CREDIT ACCEPTANCE CORP
Form 10-Q
October 29, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-Q
(Mark One)
þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2018
OR
o 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 000-20202
CREDIT ACCEPTANCE CORPORATION
(Exact name of registrant as specified in its charter)

Michigan	38-1999511
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
25505 W. Twelve Mile Road Southfield, Michigan (Address of principal executive offices)	48034-8339 (Zip Code)

248-353-2700
(Registrant's telephone number, including area code)
Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated

filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o	Smaller reporting company o	Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

The number of shares of Common Stock, $0.01 par value, outstanding on October 22, 2018 was 19,309,495.

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PART I. - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CREDIT ACCEPTANCE CORPORATION
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

(Dollars in millions, except per share data)	As of September 30, 2018	December 31, 2017
ASSETS:		
Cash and cash equivalents	$195.7	$ 8.2
Restricted cash and cash equivalents	347.6	255.6
Restricted securities available for sale	56.7	46.1
Loans receivable	6,005.2	5,049.0
Allowance for credit losses	(447.6)	(429.4)
Loans receivable, net	5,557.6	4,619.6
Property and equipment, net	38.7	20.5
Income taxes receivable	20.2	2.2
Other assets	27.6	33.4
Total Assets	$6,244.1	$ 4,985.6
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Liabilities:		
Accounts payable and accrued liabilities	$167.9	$ 151.7
Revolving secured line of credit	—	13.9
Secured financing	3,320.9	2,514.1
Senior notes	544.0	542.8
Mortgage note	12.0	—
Deferred income taxes, net	235.8	187.4
Income taxes payable	0.2	39.9
Total Liabilities	4,280.8	3,449.8
Commitments and Contingencies - See Note 16		
Shareholders' Equity:		
Preferred stock, $0.01 par value, 1,000,000 shares authorized, none issued	—	—
Common stock, $0.01 par value, 80,000,000 shares authorized, 19,309,614 and 19,310,049 shares issued and outstanding as of September 30, 2018 and December 31, 2017, respectively	0.2	0.2
Paid-in capital	152.4	145.5
Retained earnings	1,811.3	1,390.3
Accumulated other comprehensive loss	(0.6)	(0.2)
Total Shareholders' Equity	1,963.3	1,535.8
Total Liabilities and Shareholders' Equity	$6,244.1	$ 4,985.6

See accompanying notes to consolidated financial statements.

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CREDIT ACCEPTANCE CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

(Dollars in millions, except per share data)	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenue:				
Finance charges	$303.0	$ 259.4	$863.0	$ 749.2
Premiums earned	12.2	10.3	34.2	30.9
Other income	16.8	14.2	45.8	42.6
Total revenue	332.0	283.9	943.0	822.7
Costs and expenses:				
Salaries and wages	41.1	33.7	123.3	101.9
General and administrative	14.1	14.2	41.3	42.1
Sales and marketing	16.3	14.2	51.3	43.7
Provision for credit losses	14.0	25.7	39.2	68.0
Interest	41.1	30.5	114.3	88.0
Provision for claims	7.0	5.5	19.5	17.6
Total costs and expenses	133.6	123.8	388.9	361.3
Income before provision for income taxes	198.4	160.1	554.1	461.4
Provision for income taxes	47.4	59.4	132.0	168.3
Net income	$151.0	$ 100.7	$422.1	$ 293.1
Net income per share:				
Basic	$7.76	$ 5.19	$21.69	$ 15.01
Diluted	$7.75	$ 5.19	$21.68	$ 14.99
Weighted average shares outstanding:				
Basic	19,465,563	19,407,344	19,456,389	19,528,175
Diluted	19,473,978	19,415,545	19,472,197	19,547,674

See accompanying notes to consolidated financial statements.

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CREDIT ACCEPTANCE CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)

(In millions)	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income	$151.0	$100.7	$422.1	$293.1
Other comprehensive income (loss), net of tax:				
Unrealized gain (loss) on securities, net of tax	—	—	(0.4)	0.2
Other comprehensive income (loss)	—	—	(0.4)	0.2
Comprehensive income	$151.0	$100.7	$421.7	$293.3

See accompanying notes to consolidated financial statements.

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CREDIT ACCEPTANCE CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

(In millions)	For the Nine Months Ended September 30, 2018	2017
Cash Flows From Operating Activities:		
Net income	$422.1	$293.1
Adjustments to reconcile cash provided by operating activities:		
Provision for credit losses	39.2	68.0
Depreciation	3.9	4.7
Amortization	10.0	7.5
Provision for deferred income taxes	48.5	60.5
Stock-based compensation	7.8	8.3
Other	(0.2)	0.1
Change in operating assets and liabilities:		
Increase (decrease) in accounts payable and accrued liabilities	21.0	(2.8)
Increase in income taxes receivable	(18.0)	(3.2)
Decrease in income taxes payable	(39.7)	(23.4)
Decrease in other assets	6.4	1.8
Net cash provided by operating activities	501.0	414.6
Cash Flows From Investing Activities:		
Purchases of restricted securities available for sale	(35.6)	(28.0)
Proceeds from sale of restricted securities available for sale	17.3	23.0
Maturities of restricted securities available for sale	7.2	4.3
Principal collected on Loans receivable	1,949.0	1,657.4
Advances to Dealers	(1,870.2)	(1,467.2)
Purchases of Consumer Loans	(917.0)	(686.7)
Accelerated payments of Dealer Holdback	(41.0)	(35.5)
Payments of Dealer Holdback	(98.0)	(100.8)
Purchases of property and equipment	(22.1)	(6.9)
Net cash used in investing activities	(1,010.4)	(640.4)
Cash Flows From Financing Activities:		
Borrowings under revolving secured line of credit	1,724.7	3,076.7
Repayments under revolving secured line of credit	(1,738.6)	(2,946.2)
Proceeds from secured financing	2,696.6	1,664.5
Repayments of secured financing	(1,886.0)	(1,396.8)
Proceeds from mortgage note	12.0	—
Payments of debt issuance costs	(13.0)	(9.1)
Repurchase of common stock	(2.0)	(123.5)
Other	(4.8)	(0.6)
Net cash provided by financing activities	788.9	265.0
Net increase in cash, cash equivalents, restricted cash and restricted cash equivalents	279.5	39.2
Cash, cash equivalents, restricted cash and restricted cash equivalents beginning of period	263.8	239.3
Cash, cash equivalents, restricted cash and restricted cash equivalents end of period	$543.3	$278.5
Supplemental Disclosure of Cash Flow Information:		

Cash paid during the period for interest	$112.0	$88.9
Cash paid during the period for income taxes	$136.6	$132.1

See accompanying notes to consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("generally accepted accounting principles" or "GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The results of operations for interim periods are not necessarily indicative of actual results achieved for full fiscal years. The consolidated balance sheet as of December 31, 2017 has been derived from the audited financial statements at that date but does not include all the information and footnotes required by GAAP for complete financial statements. For further information, refer to the consolidated financial statements and footnotes thereto included in the Annual Report on Form 10-K for the year ended December 31, 2017 for Credit Acceptance Corporation (the "Company", "Credit Acceptance", "we", "our" or "us").

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

We have evaluated events and transactions occurring subsequent to the consolidated balance sheet date of September 30, 2018 for items that could potentially be recognized or disclosed in these financial statements. We did not identify any items which would require disclosure in or adjustment to the consolidated financial statements.

Reclassification

Certain amounts for prior periods have been reclassified to conform to the current presentation. On January 1, 2018, we adopted Accounting Standards Update 2016-18, which was applied retrospectively and changed the presentation and classification of restricted cash and restricted cash equivalents in our consolidated statements of cash flows. For additional information, see Note 3 to the consolidated financial statements. Additionally, the fair value level of measurement of our revolving secured line of credit as of December 31, 2017 was reclassified from Level 1 to Level 2. For additional information, see Note 4 to the consolidated financial statements.

2. DESCRIPTION OF BUSINESS

Since 1972, Credit Acceptance has offered financing programs that enable automobile dealers to sell vehicles to consumers, regardless of their credit history. Our financing programs are offered through a nationwide network of automobile dealers who benefit from sales of vehicles to consumers who otherwise could not obtain financing; from repeat and referral sales generated by these same customers; and from sales to customers responding to advertisements for our financing programs, but who actually end up qualifying for traditional financing.

Without our financing programs, consumers are often unable to purchase vehicles or they purchase unreliable ones. Further, as we report to the three national credit reporting agencies, an important ancillary benefit of our programs is that we provide consumers with an opportunity to improve their lives by improving their credit score and move on to more traditional sources of financing.

We refer to automobile dealers who participate in our programs and who share our commitment to changing consumers' lives as "Dealers". Upon enrollment in our financing programs, the Dealer enters into a Dealer servicing agreement with us that defines the legal relationship between Credit Acceptance and the Dealer. The Dealer servicing agreement assigns the responsibilities for administering, servicing, and collecting the amounts due on retail installment contracts (referred to as "Consumer Loans") from the Dealers to us. We are an indirect lender from a legal perspective, meaning the Consumer Loan is originated by the Dealer and assigned to us.

Substantially all of the Consumer Loans assigned to us are made to consumers with impaired or limited credit histories. The following table shows the percentage of Consumer Loans assigned to us with either FICO® scores below 650 or no FICO® scores:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
Consumer Loan Assignment Volume	2018	2017	2018	2017
Percentage of total unit volume with either FICO® scores below 650 or no FICO® scores	95.2%	95.2%	95.7%	95.7%

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (CONTINUED)
(UNAUDITED)

We have two programs: the Portfolio Program and the Purchase Program. Under the Portfolio Program, we advance money to Dealers (referred to as a "Dealer Loan") in exchange for the right to service the underlying Consumer Loans. Under the Purchase Program, we buy the Consumer Loans from the Dealers (referred to as a "Purchased Loan") and keep all amounts collected from the consumer. Dealer Loans and Purchased Loans are collectively referred to as "Loans". The following table shows the percentage of Consumer Loans assigned to us as Dealer Loans and Purchased Loans for each of the last seven quarters:

	Unit Volume		Dollar Volume (1)	
Three Months Ended	Dealer Loans	Purchased Loans	Dealer Loans	Purchased Loans
March 31, 2017	73.3%	26.7 %	67.8%	32.2 %
June 30, 2017	72.3%	27.7 %	67.9%	32.1 %
September 30, 2017	71.9%	28.1 %	68.6%	31.4 %
December 31, 2017	72.5%	27.5 %	69.7%	30.3 %
March 31, 2018	70.1%	29.9 %	67.4%	32.6 %
June 30, 2018	69.7%	30.3 %	66.8%	33.2 %
September 30, 2018	69.5%	30.5 %	67.0%	33.0 %

(1) Represents advances paid to Dealers on Consumer Loans assigned under our Portfolio Program and one-time payments made to Dealers to purchase Consumer Loans assigned under our Purchase Program. Payments of Dealer Holdback and accelerated Dealer Holdback are not included.

Portfolio Program

As payment for the vehicle, the Dealer generally receives the following:

- a down payment from the consumer;
- a non-recourse cash payment ("advance") from us; and
- after the advance has been recovered by us, the cash from payments made on the Consumer Loan, net of certain collection costs and our servicing fee ("Dealer Holdback").

We record the amount advanced to the Dealer as a Dealer Loan, which is classified within Loans receivable in our consolidated balance sheets. Cash advanced to the Dealer is automatically assigned to the Dealer's open pool of advances. We generally require Dealers to group advances into pools of at least 100 Consumer Loans. Unless we receive a request from the Dealer to keep a pool open, we automatically close a pool containing 100 Consumer Loans and assign subsequent advances to a new pool. All advances within a Dealer's pool are secured by the future collections on the related Consumer Loans assigned to the pool. For Dealers with more than one pool, the pools are cross-collateralized so the performance of other pools is considered in determining eligibility for Dealer Holdback. We perfect our security interest with respect to the Dealer Loans by obtaining control or taking possession of the Consumer Loans, which list us as lien holder on the vehicle title.

The Dealer servicing agreement provides that collections received by us during a calendar month on Consumer Loans assigned by a Dealer are applied on a pool-by-pool basis as follows:

- first, to reimburse us for certain collection costs;
- second, to pay us our servicing fee, which generally equals 20% of collections;
- third, to reduce the aggregate advance balance and to pay any other amounts due from the Dealer to us; and
- fourth, to the Dealer as payment of Dealer Holdback.

If the collections on Consumer Loans from a Dealer's pool are not sufficient to repay the advance balance and any other amounts due to us, the Dealer will not receive Dealer Holdback. Certain events may also result in Dealers forfeiting their rights to Dealer Holdback, including becoming inactive before assigning at least 100 Consumer Loans.

Dealers have an opportunity to receive an accelerated Dealer Holdback payment each time 100 Consumer Loans have been assigned to us. The amount paid to the Dealer is calculated using a formula that considers the forecasted collections and the advance balance on the related Consumer Loans.

Since typically the combination of the advance and the consumer's down payment provides the Dealer with a cash profit at the time of sale, the Dealer's risk in the Consumer Loan is limited. We cannot demand repayment of the advance from the Dealer except in the event the Dealer is in default of the Dealer servicing agreement. Advances are made only after the consumer and Dealer have signed a Consumer Loan contract, we have received the executed Consumer Loan contract and supporting documentation in either physical or electronic form, and we have approved all of the related stipulations for funding.

For accounting purposes, the transactions described under the Portfolio Program are not considered to be loans to consumers. Instead, our accounting reflects that of a lender to the Dealer. The classification as a Dealer Loan for accounting purposes is primarily a result of (1) the Dealer's financial interest in the Consumer Loan and (2) certain elements of our legal relationship with the Dealer.

Purchase Program

The Purchase Program differs from our Portfolio Program in that the Dealer receives a one-time payment from us at the time of assignment to purchase the Consumer Loan instead of a cash advance at the time of assignment and future Dealer Holdback payments. For accounting purposes, the transactions described under the Purchase Program are considered to be originated by the Dealer and then purchased by us.

Program Enrollment

Dealers may enroll in our Portfolio Program by (1) paying an up-front, one-time fee of $9,850, or (2) agreeing to allow us to retain 50% of their first accelerated Dealer Holdback payment. Access to the Purchase Program is typically only granted to Dealers that meet one of the following:

- received first accelerated Dealer Holdback payment under the Portfolio Program;
- franchise dealership; or
- independent dealership that meets certain criteria upon enrollment.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business Segment Information

We currently operate in one reportable segment which represents our core business of offering financing programs that enable Dealers to sell vehicles to consumers, regardless of their credit history. The consolidated financial statements reflect the financial results of our one reportable operating segment.

Cash, Cash Equivalents, Restricted Cash and Restricted Cash Equivalents

Cash equivalents consist of readily marketable securities with original maturities at the date of acquisition of three months or less. As of September 30, 2018 and December 31, 2017, we had $194.5 million and $7.8 million, respectively, in cash and cash equivalents that were not insured by the Federal Deposit Insurance Corporation ("FDIC").

Restricted cash and cash equivalents consist of cash pledged as collateral for secured financings and cash held in a trust for future vehicle service contract claims. As of September 30, 2018 and December 31, 2017, we had $347.0 million and $255.1 million, respectively, in restricted cash and cash equivalents that were not insured by the FDIC.

The following table provides a reconciliation of cash, cash equivalents, restricted cash and restricted cash equivalents reported in our consolidated balance sheets to the total shown in our consolidated statements of cash flows:

(In millions)	As of			
	September 30, 2018	December 31, 2017	September 30, 2017	December 31, 2016
Cash and cash equivalents	$ 195.7	$ 8.2	$ 4.9	$ 14.6
Restricted cash and cash equivalents	347.6	255.6	273.6	224.7
Total cash, cash equivalents, restricted cash and restricted cash equivalents	$ 543.3	$ 263.8	$ 278.5	$ 239.3

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (CONTINUED)
(UNAUDITED)

Restricted Securities Available for Sale

Restricted securities available for sale consist of amounts held in a trust for future vehicle service contract claims. We determine the appropriate classification of our investments in debt securities at the time of purchase and reevaluate such determinations at each balance sheet date. Debt securities for which we do not have the intent or ability to hold to maturity are classified as available for sale, and stated at fair value with unrealized gains and losses, net of income taxes included in the determination of comprehensive income and reported as a component of shareholders' equity.

Loans Receivable and Allowance for Credit Losses

Consumer Loan Assignment. For legal purposes, a Consumer Loan is considered to have been assigned to us after the following has occurred:

- the consumer and Dealer have signed a Consumer Loan contract; and
- we have received the executed Consumer Loan contract and supporting documentation in either physical or electronic form.

For accounting and financial reporting purposes, a Consumer Loan is considered to have been assigned to us after the following has occurred:

- the Consumer Loan has been legally assigned to us; and
- we have made a funding decision and generally have provided funding to the Dealer in the form of either an advance under the Portfolio Program or one-time purchase payment under the Purchase Program.

Portfolio Segments and Classes. We are considered to be a lender to our Dealers for Consumer Loans assigned under our Portfolio Program and a purchaser of Consumer Loans assigned under our Purchase Program. As a result, our Loan portfolio consists of two portfolio segments: Dealer Loans and Purchased Loans. Each portfolio segment is comprised of one class of Consumer Loan assignments, which is Consumer Loans originated by Dealers to finance purchases of vehicles and related ancillary products by consumers with impaired or limited credit histories.

Dealer Loans. Amounts advanced to Dealers for Consumer Loans assigned under the Portfolio Program are recorded as Dealer Loans and are aggregated by Dealer for purposes of recognizing revenue and evaluating impairment. We account for Dealer Loans based on forecasted cash flows instead of contractual cash flows as we do not expect to collect all of the contractually specified amounts due to the credit quality of the underlying Consumer Loans. The outstanding balance of each Dealer Loan included in Loans receivable is comprised of the following:

- the aggregate amount of all cash advances paid;
- finance charges;
- Dealer Holdback payments;
- accelerated Dealer Holdback payments; and
- recoveries.

Less:

- collections (net of certain collection costs);
- write-offs; and
- transfers.

An allowance for credit losses is maintained at an amount that reduces the net asset value (Dealer Loan balance less the allowance) to the value of forecasted future cash flows discounted at the yield established at the time of assignment. This allowance calculation is completed for each individual Dealer. Future cash flows are comprised of estimated future collections on the Consumer Loans, less any estimated Dealer Holdback payments. We write off Dealer Loans once there are no forecasted future cash flows on any of the associated Consumer Loans, which generally occurs 120 months after the last Consumer Loan assignment.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (CONTINUED)
(UNAUDITED)

Future collections on Dealer Loans are forecasted for each individual Dealer based on the historical performance of Consumer Loans with similar characteristics, adjusted for recent trends in payment patterns. Dealer Holdback is forecasted for each individual Dealer based on the expected future collections and current advance balance of each Dealer Loan. Cash flows from any individual Dealer Loan are often different than estimated cash flows at the time of assignment. If such difference is favorable, the difference is recognized prospectively into income over the remaining life of the Dealer Loan through a yield adjustment. If such difference is unfavorable, a provision for credit losses is recorded immediately as a current period expense and a corresponding allowance for credit losses is established. Because differences between estimated cash flows at the time of assignment and actual cash flows occur often, an allowance is required for a significant portion of our Dealer Loan portfolio. An allowance for credit losses does not necessarily indicate that a Dealer Loan is unprofitable, and seldom are cash flows from a Dealer Loan insufficient to repay the initial amounts advanced to the Dealer.

Purchased Loans. Amounts paid to Dealers for Consumer Loans assigned under the Purchase Program are recorded as Purchased Loans and are aggregated into pools based on the month of purchase for purposes of recognizing revenue and evaluating impairment. We account for Purchased Loans based on forecasted cash flows instead of contractual cash flows as we do not expect to collect all of the contractually specified amounts due to the credit quality of the assigned Consumer Loans. The outstanding balance of each Purchased Loan pool included in Loans receivable is comprised of the following:

- the aggregate amount of all amounts paid during the month of purchase to purchase Consumer Loans from Dealers;
- finance charges;
- recoveries; and
- transfers.

Less:
- collections (net of certain collection costs); and
- write-offs.

An allowance for credit losses is maintained at an amount that reduces the net asset value (Purchased Loan pool balance less the allowance) to the value of forecasted future cash flows discounted at the yield established at the time of assignment. This allowance calculation is completed for each individual monthly pool of Purchased Loans. Future cash flows are comprised of estimated future collections on the pool of Purchased Loans. We write off pools of Purchased Loans once there are no forecasted future cash flows on any of the Purchased Loans included in the pool, which generally occurs 120 months after the month of purchase.

Future collections on Purchased Loans are forecasted for each individual pool based on the historical performance of Consumer Loans with similar characteristics, adjusted for recent trends in payment patterns. Cash flows from any individual pool of Purchased Loans are often different than estimated cash flows at the time of assignment. If such difference is favorable, the difference is recognized prospectively into income over the remaining life of the pool of Purchased Loans through a yield adjustment. If such difference is unfavorable, a provision for credit losses is recorded immediately as a current period expense and a corresponding allowance for credit losses is established.

Under our Portfolio Program, certain events may result in Dealers forfeiting their rights to Dealer Holdback. We transfer the Dealer's outstanding Dealer Loan balance to Purchased Loans in the period this forfeiture occurs. During the fourth quarter of 2017, we enhanced our accounting methodology for transferring loans. Beginning in the fourth quarter of 2017, we:

- transfer the related Dealer Loan allowance for credit losses balance to Purchased Loans in the period this forfeiture occurs; and
- aggregate these Purchased Loans by Dealer for purposes of recognizing revenue and evaluating impairment.

Prior to the fourth quarter of 2017, we:

- reversed the Dealer Loan allowance for credit losses balance through Dealer Loan provision for credit losses and established a new allowance for credit losses in Purchased Loans through Purchased Loan provision for credit losses; and
- aggregated these Purchased Loans by month of purchase for purposes of recognizing revenue and evaluating impairment.

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Credit Quality. Substantially all of the Consumer Loans assigned to us are made to individuals with impaired or limited credit histories or higher debt-to-income ratios than are permitted by traditional lenders. Consumer Loans made to these individuals generally entail a higher risk of delinquency, default and repossession and higher losses than loans made to consumers with better credit. Since most of our revenue and cash flows are generated from these Consumer Loans, our ability to accurately forecast Consumer Loan performance is critical to our business and financial results. At the time the Consumer Loan is submitted to us for assignment, we forecast future expected cash flows from the Consumer Loan. Based on these forecasts, an advance or one-time purchase payment is made to the related Dealer at a price designed to maximize economic profit, a non-GAAP financial measure that considers our return on capital, our cost of capital and the amount of capital invested.

