

FARMER BROTHERS CO  
Form 10-K  
September 13, 2011  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the fiscal year ended June 30, 2011

OR

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

Commission file number: 001-34249

**FARMER BROS. CO.**

(Exact Name of Registrant as Specified in Its Charter)

Delaware  
(State of Incorporation)

95-0725980  
(I.R.S. Employer Identification No.)  
20333 South Normandie Avenue, Torrance, California 90502

Edgar Filing: FARMER BROTHERS CO - Form 10-K

(Address of Principal Executive Offices; Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, \$1.00 par value	The NASDAQ Stock Market LLC
Securities registered pursuant to Section 12(g) of the Act: None	

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES  NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES  NO

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company.

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the closing price at which the Farmer Bros. Co. common stock was sold on December 31, 2010 was \$142.6 million.

As of September 9, 2011 the registrant had 16,186,372 shares outstanding of its common stock, par value \$1.00 per share, which is the registrant's only class of common stock.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's definitive proxy statement to be filed with the U.S. Securities and Exchange Commission (SEC) pursuant to Regulation 14A in connection with the registrant's 2011 Annual Meeting of Stockholders (the Proxy Statement) or portions of the registrant's 10-K/A, to be filed subsequent to the date hereof, are incorporated by reference into Part III of this report. Such Proxy Statement or 10-K/A will be filed with the SEC not later than 120 days after the conclusion of the registrant's fiscal year ended June 30, 2011.

**Table of Contents****TABLE OF CONTENTS**

PART I		
ITEM 1.	<u>Business</u>	1
ITEM 1A.	<u>Risk Factors</u>	4
ITEM 1B.	<u>Unresolved Staff Comments</u>	14
ITEM 2.	<u>Properties</u>	14
ITEM 3.	<u>Legal Proceedings</u>	15
ITEM 4.	<u>[Removed and Reserved]</u>	15
PART II		
ITEM 5.	<u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	16
ITEM 6.	<u>Selected Financial Data</u>	18
ITEM 7.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	19
ITEM 7A.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	31
ITEM 8.	<u>Financial Statements and Supplementary Data</u>	33
ITEM 9.	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	68
ITEM 9A.	<u>Controls and Procedures</u>	68
ITEM 9A(T).	<u>Controls and Procedures</u>	70
ITEM 9B.	<u>Other Information</u>	70
PART III		
ITEM 10.	<u>Directors, Executive Officers and Corporate Governance</u>	71
ITEM 11.	<u>Executive Compensation</u>	71
ITEM 12.	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	71
ITEM 13.	<u>Certain Relationships and Related Transactions, and Director Independence</u>	72
ITEM 14.	<u>Principal Accountant Fees and Services</u>	72
PART IV		
ITEM 15.	<u>Exhibits and Financial Statement Schedules</u>	73
<u>SIGNATURES</u>		74

**CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

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

---

**Table of Contents**

**PART I**

**Item 1. Business**  
***Overview***

Farmer Bros. Co., a Delaware corporation (including its consolidated subsidiaries unless the context otherwise requires, the Company, we, our or Farmer Bros. ) is a manufacturer, wholesaler and distributor of coffee, tea and culinary products. We are direct distributors of coffee to restaurants, hotels, casinos, hospitals and other foodservice providers, and are providers of private brand coffee programs to grocery retailers, restaurant chains, convenience stores, and independent coffee houses, nationwide. We were founded in 1912, were incorporated in California in 1923, and reincorporated in Delaware in 2004. We operate in one business segment.

***Business Strategy***

Our mission is to sell great coffee, tea and culinary products and provide superior service one customer at a time. We reach our customers in two ways: through our nationwide Direct-Store-Delivery ( DSD ) network of approximately 500 delivery routes, 114 branch locations and six distribution centers, and by using the distribution channels of our national retail and institutional customers. We differentiate ourselves in the marketplace through our customer service model. We offer value-added services including beverage equipment service, menu solutions, wherein we recommend products, how these products are prepared in the kitchen and presented on the menu, and hassle-free inventory and product procurement management to our foodservice customers. These services are conducted primarily in person through Regional Sales Representatives, or RSR s, who develop personal relationships with chefs, restaurant owners and food buyers at their drop off locations. We also provide comprehensive coffee programs, including private brand development, green coffee procurement, category management, and supply chain management to our national retail customers.

We manufacture and distribute products under our own brands, as well as under private labels on behalf of certain customers. Our branded products are sold primarily into the foodservice channel, and are comprised of both national and regional brands. Our leading national brands include the Farmer Brothers® and Superior® brands, as well as the popular Sierra®, Metropolitan®, Prebica® and Panache® brands. We also market such regional brands as Cain ®, McGarvey®, and Ireland®, each maintaining loyal customers in its respective geographies.

Since 2007, Farmer Brothers has achieved growth, primarily due to the acquisition in 2007 of Coffee Bean Holding Co. , Inc., a Delaware corporation ( CBH ), the parent company of Coffee Bean International, Inc., an Oregon corporation ( CBI ), a specialty coffee manufacturer and wholesaler headquartered in Portland, Oregon (the CBI Acquisition ), and the acquisition in 2009 from Sara Lee Corporation ( Sara Lee ) of certain assets used in connection with their DSD coffee business in the United States (the DSD Coffee Business ). The DSD Coffee Business acquisition helped grow our sales to \$463.9 million in fiscal 2011 from \$266.5 million in fiscal 2008, and added over 2,000 new SKU s and over 60 trademarks, tradenames and service marks. In fiscal 2010 we completed much of the post-acquisition integration of the DSD Coffee Business in an effort to realize the selling and operating efficiencies of the combined organization through consolidation of product offerings and SKU s, streamlining of routes and distribution logistics, and consolidation of warehouses and distribution centers, with an expanded, customer-focused organization enabled by enhanced information management tools and training.

***Business Operations***

Our product line is specifically focused on the needs of our market segment: restaurants, hotels, casinos, hospitals and other foodservice providers, as well as private brand retailers in the grocery, restaurant, convenience stores and coffeehouse channels. Our product line of over 2,800 SKUs includes roasted coffee,

## **Table of Contents**

liquid coffee, coffee-related products such as coffee filters, sugar and creamers, assorted teas, and cappuccino, cocoa, spices, gelatins and puddings, soup, gravy and sauce mixes, pancake and biscuit mixes, and jellies and preserves. For the past three fiscal years, sales of roasted coffee products represented approximately 50% of our total sales and no single product other than roasted coffee accounted for more than 10% of our total sales. Coffee purchasing, roasting and packaging takes place at our Torrance, California; Portland, Oregon; and Houston, Texas plants. Spice blending and packaging takes place at our Torrance, California plant. Our distribution centers include our Torrance, Houston, and Portland plants, and distribution centers in Northlake, Illinois; Oklahoma City, Oklahoma; and Moonachie, New Jersey. Our distribution center in Fridley, Minnesota, was closed in July 2011.

### ***Raw Materials and Supplies***

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

Producer organizations can also affect green coffee prices. The most prominent of these are the Colombian Coffee Federation, Inc. (CCF) and the International Coffee Organization (ICO). These organizations seek to increase green coffee prices largely by attempting to restrict supplies, thereby limiting the availability of green coffee to coffee consuming nations.

Other raw materials used in the manufacture of our tea and culinary products include a wide variety of spices, such as pepper, chilies, oregano and thyme, as well as cocoa, dehydrated milk products, salt and sugar. These raw materials are agricultural products and can be subject to wide cost fluctuations. In fiscal 2011 such fluctuations in commodity prices had a material effect on our operating results.

### ***Trademarks and Licenses***

We own 148 registered trademarks which are integral to customer identification of our products. It is not possible to assess the impact of the loss of such identification. Additionally, in connection with the DSD Coffee Business acquisition, the Company and Sara Lee have entered into certain operational agreements that include trademark and formula license agreements.

### ***Seasonality***

We experience some seasonal influences. The winter months are generally the strongest sales months. However, our product line and geographic diversity provide some sales stability during the warmer months when coffee consumption ordinarily decreases. Additionally, we usually experience an increase in sales during the summer and early fall months from seasonal businesses located in vacation areas, and from grocery retailers ramping up inventory for the winter selling season.

### ***Distribution***

Most sales are made off-truck to our customers at their places of business by our sales representatives who are responsible for soliciting, selling and collecting from and otherwise maintaining our customer accounts. We serve our customers from six distribution centers strategically located for national coverage. In July 2011, we closed our distribution center in Fridley, Minnesota. Our distribution trucks are replenished from 114 branch warehouses located throughout the contiguous United States. We operate our own trucking fleet to support our

## **Table of Contents**

long-haul distribution requirements. A portion of our products are distributed by third parties or are direct shipped via common carrier. We maintain inventory levels at each branch warehouse to allow for minimal interruption in supply.

### ***Customers***

We serve a wide variety of customers, from small restaurants and donut shops to large institutional buyers like restaurant chains, hotels, casinos, hospitals, foodservice providers and convenience stores. As a result of the CBI acquisition we added additional customer categories including gourmet coffee houses, bakery/café chains, and large regional and national grocery and specialty food retailers. As a result of the DSD Coffee Business acquisition, we added more national accounts and gaming accounts. Within our DSD channel, we believe on-premise customer contact, our large distribution network and our relationship-based high quality service model are integral to our past and future success. No single customer represents a significant concentration of sales. As a result, the loss of one or more of our larger customer accounts is not likely to have a material adverse effect on our results of operations.

### ***Competition***

We face competition from many sources, including the institutional foodservice divisions of multi-national manufacturers of retail products such as The J.M. Smucker Company (Folgers Coffee), Kraft Foods Inc. (Maxwell House Coffee) and Sara Lee Corporation, wholesale grocery distributors such as Sysco Corporation and U.S. Foodservice, regional institutional coffee roasters such as S & D Coffee, Inc. and Boyd Coffee Company, and specialty coffee suppliers such as Green Mountain Coffee Roasters, Inc. and Peet's Coffee & Tea, Inc. We believe our longevity, the quality of our products, our national distribution network and our superior customer service are the major factors that differentiate us from our competitors.

Competition is robust and is primarily based on products and price, with distribution and service often a major factor. Most of our customers rely on us for distribution; however, some of our customers use third party distribution or conduct their own distribution. Some of our customers are price buyers, seeking the low cost provider with little concern about service, while others find great value in the service programs we provide. We compete well when service and distribution are valued by our customers, and are less effective when only price matters. Our customer base is price sensitive, and we are often faced with price competition.

### ***Working Capital***

We finance our operations internally and through borrowings under our \$85 million senior secured revolving credit facility with Wells Fargo Bank, National Association (Wells Fargo). We believe this credit facility, to the extent available, in addition to our cash flow from operations and other liquid assets, are sufficient to fund our working capital and capital expenditure requirements for the next twelve months.

### ***Foreign Operations***

We have no material revenues from foreign operations.

### ***Other***

On June 30, 2011 we employed 1,820 employees, 616 of whom are subject to collective bargaining agreements. Compliance with government regulations relating to the discharge of materials into the environment has not had a material effect on our financial condition or results of operations. The nature of our business does not provide for maintenance of or reliance upon a sales backlog. None of our business is subject to renegotiation of profits or termination of contracts or subcontracts at the election of the government.

## **Table of Contents**

### ***Available Information***

Our Internet website address is <http://www.farmerbros.com> (the website address is not intended to function as a hyperlink, and the information contained in our website is not intended to be part of this filing), where we make available, free of charge, copies of our annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K including amendments thereto as soon as reasonably practicable after filing such material electronically or otherwise furnishing it to the Securities and Exchange Commission ( SEC ).

### **Item 1A. Risk Factors**

You should consider each of the following factors as well as the other information in this report, including our financial statements and the related notes, in evaluating our business and our prospects. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently consider immaterial may also negatively affect our business operations. If any of the following risks actually occurs, our business and financial results could be harmed. In that case, the trading price of our common stock could decline.

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

Our primary raw material is green coffee, an agricultural commodity. Green coffee is mainly grown outside the United States and can be subject to volatile price fluctuations. Weather, real or perceived supply shortages, speculation in the commodity markets, political unrest, labor actions, currency fluctuations, armed conflict in coffee producing nations, and government actions, including treaties and trade controls between the U.S. and coffee producing nations, can affect the price of green coffee. In fiscal 2011, the market for green Arabica coffee increased approximately 80% per pound compared to the prior fiscal year. Additionally, green specialty coffees sell at a premium to other green coffees due to the inability of producers to increase supply in the short run to meet rising demand. As a result, the price spread between specialty coffee and non-specialty coffee is likely to widen as demand for specialty coffee continues to increase.

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

There can be no assurance that we will be successful in passing commodity price fluctuations on to our customers without losses in sales volume or gross margin. Similarly, rapid, sharp decreases in the cost of green coffee could also force us to lower sales prices before realizing cost reductions in our green coffee inventory. Additionally, if green coffee beans from a region become unavailable or prohibitively expensive, we could be forced to use alternative coffee beans or discontinue certain blends, which could adversely impact our sales.

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

---

**Table of Contents**

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

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

***WE FACE EXPOSURE TO OTHER COMMODITY COST FLUCTUATIONS, WHICH COULD IMPAIR OUR PROFITABILITY.***

We are exposed to cost fluctuations in other commodities, including, without limitation, milk, spices, natural gas and gasoline. In addition, an increase in the cost of fuel could indirectly lead to higher electricity costs, transportation costs and other commodity costs. Much like green coffee costs, the costs of these commodities depend on various factors beyond our control, including economic and political conditions, foreign currency fluctuations, and global weather patterns. To the extent we are unable to pass along such costs to our customers through price increases, our margins and profitability will decrease.

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

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

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

As of June 30, 2011, we had a goodwill balance of \$5.3 million. Goodwill impairment analysis and measurement is a process that requires significant judgment and the use of significant estimates related to valuation such as discount rates, long term growth rates and the level and timing of future cash flows. As a result, several factors could indicate potential impairment of our goodwill balance, including, but not limited to:

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

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

We will continue to review our goodwill and other intangible assets for possible impairment. We cannot be certain that a future downturn in CBI's business, changes in market conditions or a longer-term decline in the quoted market price of our stock will not result in an impairment of goodwill and the recognition of resulting expenses in future periods, which could adversely affect our results of operations for those periods.



---

**Table of Contents**

We also test our other long-lived assets for impairment annually and whenever events or changes in circumstances indicate that their carrying amount may be impaired. In the fourth quarter of fiscal 2011, we determined that the customer relationships acquired, and the distribution agreement and co-pack agreement that we entered into, in connection with the DSD Coffee Business acquisition were impaired and wrote these intangible assets off in their entirety. The total impairment charge of \$7.8 million was included in operating expenses in fiscal 2011. Failure to achieve our forecasted operating results, due to further weakness in the economic environment or other factors, and further declines in our market capitalization, among other things could result in further impairment of our long-lived assets.

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

We have an \$85 million revolving credit facility. As of August 31, 2011, we had outstanding borrowings of \$35.3 million, utilized \$9.0 million of the letters of credit sublimit, and had excess availability under the credit facility of \$5.7 million (before giving effect to an increase in the line of credit on September 12, 2011 pursuant to the New Loan Agreement discussed below under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources - Credit Facility"). Maintaining a large loan balance under our credit facility could adversely affect our business and limit our ability to plan for or respond to changes in our business. Additionally, our borrowings under the credit facility are at variable rates of interest, exposing us to the risk of interest rate volatility, which could lead to a decrease in our net income. Our debt obligations could also:

increase our vulnerability to general adverse economic and industry conditions;

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

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

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

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

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

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

incur additional indebtedness;

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

sell assets;

## Edgar Filing: FARMER BROTHERS CO - Form 10-K

create liens on certain assets to secure debt; and

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

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

**Table of Contents**

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

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

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

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

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

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

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

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

**Table of Contents**

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

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

distraction of management from ongoing business concerns;

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

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

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

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

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

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

integration of technologies, services and products; and

achievement of appropriate internal control over financial reporting.

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

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

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

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

We primarily compete with other coffee companies, including multi-national firms with substantially greater financial, marketing and operating resources than the Company. We face competition from many sources

---

**Table of Contents**

including the foodservice divisions of multi-national manufacturers of retail products such as The J.M. Smucker Company (Folgers Coffee), Kraft Foods Inc. (Maxwell House Coffee) and Sara Lee Corporation, wholesale grocery distributors such as Sysco Corporation and U.S. Foodservice, regional coffee roasters such as S & D Coffee, Inc. and Boyd Coffee Company, and specialty coffee suppliers such as Green Mountain Coffee Roasters, Inc. and Peet's Coffee & Tea, Inc. If we do not succeed in differentiating ourselves from our competitors or our competitors adopt our strategies, then our competitive position may be weakened. In addition, from time to time, we may need to reduce our prices in response to competitive and customer pressures and to maintain our market share. Competition and customer pressures, however, also may restrict our ability to increase prices in response to commodity and other cost increases. Our results of operations will be adversely affected if our profit margins decrease, as a result of a reduction in prices or an increase in costs, and if we are unable to increase sales volumes to offset those profit margin decreases.

***VOLATILITY IN THE EQUITY MARKETS OR INTEREST RATE FLUCTUATIONS COULD SUBSTANTIALLY INCREASE OUR PENSION FUNDING REQUIREMENTS AND NEGATIVELY IMPACT OUR FINANCIAL POSITION.***

At the end of fiscal 2011, the projected benefit obligation of our defined benefit pension plans was \$111.8 million and assets were \$83.7 million. The difference between plan obligations and assets, or the funded status of the plans, significantly affects the net periodic benefit costs of our pension plans and the ongoing funding requirements of those plans. Among other factors, changes in interest rates, mortality rates, early retirement rates, investment returns and the market value of plan assets can affect the level of plan funding, cause volatility in the net periodic pension costs, and increase our future funding requirements. We expect to make approximately \$7.5 million in contributions to our pension plans in fiscal 2012 and record an accrued expense of approximately \$1.2 million per year beginning in fiscal 2012. These payments are expected to continue at this level for several years, and the current economic environment increases the risk that we may be required to make even larger contributions in the future.

***OUR SALES AND DISTRIBUTION NETWORK IS COSTLY TO MAINTAIN.***

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

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

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

***GOVERNMENT MANDATORY HEALTHCARE REQUIREMENTS COULD ADVERSELY AFFECT OUR PROFITS.***

We offer healthcare benefits to all employees who work at least 40 hours a week and meet service eligibility requirements. In the past, some states, including California, have proposed legislation mandating that employers pay healthcare premiums into a state-run fund for all employees immediately upon hiring or pay a penalty for failing to do so. If legislation similar to this were to be enacted in California, or in the other states in which we do

---

**Table of Contents**

business, it could have an adverse effect on our results of operations. In addition, comprehensive health care legislation (the Patient Protection and Affordable Care Act and the Health Care and Education Affordability Reconciliation Act of 2010) was passed and signed into law in March 2010. Due to the breadth and complexity of this legislation, the phased-in nature of the implementation, and the lack of implementing regulations, it is difficult to predict the financial and operational impacts this legislation will have on us. Our expenses may significantly increase over the long-term as a result of this legislation.

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

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

***CHANGES IN CONSUMER PREFERENCES COULD ADVERSELY AFFECT OUR BUSINESS.***

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

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

We are self-insured for many risks up to significant deductible amounts. The premiums associated with our insurance continue to increase. General liability, fire, workers' compensation, directors and officers liability, life, employee medical, dental and vision and automobile risks present a large potential liability. While we accrue for this liability based on historical experience, future claims may exceed claims we have incurred in the past. Should a different number of claims occur compared to what was estimated or the cost of the claims increase beyond what was anticipated, reserves recorded may not be sufficient and the accruals may need to be adjusted accordingly in future periods. In May 2011, we did not meet the minimum credit rating criteria for participation in the alternative security program for California self-insurers. As a result, we were required to post a \$5.9 million letter of credit as a security deposit to the State of California Department of Industrial Relations Self-Insurance Plans. We posted the security deposit in June 2011.

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

We consider our roasting and blending methods essential to the flavor and richness of our coffees and, therefore, essential to our brand. Because our roasting methods cannot be patented, we would be unable to prevent competitors from copying these methods if such methods became known. If our competitors copy our

---

**Table of Contents**

roasts or blends, the value of our brand may be diminished, and we may lose customers to our competitors. In addition, competitors may be able to develop roasting or blending methods that are more advanced than our production methods, which may also harm our competitive position.

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

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

***OPERATING LOSSES MAY CONTINUE AND, AS A RESULT, COULD LEAD TO INCREASED LEVERAGE WHICH MAY HARM OUR FINANCIAL CONDITION AND RESULTS OF OPERATIONS.***

We have incurred operating losses and net losses for each of the prior three fiscal years. If our current strategies are unsuccessful we may not achieve the levels of sales and earnings we expect. As a result, we could suffer additional losses in future years and our stock price could decline leading to deterioration in our credit rating, which could limit the availability of additional financing and increase the cost of obtaining financing. In addition, an increase in leverage could raise the likelihood of a financial covenant breach which in turn could limit our access to existing funding under our revolving credit facility.

Our ability to satisfy our operating lease obligations and make payments of principal and interest on our indebtedness depends on our future performance. Should we experience deterioration in operating performance, we will have less cash flow available to meet these obligations. In addition, if such deterioration were to lead to the closure of warehouses or distribution centers, we would need to fund the costs of terminating those leases. If we are unable to generate sufficient cash flow from operations in the future to satisfy these financial obligations, we may be required to, among other things:

seek additional financing in the debt or equity markets;

refinance or restructure all or a portion of our indebtedness;

sell selected assets; or

reduce or delay planned capital or operating expenditures.

Such measures might not be sufficient to enable us to satisfy our financial obligations. In addition, any such financing, refinancing or sale of assets might not be available on economically favorable terms.

