

CENTRAL GARDEN & PET COMPANY  
Form 10-K/A  
December 10, 2002  
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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

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**FORM 10-K/A**

**(Amendment No. 1)**

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended September 29, 2001

Commission File Number 0-20242

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**CENTRAL GARDEN & PET COMPANY**  
(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction  
of incorporation or organization)

68-0275553  
(IRS Employer  
Identification Number)

3697 Mt. Diablo Boulevard, Lafayette, California 94549  
(Address of principal executive offices) (Zip Code)

Telephone Number: (925) 283-4573

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

Title of Each Class  
None

Name of Each Exchange on Which Registered  
None

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

Common Stock  
(Title of Class)

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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 x. No ..

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in

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Part III of this Form 10-K or any amendment to this Form 10-K. "

At December 5, 2001, the aggregate market value of the registrant's Common Stock and Class B Stock held by non-affiliates of the registrant was approximately \$127,415,000 and \$446,000, respectively.

At December 5, 2001, the number of shares outstanding of the registrant's Common Stock was 16,790,623. In addition, on such date the registrant had outstanding 1,655,462 shares of its Class B Stock which is convertible into Common Stock on a share-for-share basis.

### **DOCUMENTS INCORPORATED BY REFERENCE**

Definitive Proxy Statement for the Company's 2002 Annual Meeting of Stockholders Part III of this Form 10-K/A.

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For the fiscal year ended September 29, 2001

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**INTRODUCTORY NOTE**

This amendment is being filed to give effect to the restatement of our consolidated financial statements as discussed in Note 14 to the consolidated financial statements. This amendment incorporates certain revisions to historical financial data and related descriptions but is not intended to update other information presented in this annual report as originally filed, except where specifically noted.

**PART I**

**Item 1. Business**

**GENERAL**

**Overview**

Central Garden & Pet Company offers a broad array of branded lawn and garden and pet supply products, including Pennington®, Four Paws®, Zodiac®, Kaytee®, Nylabone®, All-Glass®, Lofts®, Max-Q®, Norcal Pottery®, Matthews®, Amdro®, Image® and Grant®. Beginning in the fiscal year ended September 29, 2001 (fiscal 2001), Central's operations were grouped into two business segments, the lawn and garden products business (Garden Products) and the pet products business (Pet Products). For fiscal 2001, Garden Products and Pet Products accounted for 57% and 43%, respectively, of consolidated net sales before corporate eliminations. These businesses accounted for income from operations before other charges and the allocation of certain corporate costs and eliminations of \$11.0 million and \$34.9 million, respectively, in fiscal 2001. These segments, their products, and the markets they serve are described under the headings The Garden Products Business and The Pet Products Business in this Part I.

Central was incorporated in Delaware in June 1992 and is the successor to a California corporation which was incorporated in 1955. References to we, us, our or Central mean Central Garden & Pet Company and its subsidiaries and divisions, and their predecessor companies and subsidiaries. Our principal executive offices are located at 3697 Mt. Diablo Boulevard, Lafayette, California 94549 and our telephone number is (925) 283-4573.

**Recent Developments**

*Garden Products*

During fiscal 2001, we intensified our focus on branded products and continued to downsize our distribution operations to reflect the reduction in business as a result of the termination on September 30, 2000 of our distribution relationship with The Scotts Company (Scotts).

*Pet Products*

On September 30, 2000, Central acquired All-Glass Aquarium Co., a leading manufacturer and marketer of aquariums and related products. Based in Franklin, Wisconsin, All-Glass had sales of approximately \$61 million for the twelve months ended September 30, 2000, with manufacturing facilities located in Franklin and its Oceanic Systems subsidiary in Dallas, Texas. Its brands include All-Glass Aquarium® and Oceanic Systems®. During fiscal 2001, we integrated the acquired All-Glass business with our existing Island aquarium business so that we now offer a full line of aquariums.

In 2001, we received numerous awards for our new and innovative pet products. In January 2001, the Pet Industry Distributors Association selected our All-Glass Mini Bow 7 as the Best New Aquarium Product, our Nylabone Fold-away Pet Carriers as the Best New Dog or Cat Product and our Kaytee Yogurt Dips as the Best New Bird or Small Animal Product. In addition, The American Pet Products Manufacturers Association named our All-Glass Mini Bow 5 as the Best New Aquatic Product and our Nylabone Fold-away Pet Carrier Display Rack as the Best POS Display.

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**THE GARDEN PRODUCTS BUSINESS**

**Overview**

Garden Products manufactures a broad array of proprietary branded lawn and garden products, including Pennington<sup>®</sup>, Amdro<sup>®</sup>, Norcal Pottery<sup>®</sup>, Lofts<sup>®</sup>, Matthews<sup>®</sup> and Grant <sup>®</sup>, and also performs logistics and sales activities for a variety of other manufacturers of lawn and garden products. Garden Products accounted for 57% of Central's consolidated net sales before corporate eliminations in fiscal 2001, 66% in fiscal 2000 and 71% in fiscal 1999, and before the allocation of certain corporate costs and eliminations accounted for income from operations before other charges of \$11.0 million in fiscal 2001, \$34.3 million in fiscal 2000, and \$50.2 million in fiscal 1999.

**Proprietary Branded Products**

The principal lawn and garden product lines are the Pennington line of grass seed, wild bird food and lawn care products, the Norcal Pottery line of pottery products, the Amdro and Grant's line of ant control products, the Matthews line of wooden garden products, and seven proprietary brands of fertilizer.

*Pennington.* Pennington offers a broad range of seed products in the lawn and garden, forage, and wild game and bird markets. Pennington is also a large manufacturer of lawn and garden chemicals, fertilizers, soils and related products. The Pennington line of grass seed and lawn and garden products includes the trademarks Pennington Seed<sup>®</sup>, Pennington<sup>®</sup>, Penkoted<sup>®</sup>, Max-Q, ProCare<sup>®</sup>, Green Charm<sup>®</sup>, Lofts<sup>®</sup> and Rebel<sup>®</sup>. Pennington products are offered nationwide and include:

- *Grass Seed.* Pennington manufactures numerous varieties and blends of cool and warm season turf grass for both the residential and professional markets, as well as forage and wild game seed varieties under the Pennington name and under private labels, including Wal\*Mart's Better Homes and Gardens<sup>®</sup> licensed program. The Pennington grass seed manufacturing facilities are some of the largest and most modern seed conditioning facilities in the industry. Pennington has recently added Lofts<sup>®</sup> and Rebel<sup>®</sup> products to its offerings under a license arrangement.
- *Bird Seed Products.* Pennington is one of the largest manufacturers of wild bird feed including premium, specialty and gourmet mixes. Pennington also manufactures liquid hummingbird food.
- *Lawn and Garden Chemicals.* Pennington manufactures a full line of lawn and garden weed and insect control products, under the names Eliminator<sup>®</sup>, ProCare<sup>®</sup> and Pennington's Pride<sup>®</sup>. Eliminator<sup>®</sup> lawn and garden insecticides and herbicides are packaged exclusively for Wal\*Mart.
- *Fertilizers and Soil Products.* Pennington manufactures several lines of lawn and garden fertilizers, including granular products and liquid plant foods, under several brands, including Pennington<sup>®</sup> and other private and controlled labels. In addition, Pennington's Earth Pak division also offers a complete line of soil, mulch and rock products under several brands, including Pennington and other private and controlled labels.

*Norcal Pottery.* Norcal Pottery designs and procures pottery products from across the United States and around the world. The products include terra cotta, stoneware, ceramics and porcelain pots and are sold to chain store accounts, independent retailers and landscapers nationwide.

*AMBRANDS.* AMBRANDS manufactures AMDRO<sup>®</sup> Fire Ant Bait, the leading fire ant bait product available in the consumer market, and IMAGE<sup>®</sup> Consumer Concentrate, a selective herbicide for the control of difficult weeds in Southern turf, such as nutsedge, dollarweed, wild onion and garlic, Virginia buttonweed and others. Both products are sold primarily in the Southern and Southeastern markets and are carried by key retailers including Wal\*Mart, Home Depot, Ace and Lowe's.

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*Grant's.* Grant's manufactures ant baits, animal repellents and garden aid products. The Grant's line of ant control products consists of Grant's ant baits and granules. These products are sold nationwide through a network of lawn and garden distributors.

*Unicorn Laboratories.* Unicorn serves the U.S. animal health and lawn and garden industries as a private label and branded manufacturer of lawn, garden and animal health chemical products.

*Matthews Four Seasons.* Matthews manufactures a complete line of wooden garden products, including planters, barrel fountains, arbors and trellises. Matthews also produces a cedar bird feeder line under the Kaytee® label.

*Cedar Works.* Pennington has an equity stake in Cedar Works, the largest producer of wooden bird feeders in the country. Its brands include Country Home®, Nature's Market, Cedar Works®, Harvest Landing® and The Address of Distinction®. Cedar Works also offers injection molded plastic bird feeders and feeder accessories to complement its wooden feeder lines.