We monitor and evaluate the credit quality of Consumer Loans on a monthly basis by comparing our current forecasted collection rates to our initial expectations. We use a statistical model that considers a number of credit quality indicators to estimate the expected collection rate for each Consumer Loan at the time of assignment. The credit quality indicators considered in our model include attributes contained in the consumer's credit bureau report, data contained in the consumer's credit application, the structure of the proposed transaction, vehicle information and other factors. We continue to evaluate the expected collection rate of each Consumer Loan subsequent to assignment primarily through the monitoring of consumer payment behavior. Our evaluation becomes more accurate as the Consumer Loans age, as we use actual performance data in our forecast. Since all known, significant credit quality indicators have already been factored into our forecasts and pricing, we are not able to use any specific credit quality indicators to predict or explain variances in actual performance from our initial expectations. Any variances in performance from our initial expectations are the result of Consumer Loans performing differently than historical Consumer Loans with similar characteristics. We periodically adjust our statistical pricing model for new trends that we identify through our evaluation of these forecasted collection rate variances.

When overall forecasted collection rates underperform our initial expectations, the decline in forecasted collections has a more adverse impact on the profitability of the Purchased Loans than on the profitability of the Dealer Loans. For Purchased Loans, the decline in forecasted collections is absorbed entirely by us. For Dealer Loans, the decline in the forecasted collections is substantially offset by a decline in forecasted payments of Dealer Holdback.

Methodology Changes. For the three and nine months ended September 30, 2018 and 2017, we did not make any methodology changes for Loans that had a material impact on our financial statements.

Reinsurance

VSC Re Company ("VSC Re"), our wholly-owned subsidiary, is engaged in the business of reinsuring coverage under vehicle service contracts sold to consumers by Dealers on vehicles financed by us. VSC Re currently reinsures vehicle service contracts that are offered through one of our third party providers. Vehicle service contract premiums, which represent the selling price of the vehicle service contract to the consumer, less fees and certain administrative costs, are contributed to a trust account controlled by VSC Re. These premiums are used to fund claims covered under the vehicle service contracts. VSC Re is a bankruptcy remote entity. As such, our exposure to fund claims is limited to the trust assets controlled by VSC Re and our net investment in VSC Re.

Premiums from the reinsurance of vehicle service contracts are recognized over the life of the policy in proportion to expected costs of servicing those contracts. Expected costs are determined based on our historical claims experience. Claims are expensed through a provision for claims in the period the claim was incurred. Capitalized acquisition costs are comprised of premium taxes and are amortized as general and administrative expense over the life of the contracts in proportion to premiums earned.

We have consolidated the trust within our financial statements based on our determination of the following:

- We have a variable interest in the trust. We have a residual interest in the assets of the trust, which is variable in nature, given that it increases or decreases based upon the actual loss experience of the related service contracts. In addition, VSC Re is required to absorb any losses in excess of the trust's assets.
- The trust is a variable interest entity. The trust has insufficient equity at risk as no parties to the trust were required to contribute assets that provide them with any ownership interest.
- We are the primary beneficiary of the trust. We control the amount of premiums written and placed in the trust through Consumer Loan assignments under our Programs, which is the activity that most significantly impacts the economic performance of the trust. We have the right to receive benefits from the trust that could potentially be significant. In addition, VSC Re has the obligation to absorb losses of the trust that could potentially be significant.

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New Accounting Updates Adopted During the Current Year

Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118. In March 2018, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2018-05, which amended Accounting Standards Codification (“ASC”) Topic 740 (Income Taxes) for income tax accounting implications of the December 2017 Tax Cuts and Jobs Act ("2017 Tax Act"). ASU 2018-05 is effective for fiscal years, and interim periods, beginning in the reporting period that includes the enactment of the 2017 Tax Act. ASU 2018-05 provides guidance for entities under three scenarios: (1) Measurement of certain income tax effects is complete—an entity must reflect the tax effects of the 2017 Tax Act for which the accounting is complete; (2) Measurement of certain income tax effects can be reasonably estimated—an entity must report provisional amounts for those specific income tax effects of the 2017 Tax Act for which the accounting is incomplete but a reasonable estimate can be determined. Provisional amounts or adjustments to provisional amounts identified in the measurement period, as defined, should be included as an adjustment to tax expense or benefit from continuing operations in the period the amounts are determined; and (3) Measurement of certain income tax effects cannot be reasonably estimated—an entity is not required to report provisional amounts for any specific income tax effects of the 2017 Tax Act for which a reasonable estimate cannot be determined, and would continue to apply ASC Topic 740 based on the provisions of the tax laws that were in effect immediately prior to the enactment of the 2017 Tax Act. Entities would report the provisional amounts of the tax effects of the 2017 Tax Act in the first reporting period in which a reasonable estimate can be determined. ASU 2018-05 further provides that the measurement period is complete when a company's accounting is complete and in no circumstances should the measurement period extend beyond one year from the enactment date of the 2017 Tax Act. An entity may be able to complete the accounting under some provisions of the 2017 Tax Act earlier than others. As a result it may need to apply all three scenarios in determining the accounting for the 2017 Tax Act based on the information that is available. The ultimate impact of the 2017 Tax Act on our consolidated financial statements and related disclosures may differ from our current estimates, possibly materially, due to, among other things, changes in interpretations and assumptions we have made, guidance that may be issued, and other actions we may take as a result of the 2017 Tax Act that differ from those presently contemplated. For additional information, see Note 12 to the consolidated financial statements.

Restricted Cash. In November 2016, the FASB issued ASU 2016-18, which amended ASC Topic 230 (Statement of Cash Flows) and requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. ASU 2016-18 is intended to reduce diversity in practice in how restricted cash or restricted cash equivalents are presented and classified in the statement of cash flows. ASU 2016-18 is effective for fiscal years, and interim periods, beginning after December 15, 2017, with early adoption permitted. The standard required application using a retrospective transition method. The adoption of ASU 2016-18 on January 1, 2018 changed the presentation and classification of restricted cash and restricted cash equivalents in our consolidated statements of cash flows. In addition, since cash and restricted cash are presented on separate lines on our consolidated balance sheets, we enhanced the cash and restricted cash disclosures in our significant accounting policies in Note 3 to the consolidated financial statements to reconcile the totals in our consolidated statement of cash flows to the related line items in our consolidated balance sheets.

The following table reconciles the consolidated statement of cash flows line items impacted by the adoption of this standard on January 1, 2018:

(In millions)	For the Nine Months Ended September 30, 2017		
	Adjusted	ASU 2016-18 Adjustment	Previously Reported

Decrease (increase) in restricted cash and cash equivalents	$—	$ 48.9	$ (48.9)
Net cash used in investing activities	(640.4)	48.9	(689.3)
Net increase (decrease) in cash, cash equivalents, restricted cash and restricted cash equivalents	39.2	48.9	(9.7)
Cash, cash equivalents, restricted cash and restricted cash equivalents beginning of period	239.3	224.7	14.6
Cash, cash equivalents, restricted cash and restricted cash equivalents end of period	$278.5	$ 273.6	$ 4.9

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Recognition and Measurement of Financial Assets and Financial Liabilities. In January 2016, the FASB issued ASU 2016-01, which revised ASC Topic 825 (Financial Instruments) for the recognition, measurement, presentation and disclosure of financial instruments. ASU 2016-01 makes targeted improvements on how entities account for equity investments, present and disclose financial instruments and measure the valuation allowance on deferred tax assets related to available-for-sale debt securities. ASU 2016-01 is effective for fiscal years, and interim periods, beginning after December 15, 2017, with early adoption not permitted. The adoption of ASU 2016-01 on January 1, 2018 did not have a material impact on our consolidated financial statements.

Revenue from Contracts with Customers. In May 2014, the FASB issued ASU 2014-09, which superseded the revenue recognition requirements of ASC Topic 605 (Revenue Recognition), and most industry-specific guidance. ASU 2014-09 is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. ASU 2014-09 is only applicable to our other income source of revenue. Finance charges and premiums earned sources of revenue are outside the scope of this guidance. ASU 2014-09 permits two methods of adoption: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (modified retrospective method). In August 2015, the FASB issued ASU 2015-14 to defer the effective date of ASU 2014-09 by one year to fiscal years beginning after December 15, 2017. ASU 2015-14 also permits early adoption of ASU 2014-09, but not before the original effective date, which was for fiscal years beginning after December 15, 2016. We adopted ASU 2014-09, as amended by ASU 2015-14, on January 1, 2018 using the modified retrospective method. We assessed the impact of the new guidance by evaluating our contracts, identifying our performance obligations, determining when the performance obligations were satisfied to allow us to recognize revenue and determining the amount of revenue to recognize. As a result of this analysis, we determined that our recognition and measurement of other income will not change. The adoption of ASU 2014-09, as amended by ASU 2015-14, did not impact the timing of our revenue recognition; however it expanded our disclosures related to our other income source of revenue.

New Accounting Updates Not Yet Adopted

Accounting for Costs of Implementing Cloud Computing. In August 2018, the FASB issued ASU 2018-15, which reduces complexity in the accounting for costs of implementing a cloud computing service arrangement. This standard aligns the accounting for implementation costs of hosting arrangements, regardless of whether they convey a license to the hosted software. Under the current guidance, the classification of an arrangement as either a software license or a service contract determines whether or not we capitalize implementation costs. If an arrangement meets the definition of a software license, implementation costs are capitalized. If an arrangement meets the definition of a service contract, implementation costs are expensed as incurred. Under the new guidance, implementation costs will be capitalized regardless of their classification. ASU 2018-15 is effective for fiscal years, and interim periods, beginning after December 15, 2019. Early application is permitted, but we have not yet adopted ASU 2018-15. The adoption of ASU 2018-15 will change how we account for our cloud computing arrangements. However, we do not believe that its adoption will have a material impact on our consolidated financial statements and related disclosures.

Measurement of Credit Losses on Financial Instruments. In June 2016, the FASB issued ASU 2016-13, which included an impairment model (known as the current expected credit loss (“CECL”) model) that is based on expected losses rather than incurred losses. Under the new guidance, an entity recognizes an allowance for credit losses based on the difference between contractual future net cash flows and its estimate of expected future net cash flows. The

new guidance also changes the scope of the special accounting for loans acquired with significant credit deterioration. ASU 2016-13 is effective for fiscal years, and interim periods, beginning after December 15, 2019. Early application is permitted for fiscal years, and interim periods, beginning after December 15, 2018. We believe the adoption of ASU 2016-13 will have a material impact on our consolidated financial statements and related disclosures as it will change our accounting policies for Loans.

Application of CECL to Existing Loans

We believe that Loans outstanding prior to the adoption date would qualify for transition relief under ASU 2016-13 and would be accounted for as purchased financial assets with credit deterioration ("PCD Method"). Under the PCD Method, on the adoption date, we would:

- calculate an effective interest rate based on expected future net cash flows; and
- increase the Loans receivable and related allowance for credit losses balances by the present value of the difference between contractual future net cash flows and expected future net cash flows discounted at the effective interest rate. This "gross-up" would not impact the net carrying amount of Loans (Loans receivable less allowance for credit losses) or net income.

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For each reporting period subsequent to adoption, we would:

- recognize finance charge revenue using the effective interest rate that was calculated on the adoption date based on expected future net cash flows; and
- adjust the allowance for credit losses so that the net carrying amount of each Loan equals the present value of expected future net cash flows discounted at the effective interest rate. The adjustment to the allowance for credit losses would be recognized as either provision for credit losses expense or a reversal of provision for credit losses expense.

Application of CECL to Future Loans

We believe that Consumer Loans assigned subsequent to the adoption of ASU 2016-13 would not qualify for the PCD Method and would be accounted for as originated financial assets ("Originated Method"). While the cash flows we expect to collect at the time of assignment are significantly lower than the contractual cash flows owed to us due to credit quality, our Loans do not qualify for the PCD Method due to the following:

- the assignment of the Consumer Loan occurs a moment after the Consumer Loan is originated by the Dealer, so "a more-than-insignificant deterioration in credit quality since origination" has not occurred; and
- Consumer Loans assigned under the Portfolio Program are considered to be advances under Dealer Loans originated by us rather than Consumer Loans purchased by us.

Under the Originated Method, at the time of assignment, we would:

- calculate the effective interest rate based on contractual future net cash flows; and
- record an allowance for credit losses equal to the difference between the initial balance of the Loan (advance or purchase amount) and the present value of expected future net cash flows discounted at the effective interest rate. The initial allowance for credit losses would be recognized as provision for credit losses expense.

For each reporting period subsequent to assignment, we would:

- recognize finance charge revenue using the effective interest rate that was calculated at the time of assignment based on contractual future net cash flows; and
- adjust the allowance for credit losses so that the net carrying amount of each Loan equals the present value of expected future net cash flows discounted at the effective interest rate. The adjustment to the allowance for credit losses would be recognized as either provision for credit losses expense or a reversal of provision for credit losses expense.

We believe the Originated Method would result in financial reporting that is inconsistent with the economics of our Loans as:

- the effective interest rate would be significantly inflated for contractual amounts that were not expected to be collected at the time of assignment; and
- all expected credit losses, including significant credit losses that were expected at both the time of origination and the time of assignment, would be recognized as provision for credit losses expense, despite the fact that credit losses expected at the time of assignment do not represent an economic loss to us.

The net Loan income (finance charge revenue less provision for credit losses) that we will recognize over the life of a Loan equals the cash we collect from the underlying Consumer Loan less the cash we pay to the Dealer. While the total amount of net Loan income we would recognize over the life of the Loan is not impacted by the new guidance, the timing of when we would recognize this income changes significantly. We believe that recognizing net Loan income on a level-yield basis over the life of the Loan based on expected future net cash flows matches the economics of our business. The Originated Method diverges from economic reality by requiring us to recognize a significant

provision for credit losses at the time of assignment for amounts we never expected to realize and finance charge revenue in subsequent periods that is significantly in excess of our expected yields.

Election of the Fair Value Option for Future Loans

Under ASC 825, Financial Instruments, we have the ability to choose to measure Loans at fair value on an instrument-by-instrument basis at specified election dates, with changes in fair value reported in net income (the fair value option). Dealer Loans are only eligible for fair value election at the time a new active Dealer assigns the first Consumer Loan under the Portfolio Program. All Purchased Loans are eligible for fair value election at the time of assignment. The fair value election may not be revoked once an election is made.

Given that we believe CECL would result in financial reporting that is inconsistent with the economics of our Loans, we are evaluating the fair value option as an alternative to CECL for future Loans. The fair value of our Loans would be determined by calculating the present value of future expected net cash flows estimated by us utilizing a discount rate based on market participant discount rates for comparable investments. While we believe the fair value option would likely result in financial reporting that approximates the economics of our Loans in a stable rate environment, this option could cause our reported results to be volatile in periods when interest rates are rapidly changing. As a result, we are continuing to evaluate our alternatives with respect to the accounting methods that are or will be available to us.

Leases. In February 2016, the FASB issued ASU 2016-02, which required lessees to recognize a right-of-use asset and related lease liability for leases classified as operating leases at the commencement date that have lease terms of more than 12 months. This ASU retains the classification distinction between finance leases and operating leases. ASU 2016-02 is effective for fiscal years, and interim periods, beginning after December 15, 2018. Early application is permitted, but we have not yet adopted ASU 2016-02. This ASU requires application using a retrospective transition method. The impact on our consolidated balance sheets will be based on the present value of future lease payments, the amount of which will depend upon the population of leases in effect at the date of adoption. As of September 30, 2018, our population of leases consisted of operating leases for office space and office equipment with future minimum lease payments totaling $5.4 million. We do not expect material changes to the recognition of operating lease expense in our consolidated statements of income.

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4. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate their value.

Cash and Cash Equivalents and Restricted Cash and Cash Equivalents. The carrying amounts approximate their fair value due to the short maturity of these instruments.

Restricted Securities Available for Sale. The fair value of U.S. Government and agency securities and corporate bonds is based on quoted market values in active markets. For asset-backed securities, mortgage-backed securities and commercial paper, we use model-based valuation techniques for which all significant assumptions are observable in the market.

Loans Receivable, net. The fair value is determined by calculating the present value of future net cash flows estimated by us utilizing a discount rate comparable with the rate used to calculate our allowance for credit losses.

Revolving Secured Line of Credit. The fair value is determined by calculating the present value of the debt instrument based on current rates for debt with a similar risk profile and maturity.

Secured Financing. The fair value of our asset-backed secured financings ("Term ABS") is determined using quoted market prices; however, these instruments trade in a market with a low trading volume. For our warehouse facilities, the fair values are determined by calculating the present value of each debt instrument based on current rates for debt with similar risk profiles and maturities.

Senior Notes. The fair value is determined using quoted market prices in an active market.

Mortgage Note. The fair value is determined by calculating the present value of the debt instrument based on current rates for debt with a similar risk profile and maturity.

A comparison of the carrying value and estimated fair value of these financial instruments is as follows:

(In millions)	As of September 30, 2018		As of December 31, 2017	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Assets				
Cash and cash equivalents	$195.7	$ 195.7	$8.2	$ 8.2
Restricted cash and cash equivalents	347.6	347.6	255.6	255.6
Restricted securities available for sale	56.7	56.7	46.1	46.1
Loans receivable, net	5,557.6	5,650.7	4,619.6	4,741.5
Liabilities				
Revolving secured line of credit	$—	$ —	$13.9	$ 13.9
Secured financing	3,320.9	3,321.5	2,514.1	2,527.6
Senior notes	544.0	564.9	542.8	569.4
Mortgage note	12.0	12.0	—	—

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (CONTINUED)
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Fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. We group 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 at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates or assumptions that market participants would use in pricing the asset or liability.

The following table provides the level of measurement used to determine the fair value for each of our financial instruments measured or disclosed at fair value:

(In millions)

	As of September 30, 2018			
	Level 1	Level 2	Level 3	Total Fair Value
Assets				
Cash and cash equivalents (1)	$ 195.7	$ —	$ —	$ 195.7
Restricted cash and cash equivalents (1)	347.6	—	—	347.6
Restricted securities available for sale (2)	44.8	11.9	—	56.7
Loans receivable, net (1)	—	—	5,650.7	5,650.7
Liabilities				
Revolving secured line of credit (1)	$ —	$ —	$ —	$ —
Secured financing (1)	—	3,321.5	—	3,321.5
Senior notes (1)	564.9	—	—	564.9
Mortgage note (1)	—	12.0	—	12.0

(In millions)

	As of December 31, 2017			
	Level 1	Level 2	Level 3	Total Fair Value
Assets				
Cash and cash equivalents (1)	$ 8.2	$ —	$ —	$ 8.2
Restricted cash and cash equivalents (1)	255.6	—	—	255.6
Restricted securities available for sale (2)	37.1	9.0	—	46.1
Loans receivable, net (1)	—	—	4,741.5	4,741.5
Liabilities				
Revolving secured line of credit (1)	$ —	$ 13.9	$ —	$ 13.9

Secured financing (1)	—	2,527.6	—	2,527.6
Senior notes (1)	569.4	—	—	569.4

(1) Measured at amortized cost with fair value disclosed.
(2) Measured and recorded at fair value on a recurring basis.

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5. RESTRICTED SECURITIES AVAILABLE FOR SALE

Restricted securities available for sale consist of the following:

(In millions)	As of September 30, 2018							
	Amortized Cost	Gross Unrealized Gains		Gross Unrealized Losses	Estimated Fair Value			
Corporate bonds	$23.5	$ —	Inventories	$ (7,682)	$ 3,644	$(1,234)	$(1,357)	$(6,629)
Derivative assets (liabilities), net	$ (3,000)	$ (38)		$ —	$ —	$(3,038)		
Accounts payable	$ 1,264	$ 38		$ —	$ —	$1,302		

The impacts shown above have also been reflected in the Company’s condensed consolidated statements of comprehensive loss for the three and six months ended December 31, 2017 as follows:

	Three Months Ended December 31, 2017		Six Months Ended December 31, 2017	
(In thousands)	As Previously Reported	Retrospectively Adjusted	As Previously Reported	Retrospectively Adjusted
Net loss	$(18,768)	$ (17,060)	$(19,746)	$ (16,220)
Unrealized losses on derivative instruments designated as cash flow hedges, net of tax	$(1,279)	$ (1,279)	$(1,711)	$ (1,707)
Losses (gains) on derivative instruments designated as cash flow hedges reclassified to cost of goods sold, net of tax	$365	$ 64	$369	$ (708)
Total comprehensive loss, net of tax	$(19,682)	$ (18,275)	$(21,088)	$ (18,635)

Note 4. Acquisitions
Boyd Coffee Company
On October 2, 2017 (“Closing Date”), the Company acquired substantially all of the assets and certain specified liabilities of Boyd Coffee Company (“Boyd Coffee” or “Seller”), a coffee roaster and distributor with a focus on restaurants, hotels, and convenience stores on the West Coast of the United States. The acquired business of Boyd Coffee (the “Boyd Business”) is expected to add to the Company’s product portfolio, improve the Company’s growth potential, deepen the Company’s distribution footprint and increase the Company’s capacity utilization at its production facilities.

At closing, as consideration for the purchase, the Company paid the Seller $38.9 million in cash from borrowings under its senior secured revolving credit facility (see Note 13), and issued to Boyd Coffee 14,700 shares of the Company's Series A Convertible Participating Cumulative Perpetual Preferred Stock, par value $1.00 per share ("Series A Preferred Stock"), with a fair value of $11.8 million as of the Closing Date. Additionally, the Company held back $3.2 million in cash ("Holdback Cash Amount") and 6,300 shares of Series A Preferred Stock ("Holdback Stock") with a fair value of $4.8 million as of the Closing Date, for the satisfaction of any post-closing working capital adjustment and to secure the Seller's (and the other seller parties') indemnification obligations under the purchase agreement. Any Holdback Cash Amount and Holdback Stock not used to satisfy indemnification claims (including pending claims) will be released to the Seller on the 18-month anniversary of the Closing Date.

In addition to the Holdback Cash, as part of the consideration for the purchase, at closing the Company held back $1.1 million in cash (the "Multiemployer Plan Holdback") to pay, on behalf of the Seller, any assessment of withdrawal liability made against the Seller following the Closing Date in respect of the Seller's multiemployer pension plan, which amount was recorded on the Company's consolidated balance sheets in "Other current liabilities" and "Other long-term liabilities" at December 31, 2018 and June 30, 2018, respectively. See Note 16 and Note 17. On January 8, 2019, the Seller notified the Company of the assessment of $0.5 million in withdrawal liability against the Seller, which the Company paid from the Multiemployer Plan Holdback. See Note 23.