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

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



---

**Table of Contents**

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

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

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

As of September 9, 2011, members of the Farmer family or entities controlled by the Farmer family (including trusts and a family partnership) as a group beneficially owned approximately 39.1% of our outstanding common stock. As a result, these stockholders, acting together, may be able to influence the outcome of stockholder votes, including votes concerning the election and removal of directors and approval of significant corporate transactions. This level of concentrated ownership may have the effect of delaying or preventing a change in the management or voting control of the Company. In addition, this significant concentration of share ownership may adversely affect the trading price of our common stock if investors perceive disadvantages in owning stock in a company with such concentrated ownership.

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

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

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

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

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

## **Table of Contents**

Further, certain provisions of our charter documents, including a classified board of directors, provisions eliminating the ability of stockholders to take action by written consent, and provisions limiting the ability of stockholders to raise matters at a meeting of stockholders without giving advance notice, may have the effect of delaying or preventing changes in control or management of the Company, which could have an adverse effect on the market price of our stock. In addition, our charter documents do not permit cumulative voting, which may make it more difficult for a third party to gain control of our Board of Directors. Further, we are subject to the anti-takeover provisions of Section 203 of the Delaware General Corporation Law, which will prohibit us from engaging in a business combination with an interested stockholder for a period of three years after the date of the transaction in which the person became an interested stockholder, even if such combination is favored by a majority of stockholders, unless the business combination is approved in a prescribed manner. The application of Section 203 also could have the effect of delaying or preventing a change of control or management.

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

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

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

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

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

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

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

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

New laws and regulations may be introduced that could result in additional compliance costs, seizures, confiscations, recalls or monetary fines, any of which could prevent or inhibit the development, distribution and

## **Table of Contents**

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

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

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

#### **Item 1.B. Unresolved Staff Comments**

None.

#### **Item 2. Properties**

Our largest and most significant facility is our corporate headquarters in Torrance, California. Our Torrance facility is our primary manufacturing facility and the distribution hub for our long-haul trucking fleet and houses our primary administrative offices. Coffee purchasing, roasting and packaging takes place at our Torrance, California; Portland, Oregon; and Houston, Texas plants. Spice blending and packaging takes place at our Torrance, California plant. Our distribution centers include our Torrance, Houston and Portland plants as well as distribution centers in Northlake, Illinois; Oklahoma City, Oklahoma; and Moonachie, New Jersey. In July 2011, we closed our distribution center in Fridley, Minnesota.

We stage our products in 114 branch warehouses throughout the contiguous United States. These warehouses and our six distribution centers, taken together, represent a vital part of our business, but no individual warehouse is material to the business as a whole. Our branch warehouses vary in size from approximately 2,500 to 50,000 square feet. Approximately 55% of our facilities are leased with a variety of expiration dates through 2019. The lease on the CBI facility expires in 2018 and has a 10 year renewal option.

We believe our plants, distribution centers and branch warehouses will continue to provide adequate capacity for the foreseeable future.

A complete list of properties and facilities operated by Farmer Bros. is attached hereto, and incorporated herein by reference, as Exhibit 99.1.

**Table of Contents**

**Item 3. Legal Proceedings**

We are both defendant and plaintiff in various legal proceedings incidental to our business which are ordinary and routine. It is our opinion that the resolution of these lawsuits will not have a material impact on our financial condition or results of operations.

**Item 4. [Removed and Reserved]**

**Table of Contents****PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**  
**Market Information**

We have one class of common stock which is traded on the NASDAQ Global Market under the symbol FARM. The following table sets forth, for the periods indicated, the cash dividends declared and the high and low sales prices of the shares of common stock of the Company as quoted on the NASDAQ Global Market.

	Fiscal year ended June 30, 2011			Fiscal year ended June 30, 2010		
	High	Low	Dividend	High	Low	Dividend
1st Quarter	\$ 17.46	\$ 13.94	\$ 0.115	\$ 24.07	\$ 18.55	\$ 0.115
2nd Quarter	\$ 18.93	\$ 15.55	\$ 0.060	\$ 21.21	\$ 16.31	\$ 0.115
3rd Quarter	\$ 18.13	\$ 10.28	\$	\$ 20.52	\$ 16.36	\$ 0.115
4th Quarter	\$ 13.38	\$ 8.59	\$	\$ 19.49	\$ 14.81	\$ 0.115

**Holdings**

There were 2,594 holders of record on September 9, 2011. Determination of Holders of record is based upon the number of record holders and individual participants in security position listings.

**Dividends**

Although historically the Company has paid a dividend to stockholders, in light of the Company's current financial position, in the third and fourth quarters of fiscal 2011 and in the first quarter of fiscal 2012, the Company's Board of Directors voted to omit the payment of a quarterly dividend for the fourth quarter of fiscal 2011, and the first and second quarters of fiscal 2012, respectively. The amount, if any, of dividends to be paid in the future will depend upon the Company's then available cash, anticipated cash needs, overall financial condition, loan agreement restrictions, future prospects for earnings and cash flows, as well as other relevant factors. For a description of the loan agreement restrictions on the payment of dividends, see Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources included in Part II, Item 7 of this Form 10-K, and Note 8 Bank Loan to the consolidated financial statements included in Part II, Item 8 of this Form 10-K.

**Equity Compensation Plan Information**

This information appears in Part III, Item 12, hereof.

**Table of Contents*****Performance Graph***

The chart set forth below shows the value of an investment of \$100 on June 30, 2006 in each of Farmer Bros. Co. common stock, the Russell 2000 Index and the Value Line Food Processing Index. All values assume reinvestment of the pre-tax value of dividends paid by companies included in these indices and are calculated as of June 30 of each year. The historical stock price performance of the Company's common stock shown in the performance graph below is not necessarily indicative of future stock price performance.

**Comparison of Five-Year Cumulative Total Return****Farmer Bros. Co., Russell 2000 Index And Value Line Food Processing Index****(Performance Results Through 6/30/11)**

	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
Farmer Bros. Co.	\$ 100.00	\$ 106.49	\$ 101.47	\$ 112.10	\$ 75.63	\$ 51.81
Russell 2000 Index	\$ 100.00	\$ 116.43	\$ 97.58	\$ 73.18	\$ 88.90	\$ 122.16
Value Line Food Processing Index	\$ 100.00	\$ 126.74	\$ 121.40	\$ 115.36	\$ 141.26	\$ 182.96

**Source: Value Line, Inc.**

**Table of Contents****Item 6. Selected Financial Data**

	Fiscal years ended June 30,				
	2011	2010	2009(1)	2008(2)	2007
	(In thousands, except per share data)				
Net sales	\$ 463,945	\$ 450,318	\$ 341,724	\$ 266,485	\$ 216,259
Cost of goods sold	\$ 306,771	\$ 252,754	\$ 181,508	\$ 147,073	\$ 108,171
Loss from operations	\$ (68,422)	\$ (39,192)	\$ (15,203)	\$ (10,644)	\$ (4,076)
Net (loss) income(3)	\$ (54,317)	\$ (23,953)	\$ (33,270)	\$ (7,924)	\$ 6,815
Net (loss) income per common share	\$ (3.61)	\$ (1.61)	\$ (2.29)	\$ (0.55)	\$ 0.48
Total assets	\$ 290,053	\$ 339,121	\$ 330,017	\$ 312,984	\$ 337,609
Capital lease obligations(4)	\$ 8,636	\$ 3,861	\$ 1,252	\$	\$
Cash dividends declared per common share	\$ 0.18	\$ 0.46	\$ 0.46	\$ 0.46	\$ 0.44

(1) Includes the results of operations of the DSD Coffee Business since its acquisition by the Company effective February 28, 2009.

(2) Includes the results of operations of CBH since its acquisition by the Company effective April 27, 2007.

(3) Includes: (i) \$7.8 million in impairment loss on intangible assets, and \$9.2 million in income tax benefit in fiscal 2011; (ii) \$2.5 million in income tax benefit in fiscal 2010; and (iii) a deferred tax asset valuation allowance of \$19.7 million recorded as income tax expense in fiscal 2009.

(4) Excludes imputed interest.

The Notes to Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this report should be read in conjunction with the selected financial data in order to understand factors such as business combinations and unusual items which may affect the comparability of the information shown above.

---

**Table of Contents**

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*The following discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of many factors. The results of operations for the fiscal years ended June 30, 2011, 2010 and 2009 are not necessarily indicative of the results that may be expected for any future period. The following discussion should be read in combination with the consolidated financial statements and the notes thereto included in Item 8 of this report and with the Risk Factors described in Item 1A of this report.*

***Overview***

Farmer Bros. Co., a Delaware corporation (including its consolidated subsidiaries unless the context otherwise requires, the Company, we, our or Farmer Bros. ) is a manufacturer, wholesaler and distributor of coffee, tea and culinary products. We are direct distributors of coffee to restaurants, hotels, casinos, hospitals and other foodservice providers, and are providers of private brand coffee programs to grocery retailers, restaurant chains, convenience stores, and independent coffee houses, nationwide. We were founded in 1912, were incorporated in California in 1923, and reincorporated in Delaware in 2004. We operate in one business segment.

In April 2007, we acquired all of the outstanding shares of CBH for a purchase price of \$23.6 million in cash, including transaction costs of approximately \$1.4 million, net of the amount of all outstanding indebtedness of CBH and its subsidiaries. The results of operations of CBH have been included in our consolidated financial statements since April 27, 2007.

On February 28, 2009, we acquired from Sara Lee Corporation, a Maryland corporation ( Sara Lee ), and Saramar, L.L.C., a Delaware limited liability company ( Saramar and collectively with Sara Lee, Seller Parties ) certain assets used in connection with Seller Parties' direct store delivery coffee business in the United States (the DSD Coffee Business ). The purchase price of \$45.6 million was paid with approximately \$16.1 million of Company cash and \$29.5 million of proceeds from a bank loan. In addition, we paid approximately \$2.7 million of acquisition related expenses in cash. At closing, we assumed certain liabilities, including obligations under contracts, environmental liabilities with respect to the transferred facilities, pension liabilities, advertising and trade promotion accruals, and accrued vacation as of the closing for hired personnel. As of June 30, 2011, there were no known liabilities related to the DSD Coffee Business acquisition. The results of operations of the DSD Coffee Business have been included in our consolidated financial statements since March 1, 2009.

In connection with the closing, we and Seller Parties entered into certain operational agreements, including trademark and formula license agreements, co-pack agreements, a liquid coffee distribution agreement, a transition services agreement, and a green coffee and tea purchase agreement. One of the co-pack agreements provided that Sara Lee would manufacture branded products for us for a period of three years. This agreement was terminated effective June 30, 2010. Under the other co-pack agreement, we have agreed to perform co-packing services for Sara Lee as Sara Lee's agent. As a result, we recognize revenue from this arrangement on a net basis, net of direct costs of revenue. The transition services agreement pursuant to which Sara Lee agreed to provide a number of services for us on an interim basis, including hosting, maintaining and supporting IT infrastructure and communications was terminated on August 31, 2010.

***Critical Accounting Policies and Estimates***

Management's discussion and analysis of financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles. Our significant accounting policies are discussed in Note 1 to our consolidated financial statements, included herein at Item 8. The preparation of these financial statements requires us to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including



## **Table of Contents**

those related to inventory valuation, including LIFO reserves, the allowance for doubtful accounts, deferred tax assets, liabilities relating to retirement benefits, liabilities resulting from self-insurance of our workers' compensation liabilities, tax liabilities and litigation. We base our estimates, judgments and assumptions on historical experience and other relevant factors that are believed to be reasonable based on information available to us at the time these estimates are made.

While we believe that the historical experience and other factors considered provide a meaningful basis for the accounting policies applied in the preparation of the consolidated financial statements, actual results may differ from these estimates, which could require us to make adjustments to these estimates in future periods.

We believe that the estimates, judgments and assumptions involved in the accounting policies described below require the most subjective judgment and have the greatest potential impact on our financial statements, so we consider these to be our critical accounting policies. Our senior management has reviewed the development and selection of these critical accounting policies and estimates, and their related disclosure in this report, with the Audit Committee of our Board of Directors.

### *Coffee Brewing Equipment and Service*

Our expenses related to coffee brewing equipment provided to customers include the depreciation cost of the equipment as well as the cost of servicing that equipment (including service employees' salaries, the cost of transportation and the cost of supplies and parts). We capitalize coffee brewing equipment and depreciate it over a three year period; the depreciation expense is reported in cost of goods sold. Since we believe the costs of servicing the equipment are better characterized as direct costs of generating revenues from our customers, we have reported such costs as cost of goods sold in the accompanying financial statements.

### *Investments*

Our investments consist of money market instruments, marketable debt and equity securities, various derivative instruments, primarily exchange traded futures and options, green coffee forward purchase contracts and commodity purchase agreements. All derivative instruments not designated as accounting hedges are marked to market and changes are recognized in current earnings. At June 30, 2011 and 2010, no derivative instruments were designated as accounting hedges. The fair value of derivative instruments is based upon broker quotes. The cost of investments sold is determined on the specific identification method. Dividend and interest income is accrued as earned.

### *Allowance for Doubtful Accounts*

We maintain an allowance for estimated losses resulting from the inability of our customers to meet their obligations. In fiscal 2010, based on a larger customer base due to the recent Company acquisitions and in response to slower collection of our accounts receivable resulting from the impact of the economic downturn on our customers, we increased our allowance for doubtful accounts. In fiscal 2011, we decreased the allowance for doubtful accounts balance by \$0.4 million due to improved collections of outstanding receivables.

### *Inventories*

Inventories are valued at the lower of cost or market. Costs of coffee, tea and culinary products are determined on the last in, first out (LIFO) basis. We account for the costs of coffee brewing equipment manufactured on the first in, first out (FIFO) basis. We regularly evaluate these inventories to determine whether market conditions are correctly reflected in the recorded carrying value.

### *Impairment of Goodwill and Intangible Assets*

We perform our annual goodwill, definite and indefinite-lived intangible assets impairment test as of June 30 of each fiscal year. Goodwill and other indefinite-lived intangible assets are not amortized but instead are reviewed for impairment annually and on an interim basis if events or changes in circumstances between annual

---

**Table of Contents**

tests indicate that an asset might be impaired. Testing for impairment of goodwill is a two-step process. The first step requires us to compare the fair value of our reporting units to the carrying value of the net assets of the respective reporting units, including goodwill. If the fair value of the reporting unit is less than the carrying value, goodwill of the reporting unit is potentially impaired and we then complete step two to measure the impairment loss, if any. The second step requires the calculation of the implied fair value of goodwill by deducting the fair value of all tangible and intangible net assets of the reporting unit from the fair value of the reporting unit. If the implied fair value of goodwill is less than the carrying amount of goodwill, an impairment loss is recognized equal to the difference.

In fiscal 2011, during our annual test for impairment of our definite-lived intangible assets, we identified indicators of impairment including a decline in market capitalization and continuing losses from operations. We performed impairment tests to determine the recoverability of the carrying values of the assets or if impairment should be measured. We determined that definite-lived intangible assets consisting of the customer relationships acquired, and the distribution agreement and co-pack agreement entered into, in connection with the DSD Coffee Business acquisition were impaired since the sum of the forecasted cash flows from each of these assets did not exceed their respective carrying values. As a result, in the fourth quarter of fiscal 2011, we wrote off the carrying values of these assets for a total of \$7.8 million.

*Self-Insurance*

We are self-insured for California workers' compensation insurance subject to specific retention levels and use historical analysis to determine and record the estimates of expected future expenses resulting from workers' compensation claims. The estimated outstanding losses are the accrued cost of unpaid claims valued as of June 30, 2011. The estimated outstanding losses, including allocated loss adjustment expenses (ALAE), include case reserves, the development on known claims and incurred but not reported (IBNR) claims. ALAE are the direct expenses for settling specific claims. The amounts reflect per occurrence and annual aggregate limits maintained by the Company. The analysis does not include estimating a provision for unallocated loss adjustment expenses.

Management believes that the amount accrued is adequate to cover all known claims at June 30, 2011. If the actual costs of such claims and related expenses exceed the amount estimated, additional reserves may be required which could have a material negative effect on operating results. If our estimate were off by as much as 15%, the reserve could be under or overstated by approximately \$0.7 million as of June 30, 2011.

In May 2011, we did not meet the minimum credit rating criteria for participation in the alternative security program for California self-insurers. As a result, we were required to post a \$5.9 million letter of credit as a security deposit to the State of California Department of Industrial Relations Self-Insurance Plans. We posted the security deposit in June 2011.

Estimated Company liability resulting from our general liability and automobile liability policies, within our deductible limits, is accounted for by specific identification. Large losses have historically been infrequent, and the lag between incurred but not reported claims has historically been short. Once a potential loss has been identified, the case is monitored by our risk manager to try and determine a likely outcome. Lawsuits arising from injury that are expected to reach our deductible are not reserved until we have consulted with legal counsel, become aware of the likely amount of loss and determined when payment is expected.

The estimated liability related to our self-insured group medical insurance is recorded on an incurred but not reported basis, within deductible limits, based on actual claims and the average lag time between the date insurance claims are filed and the date those claims are paid.

*Retirement Plans*

We have a defined benefit pension plan for the majority of our employees who are not covered under a collective bargaining agreement, the Farmer Bros. Salaried Employees Pension Plan (Farmer Bros. Plan), and

**Table of Contents**

two defined benefit pension plans for certain hourly employees covered under a collective bargaining agreement, the Brewmatic Plan and the Hourly Employees Plan. In addition, we contribute to several multi-employer defined benefit pension plans for certain union employees.

As of June 30, 2011, we amended the Farmer Bros. Plan, freezing the benefit for all participants effective June 30, 2011. After the plan freeze, participants do not accrue any benefits under the plan, and new hires are not eligible to participate in the plan. As a result, we recorded a curtailment charge of \$1.5 million in the fourth quarter ended June 30, 2011.

We obtain actuarial valuations for our plans and at present we discount the pension obligations using a 5.60% discount rate and we estimate an 8.25% return on plan assets. The performance of the stock market and other investments as well as the overall health of the economy can have a material effect on pension investment returns and these assumptions. A change in these assumptions could affect our operating results.

At the end of fiscal 2011, the projected benefit obligation of our defined benefit pension plans was \$111.8 million and the fair value of the plan assets was \$83.7 million. The difference between the projected benefit obligation and fair value of plan assets is recognized as a decrease in other comprehensive income ( OCI ) and an increase in pension liability and deferred tax assets. The difference between plan obligations and assets, or the funded status of the plans, significantly affects the net periodic benefit costs of our pension plans and the ongoing funding requirements of those plans. Among other factors, changes in interest rates, mortality rates, early retirement rates, investment returns and the market value of plan assets can affect the level of plan funding, cause volatility in the net periodic pension costs, and increase our future funding requirements. We expect to make approximately \$7.5 million in contributions to our pension plans in fiscal 2012 and record an accrued expense of approximately \$1.2 million per year beginning in fiscal 2012. Pension expense beginning in fiscal 2012 is significantly lower than the pension expense in prior years due to the freeze in benefits as of June 30, 2011 under the Farmer Bros. Plan. The pension plan payments are expected to continue at this level for several years, and the current economic environment increases the risk that we may be required to make even larger contributions in the future.

The following chart quantifies the effect on the projected benefit obligation and the net periodic benefit cost of a change in the discount rate assumption and the impact on the net periodic benefit cost of a change in the assumed long term rate of return for fiscal 2012.

		(In thousands)	
		Actual	
<b>Farmer Bros. Plan Discount Rate</b>	<b>5.10%</b>	<b>5.60%</b>	<b>6.10%</b>
Net periodic benefit cost	\$ 1,036	\$ 622	\$ 235
Projected benefit obligation	\$ 114,229	\$ 107,071	\$ 100,610
<b>Long Term Rate of Return</b>	<b>7.75%</b>	<b>Actual 8.25%</b>	<b>8.75%</b>
Net periodic benefit cost	\$ 1,032	\$ 622	\$ 212
<b>Brewmatic Plan Discount Rate</b>	<b>5.10%</b>	<b>Actual 5.60%</b>	<b>6.10%</b>
Net periodic benefit cost	\$ 136	\$ 128	\$ 121
Projected benefit obligation	\$ 3,843	\$ 3,662	\$ 3,497
<b>Long Term Rate of Return</b>	<b>7.75%</b>	<b>Actual</b>	<b>8.25%</b>
Net periodic benefit cost	\$ 142	\$ 128	\$ 114
<b>Hourly Employees Plan Discount Rate</b>	<b>5.10%</b>	<b>Actual</b>	<b>5.60%</b>
Net periodic benefit cost	\$ 531	\$ 486	\$ 452
Projected benefit obligation	\$ 1,148	\$ 1,055	\$ 973
<b>Long Term Rate of Return</b>	<b>7.75%</b>	<b>Actual</b>	<b>8.25%</b>
Net periodic benefit cost	\$ 490	\$ 486	\$ 483

---

## **Table of Contents**

### *Income Taxes*

Deferred income taxes are determined based on the temporary differences between the financial reporting and tax bases of assets and liabilities using enacted tax rates in effect for the year in which differences are expected to reverse. Estimating our tax liabilities involves judgments related to uncertainties in the application of complex tax regulations. We make certain estimates and judgments to determine tax expense for financial statement purposes as we evaluate the effect of tax credits, tax benefits and deductions, some of which result from differences in timing of recognition of revenue or expense for tax and financial statement purposes. Changes to these estimates may result in significant changes to our tax provision in future periods. Each fiscal quarter we reevaluate our tax provision and reconsider our estimates and our assumptions related to specific tax assets and liabilities, making adjustments as circumstances change.

Income tax expense or benefit from continuing operations is generally determined without regard to other categories of earnings, such as discontinued operations and other comprehensive income. An exception is provided in Accounting Standards Codification ( ASC ) 740,

Accounting for Uncertainty in Income Taxes , when there is aggregate income from categories other than continuing operations and a loss from continuing operations in the current year. In this case, the tax benefit allocated to continuing operations is the amount by which the loss from continuing operations reduces the tax expenses recorded with respect to the other categories of earnings, even when a valuation allowance has been established against the deferred tax assets. In instances where a valuation allowance is established against current year losses, income from other sources, including gain from postretirement benefits recorded as a component of other comprehensive income, is considered when determining whether sufficient future taxable income exists to realize the deferred tax assets. As a result, for the fiscal year ended June 30, 2011, we recorded a tax expense of \$9.8 million in other comprehensive income related to the gain on postretirement benefits, and recorded a corresponding tax benefit of \$9.8 million in continuing operations.