*Fertilizers.* Central has four proprietary brands of fertilizer - Colorado's Own and Mountain States®, which are manufactured by the Company, and Easy-Gro® and Turf-Magic®, which are supplied to Central by contract manufacturers. In addition, Gro Tec, Inc., a subsidiary of Pennington, markets fertilizers under Pennington®, Pro Care®, Green Charm® and other proprietary brands.

### **Distributed Lawn and Garden Products**

Garden Products also offers its customers a comprehensive selection of other manufacturers' brand name lawn and garden products. In selecting which products to distribute, Garden Products generally focuses on those lawn and garden brand name products that are suited to distribution due to their seasonality, variable sales movements, complexity to consumers and retailers, handling and transportation difficulties, and which therefore generally require value-added services. Garden Products does not carry live plants, power tools or high priced items which are generally sourced directly from manufacturers.

### **Sales and Marketing**

Garden Products' lawn and garden products are sold by approximately 175 sales personnel to a network of lawn and garden and hardware wholesale distributors nationwide. Garden Products also employs approximately 250 sales and marketing personnel to support its logistics and sales activities for a variety of other manufacturers of lawn and garden products. Most products are sold directly to retailers. Historically, Garden Products' sales have been highly seasonal. Most retail sales of lawn and garden products occur on weekends during the spring and fall.

Sales to mass merchandisers, warehouse-type clubs and home improvement centers represent a significant portion of Garden Products' sales. Sales to Wal\*Mart represented approximately 31% of Garden Products' sales in fiscal 2001, 36% in fiscal 2000 and 32% in fiscal 1999. Sales to Home Depot represented approximately 11% of Garden Products' sales in fiscal 2001, 7% in fiscal 2000 and 12% in fiscal 1999. Sales to Lowe's represented approximately 9% of Garden Products' sales in fiscal 2001, 7% in fiscal 2000 and 8% in fiscal 1999.

Subsequent to the fiscal 2000 year end, Wal\*Mart informed Garden Products of a number of significant changes in its lawn and garden supplies purchasing programs and procedures for fiscal 2001. These included Wal\*Mart's decision to purchase certain lawn and garden supplies directly from a number of manufacturers whose supplies had previously been sold through Garden Products; a change from store door deliveries of many of the lawn and garden supplies formerly delivered by Garden Products to individual Wal\*Mart stores to a new procedure whereby Garden Products would ship these products to Wal\*Mart distribution centers; and Wal\*Mart's decision not to have Garden Products personnel perform lawn and garden supplies merchandising functions inside Wal\*Mart stores. As a result of these factors, and the closing of 13 distribution centers associated with the garden distribution downsizing, sales by Garden Products of other manufacturers' lawn and garden products to Wal\*Mart in 2001 declined significantly.

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Garden Products' current practice on product returns generally is to accept and credit the return of unopened cases of products from customers where the quantity is small, the product has been misshipped or the product is defective. Garden Products has arrangements with its manufacturers and suppliers to stock balance and/or credit it for a certain percentage of returned or defective products.

### **Manufacturing**

Garden Products currently operates 14 manufacturing facilities. In addition, certain of its proprietary branded products are manufactured by contract manufacturers. Garden Products also has a development team that is responsible for developing new products within existing proprietary branded product lines and the development of new proprietary branded product lines.

Pennington has seed processing facilities in Madison, Georgia; Greenfield, Missouri; Roll, Arizona; El Centro, California; and Lebanon, Oregon to test, process and package a full range of Pennington seed varieties. Pennington also maintains observation nurseries at all manufacturing locations, enabling it to track seed growth for Pennington quality prior to selection. Pennington's fertilizer plant, Gro Te<sup>®</sup>, is located in Eatonton, Georgia. Pennington wild bird feed is manufactured in Penn Pak facilities in Madison, Georgia; Greenfield, Missouri; and Sidney, Nebraska. In addition, Pennington's Earth Pak plant in Shady Dale, Georgia produces a variety of soil amendments, including pine bark nuggets and potting soils used in landscaping. Pennington also operates a fertilizer manufacturing facility in Longmont, Colorado.

Unicorn Laboratories, Inc. is located in Clearwater, Florida where it manufactures and formulates a variety of lawn, garden and animal health products. Grant's operates a manufacturing facility in San Leandro, California, and Matthews operates a manufacturing facility in Stockton, California.

### **Purchasing**

Most of the raw materials purchased by Garden Products are acquired from a number of different suppliers; however, a number of items are purchased from limited or single sources of supply, and disruption of these sources could have a temporary adverse effect on product shipments and Garden Products' financial results. Garden Products believes alternative sources could be obtained to supply these materials, but a prolonged inability to obtain certain materials could result in lost sales.

Pennington obtains grass seed from various sources, which it presently considers to be adequate. No one source is considered to be essential to Pennington or to Garden Products' business as a whole. Pennington has never experienced a significant interruption of supply. The principal raw materials required for Pennington's wild bird seed manufacturing operations are bulk commodity grains, including millet, milo, wheat and sunflower seeds. Pennington generally purchases these raw materials one to three months in advance. Raw materials are generally purchased from large national commodity companies and local grain cooperatives. In order to ensure an adequate supply of seed to satisfy expected production volume, Pennington enters into contracts to purchase grain and seed at future dates by fixing the quantity, and often the price, at the commitment date.

The key ingredients in the Garden Products' fertilizer and insect and weed control products are various commodity and specialty chemicals including phosphates, urea, potash, herbicides, insecticides and fungicides. Garden Products obtains its raw materials from various sources, which it presently considers to be adequate. No one source is considered to be essential to any of Garden Products' companies or to its business as a whole. Garden Products has never experienced a significant interruption of supply.

### **Distribution**

Garden Products currently operates 20 distribution centers throughout the country. The primary distribution centers for Pennington's products are located both near the point of manufacture and at strategically located warehousing facilities. These facilities are located in Columbia, South Carolina; Cullman, Alabama; Greenfield, Missouri; Madison, Georgia; Kenbridge, Virginia; Hammond, Louisiana; Little Rock, Arkansas; Woburn, Massachusetts; and Laurel, Maryland. In addition, Pennington uses other outside agents and distributors, including,

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but not limited to, Excel Garden Products, Central's other garden sales and logistics operations. Pennington's products are shipped by rail and truck. While the majority of truck shipments are made by contract carriers, a portion is made by Pennington's fleet of trucks.

Excel Garden Products operates distribution centers in Dallas, Texas; Orlando, Florida; Portland, Oregon; Sacramento, California; Santa Fe Springs, California; and Salt Lake City, Utah. Norcal Pottery operates distribution centers in San Leandro, California; Richmond, California; Ontario, California; Houston, Texas; and Algona, Washington.

### **Competition**

The lawn and garden products industry is highly competitive. Garden Products' lawn and garden products compete against national and regional products and private label products produced by various suppliers. Our turf and forage grass seed products compete principally against products by Barenburg, J.R. Simplot, Scotts and numerous regional seed suppliers. Our wild bird seed products compete principally against products by Audubon Park, Wagner, Red River and Gutwein. Our fertilizers, pesticides and combination products compete principally against products marketed by such companies as Scotts, Lebanon Chemical Corp., United Industries Corporation, Vigoro/Pursell Industries and Bayer/Pursell. Since its acquisition of the Ortho® line of lawn and garden products from Pharmacia Corporation (formerly Monsanto) in 1999, Scotts' dominant position in the lawn and garden industry has been a significant competitive disadvantage for Garden Products' branded products. Garden Products competes primarily on the basis of its strong brand names, quality, value, service and price.

Garden Products also competes with a large number of smaller local and regional distributors with competition based on price, service and personal relationships. In addition to competition from other distributors, Garden Products also faces increased competition from manufacturers and suppliers which distribute some percentage of their products directly to retailers, bypassing distributors, or through a dual distribution system in which the manufacturer or supplier competes with distributors for sales to certain accounts. Such competition is typically based on service and price. The termination of the distribution relationship with Scotts effective September 2000 is a significant competitive disadvantage for Garden Products' distribution sales.

## **THE PET PRODUCTS BUSINESS**

### **Overview**

Pet Products is a leading manufacturer of proprietary branded pet supply products, including FourPaws®, Zodiac®, Kaytee®, All-Glass Aquarium®, Oceanic Systems®, Island Aquarium®, Nylabone® and TFH®, and also performs logistics and sales activities for a variety of other manufacturers of pet supply products. Pet Products accounted for 43% of Central's consolidated net sales before corporate eliminations in fiscal 2001, 34% in fiscal 2000 and 29% in fiscal 1999, and before the allocation of certain corporate costs and eliminations accounted for income from operations of \$34.9 million in fiscal 2001, \$32.3 million in fiscal 2000, and \$25.3 million in fiscal 1999.

### **Proprietary Branded Pet Products**

Pet Products' principal pet supply product lines include the Four Paws line of animal products, the TFH line of pet books and Nylabone premium dog chews and pet carriers, the Kaytee line of bird and small animal food, the Wellmark line of flea and tick products, and the All-Glass®, Oceanic Systems® and Island Aquarium® line of aquariums.