The acquisition was accounted for as a business combination. The fair value of consideration transferred was allocated to the tangible and intangible assets acquired and liabilities assumed based on their estimated fair values on the acquisition date, with the remaining unallocated amount recorded as goodwill. The fair value of consideration transferred reflected the Company's best estimate of the post-closing net working capital adjustment of $(8.1) million at June 30, 2018 when the purchase price allocation was finalized. On January 23, 2019, PricewaterhouseCoopers LLP ("PwC"), as the "Independent Expert" designated under the Asset Purchase Agreement to resolve working capital disputes, issued its determination letter with respect to adjustments to working capital. The post-closing net working capital adjustment, as determined by the Independent Expert, was ($6.3) million. See Note 23.

The following table summarizes the final allocation of consideration transferred as of the acquisition date:

(In thousands)	Fair Value	Estimated Useful Life (years)
Cash paid	$38,871	
Holdback Cash Amount	3,150	
Multiemployer Plan Holdback	1,056	
Fair value of Series A Preferred Stock (14,700 shares)(1)	11,756	
Fair value of Holdback Stock (6,300 shares)(1)	4,825	
Estimated post-closing net working capital adjustment	(8,059)	
Total consideration	$51,599	
Accounts receivable	$7,503	
Inventory	9,415	
Prepaid expense and other assets	1,951	
Property, plant and equipment	4,936	
Goodwill	25,395	
Intangible assets:		
Customer relationships	16,000	10
Trade name/trademark—indefinite-lived	3,100	
Accounts payable	(15,080)	

Other liabilities	(1,621)
Total consideration	$51,599

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Farmer Bros. Co.
Notes to Unaudited Condensed Consolidated Financial Statements (continued)

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(1) Fair value of Series A Preferred Stock and Holdback Stock as of the Closing Date, estimated as the sum of (a) the present value of the dividends payable thereon and (b) the stated value of the Series A Preferred Stock or Holdback Stock, as the case may be, adjusted for both the conversion premium and the discount for lack of marketability arising from conversion restrictions.

In connection with this acquisition, the Company recorded goodwill of $25.4 million, which is deductible for tax purposes. The Company also recorded $16.0 million in finite-lived intangible assets that included customer relationships and $3.1 million in indefinite-lived intangible assets that included a trade name/trademark. The amortization period for the finite-lived intangible assets is 10.0 years. See Note 11.

The determination of the fair value of intangible assets acquired was primarily based on significant inputs not observable in an active market and thus represent Level 3 fair value measurements as defined under GAAP.

The fair value assigned to the customer relationships was determined based on management's estimate of the retention rate utilizing certain benchmarks. Revenue and earnings projections were also significant inputs into estimating the value of customer relationships.

The fair value assigned to the trade name/trademark was determined utilizing a multi-period excess earnings approach. Under the multi-period excess earnings approach, the fair value of the intangible asset is estimated to be the present value of future earnings attributable to the asset and this method utilizes revenue and cost projections including an assumed contributory asset charge.

The following table presents the net sales and income before taxes from the Boyd Business operations that are included in the Company’s condensed consolidated statements of operations for the three and six months ended December 31, 2018 (unaudited):

(In thousands)	Three Months Ended December 31, 2018	Six Months Ended December 31, 2018
Net sales	$ 24,081	$ 44,584
Income before taxes	$ 3,505	$ 4,216

The Company considers the acquisition to be material to the Company’s financial statements and has provided certain pro forma disclosures pursuant to ASC 805, “Business Combinations.”

The following table sets forth certain unaudited pro forma financial results for the Company for the three and six months ended December 31, 2018 and 2017, as if the acquisition of the Boyd Business was consummated on the same terms as of the first day of the applicable fiscal period.

	Three Months Ended December 31,		Six Months Ended December 31,	
	2018	2017	2018	2017
(In thousands)				
Net sales	$159,773	$167,366	$307,213	321,061
(Loss) income before taxes	$(12,825)	$2,142	$(17,098)	3,900

At closing, the parties entered into a transition services agreement where the Seller agreed to provide certain accounting, marketing, human resources, information technology, sales and distribution and other administrative support during a transition period of up to 12 months. The Company also entered into a co-manufacturing agreement with the Seller for a transition period of up to 12 months as the Company transitioned production into its plants. Amounts paid by the Company to the Seller for these services totaled $3.7 million in the three and six months ended December 31, 2018 and $9.2 million in the three and six months ended December 31, 2017. The transition services and co-manufacturing agreements expired on October 2, 2018.

The Company has incurred acquisition and integration costs related to the Boyd Business acquisition, consisting primarily of legal and consulting expenses, Boyd Coffee plant decommissioning and equipment relocation costs, and one-time payroll and benefit expenses of $2.7 million and $1.0 million during the three months ended December 31, 2018 and

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2017, respectively, and $3.7 million and $3.4 million during the six months ended December 31, 2018 and 2017, respectively. These expenses are included in operating expenses in the Company's condensed consolidated statements of operations.

Note 5. Restructuring Plans

Corporate Relocation Plan

On February 5, 2015, the Company announced a plan (the “Corporate Relocation Plan”) to close its Torrance, California facility (the “Torrance Facility”) and relocate its corporate headquarters, product development lab, and manufacturing and distribution operations from Torrance, California to a new facility in Northlake, Texas (the “New Facility”). Approximately 350 positions were impacted as a result of the Torrance Facility closure. The Company’s decision resulted from a comprehensive review of alternatives designed to make the Company more competitive and better positioned to capitalize on growth opportunities.

In the three and six months ended December 31, 2018, the Company incurred $3.4 million in restructuring and other transition expenses associated with the assessment by the Western Conference of Teamsters Pension Trust (the “WCT Pension Trust”) of the Company’s share of the Western Conference of Teamsters Pension Plan (the “WCTPP”) unfunded benefits due to the Company’s partial withdrawal from the WCTPP as a result of employment actions taken by the Company in 2016 in connection with the Corporate Relocation Plan (see Note 12), of which the Company has paid $0.8 million and has outstanding contractual obligations of $2.6 million as of December 31, 2018 (see Note 22).

Since the adoption of the Corporate Relocation Plan through December 31, 2018, the Company has recognized a total of $35.2 million in aggregate cash costs including $17.4 million in employee retention and separation benefits, $3.4 million in pension withdrawal liability, $7.0 million in facility-related costs related to the temporary office space, costs associated with the move of the Company’s headquarters, relocation of the Company’s Torrance operations and certain distribution operations and $7.4 million in other related costs. The Company also recognized from inception through December 31, 2018 non-cash depreciation expense of $2.3 million associated with the Torrance production facility resulting from the consolidation of coffee production operations with the Houston and Portland production facilities and $1.4 million in non-cash rent expense recognized in the sale-leaseback of the Torrance Facility.

Direct Store Delivery (“DSD”) Restructuring Plan

On February 21, 2017, the Company announced a restructuring plan to reorganize its DSD operations in an effort to realign functions into a channel-based selling organization, streamline operations, acquire certain channel specific expertise, and improve selling effectiveness and financial results (the “DSD Restructuring Plan”). The strategic decision to undertake the DSD Restructuring Plan resulted from an ongoing operational review of various initiatives within the DSD selling organization. The Company expects to complete the DSD Restructuring Plan by the end of fiscal 2019.

The Company estimates that it will recognize approximately $4.9 million of pre-tax restructuring charges by the end of fiscal 2019 consisting of approximately $2.7 million in employee-related costs and contractual termination payments, including severance, prorated bonuses for bonus eligible employees and outplacement services, and $2.2 million in other related costs, including legal, recruiting, consulting, other professional services, and travel. The Company may also incur other charges not currently contemplated due to events that may occur as a result of, or associated with, the DSD Restructuring Plan.

The Company incurred expenses related to the DSD Restructuring Plan in the amounts of $0.2 million and $0, in employee-related costs and $0 and $0.1 million, in other related costs for three months ended December 31, 2018 and 2017, respectively, and $1.2 million and $24,000, in employee-related costs and $0.2 million and $0.2 million, in other related costs for the six months ended December 31, 2018 and 2017, respectively. Since the adoption of the DSD Restructuring Plan through December 31, 2018, the Company has recognized a total of $4.4 million in aggregate cash costs including $2.5 million in employee-related costs, and $1.9 million in other related costs. As of December 31, 2018, the Company had paid a total of $4.2 million of these costs, and had a balance of $0.3 million in DSD Restructuring Plan-related liabilities on the Company’s condensed consolidated balance sheet. The remaining

costs are expected to be incurred in the remainder of fiscal 2019.

Note 6. Derivative Instruments

Derivative Instruments Held

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Coffee-Related Derivative Instruments

The Company is exposed to commodity price risk associated with its price to be fixed green coffee purchase contracts, which are described further in Note 2 to the consolidated financial statements in the 2018 Form 10-K. The Company utilizes forward and option contracts to manage exposure to the variability in expected future cash flows from forecasted purchases of green coffee attributable to commodity price risk. Certain of these coffee-related derivative instruments utilized for risk management purposes have been designated as cash flow hedges, while other coffee-related derivative instruments have not been designated as cash flow hedges or do not qualify for hedge accounting despite hedging the Company's future cash flows on an economic basis.

The following table summarizes the notional volumes for the coffee-related derivative instruments held by the Company at December 31, 2018 and June 30, 2018:

(In thousands)	December 31, 2018	June 30, 2018
Derivative instruments designated as cash flow hedges:		
Long coffee pounds	31,350	40,913
Derivative instruments not designated as cash flow hedges:		
Long coffee pounds	7,145	2,546
Total	38,495	43,459

Coffee-related derivative instruments designated as cash flow hedges outstanding as of December 31, 2018 will expire within 18 months.

Effect of Derivative Instruments on the Financial Statements

Balance Sheets

Fair values of derivative instruments on the Company's condensed consolidated balance sheets:

	Derivative Instruments Designated as Cash Flow Hedges		Derivative Instruments Not Designated as Accounting Hedges	
	December 31, 2018	June 30, 2018	December 31, 2018	June 30, 2018
(In thousands)				
Financial Statement Location:				
Short-term derivative assets(1):				
Coffee-related derivative instruments	$5	$—	$12	$—
Short-term derivative liabilities(1):				
Coffee-related derivative instruments	$2,661	$3,081	$1,557	$219
Long-term derivative liabilities(2):				
Coffee-related derivative instruments	$322	$386	$—	$—

(1) Included in "Short-term derivative liabilities" on the Company's condensed consolidated balance sheets.
(2) Included in "Other long-term liabilities" on the Company's condensed consolidated balance sheets.

Statements of Operations

The following table presents pretax net gains and losses on coffee-related derivative instruments designated as cash flow hedges, as recognized in accumulated other comprehensive income (loss) "AOCI" and "Cost of goods sold" (prior period amounts have been retrospectively adjusted to reflect the impact of certain changes in accounting principles and corrections to previously issued financial statements as described in Note 3).

	Three Months Ended December 31,		Six Months Ended December 31,		Financial Statement Classification
(In thousands)	2018	2017	2018	2017	
Net gains (losses) recognized in AOCI	$1,005	$(2,094)	$(7,188)	$(2,453)	AOCI
Net losses recognized in earnings	$(2,217)	$(105)	$(4,179)	$1,161	Costs of goods sold

For the three and six months ended December 31, 2018 and 2017, there were no gains or losses recognized in earnings as a result of excluding amounts from the assessment of hedge effectiveness or as a result of reclassifications to earnings following the discontinuance of any cash flow hedges.

Net gains on derivative instruments and investments in the Company's condensed consolidated statements of cash flows also include net gains and losses on coffee-related derivative instruments designated as cash flow hedges reclassified to cost of goods sold from AOCI in the three and six months ended December 31, 2018 and 2017. Gains and losses on derivative instruments not designated as accounting hedges are included in "Other, net" in the Company's condensed consolidated statements of operations and in "Net losses (gains) on derivative instruments and investments" in the Company's condensed consolidated statements of cash flows.

Net gains and losses recorded in "Other, net" are as follows:

	Three Months Ended December 31,		Six Months Ended December 31,	
(In thousands)	2018	2017	2018	2017
Net losses on coffee-related derivative instruments(1)	$(920)	$(190)	$(2,025)	$(93)
Net gains on investments	—	16	—	7
Non-operating pension and other postretirement benefit plans cost(2)	1,763	1,663	3,526	3,326
Other gains, net	110	728	109	727
Other, net	$953	$2,217	$1,610	$3,967

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(1) Excludes net gains and losses on coffee-related derivative instruments designated as cash flow hedges recorded in cost of goods sold in the three and six months ended December 31, 2018 and 2017.

(2) Presented in accordance with newly implemented ASU 2017-07. See Note 2.

Offsetting of Derivative Assets and Liabilities

The Company has agreements in place that allow for the financial right of offset for derivative assets and liabilities at settlement or in the event of default under the agreements. Additionally, the Company maintains accounts with its brokers to facilitate financial derivative transactions in support of its risk management activities. Based on the value of the Company's positions in these accounts and the associated margin requirements, the Company may be required to deposit cash into these broker accounts.

The following table presents the Company’s net exposure from its offsetting derivative asset and liability positions, as well as cash collateral on deposit with its counterparties as of the reporting dates indicated:

(In thousands)		Gross Amount Reported on Balance Sheet	Netting Adjustments	Cash Collateral Posted	Net Exposure
December 31, 2018	Derivative Assets	$ 17	$ (17)	$ —	$ —
	Derivative Liabilities	$ 4,540	$ 17	$ —	$ 4,557
June 30, 2018	Derivative Assets	$ —	$ —	$ —	$ —
	Derivative Liabilities	$ 3,686	$ —	$ —	$ 3,686

Cash Flow Hedges

Changes in the fair value of the Company’s coffee-related derivative instruments designated as cash flow hedges, to the extent effective, are deferred in AOCI and reclassified into cost of goods sold in the same period or periods in which the hedged forecasted purchases affect earnings, or when it is probable that the hedged forecasted transaction will not occur by the end of the originally specified time period. Based on recorded values at December 31, 2018, $(9.7) million of net losses on coffee-related derivative instruments designated as cash flow hedges are expected to be reclassified into cost of goods sold within the next twelve months. These recorded values are based on market prices of the commodities as of December 31, 2018. Due to the volatile nature of commodity prices, actual gains or losses realized within the next twelve months will likely differ from these values. At December 31, 2018 and June 30, 2018 approximately 81% and 94%, respectively, of the Company's outstanding coffee-related derivative instruments were designated as cash flow hedges.

Note 7. Fair Value Measurements

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

(In thousands)	Total	Level 1	Level 2	Level 3
December 31, 2018				
Derivative instruments designated as cash flow hedges:				
Coffee-related derivative assets(1)	$5	$ —	$5	$ —
Coffee-related derivative liabilities(1)	$2,983	$ —	$2,983	$ —
Derivative instruments not designated as accounting hedges:				
Coffee-related derivative assets(1)	$12	$ —	$12	$ —
Coffee-related derivative liabilities(1)	$1,557	$ —	$1,557	$ —

(In thousands)	Total	Level 1	Level 2	Level 3
June 30, 2018				
Derivative instruments designated as cash flow hedges:				
Coffee-related derivative liabilities(1)	$3,467	$ —	$3,467	$ —
Derivative instruments not designated as accounting hedges:				
Coffee-related derivative liabilities(1)	$219	$ —	$219	$ —

(1) The Company’s coffee-related derivative instruments are traded over-the-counter and, therefore, classified as Level 2.

Note 8. Accounts Receivable, Net

(In thousands)	December 31, 2018	June 30, 2018

Trade receivables	$76,738	$54,547
Other receivables(1)	4,551	4,446
Allowance for doubtful accounts	(1,839)	(495)
Accounts receivable, net	$79,450	$58,498

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(1) Includes vendor rebates, earn out receivables and other non- trade receivables.

The $1.3 million increase in the allowance for doubtful accounts during the six months ended December 31, 2018 was due to bad debt expense of $1.6 million associated with an increase in aging receivables offset by net accounts receivable write-offs of $0.3 million.

Note 9. Inventories

(In thousands)	December 31, 2018	June 30, 2018
Coffee		
Processed	$32,933	$26,882
Unprocessed	42,165	37,097
Total	$75,098	$63,979
Tea and culinary products		
Processed	$33,847	$32,406
Unprocessed	102	1,161
Total	$33,949	$33,567
Coffee brewing equipment parts	$6,493	$6,885
Total inventories	$115,540	$104,431

In addition to product cost, inventory costs include expenditures such as direct labor and certain supply, freight, warehousing, overhead variances, PPVs and other expenses incurred in bringing the inventory to its existing condition and location. See Note 3. The “Unprocessed” inventory values as stated in the above table represent the value of raw materials and the “Processed” inventory values represent all other products consisting primarily of finished goods.

Note 10. Property, Plant and Equipment

(In thousands)	December 31, 2018	June 30, 2018
Buildings and facilities	$108,675	$108,590
Machinery and equipment	245,858	231,581
Equipment under capital leases	1,369	1,408
Capitalized software	26,070	24,569
Office furniture and equipment	13,795	13,721
	$395,767	$379,869
Accumulated depreciation	(218,359)	(209,498)
Land	16,218	16,218
Property, plant and equipment, net	$193,626	$186,589

The Company capitalized coffee brewing equipment (included in machinery and equipment) in the amounts of $8.9 million and $4.8 million in the six months ended December 31, 2018 and 2017, respectively. Depreciation expense related to capitalized coffee brewing equipment reported in cost of goods sold was $2.2 million and $2.3 million in the three months ended December 31, 2018 and 2017, respectively, and $4.4 million in each of the six months ended December 31, 2018 and 2017.

Note 11. Goodwill and Intangible Assets

There were no changes to the carrying value of goodwill in the six months ended December 31, 2018. The carrying value of goodwill at December 31, 2018 and June 30, 2018 was $36.2 million.

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The following is a summary of the Company’s amortized and unamortized intangible assets other than goodwill:

	December 31, 2018		June 30, 2018	
(In thousands)	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortized intangible assets:				
Customer relationships	$33,003	$ (14,096)	$33,003	$ (12,903)
Non-compete agreements	220	(102)	220	(81)
Recipes	930	(287)	930	(221)
Trade name/brand name	510	(327)	510	(271)
Total amortized intangible assets	$34,663	$ (14,812)	$34,663	$ (13,476)
Unamortized intangible assets:				
Trademarks, trade names and brand name with indefinite lives	$10,328	$ —	$10,328	$ —
Total unamortized intangible assets	$10,328	$ —	$10,328	$ —
Total intangible assets	$44,991	$ (14,812)	$44,991	$ (13,476)

Aggregate amortization expense for the three months ended December 31, 2018 and 2017 was $0.7 million and $1.1 million, respectively. Aggregate amortization expense for the six months ended December 31, 2018 and 2017 was $1.3 million and $1.4 million, respectively.

Note 12. Employee Benefit Plans

The Company provides benefit plans for full-time employees who work 30 hours or more per week, including 401(k), health and other welfare benefit plans and, in certain circumstances, pension benefits. Generally, the plans provide health benefits after 30 days and other retirement benefits based on years of service and/or a combination of years of service and earnings. In addition, the Company contributes to two multiemployer defined benefit pension plans, one multiemployer defined contribution pension plan and nine multiemployer defined contribution plans other than pension plans that provide medical, vision, dental and disability benefits for active, union-represented employees subject to collective bargaining agreements. In addition, the Company sponsors a postretirement defined benefit plan that covers qualified non-union retirees and certain qualified union retirees and provides retiree medical coverage and, depending on the age of the retiree, dental and vision coverage. The Company also provides a postretirement death benefit to certain of its employees and retirees.

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

Single Employer Pension Plans

As of December, 31, 2018, the Company has two defined benefit pension plans for certain employees (the “Brewmatic Plan” and the “Hourly Employees’ Plan”). Effective October 1, 2016, the Company froze benefit accruals and participation in the Hourly Employees’ Plan. After the plan freeze, participants do not accrue any benefits under the plan, and new hires are not eligible to participate in the plan.

Effective December 1, 2018 the Company amended and terminated the Farmer Bros. Co. Pension Plan for Salaried Employees (the “Farmer Bros. Plan”), a defined benefit pension plan for Company employees hired prior to January 1, 2010 who were not covered under a collective bargaining agreement. The Company previously amended the Farmer Bros. Plan, freezing the benefit for all participants effective June 30, 2011.

Immediately prior to the termination of the Farmer Bros. Plan, the Company spun off the benefit liability and obligations, and all allocable assets for all retirement plan benefits of certain active employees with accrued benefits

in excess of $25,000, retirees and beneficiaries currently receiving benefit payments under the Farmer Bros. Plan, and former employees who have deferred vested benefits under the Farmer Bros. Plan to the Brewmatic Plan. Upon termination of the Farmer Bros. Plan, all remaining plan participants elected to receive a distribution of his/her entire accrued benefit under the

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Farmer Bros. Plan in a single cash lump sum or an individual insurance company annuity contract, in either case, funded directly by Farmer Bros. Plan assets.

Termination of the Farmer Bros. Plan triggered re-measurement and settlement of the Farmer Bros. Plan and re-measurement of the Brewmatic Plan. As a result of the distributions to the remaining plan participants of the Farmer Bros. Plan, the Company reduced its overall pension projected benefit obligation by approximately $24.4 million and recognized a non-cash pension settlement charge of $8.1 million after-tax ($10.9 million pretax) in the three and six months ended December 31, 2018. After the re-measurement and settlement, the new projected benefit obligation and fair value of plan assets for the Brewmatic Plan are $114.1 million and $67.4 million, respectively, resulting in a net underfunded status of $46.7 million as of December 31, 2018. This represents a $6.7 million increase from the net underfunded status of the Farmer Bros. Plan and Brewmatic Plan as of June 30, 2018 primarily due to actual losses recognized on plan assets during the six months ended December 31, 2018. The Hourly Employees' Plan was not impacted by this transaction.

The net periodic benefit cost for the defined benefit pension plans is as follows:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2018	2017	2018	2017
(In thousands)				
Service cost	$—	$—	$—	$—
Interest cost	1,426	1,432	2,852	2,864
Expected return on plan assets	(1,485)	(1,456)	(2,970)	(2,912)
Amortization of net loss(1)	370	418	740	836
Pension settlement charge	10,948	—	10,948	—
Net periodic benefit cost	$11,259	$394	$11,570	$788

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(1) These amounts represent the estimated portion of the net loss in AOCI that is expected to be recognized as a component of net periodic benefit cost over the current fiscal year.

