, internally generated funds 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 63% of Garden Products' net sales occurring during the second and third fiscal quarters. For many manufacturers of garden products, this seasonality requires them to ship large quantities of their product well ahead of the peak consumer buying periods. To encourage distributors to stock large quantities of inventory, industry practice has been for manufacturers to give extended credit terms and/or promotional discounts.

Net cash used by operating activities decreased \$61.8 million from \$88.6 million for the six months ended March 29, 2008 to \$26.8 million for the six months ended March 28, 2009. The decrease was due to improved working capital management.

Net cash used in investing activities increased \$5.8 million from the six months ended March 29, 2008 to approximately \$11.9 million during the six months ended March 28, 2009. The increase was due primarily to \$12.0 million of proceeds received from the sales of facilities in the prior year period, which partially offset higher prior year capital spending.

Net cash provided by financing activities decreased \$60.2 million, from \$81.1 million, for the six months ended March 29, 2008, to \$20.9 million for the six months ended March 28, 2009. The decrease was due primarily to payments made to reduce the balance of our revolving line of credit and the repayment of \$21.6 million of our term loan under the mandatory prepayment provisions in our credit facility. Additionally, we



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repurchased 1,291,925 shares of our voting common stock in the open market at an aggregate cost of approximately \$8.2 million, or approximately \$6.33 per share, and 847,168 shares of our non-voting Class A common stock in the open market at an aggregate cost of approximately \$4.4 million, or approximately \$5.27 per share.

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As of March 28, 2009, the Company has \$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. As of March 28, 2009, the applicable interest rate on the revolving credit facility related to base rate borrowings was 3.38%, and the applicable interest rate related to LIBOR rate borrowings was 1.78%. 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. As of March 28, 2009, the applicable interest rate on the term loan related to base rate borrowings was 3.75%, and the applicable interest rate related to LIBOR rate borrowings was 2.03%. The term loan is payable in quarterly installments of \$750,000, and contains mandatory prepayment provisions when we have excess cash flow, with the balance payable in September 2012.

These facilities are secured by substantially all of our assets and contain certain financial covenants which require us to maintain minimum levels of interest coverage and maximum levels of total 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 facilities. Under the terms of our senior secured credit facilities, we may make restricted payments, including cash dividends, in an aggregate amount not to exceed \$75,000,000 over the life of the facilities; if the total leverage ratio for the fiscal quarter most recently ended is less than 3.00 to 1.00, the maximum restricted payment amount will be increased to \$100,000,000 over the life of the facilities. Apart from the covenants limiting restricted payments and capital expenditures, the facilities do not restrict the use of retained earnings or net income.

We were in compliance with all financial covenants as of March 28, 2009. There was a \$137.0 million outstanding balance at March 28, 2009 under the \$350 million revolving credit facility plus \$15.8 million of outstanding letters of credit. After giving effect to the financial covenants in our credit agreement, our remaining borrowing capacity was approximately \$170 million. See Risk Factors.

Our credit facility contains mandatory prepayment provisions when we have excess cash flow, as defined in our credit agreement, during our fiscal year. Accordingly, in December 2008, we repaid \$21.6 million of our term loan per this provision by drawing down our revolving credit facility.

At March 28, 2009, our total debt outstanding was \$547.0 million versus \$695.5 million at March 29, 2008.

In October 2003, we entered into a \$75 million pay-floating interest rate swap effectively converting half of our \$150 million fixed rate 9-1/8% senior subordinated notes (senior subordinated notes) to a floating rate of LIBOR + 4.04%. In February 2009, the swap was terminated prior to its maturity by the counterparty in accordance with the terms of the interest rate swap agreement. As a result of this swap termination, we received cash proceeds and realized a settlement gain of \$2.3 million that was recorded as an adjustment to the carrying amount of the related debt. The settlement gain is being amortized as an offset to interest expense over the remaining term of the debt, which expires in February 2013.

In connection with our purchase of an additional 60% equity interest in Tech Pac L.L.C. in March 2006, we deposited approximately \$15.5 million into an escrow for possible contingent performance-based payments. In fiscal 2009, a net amount of \$4.8 million in cash was paid in performance-based payments, which was recognized as additional goodwill. There are no remaining contingent performance-based payments due to the seller. As part of the resolution of the contingent payments, we became the beneficiary of the remaining funds in the escrow, which are comprised primarily of \$12.8 million of aggregate principal amount of our senior subordinated notes. Under the requirements of SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, the senior subordinated notes contained within the escrow have been recorded as a reduction of debt for accounting purposes against our outstanding senior subordinated notes balance as of March 28, 2009. The senior subordinated notes continue to be held in the escrow and have not been retired.

During the six months ended March 29, 2008, we repurchased 1,291,925 shares of our voting common stock in the open market at an aggregate cost of approximately \$8.2 million, or approximately \$6.33 per share, and 847,168 shares of our non-voting Class A common stock in the open market at an aggregate cost of approximately \$4.4 million, or approximately \$5.27 per share. Our Board of Directors has authorized the repurchase of up to a total of \$100 million of our common stock, of which approximately \$28.6 million has been repurchased to date. We expect to continue our repurchases from time to time depending on market conditions and subject to the ability to effect repurchases under our credit facility.

We believe that cash flows from operating activities, funds available under our revolving 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 2009, which are related primarily to replacements and upgrades to plant



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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 \$38 million from fiscal 2005 through fiscal 2008 in this initiative and plan to invest up to an additional \$5 million in fiscal 2009 for planned implementations. Capital expenditures for 2010 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 and create a common business model and common data, 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 27, 2008 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 27, 2008.