*Four Paws.* Four Paws is one of the largest producers of dog, cat, reptile and small animal products in the United States, according to the 2000-01 Pet Age Retailer Report. Four Paws products include Magic Coat® shampoos, Wee-Wee Pads, a line of grooming supplies for dogs and cats, animal cages, tie out cables, leashes, collars, and accessories, oral hygiene products and a complete line of catnip products. Four Paws also offers a line of heating equipment and bedding material for reptiles and a line of hard rubber toys called Rough & Rugged. Four Paws products are distributed throughout the United States, Canada, Europe and Asia.



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*TFH Publications.* TFH is a producer of pet books and the manufacturer of premium dog chews and edible bones under the brand names Nylabone®, Gumabone®, Healthy Edibles® and Flexibone®. TFH currently has over 1,200 titles in print and publishes a monthly magazine. TFH also offers a line of premium dog houses, pet carriers and dog and cat toys under the Nylabone® brand.

*Kaytee.* Kaytee is one of the nation's largest manufacturers of bird seed for pet and wild birds, according to the 2000-01 Pet Age Retailer Report, as well as a manufacturer of food and treats for small animals under the Kaytee® brand. Kaytee also manufactures wild bird feed under the brand name Natures Harvest for Kmart Corporation and under the PETsMART private label.

*Wellmark.* Wellmark is a leading manufacturer of flea, tick and pest protection products for a diversified group of pest control markets, according to the 2000-01 Pet Age Retailer Report. These products which include on-animal spot applications, sprays, shampoos and powders, collars, indoor foggers, aerosols, concentrates and pump-sprays are based on the active ingredient methoprene. Wellmark owns the Zodia® and Vet-Kem® trademarks in the United States and Canada as well as those of Ovitrol®, Siphotrol®, Fleatrol, vIGRen®, Petcor®, Precor® and Natural Signature®.

*All-Glass Aquarium and Island Aquarium.* All-Glass Aquarium and Island Aquarium manufacture aquariums, terrariums, aquatic lighting systems, and aquarium and terrarium furniture sold under the brand names All-Glass Aquarium®, Oceanic Systems® and Island® Aquarium.

### **Distributed Pet Supply Products**

Pet Products also offers its customers a comprehensive selection of other manufacturers' brand name pet supply products. Pet Products carries many of the best-known brands in pet foods and supplies and combines these products into single shipments, providing its pet supply customers a wide variety of products on a cost-effective basis.

### **Sales and Marketing**

Pet Products' branded products are sold nationwide through its own distribution network, as well as independent distributors and directly to retailers, including national specialty pet stores, mass merchants, bookstores and independent pet retailers. Wellmark also sells products to the professional pest control market and veterinarians. At September 29, 2001, Pet Products employed approximately 125 branded products sales and marketing personnel. Pet Products also focuses on selling pet supply products to a wide variety of retailers, including independent, regional and national retail chains. Pet Products employs approximately 100 sales and marketing personnel to support its logistics and sales activities for a variety of other manufacturers of pet supply products.

Sales to mass merchants and national specialty pet stores represent a significant portion of Pet Products' sales. Sales to PETsMART represented 7% of Pet Products' sales in fiscal 2001, 7% in fiscal 2000 and 6% in fiscal 1999. Sales to Petco represented 6% of Pet Products' sales in fiscal 2001, 8% in fiscal 2000 and 5% in fiscal 1999.

### **Manufacturing**

Pet Products currently operates ten manufacturing facilities. In addition, certain of its proprietary branded products are manufactured by contract manufacturers. Pet Products also has development teams that are responsible for developing new products within existing proprietary branded product lines and the development of new proprietary branded product lines.

Four Paws operates manufacturing facilities in Hauppauge, New York. TFH's book division and Nylabone manufacturing facilities are located in Neptune City, New Jersey. Kaytee operates manufacturing facilities in Abilene, Kansas; Chilton, Wisconsin; Cressona, Pennsylvania; and Rialto, California. Wellmark operates a manufacturing and technology center in Dallas, Texas. All-Glass Aquarium operates manufacturing facilities in Franklin, Wisconsin and Dallas, Texas. Island Aquarium operates a manufacturing facility in Fontana, California.

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### **Purchasing**

Most of the raw materials purchased by Pet Products are acquired from a number of different suppliers; however, some items, including the active ingredient Methoprene, are purchased from limited or single sources of supply, and disruption of these sources could have a temporary adverse effect on product shipments and Pet Products' financial results. Pet Products believes alternative sources could be obtained to supply these materials, but a prolonged delay in obtaining certain materials could result in lost sales.

The principal raw materials required for Kaytee's bird seed manufacturing operations are bulk commodity grains, including millet, milo, wheat and sunflower seeds. Kaytee generally purchases these raw materials one to three months in advance. Raw materials are generally purchased from large national commodity companies and local grain cooperatives. In order to ensure an adequate supply of seed to satisfy expected production volume, Kaytee enters into contracts to purchase grain and seed at future dates by fixing the quantity, and often the price, at the commitment date.

### **Distribution**

Pet Products sells its products directly to retailers and a network of distributors. Pet Products currently operates eight distribution centers throughout the country. The facilities are located in Algona, Washington; Denver, Colorado; Houston, Texas; Mahwah, New Jersey; Miami, Florida; Sacramento, California; Santa Fe Springs, California; and Tampa, Florida. While the majority of truck shipments are made by Pet Products' fleet of trucks, a portion is made by common carriers.

### **Competition**

The pet supply products industry is highly competitive. Our branded pet products compete against national and regional products and private label products produced by various suppliers. Our Four Paws and Wellmark branded products compete principally against branded products marketed by such companies as Hartz Mountain, Sargeant's and Eight in One. TFH Publications' pet books compete principally against books published by Howell and Barrons, and Nylabone products compete principally against products manufactured by Aspen/Booda and Dorskocil. Our Kaytee products compete principally against products marketed by Hartz Mountain, Sun Seed, Audobon Park and Wagner. Our All-Glass Aquarium and Island Aquarium branded products compete principally against Perfecto. Pet Products competes primarily on the basis of its strong brand names, innovative new products, quality, value, service and price.

Pet Products also competes with a large number of smaller local and regional distributors with competition based on price, service and personal relationships. In addition to competition from other distributors, Pet Products also faces increased competition from manufacturers and suppliers which distribute some percentage of their products directly to retailers, bypassing distributors, or through a dual distribution system in which the manufacturer or supplier competes with distributors for sales to certain accounts. Such competition is typically based on service and price.

## **MATTERS RELATING TO CENTRAL GENERALLY**

### **Significant Customers**

Wal\*Mart represented approximately 21% of Central's net sales in fiscal 2001, 25% in fiscal 2000 and 24% in fiscal 1999. Wal\*Mart holds significant positions in the retail lawn and garden and pet supplies markets. See "The Garden Products Business - Sales and Marketing" above.

### **Patent and Other Proprietary Rights**

Central's branded products companies hold numerous patents in the United States and in other countries, and have many patent applications pending in the United States and in other countries. Central considers the development of patents through creative research and the maintenance of an active patent program to be

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advantageous in the conduct of its business, but does not regard the holding of any particular patent as essential to its operations. Central grants licenses to certain manufacturers on various terms and enters into cross-licensing arrangements with other parties.

### **Employees**

As of September 29, 2001, Central had approximately 4,200 employees of which approximately 4,000 were full-time employees and 200 were temporary or part-time employees. We hire substantial numbers of temporary employees for the peak lawn and garden shipping season of February through June to meet the increased demand experienced during the spring and summer months, including merchandising in stores. All of our temporary employees are paid on an hourly basis. Except for certain employees at TFH Publications, Inc. and a Kaytee facility in Rialto, California, none of our employees is represented by a labor union. We consider our relationships with our employees to be good.

### **Environmental Considerations**

Many of the products that we manufacture or distribute are subject to local, state, federal and foreign laws and regulations relating to environmental matters. Such regulations are often complex and are subject to change. In the United States, all products containing pesticides must be registered with the United States Environmental Protection Agency ( USEPA ) (and in many cases, similar state and/or foreign agencies) before they can be sold. The inability to obtain or the cancellation of any such registration could have an adverse effect on our business. The severity of the effect would depend on which products were involved, whether another product could be substituted and whether our competitors were similarly affected. We attempt to anticipate regulatory developments and maintain registrations of, and access to, substitute chemicals, but there can be no assurance that we will continue to be able to avoid or minimize these risks. Fertilizer and growing media products are also subject to state and foreign labeling regulations. Grass seed is also subject to state, federal and foreign labeling regulations.

The Food Quality Protection Act, enacted by the U.S. Congress in August 1996, establishes a standard for food-use pesticides, which is that a reasonable certainty of no harm will result from the cumulative effect of pesticide exposures. Under this Act, the USEPA is evaluating the cumulative risks from dietary and non-dietary exposures to pesticides. The pesticides in our products, which are also used on foods, will be evaluated by the USEPA as part of this non-dietary exposure risk assessment. It is possible that the USEPA may decide that a pesticide that we use in our products, would be limited or made unavailable to us. We cannot predict the outcome or the severity of the effect of the USEPA's evaluation. Management believes that we should be able to obtain substitute ingredients if selected pesticides are limited or made unavailable, but there can be no assurance that it will be able to do so for all products.