On July 1, 2018, the Company adopted ASU 2017-07, which impacted the presentation of the components of net periodic benefit cost in the condensed consolidated statements of income. Net periodic benefit cost, other than the service cost component, is retrospectively included in "Interest expense" and "Other, net" in the condensed consolidated statements of income. See Note 2.

Weighted-Average Assumptions Used to Determine Net Periodic Benefit Cost

	Fiscal	
	2019	2018
Discount rate	4.05%	3.80%
Expected long-term return on plan assets	6.75%	6.75%

Basis Used to Determine Expected Long-Term Return on Plan Assets

The expected long-term return on plan assets assumption was developed as a weighted average rate based on the target asset allocation of the plan and the Long-Term Capital Market Assumptions (CMA) 2016. The capital market assumptions were developed with a primary focus on forward-looking valuation models and market indicators. The key fundamental economic inputs for these models are future inflation, economic growth, and interest rate environment. Due to the long-term nature of the pension obligations, the investment horizon for the CMA 2016 is 20 to 30 years. In addition to forward-looking models, historical analysis of market data and trends was reflected, as well

as the outlook of recognized economists, organizations and consensus CMA from other credible studies.

Multiemployer Pension Plans

The Company participates in two multiemployer defined benefit pension plans that are union sponsored and collectively bargained for the benefit of certain employees subject to collective bargaining agreements, of which the WCTPP is individually significant. The Company makes contributions to these plans generally based on the number of hours worked by the participants in accordance with the provisions of negotiated labor contracts.

The risks of participating in multiemployer pension plans are different from single-employer plans in that: (i) assets contributed to a multiemployer plan by one employer may be used to provide benefits to employees of other participating employers; (ii) if a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers; and (iii) if the Company stops participating in the multiemployer plan, the Company may be required to pay the plan an amount based on the underfunded status of the plan, referred to as a withdrawal liability.

On October 30, 2017, counsel to the Company received written confirmation that the WCT Pension Trust will be retracting its claim, stated in its letter to the Company dated July 10, 2017 (the “WCT Pension Trust Letter”), that certain of the Company’s employment actions in 2015 resulting from the Corporate Relocation Plan constituted a partial withdrawal from the WCTPP. The written confirmation stated that the WCT Pension Trust has determined that a partial withdrawal did not occur in 2015 and further stated that the withdrawal liability assessment has been rescinded. This rescinding of withdrawal liability assessment applied to Company employment actions in 2015 with respect to the bargaining units that were specified in the WCT Pension Trust Letter.

The Company received a letter dated July 10, 2018 from the WCT Pension Trust assessing withdrawal liability against the Company for a share of the WCTPP unfunded vested benefits, on the basis claimed by the WCT Pension Trust that employment actions by the Company in 2016 in connection with the Corporate Relocation Plan constituted a partial withdrawal from the WCTPP. The Company agreed with the WCT Pension Trust’s assessment of pension withdrawal liability in the amount of $3.4 million, including interest, which is payable in 17 monthly installments of $190,507 followed by a final monthly installment of $153,822, commencing September 10, 2018. At December 31, 2018 the Company had recorded $2.6 million on its condensed consolidated balance sheet relating to this obligation, with the current portion included in “Accrued payroll expenses” and the long-term portion included in “Accrued pension liabilities.” See Note 22.

In fiscal 2012, the Company withdrew from the Local 807 Labor-Management Pension Fund (“Local 807 Pension Fund”) and recorded a charge of $4.3 million associated with withdrawal from this plan, representing the present value of the estimated withdrawal liability expected to be paid in quarterly installments of $0.1 million over 80 quarters. On November 18, 2014, the Local 807 Pension Fund sent the Company a notice of assessment of withdrawal liability in the amount of $4.4 million, which the Local 807 Pension Fund adjusted to $4.9 million on January 5, 2015. The Company commenced quarterly installment payments to the Local 807 Pension Fund of $91,000 pending the final settlement of the liability. The Company recorded $3.8 million in “Other current liabilities” on its consolidated balance sheet at June 30, 2018 representing the present value of the Company’s estimated withdrawal liability at June 30, 2018. During the three months ended December 31, 2018, the parties agreed to settle the Company’s remaining withdrawal liability to the Local 807 Pension Fund for a lump sum cash settlement payment of $3.0 million plus two remaining installment payments of $91,000 due on or before October 1, 2034 and on or before January 1, 2035. In the three and six months ended December 31, 2018, the Company paid the Local 807 Pension Fund $3.0 million and recorded $0.2 million in “Accrued pension liabilities” on the Company’s condensed consolidated balance sheet at December 31, 2018.

Future collective bargaining negotiations may result in the Company withdrawing from the remaining multiemployer pension plans in which it participates and, if successful, the Company may incur a withdrawal liability, the amount of which could be material to the Company’s results of operations and cash flows.

Multiemployer Plans Other Than Pension Plans

The Company participates in nine multiemployer defined contribution plans other than pension plans that provide medical, vision, dental and disability benefits for active, union-represented employees subject to collective bargaining agreements. The plans are subject to the provisions of the Employee Retirement Income Security Act of 1974, and provide that participating employers make monthly contributions to the plans in an amount as specified in the collective bargaining agreements. Also, the plans provide that participants make self-payments to the plans, the

amounts of which are negotiated through the collective bargaining process. The Company’s participation in these plans is governed by collective bargaining agreements which expire on or before June 30, 2022.

401(k) Plan

The Company’s 401(k) Plan is available to all eligible employees. Participants in the 401(k) Plan may choose to contribute a percentage of their annual pay subject to the maximum contribution allowed by the Internal Revenue Service.

For the calendar years 2018 and 2017, the Company's Board of Directors approved a Company matching contribution for eligible employees who worked more than 1,000 hours during the calendar year and who were employed at the end of the calendar year or, in the case of calendar year 2018, who were active participants in the plan at any time during the plan year and who were terminated in connection with certain reductions-in-force that occurred during 2018, of 50% of an employee's annual contribution to the 401(k) Plan, up to 6% of the employee's eligible income. For employees subject to a collective bargaining agreement, the match was only available if so provided in the labor agreement. The matching contributions (and any earnings thereon) vest at the rate of 20% for each of the participant's first 5 years of vesting service, so that a participant is fully vested in his or her matching contribution account after 5 years of vesting service, subject to accelerated vesting under certain circumstances in connection with the Corporate Relocation Plan due to the closure of the Company's Torrance Facility, a reduction-in-force at another Company facility designated by the Administrative Committee of the Farmer Bros. Co. Qualified Employee Retirement Plans (the "Administrative Committee"), or in connection with certain reductions-in-force that occurred during 2017 and 2018. A participant is automatically vested in the Company's matching contribution in the event of death, disability or attainment of age 65 while employed by the Company.

The Company recorded matching contributions of $0.4 million and $0.5 million in operating expenses in the three months ended December, 2018 and 2017. The Company recorded matching contributions of $0.9 million and $1.0 million in operating expenses in the six months ended December, 2018 and 2017.

During the three months ended December 31, 2018, the Company amended and restated the 401(k) Plan effective January 1, 2019 to, among other things, provide for: (i) an annual safe harbor non-elective contribution of shares of the Company's common stock equal to 4% of each eligible participant's annual plan compensation; (ii) an elective matching contribution for non-collectively bargained employees and members of union local 265 equal to 100% of the first 3% of such eligible participant's tax-deferred contributions to the 401(k) Plan; and (iii) profit-sharing contributions at the Company's discretion. Participants are immediately vested in their contributions, the safe harbor non-elective contributions, the employer's elective matching contributions, and the employer's discretionary contributions.

Postretirement Benefits

The Company sponsors a postretirement defined benefit plan that covers qualified non-union retirees and certain qualified union retirees ("Retiree Medical Plan"). The plan provides medical, dental and vision coverage for retirees under age 65 and medical coverage only for retirees age 65 and above. 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, subject to a maximum monthly Company contribution.

The Company also provides a postretirement death benefit ("Death Benefit") to certain of its employees and retirees, subject, in the case of current employees, to continued employment with the Company until retirement and certain other conditions related to the manner of employment termination and manner of death. The Company records the actuarially determined liability for the present value of the postretirement death benefit. The Company has purchased life insurance policies to fund the postretirement death benefit wherein the Company owns the policy but the postretirement death benefit is paid to the employee's or retiree's beneficiary. The Company records an asset for the fair value of the life insurance policies which equates to the cash surrender value of the policies.

Retiree Medical Plan and Death Benefit

The following table shows the components of net periodic postretirement benefit cost for the Retiree Medical Plan and Death Benefit for the three and six months ended December 31, 2018 and 2017. Net periodic postretirement benefit cost for the three and six months ended December 31, 2018 was based on employee census information and asset information as of June 30, 2018.

	Three Months Ended December 31,		Six Months Ended December 31,	
	2018	2017	2018	2017
(In thousands)				
Components of Net Periodic Postretirement Benefit Cost (Credit):				
Service cost	$133	$152	$266	$304
Interest cost	222	209	444	418
Amortization of net gain	(209)	(210)	(418)	(420)
Amortization of prior service credit	(439)	(439)	(878)	(878)
Net periodic postretirement benefit credit	$(293)	$(288)	$(586)	$(576)

On July 1, 2018, the Company adopted ASU 2017-07, which impacted the presentation of the components of net periodic postretirement benefit cost in the condensed consolidated statements of income. Net periodic postretirement benefit cost, other than the service cost component, is retrospectively included in "Interest expense" and "Other, net" in the condensed consolidated statements of income. See Note 2.

Weighted-Average Assumptions Used to Determine Net Periodic Postretirement Benefit Cost

	Fiscal	
	2019	2018
Retiree Medical Plan discount rate	4.25%	4.13%
Death Benefit discount rate	4.25%	4.12%

Note 13. Revolving Credit Facility

On November 6, 2018, the Company entered into a new $150.0 million senior secured revolving credit facility (the "New Revolving Facility") with Bank of America, N.A, Citibank, N.A., JPMorgan Chase Bank, N.A., PNC Bank, National Association, Regions Bank, and SunTrust Bank, with a sublimit on letters of credit and swingline loans of $15.0 million each. The New Revolving Facility includes an accordion feature whereby the Company may increase the revolving commitments or enter into one or more tranches of incremental term loans, up to an additional $75.0 million in aggregate of increased commitments and incremental term loans, subject to certain conditions. The commitment fee is based on a leverage grid and ranges from 0.20% to 0.40%. Borrowings under the New Revolving Facility bear interest based on a leverage grid with a range of PRIME + 0.25% to PRIME + 0.875% or Adjusted LIBO Rate + 1.25% to Adjusted LIBO Rate + 1.875%. Under the New Revolving Facility, the Company is subject to a variety of affirmative and negative covenants of types customary in a senior secured lending facility, including financial covenants relating to leverage and interest expense coverage. The Company is allowed to pay dividends, provided, among other things, a total net leverage ratio is met, and no default exists or has occurred and is continuing as of the date of any such payment and after giving effect thereto. The New Revolving Facility matures on November 6, 2023, subject to the ability for the Company (subject to certain conditions) to agree with lenders who so consent to extend the maturity date of the commitments of such consenting lenders for a period of one year, such option being exercisable not more than two times during the term of the facility.

The New Revolving Facility replaced, by way of amendment and restatement, the Company's senior secured revolving credit facility (the "Prior Revolving Facility") with JPMorgan Chase Bank, N.A. and SunTrust Bank, with revolving commitments of $125.0 million as of September 30, 2018 and $135.0 million as of October 18, 2018 (the "Third

Amendment Effective Date”), subject to an accordion feature. Under the Prior Revolving Facility, as amended, advances were based on the Company’s eligible accounts receivable, eligible inventory, eligible equipment, the value of certain real property and trademarks, and an amount based on the lesser of $10.0 million (subject to monthly reduction) and the sum of certain eligible accounts and eligible inventory, less required reserves. The commitment fee was a flat fee of 0.25% per

Farmer Bros. Co.
Notes to Unaudited Condensed Consolidated Financial Statements (continued)

annum irrespective of average revolver usage. Outstanding obligations were collateralized by all of the Company's and guarantors' assets, excluding, amongst other things, certain real property not included in the borrowing base. Borrowings under the Prior Revolving Facility bore interest based on average historical excess availability levels with a range of PRIME - 0.25% to PRIME + 0.50% or Adjusted LIBO Rate + 1.25% to Adjusted LIBO Rate + 2.00%; provided, that, after the Third Amendment Effective Date, (i) until March 31, 2019 the applicable rate was PRIME + 0.25% or Adjusted LIBO Rate + 1.75%; and (ii) loans up to certain formula amounts were subject to an additional margin ranging from 0.375% to 0.50%. The Prior Revolving Facility included a variety of affirmative and negative covenants of types customary in an asset-based lending facility, including a financial covenant relating to the maintenance of a fixed charge coverage ratio, and provided for customary events of default.
At December 31, 2018, the Company was eligible to borrow up to a total of $150.0 million under the New Revolving Facility and had outstanding borrowings of $130.0 million and utilized $2.0 million of the letters of credit sublimit. At December 31, 2018, the weighted average interest rate on the Company's outstanding borrowings under the New Revolving Facility was 3.94% and the Company was in compliance with all of the covenants under the New Revolving Facility.

The Company classifies borrowings contractually due to be settled one year or less as short-term and more than one year as long-term. The Company classifies outstanding borrowings as short-term or long-term based on its ability and intent to pay or refinance the outstanding borrowings on a short-term or long-term basis. Outstanding borrowings under the Company's revolving credit facility were classified on the Company's consolidated balance sheets as "Long-term borrowings under revolving credit facility" at December 31, 2018 and "Short-Term borrowings under revolving credit facility" at June 30, 2018.

Note 14. Employee Stock Ownership Plan

The Company's ESOP was established in 2000. The plan is a leveraged ESOP in which the Company is the lender. One of the two loans established to fund the ESOP matured in fiscal 2016 and the remaining loan matured in December 2018. The loan was repaid from the Company's discretionary plan contributions over the original 15 year term with a variable rate of interest. The annual interest rate was 3.80% at June 30, 2018.

	December 31, 2018	June 30, 2018
Loan amount (in thousands)	$ —	$2,145

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.
Historically, the Company used the dividends, if any, 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. No dividends were paid in the three and six months ended December 31, 2018.
During the three and six months ended December 31, 2018, the Company charged $0.4 million and $0.9 million, respectively, to compensation expense related to the ESOP. During the three and six months ended December 31, 2017, the Company charged $0.6 million and $1.2 million, respectively, to compensation expense related to the ESOP.
The decrease in ESOP expense in the three and six months ended December 31, 2018 was primarily due to the reduction in the number of shares being allocated to participant accounts as a result of paying down the loan amount. The difference between cost and fair market value of committed to be released shares, which was zero and $0.1 million at December 31, 2018 and June 30, 2018, respectively, is recorded as additional paid-in capital.

	December 31, 2018	June 30, 2018

Allocated shares	1,323,307	1,502,323
Committed to be released shares	72,114	73,826
Unallocated shares	—	72,114
Total ESOP shares	1,395,421	1,648,263
(In thousands)		
Fair value of ESOP shares	$ 32,555	$ 50,354

During the three months ended December 31, 2018, the Company froze the ESOP such that (i) no employees of the Company may commence participation in the ESOP on or after December 31, 2018; (ii) no Company contributions will be made to the ESOP with respect to services performed or compensation received after December 31, 2018; and (iii) the ESOP accounts of all individuals who are actively employed by the Company and participating in the ESOP on December 31, 2018 will be fully vested as of such date. Additionally, the Administrative Committee, with the consent of the Board of Directors, designated certain employees who were terminated in connection with certain reductions-in-force in 2018 to be fully vested in their ESOP accounts as of their severance dates.

Note 15. Share-based Compensation

Farmer Bros. Co. 2017 Long-Term Incentive Plan

On June 20, 2017 (the “Effective Date”), the Company’s stockholders approved the Farmer Bros. Co. 2017 Long-Term Incentive Plan (the “2017 Plan”). The 2017 Plan succeeded the Company’s prior long-term incentive plans, the Farmer Bros. Co. Amended and Restated 2007 Long-Term Incentive Plan (the “Amended Equity Plan”) and the Farmer Bros. Co. 2007 Omnibus Plan (collectively, the “Prior Plans”). On the Effective Date, the Company ceased granting awards under the Prior Plans; however, awards outstanding under the Prior Plans will remain subject to the terms of the applicable Prior Plan.

The 2017 Plan provides for the grant of stock options (including incentive stock options and non-qualified stock options), stock appreciation rights, restricted stock, restricted stock units, dividend equivalents, performance shares and other stock- or cash-based awards to eligible participants. Non-employee directors of the Company and employees of the Company or any of its subsidiaries are eligible to receive awards under the 2017 Plan. The 2017 Plan authorizes the issuance of (i) 900,000 shares of common stock plus (ii) the number of shares of common stock subject to awards under the Company’s Prior Plans that are outstanding as of the Effective Date and that expire or are forfeited, cancelled or similarly lapse following the Effective Date. Subject to certain limitations, shares of common stock covered by awards granted under the 2017 Plan that are forfeited, expire or lapse, or are repurchased for or paid in cash, may be used again for new grants under the 2017 Plan. As of December 31, 2018, there were 960,288 shares available under the 2017 Plan including shares that were forfeited under the Prior Plans. Shares of common stock granted under the 2017 Plan may be authorized but unissued shares, shares purchased on the open market or treasury shares. In no event will more than 900,000 shares of common stock be issuable pursuant to the exercise of incentive stock options under the 2017 Plan.

The 2017 Plan contains a minimum vesting requirement, subject to limited exceptions, that awards made under the 2017 Plan may not vest earlier than the date that is one year following the grant date of the award. The 2017 Plan also contains provisions with respect to payment of exercise or purchase prices, vesting and expiration of awards, adjustments and treatment of awards upon certain corporate transactions, including stock splits, recapitalizations and mergers, transferability of awards and tax withholding requirements.

The 2017 Plan may be amended or terminated by the Board at any time, subject to certain limitations requiring stockholder consent or the consent of the applicable participant. In addition, the administrator of the 2017 Plan may not, without the approval of the Company’s stockholders, authorize certain re-pricings of any outstanding stock options or stock appreciation rights granted under the 2017 Plan. The 2017 Plan will expire on June 20, 2027.

Non-qualified stock options with time-based vesting (“NQOs”)

In the six months ended December 31, 2018, the Company granted 154,263 shares issuable upon the exercise of NQOs to eligible employees under the 2017 Plan. These NQOs have an exercise price of $25.04 per share, which was the closing price of the Company’s common stock as reported on the NASDAQ Global Select Market on the date of grant. One-third of the total number of shares subject to each such stock option vest ratably on each of the first three anniversaries of the grant date, contingent on continued employment, and subject to accelerated vesting in certain circumstances.

Following are the assumptions used in the Black-Scholes valuation model for NQOs granted during the six months ended December 31, 2018.

	Six Months Ended December 31, 2018	
Weighted average fair value of NQOs	$ 7.78	
Risk-free interest rate	3.0	%
Dividend yield	—	%
Average expected term	4.6 years	
Expected stock price volatility	29.6	%

The following table summarizes NQO activity for the six months ended December 31, 2018:

Outstanding NQOs:	Number of NQOs	Weighted Average Exercise Price ($)	Weighted Average Grant Date Fair Value ($)	Weighted Average Remaining Life (Years)	Aggregate Intrinsic Value ($ in thousands)
Outstanding at June 30, 2018	161,324	26.82	9.24	5.1	741
Granted	154,263	25.04	7.78	6.9	—
Exercised	(28,798)	11.32	5.33	—	466
Cancelled/Forfeited	(4,769)	31.70	10.41	—	—
Outstanding at December 31, 2018	282,020	27.35	9.30	6.2	112
Vested and exercisable at December 31, 2018	50,106	27.71	9.54	4.8	112
Vested and expected to vest at December 31, 2018	263,507	27.38	9.32	6.2	112

The aggregate intrinsic values outstanding at the end of each fiscal period in the table above represent the total pretax intrinsic values, based on the Company’s closing stock price of $23.33 at December 31, 2018 and $30.55 at June 29, 2018, representing the last trading day of the respective fiscal periods, which would have been received by NQO holders had all award holders exercised their NQOs that were in-the-money as of those dates. The aggregate intrinsic value of NQO exercises in the six months ended December 31, 2018 represents the difference between the exercise price and the value of the Company’s common stock at the time of exercise. NQOs outstanding that are expected to vest are net of estimated forfeitures.

During the six months ended December 31, 2018, 50,106 NQOs vested and 28,798 NQOs were exercised. Total fair value of NQOs vested during the six months ended December 31, 2018 was $0.4 million. The Company received $0.3 million and $0.5 million in proceeds from exercises of vested NQOs in the six months ended December 31, 2018 and 2017, respectively.

At December 31, 2018 and June 30, 2018, respectively, there was $2.0 million and $1.0 million of unrecognized compensation cost related to NQOs. The unrecognized compensation cost related to NQOs at December 31, 2018 is expected to be recognized over the weighted average period of 2.3 years. Total compensation expense for NQOs in the three months ended December 31, 2018 and 2017 was $185,000 and $62,000, respectively. Total compensation expense for NQOs in the six months ended December 31, 2018 and 2017 was $283,000 and $64,000, respectively.