### *Deferred Tax Asset Valuation Allowance*

We assess whether a valuation allowance should be recorded against deferred tax assets based on the likelihood that the benefits of the deferred tax assets will or will not ultimately be realized in future periods. In making such assessment, significant weight is to be given to evidence that can be objectively verified such as recent operating results and less consideration is to be given to less objective indicators such as future earnings projections. We have evaluated our deferred tax assets in accordance with these requirements.

In fiscal 2009, we established a valuation allowance against the deferred tax assets in the amount of \$33.3 million. Of this amount \$19.7 million was recorded as a fiscal 2009 tax expense and \$13.6 million was recorded as a reduction in other comprehensive income. A significant negative factor was the Company's three-year historical cumulative loss as of the end of the fourth quarter of fiscal 2009, compared to the size of deferred tax assets. The deferred tax assets in fiscal 2010 increased to \$53.7 million as compared to \$41.4 million in fiscal 2009. The Company remains in a three-year historical cumulative loss position as of the end of fiscal 2011 and is maintaining its valuation allowance.

The deferred tax assets in fiscal 2011 increased to \$68.8 million as compared to \$53.7 million in fiscal 2010. In fiscal 2011, deferred tax assets increased primarily due to net loss carryovers. This increase was partially offset by a reduction in deferred tax assets due to an increase in pension asset values. In fiscal 2010, deferred tax assets increased primarily due to loss carryovers and decreased pension asset values which in turn created increased pension plan contribution obligations.

### *Postretirement Benefits*

We sponsor a postretirement medical and dental plan that covers qualified non-union employees and retirees, and certain qualified union retirees. Under this postretirement plan, our contributions toward premiums

---

## **Table of Contents**

for retiree medical, dental and vision coverage for participants and dependents are scaled based on length of service, with greater Company contributions for retirees with greater length of service, but subject to a maximum monthly Company contribution.

Our retiree medical plan is unfunded and its liability was calculated using an assumed discount rate of 5.46% at June 30, 2011. We project an initial medical trend rate of 7.5% ultimately reducing to 5.0% in 6 years.

The effect of adopting the current postretirement plan was recorded on the effective date of the plan, January 1, 2008, as an increase in accumulated other comprehensive income of \$16.7 million (net of related tax effects of \$10.6 million), and a reduction to the retiree medical liability of \$27.3 million. The accumulated other comprehensive income amount is expected to be amortized as a reduction in expense over a period of 7 to 12 years. Amortization in fiscal 2011 and 2010 was \$0.7 million and \$4.2 million, respectively.

### *Share-based Compensation*

We measure all share-based compensation cost at the grant date, based on the fair value of the award, and recognize such cost as an expense in our consolidated statement of operations over the requisite service period. The process of estimating the fair value of share-based compensation awards and recognizing share-based compensation cost over the requisite service period involves significant assumptions and judgments. We estimate the fair value of stock option awards on the date of grant using the Black-Scholes option valuation model which requires that we make certain assumptions regarding: (i) the expected volatility in the market price of our common stock; (ii) dividend yield; (iii) risk-free interest rates; and (iv) the period of time employees are expected to hold the award prior to exercise (referred to as the expected holding period). In addition, we estimate the expected impact of forfeited awards and recognize share-based compensation cost only for those awards expected to vest. If actual forfeiture rates differ materially from our estimates, share-based compensation expense could differ significantly from the amounts we have recorded in the current period. We will periodically review actual forfeiture experience and revise our estimates, as necessary. We will recognize as compensation cost the cumulative effect of the change in estimated forfeiture rates on current and prior periods in earnings of the period of revision. As a result, if we revise our assumptions and estimates, our share-based compensation expense could change materially in the future. In fiscal 2011 and 2010, we used an estimated 6.5% annual forfeiture rate to calculate share-based compensation expense based on actual forfeiture experience from the inception of the Omnibus Plan.

### *Liquidity and Capital Resources*

#### *Credit Facility*

On September 12, 2011, we entered into an Amended and Restated Loan and Security Agreement (the *New Loan Agreement*) among the Company and CBI, as Borrowers, certain of the Company's other subsidiaries, as Guarantors, the Lenders party thereto, and Wells Fargo Bank, National Association, as Agent. The following description of the New Loan Agreement does not purport to be complete and is subject to, and qualified in its entirety by, reference to the New Loan Agreement which is included as Exhibit 10.12 to this Form 10-K and incorporated herein by reference. Capitalized terms used below are defined in the New Loan Agreement.

The New Loan Agreement provides for a senior secured revolving credit facility of up to \$85 million, with a letter of credit sublimit of \$20 million. The new revolving line of credit provides for advances of 85% of eligible accounts receivable and 75% of eligible inventory, as defined. The New Loan Agreement provides for a range of interest rates based on modified Monthly Average Excess Availability levels with a range of PRIME + 0.25% to PRIME + 0.75% or Adjusted Eurodollar Rate + 2.0% to Adjusted Eurodollar Rate + 2.5%. The New Loan Agreement has an amendment fee of 0.375% and an unused line fee of 0.25%. Outstanding obligations under the New Loan Agreement are collateralized by all of the Borrowers' assets, including the Company's preferred stock portfolio. The term of the New Loan Agreement expires on March 2, 2015.

---

**Table of Contents**

The New Loan Agreement contains a variety of affirmative and negative covenants of types customary in an asset-based lending facility, including those relating to reporting requirements, maintenance of records, properties and corporate existence, compliance with laws, incurrence of other indebtedness and liens, limitations on certain payments, including the payment of dividends and capital expenditures, and transactions and extraordinary corporate events. The New Loan Agreement allows us to pay dividends, subject to certain liquidity requirements. The New Loan Agreement also contains financial covenants requiring the Borrowers to maintain minimum Excess Availability and Total Liquidity levels. The New Loan Agreement allows the Lender to establish reserve requirements, which may reduce the amount of credit otherwise available to us, to reflect events, conditions, or risks that would have a reasonable likelihood of adversely affecting the Lender's collateral or our assets, including our green coffee inventory.

The New Loan Agreement provides that an event of default includes, among other things, subject to certain grace periods: (i) payment defaults; (ii) failure by any guarantor to perform any guarantee in favor of Lender; (iii) failure to abide by loan covenants; (iv) default with respect to other material indebtedness; (v) final judgment in a material amount not discharged or stayed; (vi) any change of control; (vii) bankruptcy or insolvency; and (viii) the failure of the Farmer Bros. Co. Employee Stock Ownership Benefit Trust, created by the Company to implement the ESOP, to be duly qualified under Section 401(a) of the Code or exempt from federal income taxation, or if the ESOP engages in a material non-exempt prohibited transaction.

The New Loan Agreement replaces our existing Loan and Security Agreement, dated March 2, 2009, as amended (the Original Loan Agreement), among the Borrowers, Guarantors and Wells Fargo, as Lender. The Original Loan Agreement provided for a senior secured revolving credit facility of up to \$50 million, with a letter of credit sublimit of \$10 million. The original revolving line of credit provided for advances of 85% of eligible accounts receivable and 65% of eligible inventory, as defined. The Original Loan Agreement had an unused commitment fee of 0.375%. The Original Loan Agreement provided for a range of interest rates based on modified Monthly Average Excess Availability levels (as defined) with a range of PRIME + 0.25% to PRIME + 0.75% or Adjusted Eurodollar Rate + 2.5% to Adjusted Eurodollar Rate + 3.0%. All outstanding obligations under the Original Loan Agreement were collateralized by the Company's assets, excluding the preferred stock held in investment accounts.

The interest rate on our outstanding borrowings under the Original Loan Agreement was 4.0% at June 30, 2011. As of June 30, 2011, we had outstanding borrowings of \$31.4 million, utilized \$3.1 million of the letters of credit sublimit, and had excess availability under the credit facility of \$15.5 million. Due to the short-term nature of the credit facility and the variable interest rate, fair value of the balance outstanding approximates carrying value. As of June 30, 2011, we were in compliance with all restrictive covenants under the Original Loan Agreement. On September 12, 2011, the Lender and the Company amended the Original Loan Agreement to reduce required minimum excess availability and required minimum total liquidity for the period from July 1, 2011 through September 30, 2011. The foregoing description of Amendment No. 5 to the Original Loan Agreement does not purport to be complete and is subject to, and qualified in its entirety by, reference to Amendment No. 5 to Loan and Security Agreement which is included as Exhibit 10.11 to this Form 10-K and incorporated herein by reference. There can be no assurance that the Lender will issue a waiver or grant an amendment to the covenants in future periods, if the Company required one. As of August 31, 2011, we had outstanding borrowings of \$35.3 million, utilized \$9.0 million of the letters of credit sublimit, and had excess availability under the credit facility of \$5.7 million (before giving effect to an increase in the line of credit on September 12, 2011 pursuant to the New Loan Agreement).

*Liquidity*

We generally finance our operations through cash flow from operations and borrowings under our revolving credit facility described above. As of June 30, 2011, we had \$6.1 million in cash and cash equivalents and \$24.9 million in short-term investments. We believe our revolving credit facility, to the extent available, in addition to our cash flows from operations and other liquid assets are sufficient to fund our working capital and capital expenditure requirements for the next 12 months.

**Table of Contents**

We generate cash from operating activities primarily from cash collections related to the sale of our products. Net cash provided by operating activities was \$33.9 million in fiscal 2011, compared with net cash used in operating activities of \$(1.0) million in fiscal 2010, and net cash provided by operating activities of \$87.2 million in fiscal 2009. The increase in net cash provided by operating activities in fiscal 2011 compared to fiscal 2010 was primarily a result of proceeds from the sale of a portion of our investments and an increase in accounts payable.

Net cash used in investing activities decreased to \$17.4 million in fiscal 2011 compared to \$28.0 million in fiscal 2010 and \$86.6 million in fiscal 2009 due to reduced levels of capital expenditures. Net cash used in investing activities in fiscal 2009 included \$48.3 million in cash used to acquire the DSD Coffee Business.

Net cash used in financing activities was \$14.6 million in fiscal 2011 compared to net cash provided by financing activities of \$13.2 in fiscal 2010 and net cash provided by financing activities of \$9.4 million in fiscal 2009. Net cash used in financing activities in fiscal 2011 included net borrowings (repayments) of \$(8.5) million on our revolving line of credit compared to \$21.0 million and \$16.2 million, respectively, in fiscal 2010 and 2009.

In fiscal 2011, we capitalized \$17.4 million in property and equipment purchases which included \$12.7 million in expenditures to replace normal wear and tear of coffee brewing equipment, \$3.7 million in building and facility improvements, including installation of the two roasters and other production equipment at our Torrance facility, \$2.4 million in expenditures for vehicles, and machinery and equipment, and \$0.6 million in information technology related expenditures. In addition, during fiscal 2011, we acquired equipment and trucks under capital leases totaling \$5.7 million.

Our expected capital expenditures for fiscal 2012 include expenditures to replace normal wear and tear of coffee brewing equipment, vehicles, and machinery and equipment and are expected to not significantly deviate from fiscal 2011 levels.

Our working capital is comprised of the following:

	June 30,	
	2011	2010
	(In thousands)	
Current assets	\$ 157,410	\$ 189,956
Current liabilities	103,462	98,546
<b>Working capital</b>	<b>\$ 53,948</b>	<b>\$ 91,410</b>

Liquidity Information:

	2011	June 30, 2010	2009
	(In thousands)		
Capital expenditures	\$ 19,416	\$ 28,484	\$ 38,901
Purchase of business	\$	\$	\$ 48,287
Dividends paid	\$ 4,657	\$ 6,939	\$ 6,631
Dividend payable	\$	\$ 1,849	\$ 1,849

**Results of Operations**

*Fiscal Years Ended June 30, 2011 and 2010*

**Overview**

Fiscal 2011 was a period of rapid commodity inflation, which impacted our cost of green coffee, sugar and cocoa and freight expense. Since we value our inventory on a last-in-first-out ( LIFO ) method of valuation rather than on a first-in-first out ( FIFO ) basis, the escalating coffee prices had a significant negative impact on our cost of goods sold and the resulting gross profit. To address the increase in freight and fuel expense, we instituted a fuel surcharge in fiscal 2011 and, to minimize gross margin erosion, we increased pricing to our customers several times in fiscal

## Edgar Filing: FARMER BROTHERS CO - Form 10-K

2011 although the price increases, at times, lagged the relatively rapid and steep cost increases we incurred. In an environment of record-high costs, rising unemployment and a severe economic downturn, we were unable to fully pass along our costs to our customers.



## **Table of Contents**

To address downward margin pressures, we continued to focus on streamlining our operations in fiscal 2011. Specifically, we focused on expense reductions, asset redeployment and automation intended to improve our operating results. We implemented a number of initiatives intended to reduce the cost of our operations, including headcount reduction, inventory reduction, implementation of improved collection practices of past due accounts, cost-sharing measures to address increases in employee healthcare costs, automation of certain functions, centralization of certain IT functions, and in-sourcing of certain business support functions. We have and expect to continue to improve our real-estate asset management by divesting underutilized properties and renegotiating our lease terms in response to more favorable market conditions in certain markets.

In fiscal 2011, we significantly modified our retirement-benefit program. Specifically, we amended our defined-benefit pension plan, the Farmer Bros. Salaried Employees Pension Plan, freezing the benefit for all participants effective June 30, 2011. After the plan freeze, participants do not accrue any benefits under the plan, and new hires are not eligible to participate in the plan. However, account balances continue to be credited with interest until paid out. The freeze of the defined benefit pension plan coincided with an enhanced defined contribution 401(k) plan with a discretionary Company match of the employees' annual contributions. In fiscal 2011, the Company accrued \$0.1 million towards this Company match. The pension freeze is anticipated to save over \$8 million annually in future pension expense accrual, which is expected to be offset by any discretionary Company match under the 401(k) plan.

In fiscal 2011, we also sold a portion of our investments in preferred stock in order to pay down a portion of the outstanding balance on our revolving credit facility.

### ***Operations***

Net sales in fiscal 2011 increased \$13.6 million, or 3%, to \$463.9 million from \$450.3 million in fiscal 2010, primarily due to price increases we implemented in the second half of fiscal 2011. Sales dollars as well as sales volume increased in fiscal 2011 compared to fiscal 2010. The increases were primarily due to the increases in list prices of our coffee, cappuccino, cocoa and selected spice products, offset in part by the effect of a decrease in the number of customers who purchased our products as compared to the prior fiscal year.

Cost of goods sold in fiscal 2011 increased \$54.0 million, or 21%, to \$306.8 million, or 66% of sales, from \$252.8 million, or 56% of sales, in fiscal 2010 primarily due to the increase in the cost of green coffee beans. Green coffee costs increased 80% in fiscal 2011 compared to the prior fiscal year. Cost of goods sold in fiscal 2011 also included \$40.3 million in LIFO charge compared to \$1.0 million in LIFO charge in the prior fiscal year. Additionally, the cost of coffee brewing equipment and related service also contributed to the increase in cost of goods sold. Cost of coffee brewing equipment and related service in fiscal 2011 was \$27.1 million compared to \$21.5 million in fiscal 2010.

Gross profit in fiscal 2011 decreased \$40.4 million, or 20%, to \$157.2 million from \$197.6 million in fiscal 2010. Gross margin decreased to 34% in fiscal 2011 from 44% in the prior fiscal year. This decrease in gross margin is primarily due to (1) increased raw material costs including an 80% increase in the cost of green coffee beans in fiscal 2011 compared to the prior fiscal year partially offset by price increases for finished goods during the period, (2) increased coffee brewing equipment and service costs, and (3) changes in the mix of our customers and the products we sell to them.

In fiscal 2011, operating expenses decreased \$11.2 million, or 4.7%, to \$225.6 million, or 49% of sales, from \$236.8 million, or 53% of sales, in fiscal 2010. The reduction in operating expenses in fiscal 2011, as compared to the prior fiscal year, is primarily due to lower payroll and related expenses resulting from a reduction in the number of employees offset in part by higher freight and fuel costs, and severance costs associated with the reduction in headcount of approximately 200 employees in the amount of \$3.1 million.

## **Table of Contents**

Operating expenses in fiscal 2011 also include \$7.8 million in write-off of intangible assets due to impairment, \$1.5 million in pension curtailment charge, and \$0.7 million in severance costs recorded pursuant to the Separation Agreement between the Company and Roger M. Lavery III, the Company's former President and Chief Executive Officer.

Loss from operations in fiscal 2011 was \$(68.4) million compared to \$(39.2) million in fiscal 2010, primarily due to decline in gross profit.

### ***Total other income (expense)***

Total other income in fiscal 2011 was \$4.9 million compared to \$12.7 million in fiscal 2010. The decrease in total other income was primarily due to lower net realized and unrealized gains on a smaller investment portfolio and higher interest expense related to borrowings under our revolving credit line in fiscal 2011 as compared to fiscal 2010.

### ***Income taxes***

In fiscal 2011, we recorded an income tax benefit of \$9.2 million compared to \$2.5 million in fiscal 2010. Income tax expense or benefit from continuing operations is generally determined without regard to other categories of earnings, such as discontinued operations and other comprehensive income. An exception is provided in ASC 740 when there is aggregate income from categories other than continuing operations and a loss from continuing operations in the current year. In this case, the tax benefit allocated to continuing operations is the amount by which the loss from continuing operations reduces the tax expenses recorded with respect to the other categories of earnings, even when a valuation allowance has been established against the deferred tax assets. In instances where a valuation allowance is established against current year losses, income from other sources, including gain from postretirement benefits recorded as a component of other comprehensive income, is considered when determining whether sufficient future taxable income exists to realize the deferred tax assets. As a result, for the year ended June 30, 2011, we recorded a tax expense of \$9.8 million in other comprehensive income related to the gain on postretirement benefits, and recorded a corresponding tax benefit of \$9.8 million in continuing operations. Income tax benefit for fiscal 2010 was primarily attributable to federal legislation allowing a five year net operating loss carryback period for net operating losses incurred in tax years that ended in 2008 and 2009. This legislation allowed us to claim additional income tax receivable and record a corresponding decrease in our deferred tax assets relating to our net operating loss carryovers, thereby reducing the valuation allowance recorded as of June 30, 2009 and resulting in income tax benefit for fiscal 2010.

### ***Net Loss***

As a result of the above operating factors, net loss increased to \$(54.3) million, or \$(3.61) per common share, in fiscal 2011 compared to a net loss of \$(24.0) million, or \$(1.61) per common share, in fiscal 2010.

### ***Fiscal Years Ended June 30, 2010 and 2009***

### ***Overview***

Fiscal 2010 was a year in which we primarily focused on integrating the DSD Coffee Business into our existing operations. We streamlined our routes and distribution logistics and consolidated our warehouses and distribution centers from 179 to 115 locations. Our net sales grew \$108.6 million, or 32%, to \$450.3 million in fiscal 2010 from \$341.7 million in fiscal 2009 primarily due to the acquisition of the DSD Coffee Business. Net sales from CBI also increased approximately 8% from the prior fiscal year. Although our net sales increased and our geographic reach widened in fiscal 2010, the weakness in the economy and reduced consumer spending negatively impacted our net sales.

---

## **Table of Contents**

### ***Operations***

Net sales in fiscal 2010 increased \$108.6 million, or 32%, to \$450.3 million from \$341.7 million in fiscal 2009, primarily due to the addition of DSD Coffee Business net sales beginning on March 1, 2009. Cost of goods sold in fiscal 2010 increased \$71.2 million, or 39%, to \$252.8 million, or 56% of sales, from \$181.5 million, or 53% of sales, in fiscal 2009 primarily due to the addition of the DSD Coffee Business beginning on March 1, 2009. Additionally, the cost of coffee brewing equipment and related service included in cost of goods sold also contributed to the increase in cost of goods sold. Cost of coffee brewing equipment and related service for the fiscal year ended June 30, 2010 was \$21.5 million compared to \$13.1 million for the fiscal year ended June 30, 2009.

Gross profit in fiscal 2010 increased \$37.3 million, or 23%, to \$197.6 million from \$160.2 million in fiscal 2009. However, gross margin decreased to 44% in fiscal 2010 from 47% in the prior fiscal year. As with net sales, the increase in gross profit is directly attributable to the acquisition of the DSD Coffee Business. The decrease in gross margin is primarily due to the increase in coffee brewing equipment and related service cost in cost of goods sold in the amount of \$21.5 million in fiscal 2010 from \$13.1 million in the prior fiscal year, and the addition of a new class of DSD Coffee Business customers who require a different mix of products.

Operating expenses in fiscal 2010 increased \$61.3 million, or 35%, to \$236.8 million, or 53% of sales, from \$175.4 million, or 51% of sales, in fiscal 2009. Operating expenses in fiscal 2010 consisted of a full year of expenses related to the DSD Coffee Business compared to fiscal 2009 which included only four months of expenses related to the DSD Coffee Business. Additionally, operating expenses included \$10.1 million related to the integration of the DSD Coffee Business including expenses related to SKU optimization and streamlining of facilities and routes, \$8.5 million in higher depreciation and amortization expense, \$8.4 million in higher pension expense and \$3.2 million in higher bad debt expense compared to the prior year.

For the reasons noted above, loss from operations in fiscal 2010 increased to \$(39.2) million from \$(15.2) million in fiscal 2009.

### ***Total other income (expense)***

Total other income in fiscal 2010 was \$12.7 million compared to total other expense of \$(3.8) million in fiscal 2009. This was primarily due to improved results from our preferred stock portfolio which recorded net realized and unrealized gains in fiscal 2010 compared to net realized and unrealized losses in fiscal 2009, partially offset by \$0.7 million in higher interest expense related to borrowings under our revolving credit line.