In addition, the use of certain pesticide and fertilizer products is regulated by various local, state, federal and foreign environmental and public health agencies. These regulations may include requirements that only certified or professional users apply the product or that certain products be used only on certain types of locations (such as not for use on sod farms or golf courses ), may require users to post notices on properties to which products have been or will be applied, may require notification of individuals in the vicinity that products will be applied in the future or may ban the use of certain ingredients. We believe we are operating in substantial compliance with, or taking action aimed at ensuring compliance with, these laws and regulations. Compliance with these regulations and the obtaining of registrations does not assure, however, that our products will not cause injury to the environment or to people under all circumstances.

Environmental regulations may affect us by restricting the manufacturing or use of our products or regulating their disposal. Regulatory or legislative changes may cause future increases in our operating costs or otherwise affect operations. Although we believe we are and have been in substantial compliance with such regulations and have strict internal guidelines on the handling and disposal of our products, there is no assurance that in the future we may not be adversely affected by such regulations or incur increased operating costs in complying with such regulations. However, neither the compliance with regulatory requirements nor our environmental procedures can ensure that we will not be subject to claims for personal injury, property damages or governmental enforcement. For a discussion of potential environmental issues arising from a fire in our Phoenix distribution facility, please see Item 3. Legal Proceedings.

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Certain information regarding the executive officers of the Company is set forth below:

<u>Name</u>	<u>Age</u>	<u>Position</u>
William E. Brown	60	Chairman of the Board and Chief Executive Officer
Glenn W. Novotny	54	President, Chief Operating Officer and Director
Lee D. Hines, Jr.	55	Vice President, Chief Financial Officer, Secretary and Director
Brooks M. Pennington III	47	Chief Executive Officer of Pennington Seed, Inc. and Director

William E. Brown has been Chairman and Chief Executive Officer of the Company since 1980. From 1977 to 1980, Mr. Brown was Senior Vice President of the Vivitar Corporation with responsibility for Finance, Operations, and Research & Development. From 1972 to 1977, he was with McKesson Corporation where he was responsible for its 200-site data processing organization. Prior to joining McKesson Corporation, Mr. Brown spent the first 10 years of his business career at McCormick, Inc. in manufacturing, engineering and data processing.

Glenn W. Novotny has been President of the Company since June 1990 and was President of the predecessor Weyerhaeuser Garden Supply ( WGS ) since 1988. Prior thereto, he was with Weyerhaeuser Corporation for 20 years with a wide range of managerial experience including manufacturing, accounting, strategic planning, sales, general management and business turnarounds.

Lee D. Hines, Jr. has been the Chief Financial Officer and Secretary of the Company since January 2000, a position he previously held from 1991 until 1993. Mr. Hines began his business career with the Chase Manhattan Bank in New York as a domestic and international lending officer and International Trade Specialist. From 1978 to 1982, he served as Vice President Finance and Chief Financial Officer of Vivitar Corporation. Following his tenure at Vivitar, Hines held the position of Chief Financial Officer of Applause, Inc. until 1987. From 1988 to 1990, he served as President and Chief Executive Officer of International Tropic-Cal, a designer, manufacturer and distributor of sunglasses and women's hair accessories. From 1993 until January 2000, Mr. Hines was a self-employed consultant.

Brooks M. Pennington III joined the Company in February 1998 when the Company acquired Pennington. Mr. Pennington has been the President and Chief Executive Officer of Pennington since June 1994.

**Table of Contents****Item 2. Properties**

Central currently operates 24 manufacturing facilities totaling approximately 2,979,000 square feet and 28 distribution facilities totaling approximately 3,220,000 square feet. Most distribution centers consist of office and warehouse space, and several large bays for loading and unloading. Each distribution center provides warehouse, distribution, sales and support functions for its geographic area under the supervision of a regional manager. Central's executive offices are located in Lafayette, California.

The table below lists Garden Products' manufacturing and distribution facilities:

<b>Location</b>	<b>Type of Facility</b>	<b>Owned or Leased</b>
Cullman, AL	Distribution	Owned
Little Rock, AR	Distribution	Owned
Roll, AZ	Manufacturing	Owned
El Centro, CA	Manufacturing	Owned
Ontario, CA	Distribution	Leased
Richmond, CA	Distribution	Leased
Sacramento, CA	Distribution	Leased
San Leandro, CA	Manufacturing	Leased
San Leandro, CA	Distribution	Leased
Santa Fe Springs, CA	Distribution	Leased
Stockton, CA	Manufacturing	Leased
Longmont, CO	Manufacturing	Owned
Clearwater, FL	Manufacturing	Leased
Orlando, FL	Distribution	Leased
Eatonton, GA	Manufacturing	Owned
Madison, GA (2)	Manufacturing	Owned
Madison, GA	Distribution	Owned
Shady Dale, GA	Manufacturing	Owned
Hammond, LA	Distribution	Owned
Woburn, MA	Distribution	Leased
Laurel, MD	Distribution	Leased
Greenfield, MO (2)	Manufacturing	Owned
Greenfield, MO	Distribution	Owned
Sidney, NE	Manufacturing	Owned
Lebanon, OR	Manufacturing	Owned
Portland, OR	Distribution	Leased
Columbia, SC	Distribution	Owned
Dallas, TX	Distribution	Leased
Houston, TX	Distribution	Leased
Salt Lake City, UT	Distribution	Leased
Kenbridge, VA	Distribution	Leased
Algona, WA	Distribution	Leased

The table below lists Pet Products' manufacturing and distribution facilities:

<b>Location</b>	<b>Type of Facility</b>	<b>Owned or Leased</b>
Fontana, CA	Manufacturing	Leased
Rialto, CA	Manufacturing	Owned
Sacramento, CA	Distribution	Leased
Santa Fe Springs, CA	Distribution	Leased
Denver, CO	Distribution	Leased
Miami, FL	Distribution	Leased
Tampa, FL	Distribution	Leased
Abilene, KS	Manufacturing	Owned
Mahwah, NJ	Distribution	Leased



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Location	Type of Facility	Owned or Leased
Neptune City, NJ	Manufacturing	Leased
Hauppauge, NY	Manufacturing	Owned
Cressona, PA	Manufacturing	Owned
Dallas, TX	Manufacturing	Leased
Dallas, TX	Manufacturing	Owned
Houston, TX	Distribution	Leased
Algona, WA	Distribution	Leased
Chilton, WI	Manufacturing	Owned
Franklin, WI	Manufacturing	Owned

Central's leases generally expire between 2002 and 2008. Substantially all of the leases contain renewal provisions with automatic rent escalation clauses. In addition to the facilities that are owned, Central's fixed assets are comprised primarily of trucks and warehousing, transportation and computer equipment.

**Item 3. Legal Proceedings**

*TFH Litigation.* In December 1997, the Company acquired all of the stock of TFH Publications, Inc. In connection with the transaction, the Company made a \$10 million loan to the sellers, which was evidenced by a Promissory Note. In September 1998, the prior owners of TFH brought suit against the Company and certain executives of the Company for damages and relief from their obligations under the Promissory Note, alleging, among other things, that the Company's failure to properly supervise the TFH management team had jeopardized their prospects of achieving certain earnouts. The Company believes that these allegations are without merit. The Company counterclaimed against the prior owners for enforcement of the Promissory Note, damages and other relief, alleging, among other things, fraud, misrepresentation and breach of fiduciary duty by the prior owners of TFH. These actions, *Herbert R. Axelrod and Evelyn Axelrod v. Central Garden & Pet Company*; *Glen S. Axelrod*; *Gary Hersch*; *William E. Brown*; *Robert B. Jones*; *Glen Novotny*; and *Neill Hines*, Docket No. MON-L-5100-99, and *TFH Publications, Inc. v. Herbert Axelrod et al.*, Docket No. L-2127-99 (consolidated cases), are in the New Jersey Superior Court. The case is currently in pretrial discovery and is scheduled for trial in June 2002.

During the course of discovery in this action, the Company has become aware of certain information which suggests that prior to the acquisition of TFH by the Company, certain records of TFH were prepared in an inaccurate manner which resulted in underpayment of taxes by certain individuals. Those individuals could be liable for back taxes, interest, and penalties. In addition, even though all of the events occurred prior to the acquisition of TFH by the Company, there is a possibility that TFH could be liable for penalties for events which occurred under prior management. The Company believes that TFH has strong defenses available to the assertion of any penalties against TFH. The Company cannot predict whether TFH will be required to pay any such penalties. In the event that TFH were required to pay penalties, the Company would seek compensation from the prior owners.