Non-qualified stock options with performance-based and time-based vesting (“PNQs”)
In the six months ended December 31, 2018, the Company granted no shares issuable upon the exercise of PNQs.
The following table summarizes PNQ activity for the six months ended December 31, 2018:

Outstanding PNQs:	Number of PNQs	Weighted Average Exercise Price ($)	Weighted Average Grant Date Fair Value ($)	Weighted Average Remaining Life (Years)	Aggregate Intrinsic Value ($ in thousands)
Outstanding at June 30, 2018	300,708	27.08	10.89	4.00	1,207
Granted	—	—	—	—	—
Exercised	(5,806)	22.70	10.29	—	17
Cancelled/Forfeited	(5,021)	31.09	11.44	—	—
Outstanding at December 31, 2018	289,881	27.10	10.89	3.49	118
Vested and exercisable at December 31, 2018	267,317	26.61	10.85	3.37	118
Vested and expected to vest at December 31, 2018	288,943	27.08	10.89	3.48	118

The aggregate intrinsic values outstanding at the end of each fiscal period in the table above represent the total pretax intrinsic values, based on the Company’s closing stock price of $23.33 at December 31, 2018 and $30.55 at June 29, 2018, representing the last trading day of the respective fiscal periods, which would have been received by PNQ holders had all award holders exercised their PNQs that were in-the-money as of those dates. The aggregate intrinsic value of PNQ exercises in the six months ended December 31, 2018 represents the difference between the exercise price and the value of the Company’s common stock at the time of exercise. PNQs outstanding that are expected to vest are net of estimated forfeitures.
During the six months ended December 31, 2018, 51,368 PNQs vested and 5,806 PNQs were exercised. Total fair value of PNQs vested during the six months ended December 31, 2018 was $0.6 million. The Company received $0.1 million and $0.2 million in proceeds from exercises of vested PNQs in the six months ended December 31, 2018 and 2017, respectively.
At December 31, 2018 and June 30, 2018, there was $0.2 million and $0.5 million, respectively, of unrecognized compensation cost related to PNQs. The unrecognized compensation cost related to PNQs at December 31, 2018 is expected to be recognized over the weighted average period of 0.9 years. Total compensation expense related to PNQs in the three months ended December 31, 2018 and 2017 was $0.1 million and $0.2 million, respectively. Total compensation expense related to PNQs in the six months ended December 31, 2018 and 2017 was $0.3 million and $0.4 million, respectively.
Restricted Stock
During the six months ended December 31, 2018, the Company granted 16,266 shares of restricted stock under the 2017 Plan to non-employee directors with a grant date fair value of $23.98 per share. These restricted stock awards cliff vest on the earlier of the one year anniversary of the grant date or the date of the first annual meeting of the Company’s stockholders immediately following the grant date, subject to continued service to the Company through the vesting date and the acceleration provisions of the 2017 Plan and restricted stock agreement.

The following table summarizes restricted stock activity for the six months ended December 31, 2018:

Outstanding and Nonvested Restricted Stock Awards:	Shares Awarded	Weighted Average Grant Date Fair Value ($)	Weighted Average Remaining Life (Years)	Aggregate Intrinsic Value ($ in thousands)
Outstanding and nonvested at June 30, 2018	14,958	33.48	1.7	457
Granted	16,266	23.98	0.9	390
Vested/Released	(12,722)	33.81	—	315
Cancelled/Forfeited	—	—	—	—
Outstanding and nonvested at December 31, 2018	18,502	24.90	1.0	432
Expected to vest at December 31, 2018	17,611	24.88	1.0	411

The aggregate intrinsic values of shares outstanding at the end of each fiscal period in the table above represent the total pretax intrinsic values, based on the Company's closing stock price of $23.33 at December 31, 2018 and $30.55 at June 29, 2018, representing the last trading day of the respective fiscal periods. Restricted stock that is expected to vest is net of estimated forfeitures.

At December 31, 2018 and June 30, 2018, there was $0.4 million and $0.3 million, respectively, of unrecognized compensation cost related to restricted stock. The unrecognized compensation cost related to restricted stock at December 31, 2018 is expected to be recognized over the weighted average period of 1.0 years. Total compensation expense for restricted stock was $0.1 million in each of the three months ended December 31, 2018 and 2017. Total compensation expense for restricted stock was $0.2 million and $0.1 million in the six months ended December 31, 2018 and 2017, respectively.

Performance-Based Restricted Stock Units ("PBRSUs")

During the six months ended December 31, 2018, the Company granted 47,928 PBRSUs under the 2017 Plan to eligible employees with a grant date fair value of $25.04 per unit. The fiscal 2019 PBRSU awards cliff vest on the third anniversary of the date of grant based on the Company's achievement of certain financial performance goals for the performance period July 1, 2018 through June 30, 2021, subject to certain continued employment conditions and subject to acceleration provisions of the 2017 Plan and restricted stock unit agreement. At the end of the three-year performance period, the number of PBRSUs that actually vest will be 0% to 150% of the target amount, depending on the extent to which the Company meets or exceeds the achievement of those financial performance goals measured over the full three-year performance period.

The following table summarizes PBRSU activity for the six months ended December 31, 2018:

Outstanding and Nonvested PBRSUs:	PBRSUs Awarded(1)	Weighted Average Grant Date Fair Value ($)	Weighted Average Remaining Life (Years)	Aggregate Intrinsic Value ($ in thousands)
Outstanding and nonvested at June 30, 2018	35,732	31.70	3.4	1,092
Granted(1)	47,928	25.04	2.9	1,200
Vested/Released	—	—	—	—
Cancelled/Forfeited	(1,567)	31.70	—	—
Outstanding and nonvested at December 31, 2018	82,093	27.81	2.5	1,915
Expected to vest at December 31, 2018	73,095	27.34	2.5	1,705

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(1) The target number of PBRSUs is presented in the table. Under the terms of the awards, the recipient may earn between 0% and 150% of the target number of PBRSUs depending on the extent to which the Company meets or exceeds the achievement of the applicable financial performance goals.

The aggregate intrinsic value of PBRSUs outstanding at the end of each fiscal period in the table above represents the total pretax intrinsic value, based on the Company’s closing stock price of $23.33 at December 31, 2018 and $30.55 at June

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29, 2018, representing the last trading day of the respective fiscal periods. PBRSUs that are expected to vest are net of estimated forfeitures.

At December 31, 2018 and June 30, 2018, there was $1.6 million and $0.9 million, respectively, of unrecognized compensation cost related to PBRSUs. The unrecognized compensation cost related to PBRSUs at December 31, 2018 is expected to be recognized over the weighted average period of 2.5 years. Total compensation expense for PBRSUs was $117,000 and $48,000 for the three months ended December 31, 2018 and 2017, respectively. Total compensation expense for PBRSUs was $199,000 and $48,000 for the six months ended December 31, 2018 and 2017, respectively.

Note 16. Other Current Liabilities

Other current liabilities consist of the following:

(In thousands)	December 31, 2018	June 30, 2018
Accrued postretirement benefits	$ 810	$ 810
Accrued workers' compensation liabilities	1,668	1,698
Short-term pension liabilities (1)	—	3,761
Earnout payable (2)	840	600
Multiemployer Plan Holdback—Boyd Coffee (3)	1,056	—
Other (4)	4,074	3,790
Other current liabilities	$ 8,448	$ 10,659

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(1) Amount recorded at June 30, 2018 represents the present value of the Company's estimated withdrawal liability under the Local 807 Pension Fund, which was settled during the three months ended December 31, 2018. See Note 12.

(2) Includes $0.8 million and $0.6 million at December 31, 2018 and June 30, 2018, respectively, in estimated fair value of earnout payable in connection with the Company's acquisition of substantially all of the assets of West Coast Coffee completed on February 7, 2017.

(3) Multiemployer Plan Holdback—Boyd Coffee reclassified from long-term at June 30, 2018 to short-term at December 31, 2018. On January 8, 2019, the Seller notified the Company of the assessment of $0.5 million in withdrawal liability against the Seller, which the Company paid from the Multiemployer Plan Holdback. See Note 23.

(4) Includes accrued property taxes, sales and use taxes, insurance liabilities and dividends payable.

Note 17. Other Long-Term Liabilities

Other long-term liabilities include the following:

(In thousands)	December 31, 2018	June 30, 2018
Long-term obligations under capital leases	$ 7	$58
Derivative liabilities—noncurrent	322	386
Multiemployer Plan Holdback—Boyd Coffee (1)	—	1,056
Cumulative preferred dividends, undeclared and unpaid—noncurrent	484	312
Other long-term liabilities	$ 813	$1,812

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(1) Multiemployer Plan Holdback—Boyd Coffee reclassified from long-term at June 30, 2018 to short-term at December 31, 2018. On January 8, 2019, the Seller notified the Company of the assessment of $0.5 million in withdrawal liability against the Seller, which the Company paid from the Multiemployer Plan Holdback. See Note 23.

Note 18. Income Taxes

On December 22, 2017, the President of the United States signed into law the Tax Act. The SEC subsequently issued SAB 118, which provides guidance on accounting for the tax effects of the Tax Act. Under SAB 118, companies are able to record a reasonable estimate of the impacts of the Tax Act if one is able to be determined and report it as a provisional amount during the measurement period. The measurement period is not to extend beyond one year from the enactment date. Impacts of the Tax Act that a company is not able to make a reasonable estimate for should not be recorded until a reasonable estimate can be made during the measurement period.

Pursuant to the Tax Act, the federal corporate tax rate was reduced to 21.0%, effective January 1, 2018. Deferred tax amounts are calculated based on the rates at which they are expected to reverse in the future. The provisional amount recorded in fiscal 2018 relating to the re-measurement of the Company’s deferred tax balances as a result of the reduction in the corporate tax rate was $18.0 million. There were no provisional adjustments recorded in the three and six months ended December 31, 2018. The Company finalized its assessment of the income tax effects of the Tax Act in the second quarter of fiscal 2019.

The Company’s effective tax rates for the three months ended December 31, 2018 and 2017 were 21.0% and (6,154.6)%, respectively. The Company’s effective tax rates for the six months ended December 31, 2018 and 2017 were 23.3% and 1,498.0%, respectively. The effective tax rates for the three and six months ended December 31, 2017 have been retrospectively adjusted to reflect the impact of certain changes in accounting principles and corrections to previously issued financial statements as described in Note 3. The effective tax rates for the three and six months ended December 31, 2018 varied from the federal statutory rate of 21.0% primarily due to state income taxes, offset by a deferred tax benefit resulting from the pension settlement charge of $10.9 million. The effective tax rates for the three and six months ended December 31, 2017 varied from the federal statutory rate of 28.1% primarily due to income tax expense of $(16.8) million and $(17.4) million, respectively, resulting from the adjustment of deferred tax amounts due to the enactment of the Tax Act, in addition to state income taxes.

The Company evaluates its deferred tax assets quarterly to determine if a valuation allowance is required. In making such assessment, significant weight is given to evidence that can be objectively verified, such as recent operating results, and less consideration is given to less objective indicators such as future income projections. After consideration of positive and negative evidence, including the Company’s cumulative 12-month income position at December 31, 2018, the Company concluded that it is more likely than not that the Company will generate future income sufficient to realize the majority of the Company’s deferred tax assets at December 31, 2018. As of December 31, 2018, the Company cannot conclude that certain state net operating loss carry forwards and tax credit carryovers

will be utilized before expiration. Accordingly, the Company will maintain a valuation allowance of $1.9 million to offset this deferred tax asset.
As of December 31, 2018 and June 30, 2018 the Company had no unrecognized tax benefits.

Note 19. Net (Loss) Income Per Common Share

Computation of net (loss) income per share ("EPS") for the three and six months ended December 31, 2018 excludes the dilutive effect of 571,901 shares issuable under stock options, 82,093 PBRSUs and 400,691 shares issuable upon the assumed conversion of the outstanding Series A Preferred Stock because the Company incurred net losses in the three and six months ended December 31, 2018 so their inclusion would be anti-dilutive. There were no unearned ESOP shares excluded from EPS calculations in the three and six months ended December 31, 2018.

Computation of EPS for the three and six months ended December 31, 2017 excludes the dilutive effect of 525,059 shares issuable under stock options, 37,414 PBRSUs and 383,611 shares issuable upon the assumed conversion of the outstanding Series A Preferred Stock because the Company incurred net losses in the three and six months ended December 31, 2017 so their inclusion would be anti-dilutive. There were 72,114 unearned ESOP shares excluded from EPS calculations in the three and six months ended December 31, 2017.

	Three Months Ended December 31,		Six Months Ended December 31,	
(In thousands, except share and per share amounts)	2018	2017(1)	2018	2017(1)
Undistributed net loss available to common stockholders	$(10,225)	$(17,190)	$(13,341)	$(16,384)
Undistributed net (loss) income available to nonvested restricted stockholders and holders of convertible preferred stock	(9)	1	(11)	35
Net loss available to common stockholders—basic	$(10,234)	$(17,189)	$(13,352)	$(16,349)
Weighted average common shares outstanding—basic	16,985,157	16,723,498	16,971,995	16,711,660
Effect of dilutive securities:				
Shares issuable under stock options	—	—	—	—
Shares issuable under PBRSUs	—	—	—	—
Shares issuable under convertible preferred stock	—	—	—	—
Weighted average common shares outstanding—diluted	16,985,157	16,723,498	16,971,995	16,711,660
Net loss per common share available to common stockholders—basic	$(0.60)	$(1.03)	$(0.79)	$(0.98)
Net loss per common share available to common stockholders—diluted	$(0.60)	$(1.03)	$(0.79)	$(0.98)

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(1) Prior period amounts have been retrospectively adjusted to reflect the impact of certain changes in accounting principles and corrections to previously issued financial statements as described in Note 3.

Note 20. Preferred Stock

The Company is authorized to issue 500,000 shares of preferred stock at a par value of $1.00, including 21,000 authorized shares of Series A Preferred Stock.

On October 2, 2017, the Company issued 14,700 shares of Series A Preferred Stock in connection with the Boyd Coffee acquisition. At December 31, 2018, Series A Preferred Stock consisted of the following:

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(In thousands, except share and per share amounts)

Shares Authorized	Shares Issued and Outstanding	Stated Value per Share	Carrying Value	Cumulative Preferred Dividends, Undeclared and Unpaid	Liquidation Preference
21,000	14,700	$1,045	$15,354	$ 654	$ 15,354

Note 21. Revenue Recognition

On July 1, 2018, the Company adopted ASU 2014-09, using the modified retrospective method for all contracts not completed as of the date of adoption. Adoption of ASU 2014-09 did not have a material effect on the results of operations, financial position or cash flows of the Company. See Note 2.

The Company's primary source of revenue are sales of coffee, tea and culinary products. The Company recognizes revenue when control of the promised good or service is transferred to the customer and in amounts that the Company expects to collect. The timing of revenue recognition takes into consideration the various shipping terms applicable to the Company's sales.

The Company delivers products to customers primarily through two methods, direct-store-delivery to the Company's customers at their place of business and direct ship from the Company's warehouse to the customer's warehouse or facility. Each delivery or shipment made to a third party customer is considered to satisfy a performance obligation. Performance obligations generally occur at a point in time and are satisfied when control of the goods passes to the customer. The Company is entitled to collection of the sales price under normal credit terms in the regions in which it operates.

ASC Topic 606, "Revenue from Contracts with Customers" ("ASC Topic 606"), provides certain practical expedients in order to ease the burden of implementation. The Company elected to apply the practical expedient related to applying the guidance to a portfolio of contracts with similar characteristics as the Company does not expect the effects on its condensed consolidated financial statements to differ materially from applying the guidance to the individual contracts within that portfolio. As DSD customers generally sign a standard form of contract, the Company believes that each contract in the DSD portfolio shares similar characteristics and would not result in a material difference when evaluated on an individual basis, therefore the Company adopted the practical expedient and applied one accounting treatment to the entire portfolio of DSD contracts.

In accordance with ASC Topic 606, the Company disaggregates net sales from contracts with customers based on the characteristics of the products sold:

	Three Months Ended December 31,					
	2018			2017		
(In thousands)	$	% of total		$	% of total	
Net Sales by Product Category:						
Coffee (Roasted)	$99,286	62	%	$104,457	62	%
Coffee (Frozen Liquid)	9,318	6	%	9,326	6	%
Tea (Iced & Hot)	8,651	5	%	7,751	5	%
Culinary	16,795	10	%	17,376	10	%
Spice	6,002	4	%	6,333	4	%
Other beverages(1)	18,915	12	%	21,429	13	%

Net sales by product category	158,967	99 %	166,672	100%
Fuel surcharge	806	1 %	694	— %
Net sales	$159,773	100%	$167,366	100%

(1) Includes all beverages other than roasted coffee, frozen liquid coffee, and iced and hot tea, including cappuccino, cocoa, granitas, and concentrated and ready-to drink cold brew and iced coffee.

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	Six Months Ended December 31,			
	2018		2017	
(In thousands)	$	% of total	$	% of total
Net Sales by Product Category:				
Coffee (Roasted)	$194,640	63 %	$187,340	63 %
Coffee (Frozen Liquid)	17,874	6 %	17,150	6 %
Tea (Iced & Hot)	17,555	6 %	15,423	5 %
Culinary	32,789	11 %	31,139	10 %
Spice	12,160	4 %	12,607	4 %
Other beverages(1)	30,541	10 %	34,035	11 %
Net sales by product category	305,559	100%	297,694	99 %
Fuel surcharge	1,654	— %	1,385	1 %
Net sales	$307,213	100%	$299,079	100%

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(1) Includes all beverages other than roasted coffee, frozen liquid coffee, and iced and hot tea, including cappuccino, cocoa, granitas, and concentrated and ready-to drink cold brew and iced coffee.

Contract assets and liabilities are immaterial. Receivables from contracts with customers are included in “Accounts receivable, net” on the Company’s condensed consolidated balance sheets. At December 31, 2018 and June 30, 2018, “Accounts receivable, net” included, $76.7 million and $54.5 million, respectively, in receivables from contracts with customers.

Note 22. Commitments and Contingencies

For a detailed discussion about the Company’s commitments and contingencies, see Note 24, “Commitments and Contingencies” in the Notes to Consolidated Financial Statements in the 2018 Form 10-K. During the six months ended December 31, 2018, other than the following, there were no material changes in the Company’s commitments and contingencies.

Expansion Project Contract

In the third quarter of fiscal 2018, the Company commenced a project to expand its production lines (the “Expansion Project”) in the New Facility, including expanding capacity to support the transition of acquired business volumes under a guaranteed maximum price contract of up to $19.3 million. In the six months ended December 31, 2018, the Company paid $10.6 million for machinery and equipment expenditures associated with the Expansion Project. Since inception of the contract through December 31, 2018, the Company has paid a total of $18.9 million and accrued one remaining payment of $36,000 against the guaranteed maximum price contract for the Expansion Project. See Note 10.

Pension Plan Obligations

As of December 31, 2018, the Company’s pension plan obligations include: (i) $70.5 million in estimated future benefit payments on single employer pension plan obligations; (ii) $2.6 million in pension withdrawal liability from the WCTPP; (iii) $0.2 million in aggregate future payments in fiscal 2035 to settle the withdrawal liability associated with the Company’s withdrawal from the Local 807 Labor Management Pension Plan; and (iv) $0.8 million in estimated contributions to multiemployer pension plans in the remainder of fiscal 2019.

Boyd Coffee Multiemployer Plan Holdback

In connection with the Boyd Business acquisition, at closing the Company held back $1.1 million in cash to pay, on behalf of the Seller, any assessment of withdrawal liability made against the Seller following the Closing Date in respect of the Seller’s multiemployer pension plan. On January 8, 2019, the Seller notified the Company of the assessment of $0.5 million in withdrawal liability against the Seller, which the Company paid from the Multiemployer

Plan Holdback. The Company expects to retain and apply the remaining amount of the Multiemployer Plan Holdback of $0.5 million toward satisfaction of the Seller's post-closing net working capital deficiency under the Asset Purchase Agreement. See Note 23.

Farmer Bros. Co.
Notes to Unaudited Condensed Consolidated Financial Statements (continued)

Borrowings Under Revolving Credit Facility
The Company had outstanding borrowings of $130.0 million under the New Revolving Facility that were classified as "Long-term borrowings under revolving credit facility" on the Company's condensed consolidated balance sheet at December 31, 2018, as compared to outstanding borrowings of $89.8 million under the Prior Revolving Facility that were classified as "Short-term borrowings under revolving credit facility" on the Company's consolidated balance sheet at June 30, 2018. See Note 13.
Purchase Commitments
As of December 31, 2018, the Company had committed to purchase green coffee inventory totaling $68.0 million under fixed-price contracts, and other purchases totaling $19.8 million under non-cancelable purchase orders related primarily to the purchase of finished goods inventory.
As of December 31, 2018, the Company had commitments of $0.9 million for roasting equipment ordered for the New Facility which will be accrued by the Company upon delivery and acceptance of the equipment in the fourth quarter of fiscal 2019.
Legal Proceedings
Council for Education and Research on Toxics ("CERT") v. Brad Berry Company Ltd., et al., Superior Court of the State of California, County of Los Angeles
On August 31, 2012, CERT filed an amendment to a private enforcement action adding a number of companies as defendants, the Company's subsidiary, Coffee Bean International, Inc., which sell coffee in California under the State of California's Safe Drinking Water and Toxic Enforcement Act of 1986, also known as Proposition 65. The suit alleges that the defendants have failed to issue clear and reasonable warnings in accordance with Proposition 65 that the coffee they produce, distribute, and sell contains acrylamide. This lawsuit was filed in Los Angeles Superior Court (the "Court"). CERT has demanded that the alleged violators remove acrylamide from their coffee or provide Proposition 65 warnings on their products and pay $2,500 per day for each and every violation while they are in violation of Proposition 65.
Acrylamide is produced naturally in connection with the heating of many foods, especially starchy foods, and is believed to be caused by the Maillard reaction, though it has also been found in unheated foods such as olives. With respect to coffee, acrylamide is produced when coffee beans are heated during the roasting process-it is the roasting itself that produces the acrylamide. While there has been a significant amount of research concerning proposals for treatments and other processes aimed at reducing acrylamide content of different types of foods, to our knowledge there is currently no known strategy for reducing acrylamide in coffee without negatively impacting the sensorial properties of the product.
The Company has joined a Joint Defense Group, or JDG, and, along with the other co-defendants, has answered the complaint, denying, generally, the allegations of the complaint, including the claimed violation of Proposition 65 and further denying CERT's right to any relief or damages, including the right to require a warning on products. The Joint Defense Group contends that based on proper scientific analysis and proper application of the standards set forth in Proposition 65, exposures to acrylamide from the coffee products pose no significant risk of cancer and, thus, these exposures are exempt from Proposition 65's warning requirement.
The JDG filed a pleading responding to claims and asserting affirmative defenses on January 22, 2013. The Court initially limited discovery to the four largest defendants, so the Company was not initially required to participate in discovery. The Court decided to handle the trial in two "phases," and the "no significant risk level" defense, the First Amendment defense, and the federal preemption defense were tried in the first phase. Trial commenced on September 8, 2014, and testimony completed on November 4, 2014, for the three "Phase 1" defenses.
Following final trial briefing, the Court heard, on April 9, 2015, final arguments on the Phase 1 issues. On September 1, 2015, the Court ruled against the JDG on the Phase 1 affirmative defenses. The JDG received permission to file an interlocutory appeal, which was filed by writ petition on October 14, 2015. On January 14, 2016, the Court of Appeals denied the JDG's writ petition thereby denying the interlocutory appeal so that the case stays with the trial court.