### ***Net Loss***

As a result of the above operating factors, net loss decreased to \$(24.0) million, or \$(1.61) per common share, in fiscal 2010 compared to a net loss of \$(33.3) million, or \$(2.29) per common share, in fiscal 2009, which included the recognition of a valuation allowance for deferred tax assets of \$(19.7) million, or \$(1.35) per common share in fiscal 2009.

### ***Non-GAAP Financial Measures***

In addition to net income (loss) determined in accordance with United States Generally Accepted Accounting Principles (GAAP), we use certain non-GAAP financial measures, such as Net income (loss) excluding LIFO, EBITDAE and Adjusted EBITDAE, in assessing our operating performance. We believe the non-GAAP measures serve as appropriate measures to be used in evaluating the performance of our business.

We define net income (loss) excluding LIFO as net income (loss) excluding the impact of LIFO charge or credit. We define EBITDAE as net income (loss) excluding the impact of income taxes, interest expense, depreciation

**Table of Contents**

and amortization, ESOP expense, stock-based compensation expense, non-cash impairment losses, and gains and losses from investment portfolio. We reference this particular non-GAAP financial measure frequently in our decision-making because it provides supplemental information that facilitates internal comparisons to the historical operating performance of prior periods. In addition, incentive compensation is based on EBITDAE and we base certain of our forward-looking estimates on EBITDAE to facilitate quantification of planned business activities and enhance subsequent follow-up with comparisons of actual to planned EBITDAE. We define Adjusted EBITDAE as EBITDAE excluding the impact of LIFO charges or credits. We believe the use of the LIFO method of inventory valuation for coffee, tea and culinary products results in a better matching of costs and revenues. Net income (loss) excluding LIFO, EBITDAE and Adjusted EBITDAE as defined by us may not be comparable to similarly titled measures reported by other companies. We do not intend for non-GAAP financial measures to be considered in isolation or as a substitute for other measures prepared in accordance with GAAP.

Set forth below is a reconciliation of reported net loss and reported basic and diluted loss per share to net loss excluding LIFO impact and basic and diluted loss per common share excluding LIFO impact, respectively:

	2011	Year Ended June 30, 2010 (In thousands)	2009
Net loss, as reported	\$ (54,317)	\$ (23,953)	\$ (33,270)
LIFO charge (credit)	\$ 40,317	\$ 1,033	\$ (13)
Net loss, excluding LIFO	\$ (14,000)	\$ (22,920)	\$ (33,283)
Weighted average common shares outstanding, basic and diluted	15,066,663	14,866,306	14,508,320
Net loss per common share, as reported	\$ (3.61)	\$ (1.61)	\$ (2.29)
Net loss per common share excluding LIFO, basic and diluted	\$ (0.93)	\$ (1.54)	\$ (2.29)

Set forth below is a reconciliation of reported net loss to EBITDAE and Adjusted EBITDAE:

	2011	Year Ended June 30, 2010 (In thousands)	2009
Net loss, as reported	\$ (54,317)	\$ (23,953)	\$ (33,270)
Income tax (benefit) expense	(9,167)	(2,529)	14,283
Interest expense	1,965	986	335
Depreciation and amortization expense	31,758	26,778	18,292
ESOP and stock-based compensation expense	3,825	4,784	5,452
Intangible assets impairment losses	7,805		
Investment portfolio (gains) losses	(4,191)	(10,169)	8,248
EBITDAE	\$ (22,322)	\$ (4,103)	\$ 13,340
LIFO charge (credit) net of taxes of zero*	40,317	1,033	(13)
Adjusted EBITDAE	\$ 17,995	\$ (3,070)	\$ 13,327

\* LIFO charge (credit) had no impact on income tax (benefit) expense since we have recorded a 100% valuation allowance against deferred tax assets.

**Table of Contents****Contractual Obligations**

The following table contains supplemental information regarding total contractual obligations as of June 30, 2011, including capital leases:

	Total	Payment due by period (in thousands)			
		Less Than One Year	1-3 Years	3-5 Years	More Than 5 Years
<b>Contractual obligations:</b>					
Operating lease obligations	\$ 20,727	\$ 5,228	\$ 7,571	\$ 4,698	\$ 3,230
Capital lease obligations(a)	10,519	2,210	4,213	3,758	338
Pension plan obligations	73,328	5,678	12,071	13,299	42,280
Postretirement benefits other than pensions	16,944	1,148	2,522	3,092	10,182
Revolving credit facility(b)	31,362	31,362			
	\$ 152,880	\$ 45,626	\$ 26,377	\$ 24,847	\$ 56,030

(a) Includes imputed interest of \$1,883.

(b) Revolving credit facility expires March 2, 2015.

**Off-Balance Sheet Arrangements**

We have no off-balance sheet arrangements.

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk****Interest Rate Risk**

We are exposed to market value risk arising from changes in interest rates on our securities portfolio. Our portfolio of preferred securities has sometimes included investments in derivatives that provide a natural economic hedge of interest rate risk. We review the interest rate sensitivity of these securities and (a) may enter into short positions in futures contracts on U.S. Treasury securities or (b) may hold put options on such futures contracts in order to reduce the impact of certain interest rate changes on such preferred stocks. Specifically, we attempt to manage the risk arising from changes in the general level of interest rates. We do not transact in futures contracts or put options for speculative purposes. The number and type of futures and options contracts entered into depends on, among other items, the specific maturity and issuer redemption provisions for each preferred stock held, the slope of the Treasury yield curve, the expected volatility of U.S. Treasury yields, and the costs of using futures and/or options.

The following table demonstrates the impact of varying interest rate changes based on the preferred stock holdings, futures and options positions, and market yield and price relationships at June 30, 2011. This table is predicated on an instantaneous change in the general level of interest rates and assumes predictable relationships between the prices of preferred securities holdings, the yields on U.S. Treasury securities, and related futures and options. At June 30, 2011, we had no futures contracts or put options designated as interest rate risk hedges.

Interest Rate Changes	Market Value of Preferred Securities at June 30, 2011	Change in Market Value
	(In thousands)	
150 basis points	\$ 25,043	\$ 636
100 basis points	\$ 24,944	\$ 537
Unchanged	\$ 24,407	\$

Edgar Filing: FARMER BROTHERS CO - Form 10-K

+100 basis points	\$ 23,235	\$ (1,172)
+150 basis points	\$ 22,522	\$ (1,885)

**Table of Contents**

Our revolving line of credit with Wells Fargo is at a variable rate. The interest rate varies based upon line usage, borrowing base availability and market conditions. As of June 30, 2011, we had outstanding borrowings of \$31.4 million, utilized \$3.1 million of our letters of credit sublimit, and had excess availability of \$15.5 million under the credit facility. The interest rate on the outstanding borrowings at June 30, 2011 was 4.0%. The New Loan Agreement entered on September 12, 2011, provides for a senior secured revolving credit facility of up to \$85 million, with a letter of credit sublimit of \$20 million. The New Loan Agreement provides for a range of interest rates based on modified Monthly Average Excess Availability levels with a range of PRIME + 0.25% to PRIME + 0.75% or Adjusted Eurodollar Rate + 2.0% to Adjusted Eurodollar Rate + 2.5%. The term of the New Loan Agreement expires on March 2, 2015.

The following table demonstrates the impact of interest rate changes on our interest expense on the revolving credit facility for a full year based on the outstanding balance and interest rate as of June 30, 2011:

Interest Rate Changes	Interest Rate	Annual Interest Expense (In thousands)
150 basis points	2.25%	\$ 776
100 basis points	2.75%	\$ 949
Unchanged	3.75%	\$ 1,294
+100 basis points	4.75%	\$ 1,639
+150 basis points	5.25%	\$ 1,812

**Commodity Price Risk**

We are exposed to commodity price risk arising from changes in the market price of green coffee. We price green coffee inventory on the last-in, first-out (LIFO) basis. In the normal course of business we hold a large green coffee inventory and enter into forward commodity purchase agreements with suppliers. We are subject to price risk resulting from the volatility of green coffee prices. Due to competition and market conditions, volatile price increases cannot always be passed on to our customers.

At times we also enter into specialized hedging transactions to purchase future coffee contracts to enable us to lock in green coffee prices within a pre-established range. For the year ended June 30, 2011 we recorded \$1.6 million in net unrealized losses related to hedging transactions. From time to time we may hold a mix of futures contracts and options to help hedge against volatility in green coffee prices. Gains and losses on these derivative instruments are realized immediately in Other income (expense).

The following table demonstrates the impact of changes in market value of coffee cost on market value of coffee forward purchase contracts:

Coffee Cost (Decrease) Increase	Market Value (in thousands)			(Decrease) Increase in Market Value	
	Coffee Inventory	Futures & Options	Total	Derivatives	Inventory
10%	\$ 36,000	\$ (17)	\$ 35,983	\$ (17)	\$ (3,684)
unchanged	\$ 39,684	\$ 1316	\$ 41,000	\$	\$
10%	\$ 44,000	\$ 17	\$ 44,017	\$ 17	\$ 4,316

**Table of Contents**

**Item 8. Financial Statements and Supplementary Data**  
**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders of

Farmer Bros. Co. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Farmer Bros. Co. and Subsidiaries as of June 30, 2011 and 2010, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended June 30, 2011. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Farmer Bros. Co. and Subsidiaries at June 30, 2011 and 2010, and the consolidated results of their operations and their cash flows for each of the three years in the period ended June 30, 2011, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Farmer Bros. Co. and Subsidiaries' internal control over financial reporting as of June 30, 2011, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated September 12, 2011 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Los Angeles, California

September 12, 2011



**Table of Contents****FARMER BROS. CO.****CONSOLIDATED BALANCE SHEETS****(Dollars in thousands, except share and per share data)**

	June 30, 2011	June 30, 2010
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 6,081	\$ 4,149
Short-term investments	24,874	50,942
Accounts and notes receivable, net of allowance for doubtful accounts of \$2,852 and \$3,293, respectively	43,501	42,596
Inventories	79,759	83,712
Income tax receivable	448	5,840
Deferred income taxes		4
Prepaid expenses	2,747	2,713
Total current assets	157,410	189,956
Property, plant and equipment, net	114,107	121,710
Goodwill and other intangible assets, net	14,639	23,904
Other assets	2,892	2,492
Deferred income taxes	1,005	1,059
Total assets	\$ 290,053	\$ 339,121
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 42,473	\$ 34,053
Accrued payroll expenses	15,675	14,661
Short-term borrowings under revolving credit facility	31,362	37,163
Short-term obligations under capital leases	1,570	724
Deferred income taxes	500	264
Other current liabilities	11,882	11,681
Total current liabilities	103,462	98,546
Accrued postretirement benefits	23,585	22,185
Other long term liabilities - capital leases	7,066	3,137
Accrued pension liabilities	22,371	43,497
Accrued workers' compensation liabilities	3,639	4,388
Deferred income taxes	1,815	1,773
Total liabilities	\$ 161,938	\$ 173,526
Commitments and contingencies (Note 14)		
Stockholders' equity:		
Preferred stock, \$1.00 par value, 500,000 shares authorized and none issued	\$	\$
Common stock, \$1.00 par value, 25,000,000 shares authorized; 16,186,372 and 16,164,179 issued and outstanding at June 30, 2011 and 2010, respectively	16,186	16,164
Additional paid-in capital	36,470	37,468
Retained earnings	129,784	186,900
Unearned ESOP shares	(30,437)	(35,238)
Less accumulated other comprehensive loss	(23,888)	(39,699)

Edgar Filing: FARMER BROTHERS CO - Form 10-K

Total stockholders' equity	\$ 128,115	\$ 165,595
Total liabilities and stockholders' equity	\$ 290,053	\$ 339,121

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

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

	Years ended June 30,		
	2011	2010	2009
Net sales	\$ 463,945	\$ 450,318	\$ 341,724
Cost of goods sold	306,771	252,754	181,508
Gross profit	157,174	197,564	160,216
Selling expenses	170,670	187,685	138,876
Intangible assets impairment losses	7,805		
General and administrative expenses	47,121	49,071	36,543
Operating expenses	225,596	236,756	175,419
Loss from operations	(68,422)	(39,192)	(15,203)
Other income (expense):			
Dividend income	2,534	3,224	3,563
Interest income	178	303	1,236
Interest expense	(1,965)	(986)	(335)
Other, net	4,191	10,169	(8,248)
Total other income (expense)	4,938	12,710	(3,784)
Loss before taxes	(63,484)	(26,482)	(18,987)
Income tax (benefit) expense	(9,167)	(2,529)	14,283
Net loss	\$ (54,317)	\$ (23,953)	\$ (33,270)
Net loss per common share, basic and diluted	\$ (3.61)	\$ (1.61)	\$ (2.29)
Weighted average common shares outstanding-basic and diluted	15,066,663	14,866,306	14,508,320
Cash dividends declared per common share	\$ 0.18	\$ 0.46	\$ 0.46

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

**Table of Contents****FARMER BROS. CO.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Dollars in thousands)

	Years ended June 30,		
	2011	2010	2009
Cash flows from operating activities:			
Net loss	\$ (54,317)	\$ (23,953)	\$ (33,270)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Depreciation and amortization	31,758	26,778	18,292
Provision for doubtful accounts	2,024	3,188	810
Deferred income taxes	336	758	15,556
Intangible assets impairment losses	7,805		
Loss (gain) on sales of assets	358	430	(46)
Share-based compensation expense	3,825	4,784	5,452
Net (gain) loss on investments	(1,387)	(9,382)	8,989
Change in operating assets and liabilities:			
Short-term investments	27,456	1,365	61,371
Accounts and notes receivable	(2,929)	(40)	(26,698)
Inventories	3,952	(14,751)	1,730
Income tax receivable	5,392	(1,677)	(1,283)
Prepaid expenses and other assets	(434)	179	6,518
Accounts payable	12,997	(738)	22,457
Accrued payroll, expenses and other liabilities	2,112	2,904	3,776
Accrued postretirement benefits	1,399	3,926	638
Other long term liabilities	(6,410)	5,182	2,952
Net cash provided by (used in) operating activities	\$ 33,937	\$ (1,047)	\$ 87,244
Cash flows from investing activities:			
Acquisition of businesses, net of cash acquired			(48,287)
Purchases of property, plant and equipment	(19,416)	(28,484)	(38,901)
Proceeds from sales of property, plant and equipment	2,021	437	605
Net cash used in investing activities	\$ (17,395)	\$ (28,047)	\$ (86,583)
Cash flows from financing activities:			
Proceeds from revolving line of credit	35,450	33,737	29,500
Repayments on revolving line of credit	(43,970)	(12,756)	(13,318)
Payments of capital lease obligations	(1,433)	(837)	(147)
Dividends paid	(4,657)	(6,939)	(6,631)
Net cash (used in) provided by financing activities	\$ (14,610)	\$ 13,205	\$ 9,404
Net increase (decrease) in cash and cash equivalents	\$ 1,932	\$ (15,889)	\$ 10,065
Cash and cash equivalents at beginning of year	4,149	20,038	9,973
Cash and cash equivalents at end of year	\$ 6,081	\$ 4,149	\$ 20,038
Supplemental disclosure of cash flow information:			
Cash paid for interest	\$ 1,339	\$ 890	\$ 812
Cash paid for income taxes	\$	\$	\$ 136
Non-cash financing and investing activities:			
Equipment acquired under capital leases	\$ 5,659	\$ 3,954	\$ 1,252
Dividends accrued, but not paid	\$	\$ 1,849	\$ 1,849

Edgar Filing: FARMER BROTHERS CO - Form 10-K

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

**Table of Contents****FARMER BROS. CO.****CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**

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

	Common Shares	Stock Amount	Additional Paid-in Capital	Retained Earnings	Unearned ESOP Shares	Accumulated Other Comprehensive Income (Loss)	Total
Balance at June 30, 2008	16,075,080	\$ 16,075	\$ 30,612	\$ 257,693	\$ (38,529)	\$ 604	\$ 266,455
Comprehensive income							
Net income				(33,270)			(33,270)
Retiree benefits						(35,516)	(35,516)
Total comprehensive loss							(68,786)
Dividends (\$0.46 per share)				(6,631)			(6,631)
ESOP compensation expense			(151)		4,925		4,774
Share based compensation	3,031	3	674				677
Balance at June 30, 2009	16,078,111	\$ 16,078	\$ 31,135	\$ 217,792	\$ (33,604)	\$ (34,912)	\$ 196,489
Comprehensive income							
Net loss				(23,953)			(23,953)
Retiree benefits						(4,787)	(4,787)
Total comprehensive loss							(28,740)
Dividends (\$0.46 per share)				(6,939)			(6,939)
ESOP compensation expense, including reclassifications			5,344		(1,634)		3,710
Share based compensation	86,068	86	989				1,075
Balance at June 30, 2010	16,164,179	\$ 16,164	\$ 37,468	\$ 186,900	\$ (35,238)	\$ (39,699)	\$ 165,595
Comprehensive income							
Net loss				(54,317)			(54,317)
Retiree benefits						15,811	15,811
Total comprehensive loss							(38,506)
Dividends (\$0.18 per share)				(2,799)			(2,799)
ESOP contributions	1,040	1	8		(9)		
ESOP compensation expense, including reclassifications			(2,173)		4,810		2,637
Share based compensation	21,153	21	1,167				1,188
Balance at June 30, 2011	16,186,372	\$ 16,186	\$ 36,470	\$ 129,784	\$ (30,437)	\$ (23,888)	\$ 128,115

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

**Table of Contents**

**FARMER BROS. CO.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1. Summary of Significant Accounting Policies**

***Organization***

Farmer Bros. Co., a Delaware corporation (including its consolidated subsidiaries unless the context otherwise requires, the Company, we, our or Farmer Bros. ) is a manufacturer, wholesaler and distributor of coffee, tea and culinary products. The Company is a direct distributor of coffee to restaurants, hotels, casinos, hospitals and other foodservice providers, and is a provider of private brand coffee programs to grocery retailers, restaurant chains, convenience stores, and independent coffee houses, nationwide. The Company was founded in 1912, was incorporated in California in 1923, and reincorporated in Delaware in 2004. The Company operates in one business segment.

The Company's product line includes roasted coffee, liquid coffee, coffee related products such as coffee filters, sugar and creamers, assorted teas, cappuccino, cocoa, spices, gelatins and puddings, soup, gravy and sauce mixes, pancake and biscuit mixes, and jellies and preserves. Most sales are made off-truck by the Company to its customers at their places of business.

The Company serves its customers from six distribution centers and its distribution trucks are replenished from 114 branch warehouses located throughout the contiguous United States. The Company operates its own trucking fleet to support its long-haul distribution requirements. A portion of the Company's products are distributed by third parties or are direct shipped via common carrier.

***Principles of Consolidation***

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries FBC Finance Company and Coffee Bean Holding Co., Inc. All inter-company balances and transactions have been eliminated.

***Financial Statement Preparation***

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

***Cash Equivalents***

The Company considers all highly liquid investments with original maturity dates of 90 days or less to be cash equivalents. Fair values of cash equivalents approximate cost due to the short period of time to maturity.

***Investments***

The Company's investments consist of marketable debt and equity securities, money market instruments and various derivative instruments, primarily exchange traded treasury futures and options, green coffee forward purchase contracts and commodity purchase agreements. Investments are held for trading purposes and stated at fair value. All derivative instruments not designated as accounting hedges are marked to market and changes are recognized in current earnings. At June 30, 2011 and 2010, no derivative instruments were designated as accounting hedges. The fair value of derivative instruments is based upon broker quotes. The cost of investments sold is determined on the specific identification method. Dividend and interest income is accrued as earned.

**Table of Contents****FARMER BROS. CO.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Concentration of Credit Risk***

At June 30, 2011, the financial instruments which potentially expose the Company to concentration of credit risk consist of cash in financial institutions (which exceeds federally insured limits), short-term investments, investments in the preferred stocks of other companies and trade receivables. Cash equivalents and short-term investments are not concentrated by issuer, industry or geographic area. Maturities are generally shorter than 180 days. Investments in the preferred stocks of other companies are limited to high quality issuers and are not concentrated by geographic area or issuer.

Concentration of credit risk with respect to trade receivables for the Company is limited due to the large number of customers comprising the Company's customer base and their dispersion across many different geographic areas. The trade receivables are generally short-term and all probable bad debt losses have been appropriately considered in establishing the allowance for doubtful accounts. In fiscal 2010, based on a larger customer base due to the recent Company acquisitions and in response to slower collection of the Company's accounts receivable resulting from the impact of the economic downturn on the Company's customers, the Company increased its allowance for doubtful accounts and recorded a \$2.5 million charge to bad debt expense. In fiscal 2011, due to improvements in the collection of past due accounts, the Company reduced its estimate of the allowance for doubtful accounts by \$0.4 million.

***Inventories***

Inventories are valued at the lower of cost or market. Costs of coffee, tea and culinary products for the Company are determined on the last in, first out (LIFO) basis. Costs of coffee brewing equipment manufactured are accounted for on the first in, first out (FIFO) basis. The Company regularly evaluates these inventories to determine whether market conditions are correctly reflected in the recorded carrying value.

***Property, Plant and Equipment***

Property, plant and equipment is carried at cost, less accumulated depreciation. Depreciation is computed using the straight-line method. The following useful lives are used:

Building and facilities	10 to 30 years
Machinery and equipment	3 to 5 years
Equipment under capital lease	Term of lease
Office furniture and equipment	5 years
Capitalized software	3 years

When assets are sold or retired, the asset and related accumulated depreciation are removed from the respective account balances and any gain or loss on disposal is included in operations. Maintenance and repairs are charged to expense, and betterments are capitalized.