In March 2001, the prior owners of TFH also brought a separate action in federal court seeking to enforce what they alleged was an arbitration award made by an accountant concerning the closing balance sheet of TFH. The prior owners contended that the decisions by the accountant concerning the closing balance sheet entitled them to additional monies under the purchase price provisions of the Stock Purchase Agreement. The federal court held that the accountant did not make any monetary award. The federal court entered a judgment enforcing the decisions made by the accountant concerning the closing balance sheet of TFH, but the court did not, and refused to, enter a monetary award. See *Evelyn M. Axelrod, et al. v. Central Garden & Pet Company*, Civil Action No. 01-1262 (MLC) U.S.D.C. of New Jersey. The prior owners have argued in the consolidated civil actions pending in the New Jersey Superior Court that the judgment by the federal court entitles them to additional monies under the purchase price provision of the Stock Purchase Agreement. The New Jersey Superior Court has stated that it will not, at this time, enter a monetary award, but that it, like the federal court, will confirm the decisions made by the accountant concerning the closing balance sheet of TFH. The New Jersey Superior Court has not yet issued a written Order on its rulings, but the Company anticipates such an Order shortly. The Company believes that it has defenses to the claims by the prior owner for additional monies under the purchase price provisions of the Stock Purchase Agreement, and that the prior owners' claims are subject to or will be offset by the Company's claims against the prior owners.

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The Company, based on consultation with legal counsel, does not believe that the outcome of the above matters will have a material adverse impact on its operations, financial position, or cash flows.

*Scotts and Pharmacia Litigation.* On June 30, 2000, The Scotts Company filed suit against Central to collect the purchase price of certain lawn and garden products previously sold to Central. Scotts has filed an amended complaint seeking \$23 million for such products. Central has withheld payments to Scotts on the basis of claims it has against Scotts including amounts due for services and goods previously supplied by Central and not yet paid for by Scotts. This action, *The Scotts Company v. Central Garden & Pet Company*, Docket No. C2 00-755, is in the United States District Court for the Southern District of Ohio, Eastern Division. On July 3, 2000, Pharmacia Corporation (formerly known as Monsanto Company) filed suit against Central seeking an accounting and unspecified amounts allegedly due Pharmacia under the four-year alliance agreement between Central and Pharmacia which expired in September 1999, as well as damages for breach of contract. This action, *Pharmacia Corporation v. Central Garden & Pet Company*, Docket No. 00CC-002253 Q CV, is in the Circuit Court of St. Louis County, Missouri. Central filed motions in both the *Scotts* and *Pharmacia* actions to have those cases dismissed or stayed. Central's motion in the *Scotts* action has been denied. In the *Scotts* action, Central has filed its answer and a counter complaint asserting various claims for breaches of contracts. Scotts has filed a motion to dismiss one of Central's claims, and that motion is still under submission by the court. Trial in the *Scotts* action is currently scheduled to begin in March 2002.

In the *Pharmacia* action, the court denied Central's motion to stay but granted Central's request that Scotts be joined as a party. On January 18, 2001, Pharmacia Corporation filed an Amended Petition adding Scotts to the *Pharmacia* action. On January 29, 2001, Central filed its Answer, including affirmative defenses, to the Amended Petition as well as Counter/Cross claims against Pharmacia and Scotts. Pharmacia and Scotts have filed responses to Central's counter and cross-claims. In addition, they filed a motion to stay claims other than claims arising under the alliance agreement between Central and Pharmacia. The Court granted this motion, thereby requiring that claims against Scotts or Pharmacia arising from non-alliance matters be litigated in the Ohio and California's federal actions, as appropriate. Trial in the *Pharmacia* action is scheduled to begin on January 22, 2002.

Central believes that the reconciliation of all accounts and claims with Pharmacia and Scotts in the above cases and in the action described below will in the aggregate, not result in additional charges to Central. Further, Central believes it has substantial counterclaims and rights of offset against both Scotts and Pharmacia, as well as meritorious defenses, and intends to vigorously contest both suits. However, Central cannot assure you that the resolution of this litigation will not have a material adverse effect on its results of operations, financial position and/or cash flows.

On July 7, 2000, Central filed suit against Scotts and Pharmacia seeking damages and injunctive relief as well as restitution for, among other things, breach of contract and violations of the antitrust laws. This action, *Central Garden & Pet Company, a Delaware Corporation v. The Scotts Company, an Ohio corporation; and Pharmacia Corporation, formerly known as Monsanto Company, a Delaware corporation*, Docket No. C 00 2465, is in the United States District Court for the Northern District of California. On October 26, 2000, the federal district court issued an order denying, for the most part, Pharmacia's motion to dismiss Central's federal antitrust claims. Central was given leave to file an amended federal complaint to clarify certain of its allegations. Central filed a first amended complaint on November 14, 2000. The defendants have answered the amended complaint, and trial is scheduled for July 15, 2002. The federal district court's October 26 order also ruled that it did not have jurisdiction over Central's state law claims and that such claims should be adjudicated in a state court. On October 31, 2000, Central filed an action entitled *Central Garden & Pet Company v. The Scotts Company and Pharmacia Corporation*, Docket No. C00-04586 in Contra Costa Superior Court asserting various state law claims, including the claims previously asserted in the federal action. On December 4, 2000, Pharmacia and Scotts filed a joint Motion to Stay. The state court has stayed the California action while the contract claims between and among the parties are litigated in the Ohio and Missouri actions and the antitrust claims are litigated in the California federal action.

*Phoenix Fire.* On August 2, 2000, a fire destroyed Central's leased warehouse space in Phoenix, Arizona, and an adjoining warehouse space leased by a third party. The adjoining warehouse tenant has filed a lawsuit seeking to recover for property damage from the fire. Local residents have also filed a purported class action lawsuit alleging claims for bodily injury and property damage as a result of the fire. The building owner and nearby businesses have also presented claims for property damage and business interruption but have not filed lawsuits. In addition, the



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Arizona Department of Environmental Quality is monitoring the cleanup operations and has asked Central, the building owner and the adjoining warehouse tenant to assess whether the fire and fire suppression efforts may have caused environmental impacts to soil, groundwater and/or surface water. The United States Environmental Protection Agency has also requested information relating to the fire. The overall amount of the damages to all parties caused by the fire, and the overall amount of damages which Central may sustain as a result of the fire, have not been quantified. At the time of the fire, Central maintained property insurance covering losses to the leased premises, Central's inventory and equipment, and loss of business income. Central also maintained insurance providing \$51 million of coverage (with no deductible) against third party liability. Central believes that this insurance coverage will be available with respect to third party claims against Central if parties other than Central are not found responsible. The precise amount of the damages sustained in the fire, the ultimate determination of the parties responsible and the availability of insurance coverage are likely to depend on the outcome of complex litigation, involving numerous claimants, defendants and insurance companies.

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

None.

**PART II****Item 5. Market for the Registrant's Common Equity and Related Stockholder Matters**

The Common Stock of the Company has been traded on the Nasdaq National Market under the symbol CENT since the Company's initial public offering on July 15, 1993. The following table sets forth, for the periods indicated, the highest and lowest closing sale prices for the Common Stock, as reported by the Nasdaq National Market.

	<u>High</u>	<u>Low</u>
<b>Fiscal 2000</b>		
First Quarter	9.63	6.94
Second Quarter	11.69	8.25
Third Quarter	12.13	8.72
Fourth Quarter	10.06	6.75
<b>Fiscal 2001</b>		
First Quarter	9.19	6.63
Second Quarter	8.97	6.81
Third Quarter	10.00	6.48
Fourth Quarter	9.75	7.13

As of September 29, 2001, there were approximately 154 holders of record of the Company's Common Stock and seven holders of record of the Company's Class B Stock.

Central has not paid any cash dividends on its common stock in the past. Central currently intends to retain any earnings for use in its business and does not anticipate paying any cash dividends on its common stock in the foreseeable future. In addition, Central's line of credit restricts its ability to pay dividends. See Note 5 of Notes to Consolidated Financial Statements.

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

The following selected statement of operations and balance sheet data of Central as of and for the fiscal years ended September 27, 1997, September 26, 1998, September 25, 1999, September 30, 2000 and September 29, 2001 have been derived from our audited consolidated financial statements. The financial data set forth below should be read in conjunction with the Consolidated Financial Statements of the Company and related Notes thereto in Item 8 Financial Statements and Supplementary Data and Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this Form 10-K/A. This selected financial data contains certain financial information that has been restated. See Note 14 to the consolidated financial statements for further discussion.