On February 16, 2016, the Plaintiff filed a motion for summary adjudication arguing that based upon facts that had been stipulated by the JDG, the Plaintiff had proven its prima facie case and all that remains is a determination of whether any affirmative defenses are available to Defendants. On March 16, 2016, the Court reinstated the stay on discovery for all

parties except for the four largest defendants. Following a hearing on April 20, 2016, the Court granted Plaintiff's motion for summary adjudication on its prima facie case. Plaintiff filed its motion for summary adjudication of affirmatives defenses on May 16, 2016. At the August 19, 2016 hearing on Plaintiff's motion for summary adjudication (and the JDG's opposition), the Court denied Plaintiff's motion, thus maintaining the ability of the JDG to defend the issues at trial. On October 7, 2016, the Court continued the Plaintiff's motion for preliminary injunction until the trial for Phase 2.

In November 2016, the parties pursued mediation, but were not able to resolve the dispute.

In December 2016, discovery resumed for all defendants. Depositions of "person most knowledgeable" witnesses for each defendant in the JDG commenced in late December and proceeded through early 2017, followed by new interrogatories served upon the defendants. The Court set a fact and discovery cutoff of May 31, 2017 and an expert discovery cutoff of August 4, 2017. Depositions of expert witnesses were completed by the end of July 2017. On July 6, 2017, the Court held hearings on a number of discovery motions and denied Plaintiff's motion for sanctions as to all the defendants.

At a final case management conference on August 21, 2017 the Court set August 31, 2017 as the new trial date for Phase 2, though later changed the starting date for trial to September 5, 2017. The Court elected to break up trial for Phase 2 into two segments, the first focused on liability and the second on remedies. After 14 days at trial, both sides rested on the liability segment, and the Court set a date of November 21, 2017 for the hearing for all evidentiary issues related to this liability segment. The Court also set deadlines for evidentiary motions, issues for oral argument, and oppositions to motions. This hearing date was subsequently moved to January 19, 2018.

On March 28, 2018, the Court issued a proposed statement of decision in favor of Plaintiff. Following evaluation of the parties' objections to the proposed statement of decision, the Court issued its final statement of decision on May 7, 2018 which was substantively similar to the proposed statement from March 2018. The issuance of a final statement of decision does not itself cause or order any remedy, such as any requirement to use a warning notice. Any such remedy, including any monetary damages or fee awards, would be resolved in Phase 3 of the trial.

On June 15, 2018, California's Office of Environmental Health Hazard Assessment (OEHHA) announced its proposal of a regulation that would establish, for the purposes of Proposition 65, that chemicals present in coffee as a result of roasting or brewing pose no significant risk of cancer. If adopted, the regulation would, among other things, mean that Proposition 65 warnings would generally not be required for coffee. Plaintiff had earlier filed a motion for permanent injunction, prior to OEHHA's announcement, asking that the Court issue an order requiring defendants to provide cancer warnings for coffee or remove the coffee products from store shelves in California. The JDG petitioned the Court to (1) renew and reconsider the JDG's First Amendment defense from Phase 1 based on a recent U.S. Supreme Court decision in a First Amendment case that was decided in the context of Proposition 65; (2) vacate the July 31, 2018 hearing date and briefing schedule for Plaintiff's permanent injunction motion; and (3) stay all further proceedings pending the conclusion of the rulemaking process for OEHHA's proposed regulation. On June 25, 2018, the Court denied the JDG's motion to vacate the hearing on Plaintiff's motion for permanent injunction and added the motion to stay to the July 31, 2018 docket to be heard. At the July 31st hearing, the Court granted the JDG's application and agreed to continue the hearing on all motions to September 6, 2018.

At the September 6, 2018 hearing, the Court denied the JDG's First Amendment motion, and denied the motion to stay pending conclusion of OEHHA's rulemaking process. The Plaintiff agreed to have the permanent injunction motion continued until after the remedies phase of the trial. The Court set the "Phase 3" remedies trial phase to begin on October 15, 2018.

On September 20, 2018, the JDG filed a writ petition with the California Court of Appeals, Second Appellate District, to set aside the lower court's order denying the JDG's motion to renew or reopen its First Amendment defense to the imposition of a cancer warning for their coffee products, or, alternatively, to set aside its order dated September 6, 2018, denying the JDG's motion to stay this action pending adoption by the OEHHA of the proposed regulation. On October 12, 2018, the Court of Appeals issued a Temporary Stay Order. The Temporary Stay Order ordered the Phase

3 remedies trial be stayed until further notice and did not address the JDG's First Amendment defense petition. The Court of Appeals also required the JDG to provide a written status update by January 15, 2019. Following the issuance of the Court of Appeal's Temporary Stay Order, on October 15, 2018, the trial court issued a Notice of Court's Ruling staying any further proceedings, including both remedies and liability, pending a ruling by the Court of Appeals.
At a December 3, 2018 status conference, the Court continued its stay on the Phase 3 remedies trial. The Court set

another status conference for February 4, 2019 and asked that the JDG submit a joint status report on appellate activities by January 28, 2019.

The JDG provided their written status update to the Court of Appeals timely on January 15, 2019, which update reported that OEHHA had submitted the final regulation (unchanged from its proposed rulemaking) to the California Office of Administrative Law (OAL) for review. The OAL has 30 working days (until February 19, 2019) to approve, reject, or submit questions to OEHHA concerning the regulation. If OAL approves the regulation, it would submit for publication in the April 1, 2019 update to the California Code of Regulations, at which point it is expected that it would become effective. On January 31, 2019, the Court of Appeals continued its Temporary Stay Order and required the JDG to provide a written update by April 15, 2019.

At this time, the Company is not able to predict the probability of the outcome or estimate of loss, if any, related to this matter.

The Company is a party to various other 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 23. Subsequent Events

Boyd Coffee Working Capital Settlement and Multiemployer Plan Holdback

On October 2, 2017, the Company acquired substantially all of the assets and certain specified liabilities of Boyd Coffee. The fair value of consideration transferred reflected the Company’s best estimate of the post-closing net working capital adjustment of $(8.1) million at June 30, 2018 when the purchase price allocation was finalized.

On January 23, 2019, PwC, as the “Independent Expert” designated under the Asset Purchase Agreement to resolve working capital disputes, issued its determination letter with respect to adjustments to working capital. The post-closing net working capital adjustment, as finally determined by the Independent Expert, is $(6.3) million. Under the terms of the Asset Purchase Agreement, the Seller is required to pay the Company the absolute value of this amount by wire transfer of immediately available funds or, at the option of the Company, the Company may retain the Holdback Cash Amount or the Holdback Stock to satisfy all or any portion of such deficiency, or net such deficiency against certain amounts otherwise due to the Seller under the Asset Purchase Agreement. The parties are currently discussing funding methods of the working capital shortfall along with the Company’s other indemnity claims. The parties have not yet agreed on whether this deficiency will be settled in cash or through retention of the Holdback Cash Amount and Holdback Stock. Due to unfavorable conversion pricing specified in the Asset Purchase Agreement for using the Holdback Stock to settle amounts owed, the agreed upon funding method may impact the amount of the working capital shortfall realized upon final resolution.

On January 8, 2019, the Seller notified the Company of the assessment of $0.5 million in withdrawal liability against the Seller, which the Company paid from the Multiemployer Plan Holdback. The Company expects to retain and apply the remaining amount of the Multiemployer Plan Holdback of $0.5 million toward satisfying the Seller’s post-closing net working capital deficiency under the Asset Purchase Agreement.

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

Certain statements contained in this Quarterly Report on Form 10-Q are not based on historical fact and are forward-looking statements within the meaning of federal securities laws and regulations. These statements are based on management's current expectations, assumptions, estimates and observations of future events and include any statements that do not directly relate to any historical or current fact; actual results may differ materially due in part to the risk factors set forth in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended June 30, 2018 filed with the Securities and Exchange Commission (the "SEC") on September 13, 2018 (the "2018 Form 10-K") and Part II, Item 1A of this report. These forward-looking statements can be identified by the use of words like "anticipates," "estimates," "projects," "expects," "plans," "believes," "intends," "will," "could," "assumes" and other words of similar meani 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, the success of the Corporate Relocation Plan, the timing and success of implementation of the DSD Restructuring Plan, the Company's success in consummating acquisitions and integrating acquired businesses, the impact of capital improvement projects, the adequacy and availability of capital resources to fund the Company's existing and planned business operations and the Company's capital expenditure requirements, the relative effectiveness of compensation-based employee incentives in causing improvements in Company performance, the capacity to meet the demands of our large national account customers, the extent of execution of plans for the growth of Company business and achievement of financial metrics related to those plans, the success of the Company to retain and/or attract qualified employees, the effect of the capital markets as well as other external factors on stockholder value, fluctuations in availability and cost of green coffee, competition, organizational changes, the effectiveness of our hedging strategies in reducing price risk, changes in consumer preferences, our ability to provide sustainability in ways that do not materially impair profitability, changes in the strength of the 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, as well as other risks described in this report and other factors described from time to time in our filings with the SEC. The results of operations for the three and six months ended December 31, 2018 are not necessarily indicative of the results that may be expected for any future period.

Business Overview

We are a national coffee roaster, wholesaler and distributor of coffee, tea and culinary products manufactured under supply agreements, under our owned brands, as well as under private labels on behalf of certain customers. We were founded in 1912, incorporated in California in 1923, and reincorporated in Delaware in 2004. We operate in one business segment.

We serve a wide variety of customers, from small independent restaurants and foodservice operators to large institutional buyers like restaurants, department and convenience store chains, hotels, casinos, healthcare facilities, and gourmet coffee houses, as well as grocery chains with private brand and consumer branded coffee and tea products, and foodservice distributors. Through our sustainability, stewardship, environmental efforts, and leadership we are not only committed to serving the finest products available, considering the cost needs of the customer, but also insist on their sustainable cultivation, manufacture and distribution whenever possible.

Our product categories consist of a robust line of roasted coffee, including organic, Direct Trade, Project D.I.R.E.C.T. and other sustainably-produced offerings; frozen liquid coffee; flavored and unflavored iced and hot teas; culinary products including gelatins and puddings, soup bases, dressings, gravy and sauce mixes, pancake and biscuit mixes, jellies and preserves, and coffee-related products such as coffee filters, sugar and creamers; spices; and other beverages including cappuccino, cocoa, granitas, and concentrated and ready-to-drink cold brew and iced coffee. We offer a comprehensive approach to our customers by providing not only a breadth of high-quality products, but also value-added services such as market insight, beverage planning, and equipment placement and service.

We operate production facilities in Northlake, Texas (the "New Facility"); Houston, Texas; Portland, Oregon; and Hillsboro, Oregon. Distribution takes place out of the Northlake, Portland and Hillsboro facilities, as well as separate distribution centers in Northlake, Illinois; Moonachie, New Jersey; and Scottsdale, Arizona. Our products reach our customers primarily in the following ways: through our nationwide Direct Store Delivery ("DSD") network of 386 delivery routes and 106 branch warehouses as of December 31, 2018, or direct-shipped via common carriers or third-party

distributors. DSD sales are made "off-truck" to our customers at their places of business. We operate a large fleet of trucks and other vehicles to distribute and deliver our products, and we rely on third-party logistics service providers for our long-haul distribution.

Results of Operations

Changes in Accounting Principles and Corrections to Previously Issued Financial Statements

As discussed in Note 3, Change in Accounting Principles and Corrections to Previously Issued Financial Statements, of the Notes to Unaudited Condensed Consolidated Financial Statements included in Part I, Item 1 of this report, prior period amounts recorded in our condensed consolidated financial statements have been retrospectively adjusted to reflect the impact of certain changes in accounting principles and corrections to previously issued financial statements, and the adoption of new accounting standards in the three and six months ended December 31, 2018 that required retrospective application. The discussion of our results of operations for the three and six months ended December 31, 2017 set forth below reflects these retrospective adjustments.

Financial Highlights

- Volume of green coffee pounds processed and sold decreased (5.8)% and increased 1.0% in the three and six months ended December 31, 2018, respectively, as compared to the three and six months ended December 31, 2017.
- Gross profit decreased $(3.0) million to $53.2 million in the three months ended December 31, 2018 from $56.3 million in the three months ended December 31, 2017. Gross profit decreased $(0.9) million to $101.5 million in the six months ended December 31, 2018, from $102.4 million in the six months ended December 31, 2017.
- Gross margin decreased to 33.3% and 33.0%, respectively, in the three and six months ended December 31, 2018, from 33.6% and 34.2%, respectively, in the three and six months ended December 31, 2017.
- Income (loss) from operations was $0.5 million and $(1.6) million, respectively, in the three and six months ended December 31, 2018 as compared to income from operations of $10,000 and $1.9 million, respectively, in the three and six months ended December 31, 2017.
- Net loss available to common stockholders was $(10.2) million, or $(0.60) per common share available to common stockholders—diluted, in the three months ended December 31, 2018, compared to net loss available to common stockholders of $(17.2) million, or $(1.03) per common share available to common stockholders—diluted, in the three months ended December 31, 2017. Net loss available to common stockholders was $(13.4) million, or $(0.79) per common share available to common stockholders—diluted, in the six months ended December 31, 2018, compared to net loss available to common stockholders of $(16.3) million, or $(0.98) per common share available to common stockholders—diluted, in the six months ended December 31, 2017.
- EBITDA decreased (136.8)% to $(3.2) million and EBITDA Margin was (2.0)% in the three months ended December 31, 2018, as compared to EBITDA of $8.7 million and EBITDA Margin of 5.2% in the three months ended December 31, 2017. EBITDA decreased (91.8)% to $1.5 million and EBITDA Margin was 0.5% in the six months ended December 31, 2018, as compared to EBITDA of $17.9 million and EBITDA Margin of 6.0% in the six months ended December 31, 2017.*
- Adjusted EBITDA increased 18.4% to $12.4 million and Adjusted EBITDA Margin was 7.8% in the three months ended December 31, 2018, as compared to Adjusted EBITDA of $10.5 million and Adjusted EBITDA Margin of 6.3% in the three months ended December 31, 2017. Adjusted EBITDA increased 1.9% to $23.4 million and Adjusted EBITDA Margin was 7.6% in the six months ended December 31, 2018, as compared to Adjusted EBITDA of $23.0 million and Adjusted EBITDA Margin of 7.7% in the six months ended December 31, 2017.*
- (* EBITDA, EBITDA Margin, Adjusted EBITDA and Adjusted EBITDA Margin are non-GAAP financial measures. See Non-GAAP Financial Measures below for a reconciliation of these non-GAAP measures to their corresponding GAAP measures.)

Net Sales

Net sales in the three months ended December 31, 2018 decreased $(7.6) million, or (4.5)%, to $159.8 million from $167.4 million in the three months ended December 31, 2017 due to a $(5.2) million decrease in net sales of roasted coffee products, a $(2.5) million decrease in net sales of other beverages, a $(0.6) million decrease in net sales of culinary products, and a $(0.3) million decrease in net sales of spice products, offset by a $0.9 million increase in net sales of tea products. The decline was driven primarily by lower volume in our direct ship business, the impact of lower coffee prices for our cost plus customers, a reduction in industrial soup base revenues associated with the Boyd Business acquisition which we stopped selling in the first quarter of the current fiscal year, and a decline in revenues sold through our DSD network. Net sales in the three months ended December 31, 2018 included $(1.0) million in price decreases to customers utilizing commodity-based pricing arrangements, where the changes in the green coffee commodity costs are passed on to the customer, as compared to $(0.4) million in price decreases to customers utilizing such arrangements in the three months ended December 31, 2017.

Net sales in the six months ended December 31, 2018 increased $8.1 million, or 2.7%, to $307.2 million from $299.1 million in the six months ended December 31, 2017 due to a $7.3 million increase in net sales of roasted coffee products, a $2.1 million increase in net sales of tea products, a $1.7 million increase in net sales of culinary products, and a $0.7 million increase in net sales of frozen liquid coffee, offset by a $(3.3) million decrease in net sales of other beverages and a $(0.4) million decrease in net sales of spice products. The increase in net sales was primarily due to the addition of net sales from the Boyd Business for a full six month period, which were $44.6 million for the six months ended December 31, 2018 as compared to $26.3 million for the six months ended December 31, 2017. This increase was offset by a $(10.7) million decline in net sales primarily due to lower volume in our direct ship business, a decline in revenues sold through our DSD network, and the impact of pricing to our cost plus customers. Net sales in the six months ended December 31, 2018 included $(3.0) million in price decreases to customers utilizing commodity-based pricing arrangements, where the changes in the green coffee commodity costs are passed on to the customer, as compared to $0.5 million in price increases to customers utilizing such arrangements in the six months ended December 31, 2017.

The changes in net sales in the three and six months ended December 31, 2018 compared to the same periods in the prior fiscal year were due to the following:

(In millions)	Three Months Ended December 31, 2018 vs. 2017	Six Months Ended December 31, 2018 vs. 2017
Effect of change in unit sales	$ (11.6)	$ 2.2
Effect of pricing and product mix changes	4.0	5.9
Total (decrease) increase in net sales	$ (7.6)	$ 8.1

Unit sales decreased (6.8)% while average unit price increased by 2.4% in the three months ended December 31, 2018 as compared to the same period in the prior fiscal year, resulting in a decrease in net sales of (4.5)%.

The decrease in unit sales was primarily due to a (31.9)% decrease in unit sales of spice products, a (14.1)% decrease in unit sales of other beverages, a (11.7)% decrease in unit sales of culinary products, a (9.1)% decrease in unit sales of frozen liquid coffee products, and a (5.8)% decrease in unit sales of roasted coffee products, offset by a 10.7% increase in unit sales of tea products. The decrease in unit sales was primarily due to lower volume in our direct ship business and a decline in revenues sold through our DSD network. Average unit price increased in the three months ended December 31, 2018 primarily due to price increases on the majority of our products. In the three months ended December 31, 2018, we processed and sold approximately 27.4 million pounds of green coffee as compared to approximately 29.1 million pounds of green coffee processed and sold in the three months ended December 31, 2017. There were no new product category introductions in the three months ended December 31, 2018 or 2017 which had a material impact on our net sales.

Unit sales increased 0.7% and average unit price increased by 2.0% in the six months ended December 31, 2018 as compared to the same period in the prior fiscal year, resulting in an increase in net sales of 2.7%. The increase in unit sales was primarily due to a 21.1% increase in unit sales of frozen liquid coffee products, an 8.9% increase in unit sales of tea products, a 1.0% increase in unit sales of roasted coffee products, and a 0.8% increase in unit sales of culinary products, offset by a (20.4)% decrease in unit sales of spice products and a (4.9)% decrease in unit sales of other beverages. The increase in unit sales was primarily due to the addition of the Boyd Business which is fully reflected in the six months ended December 31, 2018 compared to only three months of Boyd Business operations in the six months ended December 31, 2017, offset by lower volume in our direct ship business and a decline in revenues sold through our DSD network. Average unit price increased in the six months ended December 31, 2018 primarily due to price increases on the majority of our products. There were no new product category introductions in the six months ended December 31, 2018 or 2017 which had a material impact on our net sales.

The following tables present net sales aggregated by product category for the respective periods indicated:

	Three Months Ended December 31,					
	2018			2017		
(In thousands)	$	% of total		$	% of total	
Net Sales by Product Category:						
Coffee (Roasted)	$99,286	62	%	$104,457	62	%
Coffee (Frozen Liquid)	9,318	6	%	9,326	6	%
Tea (Iced & Hot)	8,651	5	%	7,751	5	%
Culinary	16,795	10	%	17,376	10	%
Spice	6,002	4	%	6,333	4	%
Other beverages(1)	18,915	12	%	21,429	13	%
Net sales by product category	158,967	99	%	166,672	100	%
Fuel surcharge	806	1	%	694	—	%
Net sales	$159,773	100	%	$167,366	100	%

(1) Includes all beverages other than roasted coffee, frozen liquid coffee, and iced and hot tea, including cappuccino, cocoa, granitas, and concentrated and ready-to drink cold brew and iced coffee.

	Six Months Ended December 31,					
	2018			2017		
(In thousands)	$	% of total		$	% of total	
Net Sales by Product Category:						
Coffee (Roasted)	$194,640	63	%	$187,340	63	%
Coffee (Frozen Liquid)	17,874	6	%	17,150	6	%
Tea (Iced & Hot)	17,555	6	%	15,423	5	%
Culinary	32,789	11	%	31,139	10	%
Spice	12,160	4	%	12,607	4	%
Other beverages(1)	30,541	10	%	34,035	11	%
Net sales by product category	305,559	100	%	297,694	99	%
Fuel surcharge	1,654	—	%	1,385	1	%
Net sales	$307,213	100	%	$299,079	100	%

(1) Includes all beverages other than roasted coffee, frozen liquid coffee, and iced and hot tea, including cappuccino, cocoa, granitas, and concentrated and ready-to drink cold brew and iced coffee.

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Cost of Goods Sold

Cost of goods sold in the three months ended December 31, 2018 decreased $(4.6) million, or (4.1)%, to $106.5 million, or 66.7% of net sales, from $111.1 million, or 66.4% of net sales, in the three months ended December 31, 2017. The decrease in cost of goods sold was primarily due to a decrease in net sales of $(7.6) million between the periods, partially offset by an increase in coffee brewing equipment expenses. Expenses related to coffee brewing equipment provided to customers included in cost of goods sold in the three months ended December 31, 2018 and 2017 were $8.4 million and $7.1 million, respectively. Notwithstanding the decrease in cost of goods sold, cost of goods sold as a percentage of net sales increased in the three months ended December 31, 2018 primarily due to higher manufacturing costs associated with the production operations in the New Facility and higher depreciation expense for the New Facility, offset by lower green coffee costs and increased product pricing within our DSD network . The average Arabica "C" market price of green coffee decreased 5.2% in the three months ended December 31, 2018.

Cost of goods sold in the six months ended December 31, 2018 increased $9.0 million, or 4.6%, to $205.7 million, or 67.0% of net sales, from $196.7 million, or 65.8% of net sales, in the six months ended December 31, 2017. The increase in cost of goods sold was primarily due to an increase in net sales of $8.1 million between the periods, including the addition of the Boyd Business for the full six month period which increased cost of goods sold by $33.2 million. In addition, we realized higher coffee brewing equipment expenses, freight, and manufacturing costs associated with the production operations in the New Facility, as well as higher depreciation expense for the New Facility, offset by lower green coffee costs. The average Arabica "C" market price of green coffee decreased 6.7% in the six months ended December 31, 2018.