***Coffee Brewing Equipment and Service***

The Company classifies certain expenses related to coffee brewing equipment provided to customers as cost of goods sold. These costs include the depreciation cost of the equipment as well as the cost of servicing that equipment (including service employees' salaries, cost of transportation and the cost of supplies and parts) and are considered directly attributable to the generation of revenues from its customers. Accordingly, such costs included in cost of goods sold in the accompanying financial statements for the years ended June 30, 2011, 2010 and 2009 are \$27.1 million, \$21.5 million and \$13.1 million, respectively.



---

**Table of Contents**

**FARMER BROS. CO.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company has capitalized coffee brewing equipment in the amounts of \$12.7 million and \$14.1 million in fiscal 2011 and 2010, respectively. During fiscal 2011, 2010 and 2009, the Company had depreciation expense related to the capitalized coffee brewing equipment reported as cost of goods sold in the amounts of \$9.6 million, \$6.1 million and \$1.7 million, respectively.

***Income Taxes***

Deferred income taxes are determined based on the temporary differences between the financial reporting and tax bases of assets and liabilities using enacted tax rates in effect for the year in which differences are expected to reverse. Estimating the Company's tax liabilities involves judgments related to uncertainties in the application of complex tax regulations. The Company makes certain estimates and judgments to determine tax expense for financial statement purposes as they evaluate the effect of tax credits, tax benefits and deductions, some of which result from differences in timing of recognition of revenue or expense for tax and financial statement purposes. Changes to these estimates may result in significant changes to the Company's tax provision in future periods. Each fiscal quarter the Company reevaluates their tax provision and reconsiders their estimates and their assumptions related to specific tax assets and liabilities, making adjustments as circumstances change.

***Revenue Recognition***

Most product sales are made off-truck to the Company's customers at their places of business by the Company's sales representatives. Revenue is recognized at the time the Company's sales representatives physically deliver products to customers and title passes or when it is accepted by the customer when shipped by third-party delivery.

In connection with the acquisition of the DSD Coffee Business in March 2009, the Company entered into an agreement with Sara Lee pursuant to which the Company performs co-packing services for Sara Lee as Sara Lee's agent. The Company recognizes revenue from this arrangement on a net basis, net of direct costs of revenue. As of June 30, 2011 and 2010, the Company had \$4.9 million and \$4.1 million, respectively, of receivables from Sara Lee recorded in accounts and notes receivable.

***Net Income (Loss) Per Common Share***

Basic earnings (loss) per share (EPS) is computed by dividing net income (loss) by the weighted average common shares outstanding (see Note 13), excluding unallocated shares held by the Company's Employee Stock Ownership Plan. Diluted EPS includes the effect of any potential shares outstanding, which for the Company consists of dilutive stock options. The dilutive effect of stock options is calculated using the treasury stock method with an offset from expected proceeds upon exercise of the stock options and unrecognized compensation expense. Diluted EPS for the years ended June 30, 2011, 2010 and 2009 does not include the dilutive effect of 467,131, 404,943 and 239,000 shares, respectively, issuable under stock options since their inclusion would be anti-dilutive. Accordingly, the consolidated financial statements present only basic net income (loss) per common share.

Effective July 1, 2009, the Company began using the Two-Class Method to compute EPS. The Two-Class Method considers unvested restricted stock with a right to receive non-forfeitable dividends as participating securities and allocates earnings to participating securities in the computation of EPS. The Company computed EPS using the Two-Class Method for all periods presented. The effect for the years ended June 30, 2011, 2010 and 2009 was not material.

**Table of Contents**

**FARMER BROS. CO.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***Employee Stock Ownership Plan ( ESOP )***

Compensation cost for the ESOP is based on the fair market value of shares released or deemed to be released for the period. Dividends on allocated shares retain the character of true dividends, but dividends on unallocated shares are considered compensation cost. As a leveraged ESOP with the Company as lender, a contra equity account is established to offset the Company's note receivable. The contra account will change as compensation is recognized.

***Impairment of Goodwill and Intangible Assets***

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

In addition to an annual test, goodwill and indefinite-lived intangible assets must also be tested on an interim basis if events or circumstances indicate that the estimated fair value of such assets has decreased below their carrying value. The Company identified indicators of impairment including a decline in market capitalization and continuing losses from operations. The Company performed impairment tests to determine the recoverability of the carrying values of the assets or if impairment should be measured and concluded that as of June 30, 2011 goodwill and the indefinite-lived intangible assets were not impaired.

***Long-Lived Assets, Excluding Goodwill and Indefinite-lived Intangible Assets***

The Company reviews the recoverability of its long-lived assets whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. The estimated future cash flows are based upon, among other things, assumptions about expected future operating performance, and may differ from actual cash flows. Long-lived assets evaluated for impairment are grouped with other assets to the lowest level for which identifiable cash flows are largely independent of the cash flows of other groups of assets and liabilities. If the sum of the projected undiscounted cash flows (excluding interest) is less than the carrying value of the assets, the assets will be written down to the estimated fair value in the period in which the determination is made. In its annual test of impairment as of the end of fiscal 2011, the Company identified indicators of impairment including a decline in market capitalization and continuing losses from operations. The Company performed impairment tests to determine the recoverability of the carrying values of the assets or if impairment should be measured. The carrying value of these intangible assets was higher than the sum of each of their projected undiscounted cash flows. The Company was required to make estimates of the fair value of the intangible assets in this group, which were based on the use of the income approach. Inputs to the analysis include the projection of future cash flows which are Level 3 inputs within the fair value hierarchy. The Company determined that definite-lived intangible assets consisting of the customer relationships acquired, and the distribution agreement and co-pack agreement entered into, in connection with the DSD Coffee Business acquisition were impaired. The total impairment charge recorded in operating expenses on the consolidated statement of operations as a result of the impairment test was \$7.8 million.

---

**Table of Contents**

**FARMER BROS. CO.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***Shipping and Handling Costs***

The Company distributes its products directly to its customers and shipping and handling costs are recorded as Company selling expenses.

***Collective Bargaining Agreements***

Certain Company employees are subject to collective bargaining agreements. The duration of these agreements extend to 2014. Approximately 34% of the workforce is covered by such agreements.

***Reclassifications***

Certain reclassifications have been made to prior year balances to conform to the current year presentation.

***Recently Adopted Accounting Standards***

In October 2009, the multiple-element arrangements guidance codified in ASC 605-25, Revenue Recognition Multiple Element Arrangements, was modified by the Financial Accounting Standards Board ( FASB ) as a result of the final consensus reached on EITF Issue No. 08-1, Revenue Arrangements with Multiple Deliverables, which was codified by Accounting Standards Update ( ASU ) No. 2009-13. The guidance in ASU No. 2009-13 supersedes the existing guidance on such arrangements and is effective for the first annual reporting period after June 15, 2010 and was effective for the Company beginning on July 1, 2010. Adoption of ASU No. 2009-13 did not materially affect the results of operations, financial condition or cash flows of the Company.

***New Accounting Pronouncements***

In June 2011, the FASB issued ASU No. 2011-05, Comprehensive Income (Topic 220), Presentation of Comprehensive Income ( ASU 2011-05 ). The new US GAAP guidance gives companies two choices of how to present items of net income, items of other comprehensive income ( OCI ) and total comprehensive income: Companies can create one continuous statement of comprehensive income or two separate consecutive statements. Companies will no longer be allowed to present OCI in the statement of stockholders equity. Earnings per share would continue to be based on net income. Although existing guidance related to items that must be presented in OCI has not changed, companies will be required to display reclassification adjustments for each component of OCI in both net income and OCI. Also, companies will need to present the components of OCI in their interim and annual financial statements. The amendments in the ASU should be applied retrospectively. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 and, for the Company, the amendments are effective beginning July 1, 2013. The Company believes that adoption of ASU 2011-05 will not impact the results of operations, financial position or cash flows of the Company.

In May 2011, the FASB issued ASU No. 2011-04, Fair Value Measurement (Topic 820), Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs ( ASU 2011-04 ). The ASU amends the fair value measurement and disclosure guidance in ASC 820, Fair Value Measurement, to converge US GAAP and International Financial Reporting Standards requirements for measuring amounts at fair value as well as disclosures about these measurements. Many of the amendments clarify existing concepts and are generally not expected to result in significant changes to how many companies currently apply the fair value principles. In certain instances, however, the FASB changed a principle to achieve convergence, and while limited, these amendments have the potential to significantly change practice for some

**Table of Contents****FARMER BROS. CO.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

companies. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011 and, for the Company, the amendments are effective beginning in July 1, 2013. The Company believes that adoption of ASU 2011-04 will not impact the results of operations, financial position or cash flows of the Company.

**Note 2. Investments and Derivative Instruments**

The Company purchases various derivative instruments as investments or to create economic hedges of its interest rate risk and commodity price risk. At June 30, 2011 and 2010, derivative instruments were not designated as accounting hedges as defined by ASC 815, Accounting for Derivative Instruments and Hedging Activities. The fair value of derivative instruments is based upon broker quotes. The Company records unrealized gains and losses on trading securities and changes in the market value of certain coffee contracts meeting the definition of derivatives in Other, net.

The Company adopted ASC 820, Fair Value Measurements (ASC 820) on July 1, 2008. ASC 820 defines fair value and expands disclosure for each major asset and liability category measured at fair value on either a recurring or nonrecurring basis. Under ASC 820, the Company groups its assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

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

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

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

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

Assets and liabilities measured and recorded at fair value on a recurring basis were as follows (in thousands):

<b>As of June 30, 2011</b>	<b>Total</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
Preferred stock(1)	\$ 24,407	\$ 7,181	\$ 17,226	\$
Futures, options and other derivative assets(1)	\$ 467	\$	\$ 467	\$
Derivative liabilities(2)	\$ 1,647	\$	\$ 1,647	\$
<b>As of June 30, 2010</b>	<b>Total</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
Preferred stock(1)	\$ 50,684	\$ 11,946	\$ 38,738	\$
Futures, options and other derivatives(1)	\$ 258	\$ 258	\$	\$

(1) Included in short-term investments on the consolidated balance sheet.

(2) Included in other current liabilities on the consolidated balance sheet.

There were no significant transfers of securities between Level 1 and Level 2.



**Table of Contents****FARMER BROS. CO.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Gains and losses, both realized and unrealized, are included in Other, net. Net realized and unrealized gains and losses are as follows:

	2011	June 30, 2010	2009
	(In thousands)		
Investments			
Unrealized gains	\$ 865	\$ 9,647	\$
Unrealized losses			(3,584)
Realized gains	447		238
Realized losses		(265)	(5,643)
Net realized and unrealized gains (losses)	1,312	9,382	(8,989)
Net gains from sales of assets	1,359	201	475
Other gains, net	1,520	586	266
Other, net	\$ 4,191	\$ 10,169	\$ (8,248)

Preferred stock investments as of June 30, 2011 consisted of securities with a fair value of \$18.1 million in an unrealized gain position and securities with a fair value of \$6.3 million in an unrealized loss position. Preferred stock investments as of June 30, 2010 consisted of securities with a fair value of \$36.3 million in an unrealized gain position and securities with a fair value of \$14.4 million in an unrealized loss position. The following tables show gross unrealized losses (although such losses have been recognized in the statements of operations) and fair value for those investments that were in an unrealized loss position as of June 30, 2011 and 2010, aggregated by the length of time those investments have been in a continuous loss position:

(In thousands)	June 30, 2011		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Preferred stock	\$ 319	\$ (3)	\$ 6,326	\$ (1,122)

  

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

**Note 3. Accounts and Notes Receivable, net**

	2011	June 30, 2010
	(In thousands)	
Trade receivables	\$ 40,716	\$ 39,600
Other receivables	5,637	6,289
Allowance for doubtful accounts	(2,852)	(3,293)
	\$ 43,501	\$ 42,596

## Edgar Filing: FARMER BROTHERS CO - Form 10-K

In fiscal 2010, based on a larger customer base due to recent Company acquisitions and in response to slower collection of the Company's accounts receivable resulting from the impact of the economic downturn on the Company's customers, the Company increased its allowance for doubtful accounts, and recorded a \$2.5

**Table of Contents****FARMER BROS. CO.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

million charge to bad debt expense. In fiscal 2011, due to improvements in the collection of past due accounts, the Company reduced its estimate of the allowance for doubtful accounts by \$0.4 million.

Allowance for doubtful accounts (in thousands):

Balance at June 30, 2008	\$ (494)
Additions	(810)
Write-offs	131
Balance at June 30, 2009	(1,173)
Additions	(3,188)
Write-offs	1,068
Balance at June 30, 2010	(3,293)
Additions	(2,024)
Write-offs	2,465
Balance at June 30, 2011	\$ (2,852)

**Note 4. Inventories**

June 30, 2011	Processed	Unprocessed (In thousands)	Total
Coffee	\$ 22,464	\$ 17,220	\$ 39,684
Tea and culinary products	25,469	4,100	29,569
Coffee brewing equipment	3,930	6,576	10,506
	\$ 51,863	\$ 27,896	\$ 79,759
June 30, 2010	Processed	Unprocessed (In thousands)	Total
Coffee	\$ 22,230	\$ 16,765	\$ 38,995
Tea and culinary products	28,833	3,145	31,978
Coffee brewing equipment	5,849	6,890	12,739
	\$ 56,912	\$ 26,800	\$ 83,712

Current cost of coffee, tea and culinary inventories exceeds the LIFO cost by (in thousands):

June 30,  
2011                      2010



## Edgar Filing: FARMER BROTHERS CO - Form 10-K

Coffee	\$ 62,870	\$ 24,432
Tea and culinary products	6,695	4,816
<b>Total</b>	<b>\$ 69,565</b>	<b>\$ 29,248</b>

The change in the Company's green coffee, tea and culinary product inventories during fiscal 2011, 2010 and 2009 resulted in LIFO (increments) decrements which resulted in a net increase (decrease) in gross profit for those years by \$(40.3) million, \$(0.7) million and \$(1.5) million, respectively.

**Table of Contents****FARMER BROS. CO.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

At times the Company enters into specialized hedging transactions to purchase future coffee contracts to enable the Company to lock in green coffee prices within a pre-established range. For the year ended June 30, 2011 the Company recorded \$1.6 million in net unrealized losses related to hedging transactions. From time to time the Company may hold a mix of futures contracts and options to help hedge against volatility in green coffee prices. Gains and losses on these derivative instruments are realized immediately in Other income (expense).

In fiscal 2011 and 2010, certain inventory quantities were reduced. This reduction resulted in a liquidation of LIFO inventory quantities carried at lower costs prevailing in prior years as compared with the current year cost in fiscal 2011. The effect of this liquidation was to reduce net loss for fiscal 2011 and 2010 by \$1.1 million and \$0.8 million, respectively. There was no liquidation of LIFO quantities in fiscal 2009.

**Note 5. Property, Plant and Equipment**

	2011	June 30, 2010
	(In thousands)	
Buildings and facilities	\$ 80,352	\$ 79,312
Machinery and equipment	119,209	109,738
Equipment under capital leases	10,675	7,192
Capitalized software costs	18,294	18,749
Office furniture and equipment	16,839	15,583
	\$ 245,369	\$ 230,574
Accumulated depreciation	(140,996)	(118,810)
Land	9,734	9,946
Property, plant and equipment, net	\$ 114,107	\$ 121,710

Capital leases consist mainly of vehicle leases at June 30, 2011 and 2010.

The Company has capitalized coffee brewing equipment in the amounts of \$12.7 million, \$14.1 million and \$5.4 million in fiscal years 2011, 2010 and 2009, respectively. Depreciation expense related to the capitalized coffee brewing equipment reported as cost of goods sold was \$9.6 million, \$6.1 million and \$1.7 million in fiscal years 2011, 2010 and 2009, respectively. Depreciation and amortization expense includes amortization expense for assets recorded under capitalized leases.

Maintenance and repairs to property, plant and equipment charged to expense for the years ended June 30, 2011, 2010 and 2009 were \$10.3 million, \$15.0 million and \$15.2 million, respectively.

**Table of Contents****FARMER BROS. CO.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 6. Goodwill and Intangible Assets**

The following is a summary of the Company's amortized and unamortized intangible assets other than goodwill, along with amortization expense on these intangible assets for the past three fiscal years and estimated aggregate amortization expense for each of the next five fiscal years:

	2011		2010	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
	(In thousands)			
Amortized intangible assets:				
Customer relationships	\$ 10,460	\$ (7,291)	\$ 18,216	\$ (8,485)
Distribution agreement			2,452	(327)
Co-pack agreement			743	(165)
<b>Total amortized intangible assets</b>	<b>\$ 10,460</b>	<b>\$ (7,291)</b>	<b>\$ 21,411</b>	<b>\$ (8,977)</b>
Unamortized intangible assets:				
Tradenames with indefinite lives	\$ 4,080	\$	\$ 4,080	\$
Trademarks with indefinite lives	2,080		2,080	
CBI Goodwill	5,310		5,310	
<b>Total unamortized intangible assets</b>	<b>\$ 11,470</b>	<b>\$</b>	<b>\$ 11,470</b>	<b>\$</b>
<b>Total intangible assets</b>	<b>\$ 21,930</b>	<b>\$ (7,291)</b>	<b>\$ 32,881</b>	<b>\$ (8,977)</b>
Aggregate amortization expense for the past three fiscal years:				
For the year ended June 30, 2011	\$ 2,948			
For the year ended June 30, 2010	\$ 2,849			
For the year ended June 30, 2009	\$ 2,159			
Estimated amortization expense for each of the next five fiscal years:				
For the year ended June 30, 2012	\$ 1,454			
For the year ended June 30, 2013	\$ 1,249			
For the year ended June 30, 2014	\$ 466			
For the year ended June 30, 2015	\$			
For the year ended June 30, 2016	\$			
The remaining weighted average amortization periods for intangible assets with finite lives are as follows:				
Customer relationships	2.4 years			
The following is a summary of the changes in the carrying value of goodwill:				
Balance at July 1, 2009	\$ 5,310			
Acquisitions during year				
<b>Balance at June 30, 2010</b>	<b>\$ 5,310</b>			
Acquisitions during year				
<b>Balance at June 30, 2011</b>	<b>\$ 5,310</b>			



**Table of Contents**

**FARMER BROS. CO.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 7. Employee Benefit Plans**

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

The Company is required to recognize the funded status of a benefit plan in its balance sheet. The Company is also required to recognize in other comprehensive income certain gains and losses that arise during the period but are deferred under pension accounting rules.

***Union Pension Plans***

The Company contributes to several multi-employer defined benefit pension plans for certain union employees. The contributions to these multi-employer pension plans were approximately \$3.1 million, \$4.0 million, and \$2.8 million for the fiscal years ended June 30, 2011, 2010 and 2009, respectively.

***Company Pension Plans***

The Company has a defined benefit pension plan, the Farmer Bros. Salaried Employees Pension Plan, for the majority of its employees who are not covered under a collective bargaining agreement ( Farmer Bros. Plan ) and two defined benefit pensions plan for certain hourly employees covered under a collective bargaining agreement (the Brewmatic Plan and the Hourly Employees Plan ). All assets and benefit obligations were determined using a measurement date of June 30.

The Company amended the Farmer Bros. Plan, freezing the benefit for all participants effective June 30, 2011. After the plan freeze, participants do not accrue any benefits under the plan, and new hires are not eligible to participate in the plan. As a result, the Company recorded \$1.5 million in curtailment charge in the fourth quarter ended June 30, 2011.

**Table of Contents****FARMER BROS. CO.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Obligations and Funded Status**

	Farmer Bros. Plan June 30,		Brewmatic Plan June 30,		Hourly Employees Plan June 30,	
	2011 (In thousands)	2010	2011 (In thousands)	2010	2011 (In thousands)	2010
<b>Change in projected benefit obligation</b>						
Benefit obligation at the beginning of the year	\$ 110,449	\$ 96,652	\$ 3,707	\$ 3,476	\$ 578	\$
Service cost	4,609	4,340	57	48	409	519
Interest cost	5,999	5,900	199	208	32	
Plan participant contributions	1,005	732				
Actuarial (gain)/loss	(1,409)	7,410	(24)	241	39	59
Benefits paid	(5,022)	(4,585)	(284)	(266)	(3)	
Effect of curtailment	(8,560)		7			
Projected benefit obligation at the end of the year	\$ 107,071	\$ 110,449	\$ 3,662	\$ 3,707	\$ 1,055	\$ 578
<b>Change in plan assets</b>						
Fair value of plan assets at the beginning of the year	63,462	59,266	2,490	2,395		
Actual return on plan assets	16,619	8,049	635	333	11	
Employer contributions	4,383		30	28	413	
Plan participant contributions	1,005	732				
Benefits paid	(5,022)	(4,585)	(284)	(266)	(3)	
Fair value of plan assets at the end of the year	\$ 80,447	\$ 63,462	\$ 2,871	\$ 2,490	\$ 421	\$
<b>Funded status at end of year (underfunded)/overfunded</b>	\$ (26,624)	\$ (46,987)	\$ (791)	\$ (1,217)	\$ (634)	\$ (578)
<b>Amounts recognized in balance sheet</b>						
Noncurrent assets	\$	\$	\$	\$	\$	\$
Current liabilities	(5,360)	(4,970)	(310)	(310)	(8)	(5)
Noncurrent liabilities	(21,264)	(42,017)	(481)	(907)	(626)	(573)
Total	\$ (26,624)	\$ (46,987)	\$ (791)	\$ (1,217)	\$ (634)	\$ (578)
<b>Amounts recognized in balance sheet</b>						
Total net (gain)/loss	\$ 25,900	\$ 50,037	\$ 1,587	\$ 2,186	\$ 96	\$ 59
Transition (asset)/obligation						
Prior service cost/(credit)		1,577	71	82		
Total accumulated OCI (not adjusted for applicable tax)	\$ 25,900	\$ 51,614	\$ 1,658	\$ 2,268	\$ 96	\$ 59
<b>Weighted average assumptions used to determine benefit obligations</b>						
Discount rate	5.60%	5.60%	5.60%	5.60%	5.60%	6.25%
Rate of compensation increase		3.00%			3.00%	3.00%

**Table of Contents****FARMER BROS. CO.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Components of Net Periodic Benefit Cost and****Other Changes Recognized in Other Comprehensive Income (OCI)**

	Farmer Bros. Plan June 30,		Brewmatic Plan June 30,		Hourly Employees Plan June 30,	
	2011 (In thousands)	2010 (In thousands)	2011 (In thousands)	2010 (In thousands)	2011 (In thousands)	2010 (In thousands)
<b>Components of net periodic benefit cost</b>						
Service cost	\$ 4,609	\$ 4,340	\$ 57	\$ 48	\$ 409	\$ 519
Interest cost	5,999	5,899	199	208	32	
Expected return on plan assets	(5,323)	(4,642)	(179)	(175)	(9)	
Amortization of net (gain)/loss	2,871	3,291	119	131		
Amortization of prior service cost/(credit)	122	146	18	19		
Amount recognized due to special event (curtailment)	1,456					
Net periodic benefit cost	\$ 9,734	\$ 9,034	\$ 214	\$ 231	\$ 432	\$ 519
<b>Other changes recognized in OCI</b>						
Net (gain)/loss	\$ (12,705)	\$ 4,003	\$ (480)	\$ 82	\$ 37	\$ 59
Prior service cost/(credit)			7			
Amortization of net gain/(loss)	(2,871)	(3,291)	(119)	(131)		
Amortization of transition asset/ (obligation)						
Amortization of prior service (cost)/credit	(122)	(146)	(18)	(19)		
Amount recognized due to special event (curtailment)	(10,016)					
Total recognized in other comprehensive income	\$ (25,714)	\$ 566	\$ (610)	\$ (68)	\$ 37	\$ 59
Total recognized in net periodic benefit cost and OCI	\$ (15,980)	\$ 9,600	\$ (396)	\$ 163	\$ 469	\$ 578
<b>Weighted-average assumptions used to determine net periodic benefit cost</b>						
Discount rate	5.60%	6.25%	5.60%	6.25%	5.60%	6.25%
Expected long-term return on plan assets	8.25%	8.25%	8.25%	8.25%	8.25%	8.25%
Rate of compensation increase		3.00%			3.00%	3.00%

All qualifying employees of the DSD Coffee Business who accepted the Company's offer of employment were allowed to enroll in the Farmer Bros. Plan during March 2009. Those who enrolled in the Farmer Bros. Plan were granted full service credit for plan vesting and eligibility but not for purposes of benefit accruals.