	Fiscal Year Ended				
	September 27, 1997	September 26, 1998	September 25, 1999	September 30, 2000	September 29, 2001
(in thousands, except per share data)					
<b>Statement of Operations Data:</b>					
Net sales (1)(2)	\$ 839,498	\$ 1,293,330	\$ 1,531,615	\$ 1,350,878	\$ 1,122,999
Cost of goods sold and occupancy	694,925	1,021,826	1,212,319	1,037,701	811,186
Gross profit	144,573	271,504	319,296	313,177	311,813
Selling, general and administrative expenses (2)	109,160	200,677	262,366	274,077	297,751
Other charges		6,903	2,708	27,156	
Income from operations	35,413	63,924	54,222	11,944	14,062
Interest expense net	(6,554)	(7,609)	(12,087)	(22,551)	(23,083)
Other income	1,509	1,534	1,106	1,176	1,631
Income (loss) before income taxes	30,368	57,849	43,241	(9,431)	(7,390)
Income taxes	12,765	24,302	19,041	4,053	(247)
Net income (loss)	\$ 17,603	\$ 33,547	\$ 24,200	\$ (13,484)	\$ (7,143)
Net income (loss) per common share:					
Basic	\$ 1.11	\$ 1.18	\$ 0.89	\$ (0.72)	\$ (0.39)
Diluted	\$ 1.07	\$ 1.15	\$ 0.88	\$ (0.72)	\$ (0.39)
Weighted average shares outstanding:					
Basic	15,832	28,502	27,328	18,786	18,402
Diluted	19,970	33,007	27,437	18,786	18,402
	September 27, 1997	September 26, 1998	September 25, 1999	September 30, 2000	September 29, 2001
<b>Balance Sheet Data:</b>					
Working capital	\$ 253,926	\$ 277,567	\$ 169,192	\$ 119,021	\$ 110,990
Total assets	559,043	928,554	955,394	945,311	916,626
Short-term borrowings	72	8,095	97,368	134,516	126,475
Long-term borrowings	115,200	125,125	123,898	148,242	151,623
Shareholders' equity	281,807	588,628	495,291	461,840	455,315

(1) See Management's Discussion and Analysis of Financial Condition and Results of Operations herein for a discussion of sales fluctuations related to internal growth and business acquisitions for fiscal years 2001, 2000 and 1999.

(2) Reflects the reclassification of \$2.9 million and \$4.3 million for fiscal 1999 and 2000, respectively, related to volume-based rebate incentives offset by certain shipping and handling billings.



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

The Management's Discussion and Analysis of Financial Condition and Results of Operations presented below gives effect to the restatement of previously issued consolidated financial statements. See Note 14 to the consolidated financial statements for further discussion.

**Overview**

In fiscal 2000, Central's operations were grouped into three business segments, the lawn and garden branded products business, the pet branded products business and the distribution business. In fiscal 2001, Central reorganized its garden and pet businesses. Under the reorganization, Central's garden branded products and distribution businesses became one operating unit, Garden Products, while its pet branded products and distribution businesses became another operating unit, Pet Products. For fiscal 2001, Garden Products and Pet Products accounted for approximately 57% and 43%, respectively, of consolidated net sales before corporate eliminations. These businesses accounted for income from operations before other charges and the allocation of certain corporate costs and eliminations of \$12.7 million and \$34.9 million, respectively, in fiscal 2001. The Company experienced a net loss of \$7.1 million and \$13.5 million for fiscal 2001 and 2000, respectively.

One of the measures management uses to evaluate the performance of its business segments is earnings before other charges, unusual items, interest, taxes and amortization and depreciation (EBITDA excluding other income, other charges and unusual items), which represented income of \$72.6 million and \$76.4 million in fiscal 2001 and 2000, respectively.

The discussion below, and the following presentation, are intended to assist the reader in understanding the results of our operations. This presentation is not intended to replace net income (loss), cash flows or financial position, as determined in accordance with accounting principles generally accepted in the United States of America.

	<u>Fiscal 2001</u>	<u>Fiscal 2000</u>
	(in millions)	
Net sales	\$ 1,123.0	\$ 1,350.9
Net loss	\$ (7.1)	\$ (13.5)
Add: Other charges		27.2
Unusual items	30.0	11.3
Interest expense net	23.1	22.6
Less: Other income	(1.6)	(1.2)
Income tax (benefit) expense	(0.2)	4.0
EBIT (1)	44.2	50.4
Add: Depreciation and amortization	28.4	26.0
EBITDA (2)	\$ 72.6	\$ 76.4

(1) Earnings before other charges, unusual items, interest and taxes.

(2) Earnings before other charges, unusual items, interest, taxes and amortization and depreciation.

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Shown below is a summary of these expenses, which the Company believes were unusual in nature during fiscal 2001.

	<u>Pet Products</u>	<u>Garden Products</u>	<u>Corporate</u>	<u>Company</u>
	(in thousands)			
Closed branches	\$ 274	\$ 3,910	\$	\$ 4,184
Personnel reductions	1,088	2,970	450	4,508
Excess freight		2,063		2,063
Legal & professional	597		11,875	12,472
Excess bad debt		3,100		3,100
Pre-press publication & inventory write-downs	2,000	1,700		3,700
	<u>\$ 3,959</u>	<u>\$ 13,743</u>	<u>\$ 12,325</u>	<u>\$ 30,027</u>

During the last two fiscal years, the Company has been adversely affected by a number of events.

At the end of fiscal 1999, the Company's exclusive distribution agreement for Solaris products ended. During fiscal 2000, Scotts began to distribute both its Miracle Gro and Solaris products through a system that involved a combination of distributors as well as direct sales to certain major retailers. This change, compared with fiscal 1999, reduced revenue by approximately \$176 million in fiscal 2000. Before the end of fiscal 2000, Scotts discontinued its distribution relationship with the Company. As a consequence, sales volumes for future periods were expected to significantly decline, which resulted in the Company initiating a plan to close 13 distribution centers. The closures and the related workforce reductions, employee benefit obligations and asset impairments resulted in other charges for fiscal 2000 of \$27.5 million. As a result, sales of other companies' products by Garden Products in fiscal 2001 declined approximately \$275 million compared with fiscal 2000. Also in fiscal 2000, both Scotts and Pharmacia initiated litigation against the Company arising out of the prior distribution relationship, and the Company filed suit against Scotts and Pharmacia for breach of contract and violations of the antitrust laws as discussed above in Item 3. Legal Proceedings.

In August 2000, a fire destroyed the Company's leased facility in Arizona and an adjoining warehouse space leased by a third party. Various parties have filed lawsuits, and both the Arizona Department of Environmental Quality and the U.S. Environmental Protection Agency have requested information relating to the fire. Lawyers and specialists representing several insurance companies have been meeting since August 2000 to determine the extent of liability for the various parties involved. At this time the precise amount of damages, the ultimate determination of the parties responsible and the availability of insurance coverage are likely to depend on the outcome of complex litigation.

Much of the discovery work on the above lawsuits and the other litigation described above in Item 3. Legal Proceedings was conducted during fiscal 2001 and will continue into fiscal 2002. As a result of the litigation, the Company incurred legal, accounting and other professional expenses of approximately \$12.4 million in fiscal 2001 and \$3.8 million in fiscal 2000. The Company believes that legal and professional fees for fiscal 2002 will approximate the fiscal 2001 level and will decline significantly in subsequent years.

Despite downsizing, the distribution operations of our Garden Products segment continued to adversely affect profitability in fiscal 2001. In accordance with accounting principles generally accepted in the United States of America, certain costs related to the 13 closed distribution centers were not included as part of the \$27.5 million of other charges recorded in fiscal 2000. These costs included wages and related benefits for those employees who stayed on to either sell off certain of the remaining inventory or arrange to ship inventory to other Central locations, or arrange to secure temporary storage until the inventory could be moved to other Central locations. Likewise, freight costs incurred to ship inventory from the closed locations to open facilities were not included in the fiscal 2000 other charges. These costs were incurred and recorded in fiscal 2001.

The Company underestimated the costs the remaining distribution centers would incur to service customers formerly serviced by the closed locations. Since many of these customers were outside of the local area, most of the product sold to them was shipped by common carrier. Additionally, assimilating the extra inventory from the closed

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locations created inefficient warehouse operations. With warehouse space severely limited because of the additional inventory, picking, packing and shipping an order took significantly longer than normal. To ship product timely under these conditions meant increasing the amount of outside labor.

Also during the fourth quarter of fiscal 2001, two large customers of Garden Products filed for bankruptcy.

During the last quarter of fiscal 2001, and continuing in the first quarter of fiscal 2002, the Company further reduced personnel and related people costs in both our businesses. The reductions in our Garden Products segment were largely in the administrative areas where the Company consolidated certain computer operations and administrative functions into one logistics operation.

Pet Products closed three smaller under performing distribution centers during fiscal 2001 and a small manufacturing facility which produced nylon collars and leashes. These products are now secured through outside vendors. These closures resulted in additional facility and personnel costs being incurred in fiscal 2001 which totaled \$1.5 million. In addition, sales of TFH pet books are declining due to, among other things, reduced floor space allocated to books by the larger retailers in favor of other pet products which turn faster than books. However, book production was not reduced to meet the lower sales volume. On hand inventory of books included titles with little current consumer appeal, and in certain cases large quantities of books remained on hand, which had been produced in 1998 and prior. As a result, the Company recorded a charge of \$1.5 million to reduce the carrying value of book inventory to its estimated realizable value. In addition, \$0.5 million of pre-press publication costs, which were being amortized over the anticipated useful life of specific titles, were determined to be unrecoverable in light of the sales decline and were written off.

In Garden Products, Pennington wrote-down its Bahia grass seed inventory as a result of a significant decline in the market price for that particular variety. In connection with the closure of 13 distribution centers in fiscal 2000, management evaluated the inventory remaining from such locations during fiscal 2001 to determine its estimated realizable value. Due to the age of the inventory which remained combined with the fact that more of this inventory became obsolete due to packaging changes made by the manufacturer, a further write-down was taken in fiscal 2001.