Gross Profit

Gross profit in the three months ended December 31, 2018 decreased $(3.0) million, or (5.4)%, to $53.2 million from $56.3 million in the three months ended December 31, 2017 and gross margin decreased to 33.3% in the three months ended December 31, 2018 from 33.6% in the three months ended December 31, 2017. The decrease in gross profit for the three months ended December 31, 2018 was primarily due to higher coffee brewing equipment costs associated with increased installation activity during the period, higher freight costs and higher production costs, offset by higher product margins which were driven by lower coffee prices and increased product pricing within our DSD network.

Gross profit in the six months ended December 31, 2018 decreased $(0.9) million, or (0.9)%, to $101.5 million from $102.4 million in the six months ended December 31, 2017 and gross margin decreased to 33.0% in the six months ended December 31, 2018 from 34.2% in the six months ended December 31, 2017. The decrease in gross profit for the six months ended December 31, 2018 was primarily due to higher coffee brewing equipment costs associated with increased installation activity during the period, higher production cost, and higher freight costs.

Operating Expenses

In the three months ended December 31, 2018, operating expenses decreased $(3.5) million, or (6.3)%, to $52.7 million, or 33.0% of net sales, from $56.3 million, or 33.6% of net sales, in the three months ended December 31, 2017, primarily due to a $2.5 million decrease in selling expenses and a $2.2 million decrease in general and administrative expenses. The decrease in selling expenses was associated with headcount reductions and other efficiencies from DSD route optimization and the decrease in general and administrative expenses was associated with synergies achieved though the Boyd Business acquisition and the conclusion of the transition services and co-manufacturing agreements with Boyd Coffee at the beginning of October 2018, offset by higher acquisition and integration costs and bad debt expense. Net gains from sales of assets in the second quarter of fiscal 2019 included $0.1 million in earnout from the sale of spice assets and net losses of $0.9 million from sales of other assets, primarily associated with the Boyd Coffee plant decommissioning, as compared to $0.4 million in earnout from the sale of spice assets and net losses of $0.1 million from sales of other assets in the prior year period.

In the six months ended December 31, 2018, operating expenses increased $2.5 million, or 2.5%, to $103.1 million, or 33.5% of net sales, from $100.5 million, or 33.6% of net sales, in the six months ended December 31, 2017, primarily due to a $1.9 million increase in selling expenses and a $4.4 million increase in restructuring and other transition

expenses, partially offset by a $4.9 million reduction in general and administrative expenses. The increase in selling expenses was primarily due to the addition of the Boyd Business which added $3.7 million to selling expenses exclusive of related depreciation and amortization expense, and an increase of $0.8 million in depreciation and amortization expense, offset by lower headcount and DSD route optimization.

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The decrease in general and administrative expenses during the six months ended December 31, 2018 was primarily due to synergies achieved from the integration of the Boyd Business and conclusion of the transition services and co-manufacturing agreements with Boyd Coffee at the beginning of October 2018, offset by higher acquisition and integration costs and bad debt expense. In the six months ended December 31, 2018, we paid Boyd Coffee a total of $3.7 million for services under these agreements, as compared to $9.2 million paid for such services in the six months ended December 31, 2017.

Net gains from sales of assets in the six months ended December 31, 2018 included $0.4 million in earnout from the sale of spice assets and net losses of $1.1 million from sales of other assets, primarily associated with the Boyd Coffee plant decommissioning, as compared to $0.5 million in earnout from the sale of spice assets and net losses of $0.1 million from sales of other assets in the prior year period.

Restructuring and other transition expenses in the six months ended December 31, 2018 increased $4.4 million, as compared to the same period in the prior fiscal year. This increase included $3.4 million, including interest, assessed by the Western Conference of Teamsters Pension Trust (the "WC Pension Trust") in the six months ended December 31, 2018, representing the Company's share of the Western Conference of Teamsters Pension Plan ("WCTPP") unfunded benefits due to the Company's partial withdrawal from the WCTPP as a result of employment actions taken by the Company in 2016 in connection with the Corporate Relocation Plan. In addition, in the six months ended December 31, 2018, we incurred $1.4 million in restructuring and other transition expenses, primarily employee-related costs, associated with the DSD Restructuring Plan, as compared to $0.2 million in restructuring and other transition expenses associated with the DSD Restructuring Plan in the three months ended December 31, 2017.

Income (Loss) from Operations

Income from operations in the three months ended December 31, 2018 was $0.5 million as compared to $10,000 in the three months ended December 31, 2017. The increase of $0.5 million was primarily driven by lower operating expenses, partially offset by lower gross profit.

Loss from operations in the six months ended December 31, 2018 was $(1.6) million as compared to income from operations of $1.9 million in the six months ended December 31, 2017. Loss from operations in the six months ended December 31, 2018 was primarily due to higher restructuring and other transition expenses related to the withdrawal liability from the WCTPP associated with the Corporate Relocation Plan and employee-related costs associated with the DSD Restructuring Plan, higher acquisition and integration costs associated with the Boyd Business acquisition, and lower gross profit, partially offset by lower general and administrative expenses primarily due to conclusion of the transition services and co-manufacturing agreements with Boyd Coffee.

Total Other Expense

Total other expense in the three and six months ended December 31, 2018 was $(13.3) million and $(15.5) million compared to $(0.3) million and $(0.7) million in the three and six months ended December 31, 2017. The change in total other expense in the three and six months ended December 31, 2018 was primarily a result of a pension settlement charge in the amount of $10.9 million, higher interest expense, and higher net losses on coffee-related derivative instruments.

The pension settlement charge incurred in the three and six months ended December 31, 2018 of $10.9 million was due to the termination of the Farmer Bros. Co. Pension Plan for Salaried Employees effective December 1, 2018. By terminating the Farmer Bros. Plan, we reduced our overall pension projected benefit obligation by approximately $24.4 million. The $10.9 million pension settlement charge is non-cash. As a result of the pension plan termination we expect to realize lower Pension Benefit Guaranty Corporation expenses in the future of approximately $0.3 million to $0.4 million per year.

Interest expense in the three months ended December 31, 2018 increased $0.8 million to $3.3 million from $2.5 million in the prior year period. Interest expense in the six months ended December 31, 2018 increased $1.5 million to $6.2 million as compared to $4.7 million in the prior year period. The increase in interest expense in the three and six months ended December 31, 2018 was principally due to higher outstanding borrowings on our revolving credit facility primarily related to the Boyd Business acquisition and the write-off of deferred financing costs associated with

the ending of our prior credit facility which was replaced with a new facility in November 2018.
Other, net in the three months ended December 31, 2018 decreased by $1.3 million from $1.0 million in the three months ended December 31, 2018 from $2.2 million in the prior year period. Other, net decreased by $2.4 million to $1.6

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million in the three months ended December 2018 from $4.0 million in the prior year period. The decrease in Other, net in the three and six months ended December 31, 2018 was primarily due to increased mark-to-market losses on coffee-related derivative instruments not designated as accounting hedges.

Interest expense included $1.6 million in pension related interest expense in each of the three months ended December 31, 2018 and 2017, and $3.3 million in each of the six months ended December 31, 2018 and 2017, resulting from the adoption of ASU 2017-07. Other, net included pension investment returns of $1.8 million and $1.7 million in the three months ended December 31, 2018 and 2017, respectively, and $3.5 million and $3.3 million in the six months ended December 31, 2018 and 2017, respectively, resulting from the adoption of ASU 2017-07. See Note 2, Summary of Significant Accounting Policies-Recently Adopted Accounting Standards, and Note 3, Changes in Accounting Principles and Corrections to Previously Issued Financial Statements," of the Notes to Unaudited Condensed Consolidated Financial Statements included in Part I, Item 1 of this report.

Income Taxes

In the three and six months ended December 31, 2018, we recorded income tax benefit of $(2.7) million and $(4.0) million, respectively, compared to income tax expense of $16.8 million and $17.4 million in the three and six months ended December 31, 2017, respectively. The decrease in income taxes was primarily a result of the change in (loss) income before income taxes and the reduction in deferred tax assets recorded in the three months ended December 31, 2018 associated with the Tax Cut and Jobs Act of 2017 which lowered the federal corporate tax rate to 21.0%. See Note 18, Income Taxes, of the Notes to Unaudited Condensed Consolidated Financial Statements included in Part I, Item 1 of this report.

Net Loss Available to Common Stockholders

As a result of the foregoing factors, net loss was $(10.1) million in the three months ended December 31, 2018 as compared to net loss of $(17.1) million in the three months ended December 31, 2017. Net loss available to common stockholders was $(10.2) million, or $(0.60) per common share available to common stockholders—diluted, in the three months ended December 31, 2018, compared to net loss available to common stockholders of $(17.2) million, or $(1.03) per common share available to common stockholders—diluted, in the three months ended December 31, 2017. Net loss was $(13.1) million in the six months ended December 31, 2018 as compared to net loss of $(16.2) million in the six months ended December 31, 2017. Net loss available to common stockholders was $(13.4) million, or $(0.79) per common share available to common stockholders—diluted, in the six months ended December 31, 2018, compared to net loss available to common stockholders of $(16.3) million, or $(0.98) per common share available to common stockholders—diluted, in the six months ended December 31, 2017.

Non-GAAP Financial Measures

In addition to net (loss) income determined in accordance with U.S. generally accepted accounting principles ("GAAP"), we use the following non-GAAP financial measures in assessing our operating performance:

"EBITDA" is defined as net (loss) income excluding the impact of:

- income taxes;
- interest expense; and
- depreciation and amortization expense.

"EBITDA Margin" is defined as EBITDA expressed as a percentage of net sales.

"Adjusted EBITDA" is defined as net (loss) income excluding the impact of:

- income taxes;
- interest expense;
- (loss) income from short-term investments;
- depreciation and amortization expense;
- ESOP and share-based compensation expense;
- non-cash impairment losses;
- non-cash pension withdrawal expense;
- restructuring and other transition expenses;
- net gains and losses from sales of assets;
- non-cash pension settlement charges; and
- acquisition and integration costs.

"Adjusted EBITDA Margin" is defined as Adjusted EBITDA expressed as a percentage of net sales.

Restructuring and other transition expenses are expenses that are directly attributable to (i) the Corporate Relocation Plan, consisting primarily of employee retention and separation benefits, pension withdrawal expense, facility-related costs and other related costs such as travel, legal, consulting and other professional services; and (ii) the DSD Restructuring Plan, consisting primarily of severance, prorated bonuses for bonus eligible employees, contractual termination payments and outplacement services, and other related costs, including legal, recruiting, consulting, other professional services, and travel.

Beginning in the first quarter of fiscal 2019, for purposes of calculating EBITDA and EBITDA Margin and Adjusted EBITDA and Adjusted EBITDA Margin, we have excluded the impact of interest expense resulting from the adoption of ASU 2017-07 because such interest expense is not reflective of our ongoing operating results. See Note 2, Summary of Significant Accounting Policies--Recently Adopted Accounting Standards, of the Notes to Unaudited Condensed Consolidated Financial Statements included in Part I, Item 1 of this report.

In the second quarter of fiscal 2019, we modified the calculation of Adjusted EBITDA and Adjusted EBITDA Margin to exclude a non-cash pretax pension settlement charge resulting from the amendment and termination of the Farmer Bros. Plan effective December 1, 2018. This modification to our non-GAAP financial measures was made because such expenses are not reflective of our ongoing operating results and adjusting for them will help investors with comparability of our results.

We believe these non-GAAP financial measures provide a useful measure of the Company's operating results, a meaningful comparison with historical results and with the results of other companies, and insight into the Company's ongoing operating performance. Further, management utilizes these measures, in addition to GAAP measures, when evaluating and comparing the Company's operating performance against internal financial forecasts and budgets.

We believe that EBITDA facilitates operating performance comparisons from period to period by isolating the effects of certain items that vary from period to period without any correlation to core operating performance or that vary widely among similar companies. These potential differences may be caused by variations in capital structures (affecting interest expense), tax positions (such as the impact on periods or companies of changes in effective tax rates or net operating losses) and the age and book depreciation of facilities and equipment (affecting relative depreciation expense). We also

present EBITDA and EBITDA Margin because (i) we believe that these measures are frequently used by securities analysts, investors and other interested parties to evaluate companies in our industry, (ii) we believe that investors will find these measures useful in assessing our ability to service or incur indebtedness, and (iii) we use these measures internally as benchmarks to compare our performance to that of our competitors.

EBITDA, EBITDA Margin, Adjusted EBITDA and Adjusted EBITDA Margin, 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.

Prior year periods set forth in the tables below have been retrospectively adjusted to reflect the impact of certain changes in accounting principles and corrections to previously issued financial statements, and the adoption of new accounting standards in the three and six months ended December 31, 2018 that required retrospective application. See Note 3, Changes in Accounting Principles and Corrections to Previously Issued Financial Statements, of the Notes to Unaudited Condensed Consolidated Financial Statements included in Part I, Item 1 of this report.

Set forth below is a reconciliation of reported net loss to EBITDA (unaudited):

	Three Months Ended December 31,		Six Months Ended December 31,	
(In thousands)	2018	2017	2018	2017
Net loss, as reported	$(10,100)	$(17,060)	$(13,086)	$(16,220)
Income tax (benefit) expense	(2,725)	16,788	(4,012)	17,380
Interest expense (1)	1,735	861	2,938	1,384
Depreciation and amortization expense	7,902	8,077	15,630	15,330
EBITDA	$(3,188)	$8,666	$1,470	$17,874
EBITDA Margin	(2.0)%	5.2%	0.5%	6.0%

(1) Excludes interest expense of $1.6 million in each of the three months ended December 31, 2018 and 2017, and $3.3 million in each of the six months ended December 31, 2018 and 2017, resulting from the adoption of ASU 2017-07. See Note 2, Summary of Significant Accounting Policies--Recently Adopted Accounting Standards, of the Notes to Unaudited Condensed Consolidated Financial Statements included in Part I, Item 1 of this report.

Set forth below is a reconciliation of reported net loss to Adjusted EBITDA (unaudited):

	Three Months Ended December 31,		Six Months Ended December 31,	
(In thousands)	2018	2017	2018	2017
Net loss, as reported	$(10,100)	$(17,060)	$(13,086)	$(16,220)
Income tax (benefit) expense	(2,725)	16,788	(4,012)	17,380
Interest expense(1)	1,735	861	2,938	1,384
Depreciation and amortization expense	7,902	8,077	15,630	15,330
ESOP and share-based compensation expense	945	1,038	1,857	1,844
Restructuring and other transition expenses(2)	207	139	4,674	259
Net gains from sale of spice assets	(138)	(395)	(390)	(545)
Net losses from sales of other assets	942	91	1,113	144
Acquisition and integration costs	2,727	971	3,738	3,382
Pension settlement charge	10,948	—	10,948	—
Adjusted EBITDA	$12,443	$10,510	$23,410	$22,958
Adjusted EBITDA Margin	7.8%	6.3%	7.6%	7.7%

(1) Excludes interest expense of $1.6 million in each of the three months ended December 31, 2018 and 2017, and $3.3 million in each of the six months ended December 31, 2018 and 2017, resulting from the adoption of ASU 2017-07. See

Note 2, Summary of Significant Accounting Policies--Recently Adopted Accounting Standards, of the Notes to Unaudited Condensed Consolidated Financial Statements included in Part I, Item 1 of this report.
(2) In the six months ended December 31, 2018, includes $3.4 million, including interest, assessed by the WC Pension Trust representing the Company's share of the WCTPP unfunded benefits due to the Company's partial withdrawal from the WCTPP as a result of employment actions taken by the Company in 2016 in connection with the Corporate Relocation Plan, net of payments of $0.8 million in the six months ended December 31, 2018.

Liquidity, Capital Resources and Financial Condition
Revolving Credit Facility
On November 6, 2018 (the "Closing Date"), we entered into a new $150.0 million senior secured revolving credit facility (the "New Revolving Facility") with Bank of America, N.A, Citibank, N.A., JPMorgan Chase Bank, N.A., PNC Bank, National Association, Regions Bank, and SunTrust Bank, with a sublimit on letters of credit and swingline loans of $15.0 million each. The New Revolving Facility includes an accordion feature whereby we may increase the revolving commitments or enter into one or more tranches of incremental term loans, up to an additional $75.0 million in aggregate of increased commitments and incremental term loans, subject to certain conditions. The commitment fee is based on a leverage grid and ranges from 0.20% to 0.40%. Borrowings under the New Revolving Facility bear interest based on a leverage grid with a range of PRIME + 0.25% to PRIME + 0.875% or Adjusted LIBO Rate + 1.25% to Adjusted LIBO Rate + 1.875%. Under the New Revolving Facility, we are subject to a variety of affirmative and negative covenants of types customary in a senior secured lending facility, including financial covenants relating to leverage and interest expense coverage. We are allowed to pay dividends, provided, among other things, a total net leverage ratio is met, and no default exists or has occurred and is continuing as of the date of any such payment and after giving effect thereto. The New Revolving Facility matures on November 6, 2023, subject to the ability for the Company (subject to certain conditions) to agree with lenders who so consent to extend the maturity date of the commitments of such consenting lenders for a period of one year, such option being exercisable not more than two times during the term of the facility.
The New Revolving Facility replaced, by way of amendment and restatement, our senior secured revolving credit facility (the "Prior Revolving Facility") with JPMorgan Chase Bank, N.A. and SunTrust Bank, with revolving commitments of $125.0 million as of September 30, 2018 and $135.0 million as of October 18, 2018 (the "Third Amendment Effective Date"), subject to an accordion feature. Under the Prior Revolving Facility, as amended, advances were based on our eligible accounts receivable, eligible inventory, eligible equipment, the value of certain real property and trademarks, and an amount based on the lesser of $10.0 million (subject to monthly reduction) and the sum of certain eligible accounts and eligible inventory, less required reserves. The commitment fee was a flat fee of 0.25% per annum irrespective of average revolver usage. Outstanding obligations were collateralized by all of our assets, excluding, amongst other things, certain real property not included in the borrowing base. Borrowings under the Prior Revolving Facility bore interest based on average historical excess availability levels with a range of PRIME - 0.25% to PRIME + 0.50% or Adjusted LIBO Rate + 1.25% to Adjusted LIBO Rate + 2.00%; provided, that, after the Third Amendment Effective Date, (i) until March 31, 2019 the applicable rate was PRIME + 0.25% or Adjusted LIBO Rate + 1.75%; and (ii) loans up to certain formula amounts were subject to an additional margin ranging from 0.375% to 0.50%. The Prior Revolving Facility included a variety of affirmative and negative covenants of types customary in an asset-based lending facility, including a financial covenant relating to the maintenance of a fixed charge coverage ratio, and provided for customary events of default.
At December 31, 2018, we were eligible to borrow up to a total of $150.0 million under the New Revolving Facility and had outstanding borrowings of $130.0 million and utilized $2.0 million of the letters of credit sublimit. At December 31, 2018, the weighted average interest rate on our outstanding borrowings under the New Revolving Facility was 3.94%. At December 31, 2018, we were in compliance with all of the covenants under the New Revolving Facility.
At February 8, 2019, we were eligible to borrow up to a total of $150.0 million under the New Revolving Facility and had outstanding borrowings of $140.0 million and utilized $2.0 million of the letters of credit sublimit.

We classify borrowings contractually due to be settled one year or less as short-term and more than one year as long-term. We classify outstanding borrowings as short-term or long-term based on our ability and intent to pay or refinance the outstanding borrowings on a short-term or long-term basis. Outstanding borrowings under our revolving credit facility were classified on our consolidated balance sheets as “Long-term borrowings under revolving credit facility” at December 31, 2018 and “Short-Term borrowings under revolving credit facility” at June 30, 2018.

Liquidity

We generally finance our operations through cash flows from operations and borrowings under our revolving credit facility described above. In fiscal 2018, we filed a shelf registration statement with the SEC which allows us to issue unspecified amounts of common stock, preferred stock, depository shares, warrants for the purchase of shares of common stock or preferred stock, purchase contracts for the purchase of equity securities, currencies or commodities, and units consisting of any combination of any of the foregoing securities, in one or more series, from time to time and in one or more offerings up to a total dollar amount of $250.0 million. We believe our New Revolving Facility, to the extent available, in addition to our cash flows from operations, collectively, will be sufficient to fund our working capital and capital expenditure requirements for the next 12 months.

At December 31, 2018, we had $13.3 million in cash and cash equivalents. At December 31, 2018, none of the cash in our coffee-related derivative margin accounts was restricted. Further changes in commodity prices and the number of coffee-related derivative instruments held could have a significant impact on cash deposit requirements under our broker and counterparty agreements and may adversely affect our liquidity.

Changes in Cash Flows

Net cash used in operating activities was $5.6 million in the six months ended December 31, 2018 compared to net cash used in operating activities of $1.5 million in the six months ended December 31, 2017. Net cash used in operating activities in the six months ended December 31, 2018 was primarily due to increases in accounts and notes receivable balances and inventory purchases, offset by increases in accounts payable. The increase in accounts receivables was primarily due to increased past due receivables from several large direct ship customers and a lower recovery rate of collections. The increase in accounts payable was primarily due to higher inventory levels associated with the integration of the Boyd Business and higher acquisition and integration costs incurred during the six months ended December 31, 2018 associated with the one-time payroll and benefit expenses, and Boyd Coffee plant decommissioning and equipment relocation costs. Net cash used in operating activities in the six months ended December 31, 2017 was primarily due to a higher level of cash outflows from operating activities primarily due to an increase in inventory balances and payment of accounts payable balances, and lower cash inflows from operations due to an increase in accounts receivable balances. The increase in cash outflows was primarily related to the addition of the Boyd Business as well as softer than expected sales resulting in higher inventories.

Net cash used in investing activities during the six months ended December 31, 2018 was $23.0 million as compared to $55.8 million in the six months ended December 31, 2017, a decrease of $32.8 million. Investment activities were elevated in the prior year period principally due to the acquisition of the Boyd Business for $39.6 million in cash. For the six months ended December 31, 2018 we had purchases of property, plant and equipment of $23.1 million, which included $10.6 million for machinery and equipment relating to the Expansion Project, and $12.6 million in maintenance capital expenditures. Maintenance capital expenditures included higher coffee brewing equipment purchases compared to the prior year period due to an increased level of installations for new customers.