***Basis Used to Determine Expected Long-term Return on Plan Assets***

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

***Description of Investment Policy***

The Company's investment strategy is to build an efficient, well-diversified portfolio based on a long-term, strategic outlook of the investment markets. The investment markets outlook utilizes both the historical-based





**Table of Contents****FARMER BROS. CO.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

and forward-looking return forecasts to establish future return expectations for various asset classes. These return expectations are used to develop a core asset allocation based on the specific needs of each plan. The core asset allocation utilizes investment portfolios of various asset classes and multiple investment managers in order to maximize the plan's return while providing multiple layers of diversification to help minimize risk.

**Additional Disclosures**

	Farmer Bros. Plan June 30,		Brewmatic Plan June 30,		Hourly Employees Plan June 30,	
	2011	2010	2011	2010	2011	2010
	(\$ In thousands)		(\$ In thousands)		(\$ In thousands)	
<b>Comparison of obligations to plan assets</b>						
Projected benefit obligation	\$ 107,071	\$ 110,449	\$ 3,662	\$ 3,707	\$ 1,055	\$ 578
Accumulated benefit obligation	\$ 107,071	\$ 101,280	\$ 3,662	\$ 3,707	\$ 1,035	\$ 574
Fair value of plan assets at measurement date	\$ 80,447	\$ 63,462	\$ 2,871	\$ 2,490	\$ 421	\$
<b>Plan assets by category</b>						
Equity securities	\$ 56,791	\$ 44,398	\$ 2,016	\$ 1,675	\$ 297	\$
Debt securities	18,945	15,917	688	683	99	
Real estate	4,711	3,147	167	132	\$ 25	
Total	\$ 80,447	\$ 63,462	\$ 2,871	\$ 2,490	\$ 421	\$
<b>Plan assets by category</b>						
Equity securities	70%	70%	70%	67%	70%	
Debt securities	24%	25%	24%	28%	24%	
Real estate	6%	5%	6%	5%	6%	
Total	100%	100%	100%	100%	100%	

As of June 30, 2011, fair values of plan assets were as follows (in thousands):

	Total	Level 1	Level 2	Level 3
Farmer Bros. Plan	\$ 80,447	\$	\$ 75,736	\$ 4,711
Brewmatic Plan	\$ 2,871	\$	\$ 2,704	\$ 167
Hourly Employees Plan	\$ 421	\$	\$ 396	\$ 25

As of June 30, 2010, fair values of plan assets were as follows (in thousands):

	Total	Level 1	Level 2	Level 3
Farmer Bros. Plan	\$ 63,462	\$	\$ 60,315	\$ 3,147
Brewmatic Plan	\$ 2,490	\$	\$ 2,358	\$ 132
Hourly Employees Plan	\$	\$	\$	\$

As of June 30, 2011 and 2010, approximately 94% and 95%, respectively, of the assets in each of the Farmer Bros. Plan and the Brewmatic Plan and, as of June 30, 2011, approximately 94% of the assets of the Hourly Employees Plan were invested in pooled separate accounts which did

## Edgar Filing: FARMER BROTHERS CO - Form 10-K

not have publicly quoted prices. The pooled separate accounts invest in publicly traded mutual funds. The fair values of the mutual funds were publicly quoted pricing input (Level 1) and were used to determine the net asset value of the pooled separate accounts. Therefore, these assets have Level 2 pricing inputs.

**Table of Contents****FARMER BROS. CO.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

As of June 30, 2011 and 2010, approximately 6% and 5%, respectively, of the assets in each of the Farmer Bros. Plan and the Brewmatic Plan and, as of June 30, 2011, approximately 6% of assets of the Hourly Employees Plan were invested in commercial real estate and include mortgage loans which are backed by the associated properties. These underlying real estate investments have unobservable Level 3 pricing inputs. The fair value of the underlying real estate is estimated using discounted cash flow valuation models that utilize public real estate market data inputs such as transaction prices, market rents, vacancy levels, leasing absorption, market capitalization rates and discount rates. In addition, each property is appraised annually by an independent appraiser. The amounts and types of investments within plan assets did not change significantly from June 30, 2010.

The following is a reconciliation of asset balances with Level 3 input pricing:

**As of June 30, 2011:**

<b>Plan</b>	<b>Beginning Balance</b>	<b>Total Gains or Losses</b>	<b>Settlements</b>	<b>Ending Balance</b>	<b>Unrealized Gains or Losses</b>
Farmer Bros. Plan	\$ 3,147	\$ 652	\$ 912	\$ 4,711	\$ 652
Brewmatic Plan	\$ 132	\$ 28	\$ 7	\$ 167	\$ 28
Hourly Employees Plan		\$	\$ 25	\$ 25	\$

**As of June 30, 2010:**

<b>Plan</b>	<b>Beginning Balance</b>	<b>Total Gains or Losses</b>	<b>Settlements</b>	<b>Ending Balance</b>	<b>Unrealized Gains or Losses</b>
Farmer Bros. Plan	\$ 3,458	\$ (311)	\$	\$ 3,147	\$ (311)
Brewmatic Plan	\$ 145	\$ (13)	\$	\$ 132	\$ (13)
Hourly Employees Plan					

**Target Plan Asset Allocation for Farmer Bros. Plan and Brewmatic Plan**

	<b>Fiscal 2012</b>
U.S. large cap equity securities	40.6%
U.S. small cap equity securities	10.0%
International equity securities	16.9%
Debt securities	24.0%
Real estate	8.5%
Total	100.0%

***Estimated Amounts in Other Comprehensive Income Expected To Be Recognized***

In fiscal 2012, the Company expects to recognize \$1.3 million as a component of net periodic benefit cost for the Farmer Bros. Plan, \$87,000 for the Brewmatic Plan, and \$0 for the Hourly Employees Plan.

***Estimated Future Contributions and Refunds***

## Edgar Filing: FARMER BROTHERS CO - Form 10-K

In fiscal 2012, the Company expects to contribute \$6.7 million to the Farmer Bros. Plan, \$0.2 million to the Brewmatic Plan, and \$0.7 million to the Hourly Employees Plan. The Company is not aware of any refunds expected from postretirement plans.

**Table of Contents****FARMER BROS. CO.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Estimated Future Benefit Payments***

The following benefit payments are expected to be paid over the next 10 fiscal years:

**Estimated future benefit payments**

Year ending	Farmer Bros. Plan	Brewmatic Plan	Hourly Employees Plan
	(In thousands)		
June 30, 2012	\$ 5,360	\$ 310	\$ 8
June 30, 2013	\$ 5,640	\$ 300	\$ 17
June 30, 2014	\$ 5,790	\$ 290	\$ 34
June 30, 2015	\$ 6,130	\$ 290	\$ 49
June 30, 2016	\$ 6,470	\$ 290	\$ 70
June 30, 2017    June 30, 2021	\$ 40,180	\$ 1,420	\$ 680

These amounts are based on current data and assumptions and reflect expected future service, as appropriate.

***Defined Contribution Plans***

The Company also has defined contribution plans for all its eligible employees. No Company contributions have been made nor were any required to be made to these defined contribution plans during the years ended June 30, 2011, 2010 or 2009.

The Company amended its defined contribution 401(k) plan effective June 30, 2011, to provide for a discretionary Company match of the employees' annual contribution. As of June 30, 2011, the Company accrued \$0.1 million towards this Company match.

***Postretirement Benefits***

The Company sponsors an unfunded postretirement medical, dental and vision plan that covers qualified non-union retirees and certain qualified union retirees. Under this postretirement plan, the Company's contributions toward premiums for retiree medical, dental and vision coverage for participants and dependents are scaled based on length of service, with greater Company contributions for retirees with greater length of service, but subject to a maximum monthly Company contribution.

**Table of Contents****FARMER BROS. CO.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table shows the components of net periodic postretirement benefit cost for the fiscal years ended June 30, 2011 and 2010. Fiscal 2011 postretirement cost/(income) was based on employee census information as of July 1, 2010 and asset information as of June 30, 2011.

Components of Net Periodic Postretirement Benefit Cost	June 30,	
	2011	2010
	(In thousands)	
Service cost	\$ 1,564	\$ 1,490
Interest cost	1,205	1,239
Expected return on plan assets		
Amortization of unrecognized net gain	(802)	(1,032)
Amortization of unrecognized transition (asset)/obligation		
Amortization of unrecognized prior service cost/(credit)	(230)	(230)
Net periodic benefit cost	\$ 1,737	\$ 1,467

The difference between the assets and the Accumulated Postretirement Benefit Obligation (APBO) at the adoption of ASC 715-60 was established as a transition (asset)/obligation and is amortized over the average expected future service for active employees as measured at the date of adoption. Any plan amendments that retroactively increase benefits create prior service cost. The increase in the APBO due to any plan amendment is established as a base and amortized over the average remaining years of service to the full eligibility date of active participants who are not yet fully eligible for benefits at the plan amendment date. Gains and losses due to experience different than that assumed or from changes in actuarial assumptions are not immediately recognized. The tables below show the remaining bases for the transition (asset)/obligation, prior service cost/(credit), and the calculation of the amortizable gain or loss.

**Amortization Schedule****Transition (Asset)/Obligation:**

The transition (asset)/obligations have been fully amortized.

Prior Service Cost/(Credit) (dollars in thousands):

Date Established	Balance at July 1, 2010	Annual Amortization	Years Remaining	Curtailment	Balance at June 30, 2011
January 1, 2008	\$ (2,114)	\$ 230	9.18	0	\$ (1,884)

**Amortization of Net (Gain)/Loss (dollars in thousands):**

Net (gain)/loss as of July 1, 2010 \$ (13,374)

Asset (gains)/losses not yet recognized in market related value of assets

Net (gain)/loss subject to amortization \$ (13,374)

Corridor (10% of greater of APBO or assets) 2,239

Net (gain)/loss in excess of corridor \$ (11,135)

Edgar Filing: FARMER BROTHERS CO - Form 10-K

Amortization years	13.89
Amortization of net (gain)/loss for the year	\$ (802)

**Table of Contents****FARMER BROS. CO.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following tables provide a reconciliation of the benefit obligation and plan assets:

<b>Change in Benefit Obligation</b>	<b>Year Ended June 30,</b>	
	<b>2011</b>	<b>2010</b>
	(In thousands)	
Projected benefit obligation at beginning of year	\$ 23,261	\$ 19,222
Service cost	1,564	1,490
Interest cost	1,205	1,239
Participant contributions	1,103	
(Gains) losses	(379)	2,969
Benefits paid	(2,022)	(1,659)
Projected benefit obligation at end of year	\$ 24,732	\$ 23,261

<b>Change in Plan Assets</b>	<b>Year Ended June 30,</b>	
	<b>2011</b>	<b>2010</b>
	(In thousands)	
Fair value of plan assets at beginning of year	\$	\$
Actual return on assets		
Employer contributions	919	1,659
Participant contributions	1,103	
Benefits paid	(2,022)	(1,659)
Fair value of plan assets at end of year	\$	\$
Funded status of plan	\$ (24,732)	\$ (23,261)

<b>Amounts Recognized in the Balance Sheet Consist of:</b>	<b>As of June 30,</b>	
	<b>2011</b>	<b>2010</b>
	(In thousands)	
Noncurrent assets	\$	\$
Current liabilities	1,148	1,076
Noncurrent liabilities	23,584	22,185
Total	\$ 24,732	\$ 23,261

<b>Amounts Recognized in Accumulated Other Comprehensive Income Consist of:</b>	<b>Year Ended June 30,</b>	
	<b>2011</b>	<b>2010</b>
	(In thousands)	
Net gain	\$ (12,086)	\$ (12,509)
Transition obligation		
Prior service credit	(1,884)	(2,114)



Edgar Filing: FARMER BROTHERS CO - Form 10-K

Total accumulated other comprehensive income	\$ (13,970)	\$ (14,623)
--	-------------	-------------

**Table of Contents****FARMER BROS. CO.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Other Changes in Plan Assets and Benefit Obligations Recognized in Other Comprehensive Income	Year Ended June 30,	
	2011	2010
	(In thousands)	
Unrecognized actuarial loss/(gain)	\$ (379)	\$ 2,969
Unrecognized transition (asset)/obligation		
Unrecognized prior service cost		
Amortization of net loss	802	1,032
Amortization of prior service cost	230	230
Total recognized in other comprehensive income	653	4,231
Net periodic benefit cost	1,737	1,467
Total recognized in other comprehensive income and net periodic benefit cost	\$ 2,390	\$ 5,698

The estimated net gain and prior service cost credit that will be amortized from accumulated other comprehensive income into net periodic benefit cost in fiscal 2012 are \$0.8 million and \$0.2 million, respectively.

Estimated Future Benefit Payments (in thousands)	
Fiscal 2012	\$ 1,148
Fiscal 2013	\$ 1,232
Fiscal 2014	\$ 1,290
Fiscal 2015	\$ 1,486
Fiscal 2016	\$ 1,606
Fiscal 2017-2021	\$ 10,182
Expected Contributions for the Year Ending June 30, 2012 (in thousands)	
Fiscal 2012	\$ 1,148

**Sensitivity in Fiscal 2011 Results**

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plan. A one percentage point change in assumed health care cost trend rates would have the following effects in fiscal 2011 (in thousands):

	1-Percentage Point	
	Increase	Decrease
Effect on total of service and interest cost components	\$ 81	\$ (89)
Effect on accumulated postretirement benefit obligation	\$ 794	\$ (924)

**Note 8. Bank Loan**

On September 12, 2011, the Company entered into an Amended and Restated Loan and Security Agreement (the "New Loan Agreement") among the Company and CBI, as Borrowers, certain of the Company's other subsidiaries, as Guarantors, the Lenders party thereto, and Wells Fargo Bank, National Association, as Agent. The New Loan Agreement provides for a senior secured revolving credit facility of up to \$85 million, with a letter of credit sublimit of \$20 million. The new revolving line of credit provides for advances of 85% of eligible



**Table of Contents**

**FARMER BROS. CO.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

accounts receivable and 75% of eligible inventory (subject to a \$60 million inventory loan limit), as defined. The New Loan Agreement provides for a range of interest rates based on modified Monthly Average Excess Availability levels with a range of PRIME + 0.25% to PRIME + 0.75% or Adjusted Eurodollar Rate + 2.0% to Adjusted Eurodollar Rate + 2.5%. The New Loan Agreement has an amendment fee of 0.375% and an unused line fee of 0.25%. Outstanding obligations under the New Loan Agreement are collateralized by all of the Borrowers' assets, including the Company's preferred stock portfolio. The term of the New Loan Agreement expires on March 2, 2015.

The New Loan Agreement contains a variety of affirmative and negative covenants of types customary in an asset-based lending facility, including those relating to reporting requirements, maintenance of records, properties and corporate existence, compliance with laws, incurrence of other indebtedness and liens, limitations on certain payments, including the payment of dividends and capital expenditures, and transactions and extraordinary corporate events. The New Loan Agreement allows the Company to pay dividends, subject to certain liquidity requirements. The New Loan Agreement also contains financial covenants requiring the Borrowers to maintain minimum Excess Availability and Total Liquidity levels. The New Loan Agreement allows the Lender to establish reserve requirements, which may reduce the amount of credit otherwise available to the Company, to reflect events, conditions, or risks that would have a reasonable likelihood of adversely affecting the Lender's collateral or the Company's assets, including the Company's green coffee inventory.

The New Loan Agreement replaces the Company's existing Loan and Security Agreement, dated March 2, 2009, as amended (the Original Loan Agreement), among the Borrowers, Guarantors and Wells Fargo, as Lender. The Original Loan Agreement provided for a senior secured revolving credit facility of up to \$50 million, with a letter of credit sublimit of \$10 million. The original revolving line of credit provided for advances of 85% of eligible accounts receivable and 65% of eligible inventory, as defined. The Original Loan Agreement had an unused commitment fee of 0.375%. The Original Loan Agreement provided for a range of interest rates based on modified Monthly Average Excess Availability levels (as defined) with a range of PRIME + 0.25% to PRIME + 0.75% or Adjusted Eurodollar Rate + 2.5% to Adjusted Eurodollar Rate + 3.0%. All outstanding obligations under the Original Loan Agreement were collateralized by the Company's assets, excluding the preferred stock held in investment accounts.

The interest rate on the Company's outstanding borrowings under the Original Loan Agreement was 4.0% at June 30, 2011. As of June 30, 2011, the Company had outstanding borrowings of \$31.4 million, utilized \$3.1 million of the letters of credit sublimit, and had excess availability under the credit facility of \$15.5 million. Due to the short-term nature of the credit facility and the variable interest rate, fair value of the balance outstanding approximates carrying value. As of June 30, 2011, the Company was in compliance with all restrictive covenants under the Original Loan Agreement. On September 12, 2011, the Lender and the Company amended the Original Loan Agreement to reduce required minimum excess availability and required minimum total liquidity for the period from July 1, 2011 through September 30, 2011. There can be no assurance that the Lender will issue a waiver or grant an amendment to the covenants in future periods, if the Company required one.

**Note 9. Employee Stock Ownership Plan**

The Company's ESOP was established in 2000 to provide benefits to all employees. The plan is a leveraged ESOP in which the Company is the lender. The loans will be repaid from the Company's discretionary plan contributions over the original fifteen year terms with a variable rate of interest. The annual interest rate was 1.68% at June 30, 2011, which is updated on a quarterly basis.

**Table of Contents****FARMER BROS. CO.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

	As of and for the years ended		
	June 30,		
	2011	2010	2009
Loan amount (in thousands)	\$ 30,437	\$ 35,238	\$ 40,039
Shares purchased			

Shares are held by the plan trustee for allocation among participants as the loan is repaid. The unencumbered shares are allocated to participants using a compensation-based formula. Subject to vesting requirements, allocated shares are owned by participants and shares are held by the plan trustee until the participant retires.

In fiscal 2011, fiscal 2010 and fiscal 2009, the Company used \$1.3 million, \$0.7 million and \$1.0 million of dividends on ESOP shares to pay down the loans, and allocated to the ESOP participants shares equivalent to the fair market value of the dividends they would have received. In fiscal 2011, the Company issued 1,040 shares of common stock to the ESOP to compensate for a shortfall in unallocated, uncommitted shares.

The Company reports compensation expense equal to the fair market value of shares committed to be released to employees in the period in which they are committed. The cost of shares purchased by the ESOP which have not been committed to be released or allocated to participants are shown as a contra-equity account Unearned ESOP Shares and are excluded from earnings per share calculations.

During the fiscal years ended June 30, 2011, 2010 and 2009, the Company charged \$2.6 million, \$3.7 million and \$4.9 million to compensation expense related to the ESOP. The difference between cost and fair market value of committed to be released shares, which was \$(1.4) million, \$(0.2) million and \$(0.2) million for the years ended June 30, 2011, 2010 and 2009, respectively, is recorded as additional paid-in capital.

	June 30,	
	2011	2010
Allocated shares	1,533,578	1,488,724
Committed to be released shares	186,582	192,069
Unallocated shares	1,097,136	1,283,719
Total ESOP shares	2,817,296	2,964,512

	(In thousands)	
Fair value of ESOP shares	\$ 28,567	\$ 44,632

**Note 10. Share-based Compensation**

On August 23, 2007, the Company's Board of Directors approved the Omnibus Plan, which was approved by stockholders on December 6, 2007. Prior to adoption of the Omnibus Plan the Company had no share-based compensation plan. Awards issued under the Omnibus Plan may take the form of stock options, stock appreciation rights, restricted stock, restricted stock units, dividend equivalents, performance-based awards, stock payments, cash-based awards or other incentives payable in cash or shares of stock, or any combination thereof. Each award will be set forth in a separate agreement with the person receiving the award and will indicate the type, terms and conditions of the award. The maximum number of shares of common stock as to which awards may be granted under the Plan is 1,000,000, subject to adjustment as provided in the Omnibus Plan.