**Results of Operations**

The following table sets forth, for the periods indicated, the relative percentages that certain income and expense items bear to net sales:

	Fiscal Year Ended		
	September 29, 2001	September 30, 2000	September 25, 1999
Net sales	100.0%	100.0%	100.0%
Cost of goods sold and occupancy	72.2	76.8	79.2
Gross profit	27.8	23.2	20.8
Selling, general and administrative	26.5	20.3	17.1
Other charges		2.0	0.2
Income from operations	1.3	0.9	3.5
Interest expense, net	(2.1)	(1.7)	(0.8)
Other income	0.2	0.1	0.1
Income tax expense (benefit)	(0.0)	0.3	1.2
Net income (loss)	(0.6)%	(1.0)%	1.6%

**Fiscal 2001 Compared with Fiscal 2000**

Net sales for fiscal 2001 decreased by 16.9% or \$227.9 million to \$1,123.0 million from \$1,350.9 million for fiscal 2000. The decrease is due to a \$243.1 million decrease in net sales of Garden Products offset in part by a sales increase in Pet Products of \$15.2 million. Adjusting for newly acquired operations, the sales decrease in Garden Products was \$252.8 million and in Pet Products net sales would have resulted in a decrease of \$32.7 million. The



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decrease in Garden Products relates to the sales and logistics group, which was expected after we closed 13 distribution centers in late fiscal 2000 as a result of the termination of our distribution relationship with Scotts. The sales decrease in our Pet Products business was attributable to the closure of three pet distribution centers during fiscal 2000 and a decline in Kaytee sales of wild birdseed. In fiscal 2001, Arch, a major pool chemical supplier, and Kal Kan, a supplier of dog food, notified us that they each intend to terminate their relationship with the Company and distribute their products directly to retailers. In fiscal 2001, sales of Arch products were approximately \$50.5 million. The gross profit associated with these sales in fiscal 2001 was approximately \$8.0 million. Sales of Kal Kan products to independent retailers were approximately \$8.5 million in fiscal 2001. The gross profit associated with these sales in fiscal 2001 was estimated to be \$0.9 million based on historical customer profitability. In addition, the Kal Kan business lost includes approximately \$5.8 million of fees related to shipments to PETSMART. The loss of the Kal Kan business contributed to the decision to close two smaller pet distribution centers during the first quarter of fiscal 2002 with a third facility closure planned for February 2002.

Gross profit decreased by \$1.4 million or 0.4% from \$313.2 million during fiscal 2000 to \$311.8 million for fiscal 2001. Adjusting for newly acquired operations, gross profit would have decreased by 4.3% or \$13.5 million. The decrease in gross profit dollars relates principally to lower revenues in the sales and logistics group within Garden Products, while Pet Products generated approximately the same gross profit dollars as in fiscal 2000. Gross profit for both segments was adversely affected by inventory and inventory related write-downs in fiscal 2001. In Pet Products, TFH reduced the carrying value of their book inventory by \$1.5 million and wrote off \$0.5 million of pre-press publication costs. The inventory write-down is primarily the result of a continuing sales decline in pet books which in turn has created excess and obsolete book inventory. The decline in pet book sales relates principally to reduced floor space allocated to books by the large retailers coupled with a reduction in the number of titles they will carry. In Garden Products, Pennington wrote-down its Bahia grass seed inventory by \$1.7 million as a result of a significant decline in the market price for that particular variety. In connection with the closure of 13 distribution centers in fiscal 2000, management, at the existing centers, evaluated the inventory at these facilities to determine the amount of potential overstock and to assess how much inventory could be moved to those locations which would remain open. This evaluation resulted in a write-down of \$7.5 million in fiscal 2000 to adjust the inventory to its estimated realizable value. Due to the age of the inventory which remained combined with the fact that more of this inventory became obsolete due to packaging changes made by the manufacturer, management's evaluation of its estimated realizable value resulted in a further write-down of \$2.2 million in fiscal 2001.

Gross profit as a percentage of sales increased to 27.8% during fiscal 2001 from 23.2% for fiscal 2000. The percentage improvement is principally due to a reduction in sales of other manufacturers' products within Garden Products, which accounted for a significantly lower percentage of total sales. Sales of other manufacturers' products generally result in lower gross margins compared to sales of Central's own branded products. Overall, Garden Products' gross profit improved from 18.5% in fiscal 2000 to 23.0% in fiscal 2001.

Selling, general and administrative expenses increased by \$23.7 million or 8.6% from \$274.1 million during fiscal 2000 to \$297.8 million in fiscal 2001. Of the \$23.7 million increase, approximately \$17.8 million was attributable to newly acquired businesses. As a percentage of net sales, selling, general and administrative expenses increased from 20.3% during fiscal 2000 to 26.5% for fiscal 2001.

Selling and delivery expenses decreased by \$15.6 million, which was net of a \$10.0 million increase related to newly acquired operations, from \$146.7 million in fiscal 2000 to \$131.1 million in fiscal 2001. The decrease in selling and delivery expenses relates principally to the sales decline in Garden Products compared with fiscal 2000. Included in fiscal 2001 selling and delivery expense was approximately \$2.1 million attributable to the closure of three Pet Products branches during fiscal 2001 and increased freight costs to service out of market customers transferred from Garden Products 13 distribution centers closed in fiscal 2000.

Facilities expense decreased by \$2.9 million from \$14.4 million in fiscal 2000 to \$11.5 million in fiscal 2001. Included in fiscal 2001 is approximately \$0.5 million related to newly acquired businesses. This increase was more than offset by decreased expenses from the closure of the distribution centers, the majority of which was in Garden Products.

Warehouse and administrative expenses increased \$42.2 million to \$155.2 million in fiscal 2001 from \$113.0 million in fiscal 2000. Of the \$42.2 million increase, approximately \$7.3 million related to newly acquired



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businesses. Of the \$34.9 million increase from existing operations, approximately \$4.0 million was attributable to Pet Products, \$20.5 million to Garden Products and \$10.4 million to corporate. The increase of \$34.9 million compared with fiscal 2000 related principally to 1) additional bad debt provisions of \$4.5 million, of which \$3.1 million relates to two large Garden Products customers who went bankrupt or ceased operations during the last month of fiscal 2001; 2) increased legal and professional fees of \$5.4 million, which included in fiscal 2001 approximately \$12.4 million associated with the fire at our Arizona warehouse and the litigation work related to the Scotts and T.F.H. lawsuits; 3) an increase in general and medical insurance of \$2.4 million; 4) increased depreciation and goodwill amortization of \$2.4 million; 5) as a result of the closure of Garden Products and Pet Products locations, there has been a significant decrease in both sales and inventory levels, which resulted in an \$11.3 million increase in the amount of purchasing, merchandise handling and storage costs charged to warehouse and administration expense, and not included as inventory costs, compared to the prior year; 6) increased information systems costs of \$0.9 million primarily new systems being implemented to centralize sales, marketing, inventory and financial data; 7) an increase in personnel and other professional costs for research and development of \$0.6 million; and 8) increases in office rents and general increases in normal operating expenses of \$7.4 million.

Net interest expense for the fiscal year ended September 29, 2001 increased by \$0.5 million to \$23.1 million from \$22.6 million for the fiscal year ended September 30, 2000. The increase is due to new long term borrowings resulting principally from the businesses acquired, offset by lower average short-term interest rates.

Average short-term borrowings for the fiscal year ended September 29, 2001 were \$160.3 million compared with \$159.2 million for the fiscal year ended September 30, 2000. The average short-term interest rates for the fiscal years ended September 29, 2001 and September 30, 2000 were 7.5% and 9.0%, respectively.

During fiscal 2001, the Company recognized a tax benefit of \$2 million on a pre-tax loss of \$7.4 million. The tax benefit was affected by certain goodwill amortization which is not deductible for income tax purposes.

**Fiscal 2000 Compared with Fiscal 1999**

Net sales for fiscal 2000 decreased by 11.8% or \$180.7 million to \$1,350.9 million from \$1,531.6 million for fiscal 1999. The decrease was due to a \$218.7 million decrease in Garden Products sales (\$261.1 million attributable to reduced sales of other companies products, primarily sales of Solaris products, which was partially offset by \$12.7 million in sales of existing branded product offerings and \$29.7 million in sales attributable to businesses acquired Norcal Pottery, acquired in January 1999; Unicorn Laboratories, acquired in December 1999; and the Amdro and Image product lines, acquired in March 2000) being partially offset by a \$38.0 million increase in Pet Products sales.