Net cash provided by financing activities in the six months ended December 31, 2018 was $39.6 million as compared to $56.5 million in the six months ended December 31, 2017, a decrease of $16.9 million. Net cash provided by financing activities in the six months ended December 31, 2018 included $40.2 million in net borrowings under our New Revolving Facility and Prior Revolving Facility, compared to $56.8 million in net borrowings under the Prior Revolving Facility in the six months ended December 31, 2017.

Acquisitions

On October 2, 2017, we acquired substantially all of the assets and certain specified liabilities of Boyd Coffee Company (“Boyd Coffee”), a coffee roaster and distributor with a focus on restaurants, hotels, and convenience stores on the West Coast of the United States, in consideration of cash and preferred stock. The acquired business of Boyd Coffee (the “Boyd Business”) is expected to add to our product portfolio, improve our growth potential, deepen our distribution footprint and increase our capacity utilization at our production facilities. At closing, for consideration of the purchase, we paid Boyd Coffee $38.9 million in cash from borrowings under our Prior Revolving Facility and issued to Boyd Coffee 14,700 shares of Series A Convertible Participating Cumulative Perpetual Preferred Stock, par value $1.00 per share (“Series A Preferred Stock”), with a fair value of $11.8 million as of the closing date.

Additionally, we held back $3.2 million in cash and 6,300 shares of Series A Preferred Stock, with a fair value of $4.8 million as of the closing date, for the satisfaction of any post-closing working capital adjustments and to secure Boyd Coffee's (and the other seller parties')

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indemnification obligations under the purchase agreement. Any holdback amounts not used to satisfy indemnification claims (including pending claims) will be released to the seller on the 18-month anniversary of the closing date.
In addition to the $3.2 million cash holdback, as part of the consideration for the purchase, at closing we held back $1.1 million in cash to pay, on behalf of Boyd Coffee, any assessment of withdrawal liability made against Boyd Coffee following the closing date in respect of Boyd Coffee's multiemployer pension plan, which amount was recorded in "Other current liabilities" and "Other long-term liabilities" on our consolidated balance sheets at December 31, 2018 and June 30, 2018, respectively. On January 8, 2019, Boyd Coffee notified the Company of the assessment of $0.5 million in withdrawal liability against Boyd Coffee, which the Company paid from the Multiemployer Plan Holdback. See Note 23, Subsequent Events, of the Notes to Unaudited Consolidated Financial Statements included in Part I, Item 1 of this report.
The acquisition was accounted for as a business combination. The fair value of consideration transferred was allocated to the tangible and intangible assets acquired and liabilities assumed based on their estimated fair values on the acquisition date, with the remaining unallocated amount recorded as goodwill. The fair value of consideration transferred reflected the Company's best estimate of the post-closing net working capital adjustment of $(8.1) million at June 30, 2018 when the purchase price allocation was finalized. On January 23, 2019, PricewaterhouseCoopers LLP ("PwC"), as the "Independent Expert" designated under the Asset Purchase Agreement to resolve working capital disputes, issued its determination letter with respect to adjustments to working capital. The post-closing net working capital adjustment, as determined by the Independent Expert, was ($6.3) million. See Note 23, Subsequent Events, of the Notes to Unaudited Consolidated Financial Statements included in Part I, Item 1 of this report.
At closing, the parties entered into a transition services agreement where Boyd Coffee agreed to provide certain accounting, marketing, human resources, information technology, sales and distribution and other administrative support during a transition period of up to 12 months. We also entered into a co-manufacturing agreement with Boyd Coffee for a transition period of up to 12 months as we transitioned production into our plants. Amounts paid by the Company to Boyd Coffee for these services totaled $3.7 million in the three and six months ended December 31, 2018, and $9.2 million in the three and six months ended December 31, 2017. The transition services and co-manufacturing agreements expired on October 2, 2018.
We incurred acquisition and integration costs related to the Boyd Business acquisition, consisting primarily of legal and consulting expenses, Boyd Coffee plant decommissioning and equipment relocation costs, and one-time payroll and benefit expenses, of $2.7 million and $1.0 million, respectively, during the three months ended December 31, 2018 and 2017, and $3.7 million and $3.4 million, respectively, during the six months ended December 31, 2018 and 2017. These expenses are included in operating expenses in the Company's condensed consolidated statements of operations.
See Note 4, Acquisitions, of the Notes to Unaudited Condensed Consolidated Financial Statements included in Part I, Item 1 of this report.
DSD Restructuring Plan
As a result of an ongoing operational review of various initiatives within our DSD selling organization, in the third quarter of fiscal 2017, we commenced a plan to reorganize our DSD operations in an effort to realign functions into a channel based selling organization, streamline operations, acquire certain channel specific expertise, and improve selling effectiveness and financial results (the "DSD Restructuring Plan"). We estimate that we will recognize approximately $4.9 million of pretax restructuring charges by the end of fiscal 2019 consisting of approximately $2.7 million in employee-related costs and contractual termination payments, including severance, prorated bonuses for bonus eligible employees and outplacement services, and $2.2 million in other related costs, including legal, recruiting, consulting, other professional services, and travel. We expect to complete the DSD Restructuring Plan by the end of fiscal 2019.
We incurred expenses related to the DSD Restructuring Plan in the amounts of $0.2 million and $0, in employee-related costs and $0 and $0.1 million, in other related costs for three months ended December 31, 2018 and 2017, respectively, and $1.2 million and $24,000, in employee-related costs and $0.2 million and $0.2 million, in other related costs for the six months ended December 31, 2018 and 2017, respectively. Since the adoption of the DSD Restructuring Plan through December 31, 2018, we have recognized a total of $4.5 million in aggregate cash

costs including $2.5 million in employee-related costs, and $1.9 million in other related costs. As of December 31, 2018, we had paid a total of $4.2 million of these costs, and had a balance of $0.3 million in DSD Restructuring Plan-related liabilities on our condensed consolidated balance sheet. The remaining costs are expected to be incurred in the remainder of fiscal 2019. We may also incur other charges not currently contemplated due to events that may occur as a result of, or associated with, the DSD

Restructuring Plan. See Note 5, Restructuring Plans-Direct Store Delivery ("DSD") Restructuring Plan, of the Notes to Unaudited Condensed Consolidated Financial Statements included in Part I, Item 1 of this report.

Corporate Relocation Plan

In the three and six months ended December 31, we incurred $3.4 million in restructuring and other transition expenses associated with the assessment by the WCTPP of our share of the WCTPP unfunded benefits due to our partial withdrawal from the WCTPP as a result of employment actions taken by the Company in 2016 in connection with the Corporate Relocation Plan. Since the adoption of the Corporate Relocation Plan through December 31, 2018, we have recognized a total of $35.2 million in aggregate cash costs including $17.4 million in employee retention and separation benefits, $3.4 million in pension withdrawal liability, $7.0 million in facility-related costs related to the temporary office space, costs associated with the move of the Company's headquarters, relocation of our Torrance operations and certain distribution operations and $7.4 million in other related costs. We also recognized from inception through December 31, 2018 non-cash depreciation expense of $2.3 million associated with the Torrance production facility resulting from the consolidation of coffee production operations with the Houston and Portland production facilities and $1.4 million in non-cash rent expense recognized in the sale-leaseback of the Torrance Facility. See Note 5, Restructuring Plans—Corporate Relocation Plan, of the Notes to Unaudited Condensed Consolidated Financial Statements included in Part I, Item 1 of this report.

New Facility Expansion Project

In the third quarter of fiscal 2018, we commenced a project to expand our production lines (the "Expansion Project") in the New Facility, including expanding capacity to support the transition of acquired business volumes under a guaranteed maximum price contract of up to $19.3 million. See Note 22, Commitments and Contingencies, of the Notes to Unaudited Condensed Consolidated Financial Statements included in Part I, Item 1 of this report.

Capital Expenditures

For the six months ended December 31, 2018 and 2017, our capital expenditures paid were as follows:

(In thousands)	Six Months Ended December 31, 2018	2017
Maintenance:		
Coffee brewing equipment	$8,922	$4,816
Building and facilities	15	265
Vehicles, machinery and equipment	1,723	5,051
IT, software, office furniture and equipment	1,907	1,625
Capital expenditures, maintenance	$12,567	$11,757
Expansion Project:		
Machinery and equipment	$10,553	$—
Capital expenditures, Expansion Project	$10,553	$—
New Facility Costs		
Building and facilities, including land	—	1,577
Machinery and equipment	—	2,489
Software, office furniture and equipment	—	426
Capital expenditures, New Facility	$—	$4,492
Total capital expenditures	$23,120	$16,249

In fiscal 2019, we anticipate paying between $20 million to $22 million in maintenance capital expenditures to replace normal wear and tear of coffee brewing equipment and to support increased installation activity in the three and six months ended December 31, 2018, building and facilities, vehicles, machinery and equipment, and IT, software, office furniture and

equipment. We expect to finance these expenditures through cash flows from operations and borrowings under our New Revolving Facility described above.
Depreciation and amortization expense was $15.6 million and $15.3 million in the six months ended December 31, 2018 and 2017, respectively. We anticipate our depreciation and amortization expense will be approximately $8.0 million to $8.5 million per quarter in the remainder of fiscal 2019 based on our existing fixed asset commitments and the useful lives of our intangible assets.
Working Capital
At December 31, 2018 and June 30, 2018, our working capital was composed of the following:

	December 31, 2018	June 30, 2018
(In thousands)		
Current assets	$215,982	$173,514
Current liabilities(1)	108,052	178,457
Working capital	$107,930	$(4,943)

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(1) Current liabilities includes short-term borrowings under the Prior Revolving Facility of $89.8 million as of June 30, 2018. Outstanding borrowings under our revolving credit facility were reclassified on our consolidated balance sheet from short-term to long-term at December 31, 2018.
Contractual Obligations
During the six months ended December 31, 2018, other than the following, there were no material changes in our contractual obligations.
In the three and six months ended December 31, 2018, we paid $8.2 and $10.6 million, respectively, for machinery and equipment expenditures associated with the Expansion Project. Since inception of the contract through December 31, 2018, we have paid a total of $18.9 million, with $36,000 to be paid in the remainder of fiscal 2019.

In connection with our partial withdrawal from the WCTPP, we agreed with the WCT Pension Trust's assessment of pension withdrawal liability in the amount of $3.4 million, including interest, which is payable in 17 monthly installments of $190,507 followed by a final monthly installment of $153,822, commencing September 10, 2018. At December 31, 2018, we had paid $0.8 million and recorded $2.6 million on our condensed consolidated balance sheet relating to this obligation, with the current portion included in "Accrued payroll expenses" and the long-term portion included in "Accrued pension liabilities."
Effective December 1, 2018 we amended and terminated the Farmer Bros. Plan. Termination of the Farmer Bros. Plan triggered re-measurement and settlement of the Farmer Bros. Plan and re-measurement of the Brewmatic Plan. As a result of the distributions to the remaining plan participants of the Farmer Bros. Plan, we reduced our overall pension projected benefit obligation by approximately $24.4 million and recognized a non-cash pension settlement charge of $8.1 million after-tax ($10.9 million pretax) in the three and six months ended December 31, 2018. After the re-measurement and settlement, the new projected benefit obligation and fair value of plan assets for the Brewmatic Plan are $114.1 million and $67.4 million, respectively, resulting in a net underfunded status of $46.7 million as of December 31, 2018. This represents a $6.7 million increase from the net underfunded status of the Farmer Bros. Plan and Brewmatic Plan as of June 30, 2018 primarily due to actual losses recognized on plan assets during the six months ended December 31, 2018.

During the three months ended December 31, 2018, the Company and the Local 807 Pension Fund agreed to settle the Company's remaining withdrawal liability to the Local 807 Pension Fund relating to the Company's withdrawal from the Local 807 Labor Management Pension Plan in fiscal 2012 for a lump sum cash settlement payment of $3.0 million plus two remaining installment payments of $91,000 due on or before October 1, 2034 and on or before January 1, 2035. In the three and six months ended December 31, 2018, we paid the Local 807 Pension Fund $3.0 million in cash and recorded $0.2 million in "Accrued pension liabilities" on our condensed consolidated balance sheet at December 31, 2018.

As of December 31, 2018, our pension plan obligations include: (i) $70.5 million in estimated future benefit payments on single employer pension plan obligations; (ii) $2.6 million in pension withdrawal liability from the WCTPP; (iii) $0.2

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million in aggregate future payments in fiscal 2035 to settle the withdrawal liability associated with our withdrawal from the Local 807 Labor Management Pension Plan; and (iv) $0.8 million in estimated contributions to multiemployer pension plans in the remainder of fiscal 2019.

In connection with the Boyd Business acquisition, at closing we held back $1.1 million in cash to pay, on behalf of Boyd Coffee, any assessment of withdrawal liability made against Boyd Coffee following the Closing Date in respect of the Boyd Coffee's multiemployer pension plan. On January 8, 2019, Boyd Coffee notified us of the assessment of $0.5 million in withdrawal liability against Boyd Coffee, which we paid from the Multiemployer Plan Holdback. We expect to retain and apply the remaining amount of the Multiemployer Plan Holdback of $0.5 million toward satisfaction of Boyd Coffee's post-closing net working capital deficiency under the Asset Purchase Agreement. See Note 23, Subsequent Events, of the Notes to Unaudited Condensed Consolidated Financial Statements included in Part I, Item 1 of this report.

We had outstanding borrowings of $130.0 million under the New Revolving Facility that were classified as "Long-term borrowings under revolving credit facility" on our condensed consolidated balance sheet at December 31, 2018, as compared to outstanding borrowings of $89.8 million under the Prior Revolving Facility that were classified as "Short-term borrowings under revolving credit facility" on our consolidated balance sheet at June 30, 2018.

As of December 31, 2018, the Company had committed to purchase green coffee inventory totaling $68.0 million under fixed-price contracts, and other purchases totaling $19.8 million under non-cancelable purchase orders related primarily to the purchase of finished goods inventory.

As of December 31, 2018, we had commitments of $0.9 million for roasting equipment ordered for the New Facility which will be accrued by the Company upon delivery and acceptance of the equipment in the fourth quarter of fiscal 2019.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk

Borrowings under our New Revolving Facility bear interest based on a leverage grid with a range of PRIME + 0.25% to PRIME + 0.875% or Adjusted LIBO Rate + 1.25% to Adjusted LIBO Rate + 1.875%. Borrowings under our Prior Revolving Facility bore interest based on average historical excess availability levels with a range of PRIME - 0.25% to PRIME + 0.50% or Adjusted LIBO Rate + 1.25% to Adjusted LIBO Rate + 2.00%, %; provided, that, after the Third Amendment Effective Date, (i) until March 31, 2019 the applicable rate was PRIME + 0.25% or Adjusted LIBO Rate + 1.75%; and (ii) loans up to certain formula amounts were subject to an additional margin ranging from 0.375% to 0.50%.

At December 31, 2018, we were eligible to borrow up to a total of $150.0 million under the New Revolving Facility and had outstanding borrowings of $130.0 million and utilized $2.0 million of the letters of credit sublimit. The weighted average interest rate on our outstanding borrowings under the New Revolving Facility at December 31, 2018 was 3.94%.

The following table demonstrates the impact of interest rate changes on our annual interest expense on outstanding borrowings under the New Revolving Facility based on the weighted average interest rate on the outstanding borrowings as of December 31, 2018:

($ in thousands)	Principal	Interest Rate	Annual Interest Expense
–150 basis points	$130,000	2.44 %	$ 3,172
–100 basis points	$130,000	2.94 %	$ 3,822

Unchanged	$130,000	3.94 %	$ 5,122
+100 basis points	$130,000	4.94 %	$ 6,422
+150 basis points	$130,000	5.44 %	$ 7,072

Commodity Price Risk

We are exposed to commodity price risk arising from changes in the market price of green coffee. We value green coffee inventory on the FIFO 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.

We purchase over-the-counter coffee-related derivative instruments to enable us to lock in the price of green coffee commodity purchases. These derivative instruments also may be entered into at the direction of the customer under commodity-based pricing arrangements to effectively lock in the purchase price of green coffee under such customer arrangements, in certain cases up to 18 months or longer in the future. We account for certain coffee-related derivative instruments as accounting hedges in order to minimize the volatility created in our quarterly results from utilizing these derivative contracts and to improve comparability between reporting periods.

When we designate coffee-related derivative instruments as cash flow hedges, we formally document the hedging instruments and hedged items, and measure at each balance sheet date the effectiveness of our hedges. The change in fair value of the derivative is reported in AOCI and subsequently reclassified into cost of goods sold in the period or periods when the hedged transaction affects earnings. For the three months ended December 31, 2018 and 2017, respectively, we reclassified \$(2.2) million in net losses and \$(0.1) million in net losses on coffee-related derivative instruments designated as cash flow hedges, excluding tax, respectively, into cost of goods sold from AOCI. For the six months ended December 31, 2018 and 2017, respectively, we reclassified \$(4.2) million in net losses and \$1.2 million in net gains on coffee-related derivative instruments designated as cash flow hedges, excluding tax, respectively, into cost of goods sold from AOCI. Gains or losses deferred in AOCI associated with terminated derivative instruments, derivative instruments that cease to be highly effective hedges, derivative instruments for which the forecasted transaction is reasonably possible but no longer probable of occurring, and cash flow hedges that have been otherwise discontinued remain in AOCI until the hedged item affects earnings. If it becomes probable that the forecasted transaction designated as the hedged item in a cash flow hedge will not occur, we recognize any gain or loss deferred in AOCI in “Other, net” at that time.

For derivative instruments that are not designated in a hedging relationship, and for which the normal purchases and normal sales exception has not been elected, the changes in fair value are reported in “Other, net.” In the three months ended December 31, 2018 and 2017, we recorded in “Other, net” net losses of \$(0.9) million and \$(0.2) million, respectively, on coffee-related derivative instruments not designated as accounting hedges. In the six months ended December 31, 2018 and 2017, we recorded in “Other, net” net losses of \$(2.0) million and \$(0.1) million, respectively, on coffee-related derivative instruments not designated as accounting hedges.

The following table summarizes the potential impact as of December 31, 2018 to net income and AOCI from a hypothetical 10% change in coffee commodity prices. The information provided below relates only to the coffee-related derivative instruments and does not include, when applicable, the corresponding changes in the underlying hedged items:

	Increase (Decrease) to Net Income		Increase (Decrease) to AOCI	
(In thousands)	10% Increase in Underlying Rate	10% Decrease in Underlying Rate	10% Increase in Underlying Rate	10% Decrease in Underlying Rate
Coffee-related derivative instruments(1)	\$747	\$ (747)	\$3,507	\$ (3,507)

(1) The Company’s purchase contracts that qualify as normal purchases include green coffee purchase commitments for which the price has been locked in as of December 31, 2018. These contracts are not included in the sensitivity analysis above as the underlying price has been fixed.

Item 4. 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 principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosures.

As of December 31, 2018, our management, with the participation of our Chief Executive Officer (principal executive officer) and Chief Financial Officer (principal financial and accounting 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 on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective.

Changes in Internal Control Over Financial Reporting

Management has determined that there has been no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) promulgated under the Exchange Act) during our fiscal quarter ended December 31, 2018 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II -
OTHER
INFORMATION

Item 1. Legal Proceedings
The information set forth in Note 22, Commitments and Contingencies, of the Notes to Unaudited Condensed Consolidated Financial Statements included in Part I, Item 1 of this Form 10-Q is incorporated herein by reference.

Item 1A. Risk Factors

Our accounts receivable represent a significant portion of our current assets and a substantial portion of our trade accounts receivables relate principally to a limited number of customers, increasing our exposure to bad debts and counter-party risk which could potentially have a material adverse effect on our results of operations.

A significant portion of our trade accounts receivable are from five customers. The concentration of our accounts receivable across a limited number of parties subjects us to individual counter-party and credit risk as these parties may breach our agreement, claim that we have breached the agreement, become insolvent and/or declare bankruptcy, delaying or reducing our collection of receivables or rendering collection impossible altogether. Certain of the parties use third-party distributors or do business through a network of affiliate entities which can make collection efforts more challenging and, at times, collections may be economically unfeasible. Adverse changes in general economic conditions and/or contraction in global credit markets could precipitate liquidity problems among our debtors. This could increase our exposure to losses from bad debts and have a material adverse effect on our business, financial condition and results of operations.

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Item 6. Exhibits

Exhibit No.	Description
3.3*	Amended and Restated Bylaws, adopted as of October 14, 2018.
10.15+*	Farmer Bros. Co. 2005 Incentive Compensation Plan.
10.35+*	Farmer Bros. Co. Amended and Restated 2007 Long-Term Incentive Plan (as approved by the stockholders at the 2013 Annual Meeting of Stockholders on December 5, 2013).
10.43+*	Form of Farmer Bros. Co. Amended and Restated 2007 Long-Term Incentive Plan Stock Option Grant Notice and Stock Option Agreement.
10.45+*	Form of Farmer Bros. Co. Amended and Restated 2007 Long-Term Incentive Plan Restricted Stock Award Grant Notice and Restricted Stock Award Agreement.
10.46+*	Stock Ownership Guidelines for Directors and Executive Officers, as amended February 7, 2019.
10.52+*	Second Amendment to the Farmer Bros. Co. Amended and Restated Employee Stock Ownership Plan, dated as of December 31, 2018.
10.53+*	Amendment to the Farmer Bros. Co. Retirement Plan, dated as of December 1, 2018.
31.1*	Principal Executive Officer Certification Pursuant to Securities Exchange Act Rules 13a-14 and 15d-14 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Principal Financial and Accounting Officer Certification Pursuant to Securities Exchange Act Rules 13a-14 and 15d-14 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1**	Principal Executive Officer Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2**	Principal Financial and Accounting Officer Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	The following financial statements from the Company’s Quarterly Report on Form 10-Q for the fiscal period ended December 31, 2018, formatted in eXtensible Business Reporting Language: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations, (iii) Consolidated Statements of Comprehensive Loss, (iv) Consolidated Statements of Cash Flows, and (v) Notes to Unaudited Condensed Consolidated Financial Statements (furnished herewith).

+ Management contract or compensatory plan or arrangement.

* Filed herewith

** Furnished, not filed, herewith

SIGNATURES

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

FARMER BROS. CO.

By:	/s/ Michael H. Keown Michael H. Keown President and Chief Executive Officer (chief executive officer) February 11, 2019
By:	/s/ David G. Robson David G. Robson Treasurer and Chief Financial Officer (principal financial and accounting officer) February 11, 2019