### **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 2008 Annual Report filed on Form 10-K.

### **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 March 28, 2009.

(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 second quarter of fiscal 2009. Based on that evaluation, management concluded that there has been no change in Central's internal control over financial reporting during the second quarter of fiscal 2009 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**

On February 11, 2008, Central Garden & Pet Company and two of its affiliates were named as defendants in an action filed in United States District Court in the Western District of Texas in a matter entitled *Perfect Birds LLC v. Kaytee Products, Inc., Pets International, Ltd. and Central Garden & Pet Co.*, No. W08CA042 (W.D. Texas - Waco Division). Plaintiff asserts various claims arising out of its \$1.2 million purchase of assets of our former affiliate, Perfect Birds, LLC, including claims of breach of contract, breach of implied warranty, fraud and

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improper trade practices, and seeks unspecified damages. Discovery in the case is ongoing and the matter is currently scheduled for trial in September 2009.

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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 other 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 27, 2008.

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

The following table sets forth the repurchases of any equity securities during the fiscal quarter ended March 28, 2009 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) |
|--------------------------------------|---|---|---|---|
| December 28, 2008 – January 31, 2009 | 401,118 <sup>(2)</sup>                      | \$ 5.88                                 | 397,700   | \$ 78,311,000   |
| February 1, 2009 – February 28, 2009 | 167,720 <sup>(3)</sup>                      | \$ 7.47                                 | 164,500   | \$ 77,079,000   |
| March 1, 2009 – March 28, 2009       | 849,329 <sup>(4)</sup>                      | \$ 6.70                                 | 842,800   | \$ 71,439,000   |
| Total                                | 1,418,167                                   | \$ 6.56                                 | 1,405,000   | \$ 71,439,000   |

- (1) In December 2005, the Board of Directors authorized the repurchase of up to \$100 million of the Company's common stock. The program has no expiration date and expires when the amount authorized has been used or the Board withdraws its authorization.
- (2) Includes 3,418 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.
- (3) Includes 3,220 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.
- (4) Includes 6,529 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.

**Item 3. Defaults Upon Senior Securities**

Not applicable

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

(a) The annual meeting of shareholders was held on February 9, 2009.

(b) The following directors were elected at the meeting:

William E. Brown

Brooks M. Pennington III

John B. Balousek

David N. Chichester

Alfred A. Piergallini

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Set forth below is the tabulation of votes with respect to the election of directors at the meeting:

|                          | <b>For</b> | <b>Against/Withheld</b> |
|--------------------------|------------|-------------------------|
| William E. Brown         |            |                         |
| Common                   | 11,537,833 | 7,230,468               |
| Class B                  | 16,460,070 | 0                       |
| Brooks M. Pennington III |            |                         |
| Common                   | 11,271,911 | 7,496,390               |
| Class B                  | 16,460,070 | 0                       |
| John B. Balousek         |            |                         |
| Common                   | 13,197,157 | 5,571,144               |
| Class B                  | 16,460,070 | 0                       |
| David N. Chichester      |            |                         |
| Common                   | 17,461,361 | 1,306,940               |
| Class B                  | 16,460,070 | 0                       |
| Alfred A. Piergallini    |            |                         |
| Common                   | 12,199,361 | 6,568,940               |
| Class B                  | 16,460,070 | 0                       |

- (c) At the meeting, the shareholders of the Company approved the amendment of the 2003 Omnibus Equity Incentive Plan (the 2003 Plan ) to increase the number of shares authorized for issuance under the 2003 Plan by an additional 5,000,000 shares of Class A Common Stock and to authorize for issuance 500,000 shares of Preferred Stock.

Set forth below is the tabulation with respect to the matter voted on at the meeting:

|         | <b>Common</b> | <b>Class B</b> |
|---------|---------------|----------------|
| For     | 4,766,092     | 16,460,070     |
| Against | 10,251,103    |                |
| Abstain | 23,747        |                |

- (d) At the meeting, the shareholders of the Company approved the amendment of the Nonemployee Director Stock Option Plan (the Director Plan ) to increase the number of shares authorized for issuance under the Director Plan by an additional 600,000 shares of Class A Common Stock.

Set forth below is the tabulation with respect to the matter voted on at the meeting:

|         | <b>Common</b> | <b>Class B</b> |
|---------|---------------|----------------|
| For     | 4,820,089     | 16,460,070     |
| Against | 10,201,170    |                |
| Abstain | 19,683        |                |

**Item 5. Other Information**

Not applicable

**Item 6. Exhibits**



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- 3.2 Amended and Restated By-Laws of Central Garden & Pet Company, dated February 10, 2009.
- 10.1 Employment Agreement between Central Garden & Pet and Glen R. Fleischer, dated January 14, 2009.

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- 10.4 2003 Omnibus Equity Incentive Plan, as amended December 10, 2008.
- 10.5 Nonemployee Director Equity Incentive Plan, as amended December 10, 2008.
- 31.1 Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350.
- 32.2 Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350.

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**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: May 7, 2009

/s/ WILLIAM E. BROWN

William E. Brown

Chairman and Chief Executive Officer

*(Principal Executive Officer)*

/s/ STUART W. BOOTH

Stuart W. Booth

Executive Vice President and Chief Financial Officer

*(Principal Financial Officer)*