The Company measures and recognizes compensation expense for all share-based payment awards made under the Omnibus Plan based on estimated fair values.



**Table of Contents****FARMER BROS. CO.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Stock Options**

The Company estimates the fair value of share-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service period in the Company's consolidated statement of operations. Prior to fiscal 2008, the Company did not have share-based compensation.

Share-based compensation expense recognized during the period is based on the value of the portion of share-based payment awards that is ultimately expected to vest during the period. Compensation expense recognized for all stock option awards granted is recognized using the straight-line method over the vesting period. The options generally vest ratably over a period of three years. Fiscal 2011 grants include nonqualified options granted in May 2011 ( May Grant ) to purchase 50,000 shares each to Jeffrey A. Wahba and Patrick G. Criteser, and an option to purchase 20,000 shares to Mark A. Harding. The options under the May Grant vest ratably over one year from the date of grant with an exercise price of \$9.63 per share. The share-based compensation expense recognized in the Company's consolidated statement of operations for the fiscal years ended June 30, 2011, 2010 and 2009 is based on awards ultimately expected to vest. Currently, management estimates a forfeiture rate of 6.5% based on the Company's historical turnover. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

The Company uses the Black-Scholes option valuation model, which requires management to make certain assumptions for estimating the fair value of stock options at the date of the grant. The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimates, in management's opinion the existing models may not necessarily provide a reliable single measure of the fair value of the Company's stock options. Although the fair value of stock options is determined using an option valuation model that value may not be indicative of the fair value observed in a willing buyer/willing seller market transaction.

The following are the weighted average assumptions used in the Black-Scholes valuation model:

	<b>Year Ended June 30,</b>		
	<b>2011</b>	<b>2010</b>	<b>2009</b>
Average fair value of options	\$ 7.05	\$ 6.09	\$ 6.68
Forfeiture rate	6.50%	6.50%	
Risk-free interest rate	2.70%	2.59%	5.45%
Dividend yield	1.27%	2.50%	2.20%
Average expected life	6 years	6 years	5 years
Expected stock price volatility	54.68%	41.20%	32.38%

The Company's assumption regarding expected stock price volatility is based on the historical volatility of the Company's stock price. The risk-free interest rate is based on U.S. Treasury zero-coupon issues at the date of grant with a remaining term equal to the expected life of the stock options.

**Table of Contents****FARMER BROS. CO.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following tables summarize stock option activity from adoption of the Omnibus Plan through June 30, 2011:

**Outstanding Stock Options**

	Number of Stock Options	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value	Weighted Average Remaining Life (Years)	Aggregate Intrinsic Value (In thousands)
Outstanding at June 30, 2008	117,500	\$ 22.62	\$ 6.16	6.6	\$
Granted	121,500	\$ 21.76	\$ 6.68		\$ 2
Outstanding at June 30, 2009	239,000	\$ 22.22	\$ 6.41	6.1	\$ 60
Granted	220,789	\$ 18.25	\$ 6.09		\$
Cancelled/Forfeited	(54,846)	\$ 21.65	\$ 6.87		\$
Outstanding at June 30, 2010	404,943	\$ 20.17	\$ 6.25	5.8	\$
Granted	327,656	\$ 14.95	\$ 7.05		\$
Cancelled/Forfeited	(234,789)	\$ 19.21	\$ 6.97		\$
Outstanding at June 30, 2011	497,810	\$ 17.19	\$ 6.44	5.7	\$ 61
Vested and exercisable, June 30, 2011	174,941	\$ 21.20	\$ 6.32	4.4	\$
Vested and expected to vest, June 30, 2011	467,131	\$ 17.26	\$ 6.40	5.6	\$ 58

**Nonvested Stock Options**

	Number of Stock Options	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value	Weighted Average Remaining Amortization Period (Years)
Outstanding at June 30, 2008	117,500	\$ 22.62	\$ 6.16	
Granted	121,500	\$ 21.76	\$ 6.68	
Vested	(40,490)	\$ 22.66	\$ 6.16	
Outstanding at June 30, 2009	198,510	\$ 22.13	\$ 6.46	2.1
Granted	220,789	\$ 18.25	\$ 6.09	
Vested	(68,990)	\$ 22.20	\$ 6.43	
Cancelled/Forfeited	(49,515)	\$ 21.21	\$ 6.35	
Outstanding at June 30, 2010	300,794	\$ 19.42	\$ 6.22	2.1
Granted	327,656	\$ 14.95	\$ 7.05	
Vested	(105,458)	\$ 20.29	\$ 6.30	
Cancelled/Forfeited	(200,123)	\$ 18.74	\$ 7.09	
Outstanding at June 30, 2011	322,869	\$ 15.02	\$ 6.50	1.7





**Table of Contents****FARMER BROS. CO.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The aggregate intrinsic values in the table above represent the total pretax intrinsic value, based on the Company's closing stock price of \$10.14 at June 30, 2011, \$15.09 at June 30, 2010 and \$22.88 at June 30, 2009, representing the last trading day of the respective years, which would have been received by award holders had all award holders exercised their awards that were in-the-money as of those dates. As of June 30, 2011, June 30, 2010 and June 30, 2009, respectively, there was approximately \$1.5 million, \$1.4 million, and \$1.0 million of unrecognized compensation cost related to stock options. Compensation expense recognized in general and administrative expense was \$0.7 million, \$0.6 million and \$0.4 million for fiscal 2011, 2010 and 2009, respectively.

**Restricted Stock**

During each of fiscal 2011, 2010 and 2009 the Company granted a total of 63,979 shares, 48,722 shares and 26,100 shares of restricted stock, respectively, with a weighted average grant date fair value of \$16.67, \$18.31 and \$21.76 per share, respectively, to eligible employees, officers and directors under the Omnibus Plan. Shares of restricted stock generally vest at the end of three years for eligible employees and officers who are employees. The fiscal 2011 grant of 63,979 shares include 10,384 shares of restricted stock granted to Patrick G. Criteser, the Company's Interim Co-CEO, which shares vest at one year from the date of grant. Shares of restricted stock generally vest ratably over a period of three years for directors and officers who are not employees. Compensation expense is recognized on a straight-line basis over the service period based on the estimated fair value of the restricted stock. Compensation expense recognized in general and administrative expense was \$0.5 million, \$0.4 million and \$0.3 million, respectively, for the fiscal years ended June 30, 2011, 2010 and 2009. As of June 30, 2011, 2010 and 2009, there was approximately \$0.9 million, \$0.9 million and \$0.8 million, respectively, of unrecognized compensation cost related to restricted stock. The following tables summarize restricted stock activity from adoption of the Omnibus Plan through June 30, 2011:

**Outstanding Restricted Stock Awards**

	Shares Awarded	Weighted Average Grant Date Fair Value	Weighted Average Remaining Life (Years)	Aggregate Intrinsic Value (In thousands)
Outstanding June 30, 2008	25,600	\$ 22.67		\$ 545.3
Granted	26,100	\$ 21.76		\$ 568.2
Exercised/Released	(3,031)	\$ 22.70		\$ 57.5
Cancelled/Forfeited	(500)	\$ 21.76		\$ 11.4
Outstanding at June 30, 2009	48,169	\$ 22.19	2.1	\$ 1,072.2
Granted	48,722	\$ 18.31		\$ 892.0
Exercised/Released	(5,860)	\$ 22.18		\$ 105.0
Cancelled/Forfeited	(10,823)	\$ 21.79		\$ 235.0
Outstanding at June 30, 2010	80,208	\$ 19.91	2.0	\$ 1,210.0
Granted	63,979	\$ 16.67		\$ 1,066.0
Exercised/Released	(20,674)	\$ 21.52		\$ 332.0
Cancelled/Forfeited	(42,826)	\$ 19.19		\$ 497.0
Outstanding June 30, 2011	80,687	\$ 17.31	2.6	\$ 818.0
Vested and exercisable, June 30, 2011				
Vested and expected to vest, June 30, 2011	73,063	\$ 17.30	2.6	\$ 740.0



**Table of Contents****FARMER BROS. CO.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Nonvested Restricted Stock Awards**

	<b>Shares Awarded</b>	<b>Weighted Average Grant Date Fair Value</b>
Outstanding at June 30, 2008	25,600	\$ 22.67
Granted	26,100	\$ 21.76
Vested	(3,031)	\$ 22.70
Cancelled/Forfeited	(500)	\$ 21.76
Outstanding at June 30, 2009	48,169	\$ 22.19
Granted	48,722	\$ 18.31
Vested	(5,860)	\$ 22.18
Cancelled/Forfeited	(10,823)	\$ 21.49
Outstanding at June 30, 2010	80,208	\$ 19.91
Granted	63,979	\$ 16.67
Vested	(20,674)	\$ 21.52
Cancelled/Forfeited	(42,826)	\$ 19.19
Outstanding at June 30, 2011	80,687	\$ 17.31

**Note 11. Other Current Liabilities**

Other current liabilities consist of the following:

	<b>June 30,</b>	
	<b>2011</b>	<b>2010</b>
	<b>(In thousands)</b>	
Accrued workers compensation liabilities	\$ 1,320	\$ 1,293
Dividends payable	9	1,849
Postretirement medical liability	1,148	1,076
Accrued pension liabilities	5,678	5,285
Other (including net taxes payable)	3,727	2,178
	\$ 11,882	\$ 11,681

**Note 12. Income Taxes**

The current and deferred components of the provision for income taxes consist of the following:

Edgar Filing: FARMER BROTHERS CO - Form 10-K

	2011	June 30, 2010 (In thousands)	2009
<b>Current:</b>			
Federal	\$ (4)	\$ (3,514)	\$ (1,433)
State	324	227	(5)
Total current income tax benefit	320	(3,287)	(1,439)
<b>Deferred:</b>			
Federal	(7,867)	629	11,916
State	(1,620)	129	3,805
Total deferred income tax expense (benefit)	(9,487)	758	15,721
<b>Income tax (benefit) expense</b>	<b>\$ (9,167)</b>	<b>\$ (2,529)</b>	<b>\$ 14,283</b>

**Table of Contents****FARMER BROS. CO.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Income tax expense or benefit from continuing operations is generally determined without regard to other categories of earnings, such as discontinued operations and other comprehensive income. An exception is provided in ASC 740 when there is aggregate income from categories other than continuing operations and a loss from continuing operations in the current year. In this case, the tax benefit allocated to continuing operations is the amount by which the loss from continuing operations reduces the tax expenses recorded with respect to the other categories of earnings, even when a valuation allowance has been established against the deferred tax assets. In instances where a valuation allowance is established against current year losses, income from other sources, including gain from post retirement benefits recorded as a component of other comprehensive income, is considered when determining whether sufficient future taxable income exists to realize the deferred tax assets. As a result, for the year ended June 30, 2011, the Company recorded a tax expense of \$9.8 million in other comprehensive income related to the gain on post retirement benefits, and recorded a corresponding tax benefit of \$9.8 million in continuing operations.

A reconciliation of income tax (benefit) expense to the federal statutory tax rate is as follows:

	June 30, 2011	June 30, 2010	June 30, 2009
Statutory tax rate	34%	34%	34%
	(In thousands)		
Income tax benefit at statutory rate	\$ (21,585)	\$ (9,004)	\$ (6,456)
State income tax (net of federal tax benefit)	(2,765)	(1,238)	(985)
Dividend income exclusion	(532)	(765)	(840)
Valuation allowance	16,529	8,752	19,663
Change in contingency reserve (net)	(1,308)	7	3,578
Research tax credit (net)	(16)	(66)	(97)
Other (net)	510	(215)	(580)
Income tax (benefit) expense	\$ (9,167)	\$ (2,529)	\$ 14,283

The primary components of the temporary differences which give rise to the Company's net deferred tax assets are as follows:

	2011	June 30, 2010	2009
	(In thousands)		
Deferred tax assets:			
Postretirement benefits	\$ 20,226	\$ 27,589	\$ 22,110
Accrued liabilities	4,138	4,376	4,594
Capital loss carryforward	2,945	1,971	2,757
Net operating loss carryforward	37,170	17,261	5,564
Other	4,328	2,464	6,362
Total deferred tax assets	68,807	53,661	41,387
Deferred tax liabilities:			
Fixed assets	(7,881)	(5,551)	(5,056)
Intangible assets	(1,032)	(4,498)	(2,725)
Other	(814)	(726)	(545)

Edgar Filing: FARMER BROTHERS CO - Form 10-K

Total deferred tax liabilities	(9,727)	(10,775)	(8,326)
Valuation allowance	(60,390)	(43,860)	(33,278)
Net deferred tax (liability) asset	\$ (1,310)	\$ (974)	\$ (217)

**Table of Contents****FARMER BROS. CO.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company has approximately \$96.1 million and \$104.3 million of federal and state net operating loss carryforwards that will begin to expire in the years ending June 30, 2025 and June 30, 2020, respectively. The Company also has approximately \$7.8 million and \$7.0 million of federal and state capital loss carryforwards, respectively, that may only be used to offset capital gains that begin expiring in June 30, 2012.

At June 30, 2011, the Company had total deferred tax assets of \$68.8 million and a net deferred tax asset before valuation allowance of \$59.1 million. The Company considered whether a valuation allowance should be recorded against deferred tax assets based on the likelihood that the benefits of the deferred tax assets would or would not ultimately be realized in future periods. In making such assessment, significant weight was given to evidence that could be objectively verified such as recent operating results and less consideration was given to less objective indicators such as future earnings projections.

After consideration of positive and negative evidence, including the recent history of losses, the Company cannot conclude that it is more likely than not to generate future earnings sufficient to realize the Company's deferred tax assets as of June 30, 2011. Accordingly, a valuation allowance of \$60.4 million has been recorded to offset this deferred tax asset. The valuation allowance increased by \$16.5 million, \$10.6 million and \$33.3 million in fiscal years ended June 30, 2011, 2010 and 2009, respectively.

The Worker, Homeownership, and Business Assistance Act of 2009, which was signed into law on November 6, 2009, extended the carryback period for certain net operating losses from two years to five years. As a result of the extended carryback period, the Company recorded a tax benefit of \$3.5 million in fiscal 2010.

A tabular reconciliation of the total amounts (in absolute values) of unrecognized tax benefits is as follows (in thousands):

	Year Ended June 30,		
	2011	2010	2009
Unrecognized tax benefits at beginning of year	\$ 5,218	\$ 4,382	\$ 807
Increases in tax positions for prior years			4,005
(Decreases) increases in tax positions for current year	(1,316)	836	
Settlements			(430)
Lapse in statute of limitations			
Unrecognized tax benefits at end of year	\$ 3,902	\$ 5,218	\$ 4,382

At June 30, 2011 and 2010, the Company has approximately \$3.6 million and \$5.0 million, respectively, of unrecognized tax benefits that, if recognized, would affect the effective tax rate, subject to the valuation allowance.

The Internal Revenue Service completed an audit of the Company's open tax years in December 2010. The Company is currently appealing the result of this audit. The State of California is currently conducting an examination of the Company's tax returns for the years ended June 30, 2006 and 2007. The Company believes it is reasonably possible that a portion of its total unrecognized tax benefits will decrease in the next twelve months upon the conclusion of these examinations. However, it is premature to assess the range or the nature of the reasonably possible changes to the Company's unrecognized tax benefits.

The Company files income tax returns in the U.S. and in various state jurisdictions with varying statutes of limitations. The Company is no longer subject to U.S. income tax examinations for the fiscal years prior to June 30, 2003.



**Table of Contents****FARMER BROS. CO.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company's policy is to recognize interest expense and penalties related to income tax matters as a component of income tax expense. As of June 30, 2011 and 2010, the Company recorded \$47,000 and \$36,000, respectively, in accrued interest and penalties associated with uncertain tax positions. Additionally, the Company recorded (income)/expense of \$12,000, \$10,000 and (\$38,000) related to interest and penalties on uncertain tax positions in the years ended June 30, 2011, 2010 and 2009, respectively.

**Note 13. Earnings (Loss) Per Share**

(In thousands, except share and per share amounts)	2011	Year ended June 30, 2010	2009
Net loss attributable to common stockholders-basic	\$ (53,897)	\$ (23,847)	\$ (33,160)
Net loss attributable to unvested restricted stockholders	(420)	(106)	(110)
<b>Total net loss</b>	<b>\$ (54,317)</b>	<b>\$ (23,953)</b>	<b>\$ (33,270)</b>

(In thousands, except share and per share amounts)	2011	Year ended June 30, 2010	2009
Weighted average shares outstanding-basic	15,066,663	14,866,306	14,508,320
Effect of dilutive securities:			
Shares issuable under stock options			
Weighted average shares outstanding-diluted	15,066,663	14,866,306	14,508,320
<b>Basic and diluted net loss per common share</b>	<b>\$ (3.61)</b>	<b>\$ (1.61)</b>	<b>\$ (2.29)</b>

**Note 14. Commitments and Contingencies**

With the acquisition of the DSD Coffee Business in the fiscal year ended June 30, 2009, the Company assumed some of the operating lease obligations associated with the acquired vehicles. The Company also refinanced some of the existing leases and entered into new capital leases for certain vehicles. The terms of the capital leases vary from 13 months to 26 months with varying expiration dates through 2011. The Company is obligated under operating leases for branch warehouses. Some operating leases have renewal options that allow the Company, as lessee, to extend the leases. The Company has one operating lease with a term greater than five years that expires in 2018 and has a 10 year renewal option, and operating leases for computer hardware with terms that do not exceed four years. Rent expense for the fiscal years ended June 30, 2011, 2010 and 2009 was \$6.3 million, \$6.6 million and \$3.2 million, respectively.

In May 2011, the Company did not meet the minimum credit rating criteria for participation in the alternative security program for California self-insurers. As a result, the Company was required to post a \$5.9 million letter of credit as a security deposit to the State of California Department of Industrial Relations Self-Insurance Plans. The Company posted the security deposit in June 2011.

**Table of Contents****FARMER BROS. CO.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Contractual obligations for future fiscal years are as follows (in thousands):

Year Ended June 30,	Contractual Obligations			Postretirement
	Capital Lease Obligations	Operating Lease Obligations	Pension Plan Obligations	Benefits Other Than Pensions
2012	\$ 2,210	\$ 5,228	\$ 5,678	\$ 1,148
2013	2,171	4,125	5,957	1,232
2014	2,042	3,446	6,114	1,290
2015	1,994	2,833	6,469	1,486
2016	1,764	1,865	6,830	1,606
Thereafter	338	3,230	42,280	10,182
		\$ 20,727	\$ 73,328	\$ 16,944
Total minimum lease payments	\$ 10,519			
Less: imputed interest (6.30% to 13.60%)	(1,883)			
Present value of future minimum lease payments	\$ 8,636			
Less: current portion	1,570			
Long-term capital lease obligation	\$ 7,066			

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

**Note 15. Quarterly Financial Data (Unaudited)**

	September 30, 2010	December 31, 2010	March 31, 2011	June 30, 2011
	(In thousands, except share data)			
Net sales	\$ 108,743	\$ 119,227	\$ 116,732	\$ 119,243
Gross profit	\$ 43,945	\$ 45,016	\$ 41,861	\$ 26,352
Loss from operations	\$ (12,019)	\$ (10,543)	\$ (14,463)	\$ (31,397)
Net loss	\$ (9,873)	\$ (8,912)	\$ (13,196)	\$ (22,336)
Net loss per common share	\$ (0.66)	\$ (0.59)	\$ (0.87)	\$ (1.47)
	September 30, 2009	December 31, 2009	March 31, 2010	June 30, 2010
	(In thousands, except share data)			
Net sales	\$ 112,127	\$ 120,225	\$ 111,002	\$ 106,964
Gross profit	\$ 54,304	\$ 51,092	\$ 49,261	\$ 42,907
Loss from operations	\$ (2,499)	\$ (5,102)	\$ (9,288)	\$ (22,303)

## Edgar Filing: FARMER BROTHERS CO - Form 10-K

Net income (loss)	\$ 2,199	\$ 1,417	\$ (6,575)	\$ (20,994)
Net income (loss) per common share	\$ 0.15	\$ 0.10	\$ (0.44)	\$ (1.40)

During the fourth quarter and for the fiscal year ended June 30, 2011, the Company recorded \$40.3 million in LIFO charge in cost of goods sold and an impairment loss of \$7.8 million related to the write-off of definite-lived intangible assets that the Company acquired or entered into during the DSD Coffee Business acquisition. During the fourth quarter of fiscal 2011, the Company also recorded \$9.2 million in income tax benefit (see Note 12).

**Table of Contents**

**FARMER BROS. CO.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

During the fourth quarter and for the fiscal year ended June 30, 2010, the Company identified two errors in its consolidated financial statements. The first error was an understatement of coffee brewing equipment parts inventory and an overstatement of cost of sales by \$1.8 million, of which \$1.5 million related to fiscal year 2009 and \$0.3 million related to the first three quarters of fiscal 2010. The error resulted from the Company charging the cost of coffee brewing equipment at one recently acquired location to cost of sales upon receipt rather than accounting for parts on hand as inventory. The second error was an understatement of accrued liabilities and operating expense by \$1.8 million, of which \$0.5 million related to fiscal year 2009 and \$1.3 million related to the first three quarters of fiscal 2010. This error resulted from a misapplication of a system configuration at a recently acquired location. In accordance with relevant guidance, management evaluated the materiality of these errors from a qualitative and quantitative perspective both individually and in the aggregate. Based on such evaluation, the Company concluded that correcting the cumulative errors would be immaterial to the expected full year results for fiscal 2010 and correcting the error would not have had a material impact to any of the individual prior period financial statements or affect the trend of financial results. Accordingly, the Company recorded an adjustment during the fourth quarter of fiscal 2010 to increase total inventory and reduce cost of sales by \$1.8 million and to increase accrued liabilities and operating expense by \$1.8 million.

**Note 16. Subsequent Events**

On September 12, 2011, the Lender and the Company amended the Original Loan Agreement to reduce required minimum excess availability and required minimum total liquidity for the period from July 1, 2011 through September 30, 2011. See Note 8.

On September 12, 2011, the Company entered into an Amended and Restated Loan and Security Agreement among the Company and CBI, as Borrowers, certain of the Company's other subsidiaries, as Guarantors, the Lenders party thereto, and Wells Fargo Bank, National Association, as Agent. See Note 8.

**Table of Contents**

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

**Item 9A. Controls and Procedures**

***Disclosure Controls and Procedures***

Disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act), are controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the rules and forms of the SEC. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information we are required to disclose in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer (including our Interim Co-Chief Executive Officers) and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures.

As of June 30, 2011, our management, with the participation of our Interim Co-Chief Executive Officers and Chief Financial Officer, carried out an evaluation of the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15(e) promulgated under the Exchange Act. Based upon this evaluation, our Interim Co-Chief Executive Officers and our Chief Financial Officer concluded that, as of June 30, 2011, our disclosure controls and procedures were effective.

***Management Report on Internal Control Over Financial Reporting***

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). With the participation of the Interim Co-Chief Executive Officers and Chief Financial Officer, our management conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework and criteria established in Internal Control Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, our management has concluded that our internal control over financial reporting was effective as of June 30, 2011.

Ernst & Young LLP, an independent registered public accounting firm, issued an attestation report on the Company's internal control over financial reporting as of June 30, 2011, as stated in their report which is included herein.

***Changes in Internal Control Over Financial Reporting***

There has been no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) promulgated under the Exchange Act) during our fiscal quarter ended June 30, 2011, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

During the fiscal quarter ended March 31, 2009, the Company entered into a transition services agreement with Sara Lee to host, maintain and support the IT infrastructure of the DSD Coffee Business for up to eighteen months. This agreement was scaled back in February 2010 to include only IT infrastructure support and terminated on August 31, 2010.

---

**Table of Contents**

**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders of

Farmer Bros. Co. and Subsidiaries

We have audited Farmer Bros. Co. and Subsidiaries' internal control over financial reporting as of June 30, 2011, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Farmer Bros. Co. and Subsidiaries' management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Farmer Bros. Co. and Subsidiaries maintained, in all material respects, effective internal control over financial reporting as of June 30, 2011, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Farmer Bros. Co. and Subsidiaries as of June 30, 2011 and 2010, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended June 30, 2011 of Farmer Bros. Co. and Subsidiaries and our report dated September 12, 2011 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Los Angeles, California

September 12, 2011

**Table of Contents**

**Item 9A(T). Controls and Procedures**

Not applicable.

**Item 9B. Other Information**

On September 12, 2011, the Lender and the Company amended the Original Loan Agreement to reduce required minimum excess availability and required minimum total liquidity for the period from July 1, 2011 through September 30, 2011. The foregoing description of Amendment No. 5 to the Original Loan Agreement does not purport to be complete and is subject to, and qualified in its entirety by, reference to Amendment No. 5 to Loan and Security Agreement which is included as Exhibit 10.11 to this Form 10-K and incorporated herein by reference.

On September 12, 2011, we entered into an Amended and Restated Loan and Security Agreement among the Company and CBI, as Borrowers, certain of the Company's other subsidiaries, as Guarantors, the Lenders party thereto, and Wells Fargo Bank, National Association, as Agent. A description of the material terms and conditions of the Loan Agreement are set forth in Part II, Item 7 of this Annual Report on Form 10-K under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources - Credit Facility" and incorporated herein by reference.

**Table of Contents****PART III****Item 10. Directors, Executive Officers and Corporate Governance**

The information required by this item will be set forth in the Proxy Statement or Form 10-K/A and is incorporated in this report by reference.

To the Company's knowledge, based solely on a review of the copies of such reports furnished to the Company and written representations that no other reports were required during the fiscal year ended June 30, 2011, its officers, directors and ten percent shareholders complied with all applicable Section 16(a) filing requirements, with the exception of those filings listed in the Registrant's Proxy Statement expected to be dated and filed with the SEC on or before October 28, 2011.

**Item 11. Executive Compensation**

The information required by this item will be set forth in the Proxy Statement or Form 10-K/A and is incorporated in this report by reference.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The information required by this item will be set forth in the Proxy Statement or Form 10-K/A and is incorporated in this report by reference.

***Equity Compensation Plan Information***

Information about our equity compensation plans at June 30, 2011 that were either approved or not approved by our stockholders was as follows:

<b>Plan Category</b>	<b>Number of Shares to be Issued Upon Exercise of Outstanding Options</b>	<b>Weighted Average Exercise Price of Outstanding Options</b>	<b>Number of Shares Remaining Available for Future Issuance(b)</b>
Equity compensation plans approved by stockholders(a)	497,810	\$ 17.19	391,938
Equity compensation plans not approved by stockholders			
<b>Total</b>	<b>497,810</b>	<b>\$ 17.19</b>	<b>391,938</b>

(a) Includes the Omnibus Plan.

(b) Shares available for future issuance under the Omnibus Plan may be awarded in the form of stock options, stock appreciation rights, restricted stock, restricted stock units, dividend equivalents, performance-based awards, stock payments, or other incentives payable in shares of stock, or any combination thereof. Shares covered by an award will be counted as used at the time the award is granted to a participant. If any award lapses, expires, terminates or is canceled prior to the issuance of shares thereunder or if shares are issued under the Omnibus Plan to a participant and are thereafter reacquired by the Company, the shares subject to such awards and the reacquired shares shall again be available for issuance under the Omnibus Plan. In addition to the shares that are actually issued to a participant, the following items will be counted against the total number of shares available for issuance under the Omnibus Plan: (i) shares subject to an award that are not delivered to a participant because the award is exercised through a reduction of shares subject to the award (i.e., net exercised); (ii) shares subject to an award that are not delivered to a participant because such shares are withheld in satisfaction of the withholding of taxes incurred in connection with the exercise of or issuance of shares under certain types of awards; and (iii) shares that are tendered to the Company to pay the exercise price of any stock award. The following items will not be counted against the total number of shares available for issuance under the Omnibus Plan: (A) the payment in cash of dividends or dividend equivalents; and (B) any award that is



settled in cash rather than by issuance of stock.

**Table of Contents**

**Item 13. Certain Relationships and Related Transactions, and Director Independence**

The information required by this item will be set forth in the Proxy Statement or Form 10-K/A and is incorporated in this report by reference.

**Item 14. Principal Accountant Fees and Services**

The information required by this item will be set forth in the Proxy Statement or Form 10-K/A and is incorporated in this report by reference.

**Table of Contents**

**PART IV**

**Item 15. Exhibits and Financial Statement Schedules**

(a) List of Financial Statements and Financial Statement Schedules:

1. Financial Statements included in Item 8:

<u>Consolidated Balance Sheets as of June 30, 2011 and 2010</u>	34
<u>Consolidated Statements of Operations for the Years Ended June 30, 2011, 2010 and 2009</u>	35
<u>Consolidated Statements of Cash Flows for the Years Ended June 30, 2011, 2010 and 2009</u>	36
<u>Consolidated Statements of Stockholders Equity for the Years Ended June 30, 2011, 2010, and 2009</u>	37
<u>Notes to Consolidated Financial Statements</u>	38

2. Financial Statement Schedules: Financial Statement Schedules are omitted as they are not applicable, or the required information is given in the consolidated financial statements and notes thereto.

3. The exhibits to this Annual Report on Form 10-K are listed on the accompanying index to exhibits and are incorporated herein by reference or are filed as part of the Annual Report on Form 10-K. Each management contract or compensation plan required to be filed as an exhibit is identified by an asterisk (\*).

(b) Exhibits: See Exhibit Index.

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FARMER BROS. CO.

By: /s/ JEFFREY A. WAHBA  
**Jeffrey A. Wahba**

*Interim Co-Chief Executive Officer,*

*Treasurer and Chief Financial Officer*

*(co-chief executive officer, principal financial and accounting officer)*

**Date: September 12, 2011**

By: /s/ PATRICK G. CRITESER  
**Patrick G. Criteser**

*Interim Co-Chief Executive Officer*

*(co-chief executive officer)*

**Date: September 12, 2011**

By: /s/ HORTENSIA GÓMEZ  
**Hortensia Gómez**

*Vice President and Controller*

*(controller)*

**Date: September 12, 2011**

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

/s/ GUENTER W. BERGER	Chairman of the Board and Director	September 12, 2011
<b>Guenter W. Berger</b>		
/s/ MARTIN A. LYNCH	Director	September 12, 2011
<b>Martin A. Lynch</b>		
/s/ THOMAS A. MALOOF	Director	September 12, 2011
<b>Thomas A. Maloof</b>		

Edgar Filing: FARMER BROTHERS CO - Form 10-K

/s/ JAMES J. MCGARRY	Director	September 12, 2011
<b>James J. McGarry</b>		
/s/ JOHN H. MERRELL	Director	September 12, 2011
<b>John H. Merrell</b>		
/s/ JEFFREY A. WAHBA	Director	September 12, 2011
<b>Jeffrey A. Wahba</b>		
	Director	
<b>Jeanne Farmer Grossman</b>		

**Table of Contents**

**EXHIBIT INDEX**

- 3.1 Certificate of Incorporation (filed as Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2009 filed with the SEC on May 11, 2009 and incorporated herein by reference).
- 3.2 Amended and Restated Bylaws (filed as Exhibit 3.2 to the Company's Current Report on Form 8-K filed with the SEC on April 25, 2011 and incorporated herein by reference).
- 4.1 Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock (filed as Exhibit 4.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2010 filed with the SEC on May 10, 2010 and incorporated herein by reference).
- 4.2 Rights Agreement, dated March 17, 2005, by and between Farmer Bros. Co. and Wells Fargo Bank, N.A., as Rights Agent (filed as Exhibit 4.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2010 filed with the SEC on May 10, 2010 and incorporated herein by reference).
- 4.3 Specimen Stock Certificate (filed as Exhibit 4.1 to the Company's Form 8-A/A filed with the SEC on February 6, 2009 and incorporated herein by reference).
- 10.1 Asset Purchase Agreement dated as of December 2, 2008, by and among Sara Lee Corporation, Saramar, LLC and Farmer Bros. Co. (filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2008 filed with the SEC on February 10, 2009 and incorporated herein by reference).
- 10.2 Amendment No. 1 to Asset Purchase Agreement, dated February 27, 2009, by and among Sara Lee Corporation, Saramar, LLC and Farmer Bros. Co. (filed as Exhibit 10.2 to the Company's Annual Report on Form 10-K/A for the fiscal year ended June 30, 2009 filed with the SEC on September 15, 2009 and incorporated herein by reference).
- 10.3 Second Amendment to Asset Purchase Agreement, dated December 17, 2009, by and among Sara Lee Corporation, Saramar, LLC and Farmer Bros. Co. (filed as Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2009 filed with the SEC on February 9, 2010 and incorporated herein by reference).
- 10.4 Stock Purchase Agreement, dated April 27, 2007, by and among Farmer Bros. Co., Coffee Bean Holding Co., Inc., and the Stockholders of Coffee Bean Holding Co., Inc. (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on May 1, 2007 and incorporated herein by reference).
- 10.5 Loan and Security Agreement, dated March 2, 2009, by and among Farmer Bros. Co. and Coffee Bean International, Inc., as Borrowers, Coffee Bean Holding Co., Inc., FBC Finance Company and SL Realty, LLC, as Guarantors, and Wells Fargo Bank, National Association, successor by merger to Wachovia Bank, National Association, as Lender (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on February 10, 2009 and incorporated herein by reference).
- 10.6 Amendment No. 1 to Loan and Security Agreement and Consent, dated March 2, 2009, by and among Farmer Bros. Co. and Coffee Bean International, Inc., as Borrowers, Coffee Bean Holding Co., Inc. and FBC Finance Company, as Guarantors, and Wells Fargo Bank, National Association, successor by merger to Wachovia Bank, National Association, as Lender (filed as Exhibit 10.5 to the Company's Annual Report on Form 10-K/A for the fiscal year ended June 30, 2009 filed with the SEC on September 15, 2009 and incorporated herein by reference).

**Table of Contents**

- 10.7 Amendment No. 2 to Loan and Security Agreement and Consent, dated July 27, 2009, by and among Farmer Bros. Co. and Coffee Bean International, Inc., as Borrowers, Coffee Bean Holding Co., Inc. and FBC Finance Company, as Guarantors, and Wells Fargo Bank, National Association, successor by merger to Wachovia Bank, National Association, as Lender (filed as Exhibit 10.6 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2009 filed with the SEC on November 9, 2009 and incorporated herein by reference).
- 10.8 Amendment No. 3 to Loan and Security Agreement, dated November 20, 2009, by and among Farmer Bros. Co. and Coffee Bean International, Inc., as Borrowers, Coffee Bean Holding Co., Inc. and FBC Finance Company, as Guarantors, and Wells Fargo Bank, National Association, successor by merger to Wachovia Bank, National Association, as Lender (filed as Exhibit 10.8 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2009 filed with the SEC on February 9, 2010 and incorporated herein by reference).
- 10.9 Amendment No. 4 to Loan and Security Agreement and Consent, dated August 31, 2010, by and among Farmer Bros. Co. and Coffee Bean International, Inc., as Borrowers, Coffee Bean Holding Co., Inc. and FBC Finance Company, as Guarantors, and Wells Fargo Bank, National Association, successor by merger to Wachovia Bank, National Association, as Lender (filed as Exhibit 10.9 to the Company's Annual Report on Form 10-K/A for the year ended June 30, 2010 filed with the SEC on September 14, 2010 and incorporated herein by reference).
- 10.10 Letter Agreement regarding Waiver of Event of Default dated May 7, 2010, by and among Farmer Bros. Co. and Coffee Bean International, Inc., as Borrowers, Coffee Bean Holding Co., Inc. and FBC Finance Company, as Guarantors, and Wells Fargo Bank, National Association, successor by merger to Wachovia Bank, National Association, as Lender (filed as Exhibit 10.9 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2010 filed with the SEC on May 10, 2010 and incorporated herein by reference).
- 10.11 Amendment No. 5 to Loan and Security Agreement, dated September 12, 2011, by and among Farmer Bros. Co. and Coffee Bean International, Inc., as Borrowers, Coffee Bean Holding Co., Inc. and FBC Finance Company, as Guarantors, and Wells Fargo Bank, National Association, successor by merger to Wachovia Bank, National Association, as Lender (filed herewith).
- 10.12 Amended and Restated Loan and Security Agreement, dated September 12, 2011, by and among Farmer Bros. Co. and Coffee Bean International, Inc., as Borrowers, Coffee Bean Holding Co., Inc. and FBC Finance Company, as Guarantors, the Lenders party thereto, and Wells Fargo Bank, National Association, as Agent (filed herewith).
- 10.13 Farmer Bros. Co. Pension Plan for Salaried Employees (filed as Exhibit 10.1 to the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2007 filed with the SEC on September 13, 2007 and incorporated herein by reference).\*
- 10.14 Amendment No. 1 to Farmer Bros. Co. Retirement Plan effective June 30, 2011 (filed herewith).\*
- 10.15 Farmer Bros. Co. 2005 Incentive Compensation Plan (Amended and Restated as of December 31, 2008) (filed as Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2008 filed with the SEC on February 10, 2009 and incorporated herein by reference).\*
- 10.16 Farmer Bros. Co. Amended and Restated Employee Stock Ownership Plan, as adopted by the Board of Directors on December 9, 2010 and effective as of January 1, 2010 (filed as Exhibit 10.12 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2010 filed with the SEC on February 9, 2011 and incorporated herein by reference).\*

**Table of Contents**

- 10.17 ESOP Loan Agreement including ESOP Pledge Agreement and Promissory Note, dated March 28, 2000, between Farmer Bros. Co. and Wells Fargo Bank, N.A., Trustee for the Farmer Bros Co. Employee Stock Ownership Plan (filed as Exhibit 10.13 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2010 filed with the SEC on February 9, 2011 and incorporated herein by reference).
- 10.18 Amendment No. 1 to ESOP Loan Agreement, dated June 30, 2003, between Farmer Bros. Co. and Wells Fargo Bank, N.A., Trustee for the Farmer Bros Co. Employee Stock Ownership Plan (filed as Exhibit 10.14 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2010 filed with the SEC on February 9, 2011 and incorporated herein by reference).
- 10.19 ESOP Loan Agreement No. 2 including ESOP Pledge Agreement and Promissory Note, dated July 21, 2003 between Farmer Bros. Co. and Wells Fargo Bank, N.A., Trustee for the Farmer Bros Co. Employee Stock Ownership Plan (filed as Exhibit 10.15 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2010 filed with the SEC on February 9, 2011 and incorporated herein by reference).
- 10.20 Employment Agreement, dated as of June 2, 2006, by and between Farmer Bros. Co. and Roger M. Lavery III (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on June 8, 2006 and incorporated herein by reference).\*
- 10.21 Amendment No. 1 to Employment Agreement, dated as of December 5, 2007, by and between Farmer Bros. Co. and Roger M. Lavery III (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K/A filed with the SEC on December 11, 2007 and incorporated herein by reference).\*
- 10.22 Amendment No. 2 to Employment Agreement, dated as of December 31, 2008, by and between Farmer Bros. Co. and Roger M. Lavery III (filed as Exhibit 10.13 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2008 filed with the SEC on February 10, 2009 and incorporated herein by reference).\*
- 10.23 Separation Agreement, dated as of April 1, 2011, by and between Farmer Bros. Co. and Roger M. Lavery III (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on April 6, 2011 and incorporated herein by reference).\*
- 10.24 Employment Agreement, dated as of February 25, 2010, by and between Farmer Bros. Co. and Jeffrey A. Wahba (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on March 3, 2010 and incorporated herein by reference).\*
- 10.25 Amended and Restated Employment Agreement, effective as of April 19, 2011, by and between Farmer Bros. Co. and Jeffrey A. Wahba (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on May 23, 2011 and incorporated herein by reference).\*
- 10.26 Amendment No. 1 to Amended and Restated Employment Agreement, dated as of August 30, 2011, by and between Farmer Bros. Co. and Jeffrey A. Wahba (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on September 2, 2011 and incorporated herein by reference).\*
- 10.27 Employment Agreement, effective as of April 19, 2011, by and between Farmer Bros. Co. and Patrick G. Criteser (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the SEC on May 23, 2011 and incorporated herein by reference).\*
- 10.28 Letter Agreement, effective as of April 19, 2011, by and between Farmer Bros. Co. and Mark A. Harding (filed as Exhibit 10.3 to the Company's Current Report on Form 8-K filed with the SEC on May 23, 2011 and incorporated herein by reference).\*
- 10.29 Employment Agreement, dated as of December 1, 2010, by and between Farmer Bros. Co. and Larry B. Garrett (filed herewith).\*



**Table of Contents**

10.30	Consulting Agreement, dated as of March 2, 2009, by and between Farmer Bros. Co. and Michael J. King (filed as Exhibit 10.16 to the Company's Annual Report on Form 10-K/A for the fiscal year ended June 30, 2009 filed with the SEC on September 15, 2009 and incorporated herein by reference).*
10.31	Interim Services Agreement, dated as of December 17, 2009, by and between Farmer Bros. Co. and Tatum, LLC (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on February 10, 2010 and incorporated herein by reference).*
10.32	2007 Omnibus Plan (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on August 29, 2007 and incorporated herein by reference).*
10.33	Form of 2007 Omnibus Plan Stock Option Grant Notice and Stock Option Agreement (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on February 26, 2008 and incorporated herein by reference).*
10.34	Form of 2007 Omnibus Plan Restricted Stock Award Grant Notice and Restricted Stock Award Agreement (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the SEC on February 26, 2008 and incorporated herein by reference).*
10.35	Stock Ownership Guidelines for Directors and Executive Officers (filed as Exhibit 10.3 to the Company's Current Report on Form 8-K filed with the SEC on February 26, 2008 and incorporated herein by reference).*
10.36	Form of Target Award Notification Letter (Fiscal 2011) under Farmer Bros. Co. 2005 Incentive Compensation Plan (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on September 30, 2010 and incorporated herein by reference).*
10.37	Form of Target Award Notification Letter (Fiscal 2010) under Farmer Bros. Co. 2005 Incentive Compensation Plan (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the SEC on December 16, 2009 and incorporated herein by reference).*
10.38	Form of Change in Control Severance Agreement for Executive Officers of the Company (with schedule of executive officers attached) (filed as Exhibit 10.28 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2011 filed with the SEC on May 10, 2011 and incorporated herein by reference).*
10.39	Form of Indemnification Agreement for Directors and Officers of the Company, as adopted on May 18, 2006 and as amended on December 31, 2008 (with schedule of indemnitees attached) (filed as Exhibit 10.29 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2011 filed with the SEC on May 10, 2011 and incorporated herein by reference).*
14.1	Farmer Bros. Co. Code of Conduct and Ethics adopted on August 26, 2010 (filed as Exhibit 14.1 to the Company's Current Report on Form 8-K filed with the SEC on September 1, 2010 and incorporated herein by reference).
21.1	List of all Subsidiaries of Farmer Bros. Co. (filed herewith).
23.1	Consent of Independent Registered Accounting Firm (filed herewith).
31.1	Principal Executive Officer and Principal Financial and Accounting Officer Certification Pursuant to Securities Exchange Act Rules 13a-14 and 15d-14 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
31.2	Principal Executive Officer Certification Pursuant to Securities Exchange Act Rules 13a-14 and 15d-14 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
32.1	Principal Executive Officer and Principal Financial and Accounting Officer Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).
32.2	Principal Executive Officer Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).
99.1	Properties List (filed herewith).

\* Management contract or compensatory plan or arrangement.