Gross profit decreased by \$6.1 million or 1.3% from \$319.3 million during fiscal 1999 to \$313.2 million for fiscal 2000. Gross profit as a percentage of net sales increased from 20.8% for fiscal 1999 to 23.2% for fiscal 2000. The decrease in gross profit dollars was principally related to a \$16.9 million decrease in Garden Products gross profit partially offset by a \$10.8 million increase in Pet Products gross profit. As a result of resizing our lawn and garden distribution operations, the carrying value of inventory at the distribution centers to be closed was evaluated to determine what products could be moved to the locations remaining open, how much of it would represent significant overstock and what products would have to be liquidated at the individual distribution centers. This evaluation resulted in a write-down of lawn and garden inventory of \$7.5 million to adjust such inventory to its estimated realizable value. This write-down resulted in an increase in cost of goods sold and occupancy of \$2.6 million in fiscal 2000 compared with the inventory write-down of \$4.9 million recorded in fiscal 1999. The increase in gross profit as a percentage of net sales was primarily driven by an increase in Garden Products resulting from a larger proportion of higher margin branded product sales relative to total sales due to the reduction in sales of low margin Solaris products principally to retailers distribution centers. Pet Products gross profit percentage remained relatively constant.

Selling, general and administrative expenses increased \$11.7 million, or 4.5% from \$262.4 million during fiscal 1999 to \$274.1 million for fiscal 2000. Of the \$11.7 million increase, approximately \$8.3 million was attributed to newly acquired businesses. As a percentage of net sales, selling, general and administrative expenses increased from 17.1% during fiscal 1999 to 20.3% for fiscal 2000. Selling and delivery expenses increased by \$1.6 million from \$145.1 million in fiscal 1999 to \$146.7 million in fiscal 2000. Of this increase, \$3.7 million related to newly

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acquired businesses. These increases were offset by a decrease from existing operations of \$2.1 million primarily attributable to a \$6.7 million decrease in lawn and garden distribution operations resulting from lower sales, offset by a \$4.6 million increase principally related to Pennington as a result of increased coop and media advertising, and expanded use of common freight carriers coupled with increased fuel costs. Facilities expense totaled \$14.4 million in both fiscal 1999 and 2000. This results from an increase in costs associated with newly acquired businesses of \$0.3 million, offset by a reduction in costs associated with existing operations of \$0.3 million. The decrease in existing operations related principally to lawn and garden distribution operations resulting from certain facilities which were closed during fiscal 1999. Warehouse and administrative expense increased \$10.1 million from \$102.9 million in fiscal 1999 to \$113.0 million in fiscal 2000. Of this increase, \$4.3 million related to newly acquired businesses. The increase from existing operations, \$5.8 million, related principally to increases in legal and professional fees of \$5.3 million related to our strategic planning and evaluation process, and increases in corporate personnel, related travel and corporate office space.

In September 2000, the Company recorded \$27.5 million of charges resulting from workforce reductions, employee benefit obligations, facility closures, and asset impairments that were necessary due to the termination of the Company's distribution arrangement with Scotts and other anticipated sales decreases in Garden Products. These charges were offset by the reversal of \$0.3 million of certain exit-related costs recorded in connection with the fiscal 1998 restructuring plan for which the Company was no longer obligated.

As a result of the fiscal 2000, and anticipated future, sales decreases in Garden Products, the Company initiated a plan to close 13 distribution centers and reduce its workforce which was completed in fiscal 2001. In connection with this plan, the Company recorded a severance charge of \$1.1 million associated with the termination of 309 employees, primarily in the sales force and distribution centers. Severance of \$0.7 million was paid to 196 employees terminated during fiscal 2000, with the balance expected to be paid to employees who will be terminated in fiscal 2001. In connection with the facilities closures, \$3.6 million was accrued for estimated lease costs, and \$0.2 million for estimated property tax and facilities maintenance costs, that the Company is obligated to pay for periods subsequent to closure. The Company also recorded an \$0.8 million impairment charge to reduce certain facility assets to their estimated fair value based on an independent appraisal, and an \$0.8 million provision for estimated uncollectible receivables from customers of the closed facilities.

In addition, as a direct result of the termination of the distribution relationship with Scotts, the Company recorded a charge of \$4.7 million as the Company became obligated to make cash payments which were guaranteed to certain employees in the event of such termination. These payments were paid during fiscal 2001.

As a result of the events described above, management reevaluated the recoverability of certain intangible assets in Garden Products. Based on an evaluation of estimated future cash flows associated with affected facilities, the Company determined that goodwill and certain trademarks were impaired, and accordingly recorded charges of \$15.7 million and \$0.6 million, respectively, to reduce those assets to estimated fair values.

Net interest expense for the fiscal year ended September 30, 2000 increased by \$10.5 million to \$22.6 million from \$12.1 million for the fiscal year ended September 25, 1999. The increase is due to higher average outstanding short-term debt resulting principally from the Company's stock repurchase program and the businesses acquired. During the fiscal year ended September 30, 2000, the Company repurchased 2,890,900 shares of its stock for a total cost of approximately \$21.7 million, primarily through the use of its revolving credit facility.

Average short-term borrowings for the fiscal year ended September 30, 2000 were \$159.2 million compared with \$65.8 million for the fiscal year ended September 25, 1999. The average short-term interest rates for the fiscal years ended September 30, 2000 and September 25, 1999 were 9.0% and 7.5%, respectively.

During fiscal 2000 the Company recognized tax expense of \$4.1 million on a pre-tax loss of \$9.4 million primarily as the result of non-deductible charges, primarily goodwill amortization and impairment charges, recorded during the year.

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### **New Accounting Pronouncements**

See Note 1, Organization and Significant Accounting Policies in the accompanying consolidated financial statements.

### **Inflation**

The results of operations and financial condition are presented based upon historical cost. While it is difficult to accurately measure the impact of inflation, the Company believes that the effects of inflation on its operations have been immaterial.

### **Liquidity and Capital Resources**

The Company has financed its growth through a combination of bank borrowings, supplier credit, internally generated funds and sales of securities to the public. The Company received net proceeds (after offering expenses) of approximately \$431.0 million from its five public offerings of common stock in July 1993, November 1995, July 1996, August 1997 and January 1998. In November 1996, the Company completed the sale of \$115 million 6% subordinated convertible notes generating approximately \$112 million net of underwriting commissions.

Historically, the Company's business has been highly seasonal and its working capital requirements and capital resources tracked closely to this seasonal pattern. During the first fiscal quarter accounts receivable reach their lowest level while inventory, accounts payable and short-term borrowings begin to increase. Since the Company's short-term credit line fluctuates based upon a specified asset borrowing base, this quarter is typically the period when the asset borrowing base is at its lowest and consequently the Company's ability to borrow is at its lowest. During the second fiscal quarter, receivables, accounts payable and short-term borrowings begin to increase, reflecting the build-up of inventory and related payables in anticipation of the peak selling season. During the third fiscal quarter, inventory levels remain relatively constant while accounts receivable peak and short-term borrowings start to decline as cash collections are received during the peak selling season. During the fourth fiscal quarter, inventory levels are at their lowest, and accounts receivable and payables are substantially reduced through conversion of receivables to cash. As a result of the termination of the Solaris agreement and the associated reduction in distribution sales as a percentage of overall sales, this seasonal pattern is expected to be less significant in the future.

The Company's businesses service two broad markets: lawn and garden and pet supplies. The pet supplies businesses involve products that have a year round selling cycle with very little change quarter to quarter. As a result, it is not necessary to carry large quantities of inventory to meet peak demands. Additionally, this level sales cycle eliminates the need for manufacturers to give extended credit terms to either distributors or retailers. On the other hand, the Garden Products' businesses are highly seasonal with approximately 66% of their aggregate sales occurring during the second and third fiscal quarters. For many manufacturers of garden products this seasonality requires them to move large quantities of their product well ahead of the peak selling periods. To encourage distributors to carry large amounts of inventory, industry practice has been for manufacturers to give extended credit terms and/or promotional discounts.

The Company generated cash from operating activities of \$38.8 million during fiscal 2001, which declined from \$40.1 million during fiscal 2000, primarily due to the decline in sales volume during the year. Net cash used in investing activities of \$32.2 million resulted from acquisitions of new companies and the acquisition of office and warehouse equipment, including computer hardware and software. Net cash used in financing activities of \$4.0 million consisted principally of net repayments of \$9.8 million under the Company's lines of credit and payments of \$12.8 million related to long-term debt, partially offset by \$18.0 million in new long-term borrowings.

The Company has a \$200.0 million line of credit with Congress Financial Corporation (Western). The available amount under the line of credit fluctuates based upon a specific asset-borrowing base. The line of credit bears interest at a rate either equal to the prime rate or LIBOR plus 2% at the Company's option, and is secured by substantially all of the Company's assets. At September 29, 2001, the Company had \$83.1 million of outstanding borrowings, and had \$16.8 million of available borrowing capacity under this line. The Company's line of credit

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contains certain financial covenants such as minimum net worth and minimum working capital requirements. The line also requires the lender's prior written consent to any acquisition of a business. The Company's Pennington subsidiary also has a \$85.0 million line of credit. At September 29, 2001, there were \$31.6 million of outstanding borrowings and \$53.4 million of available borrowing capacity under this line. Interest related to this line is based on a rate either equal to the prime rate or LIBOR plus .875% at the Company's option. The Company All-Glass Aquarium subsidiary also has a \$10.0 million line of credit. As of September 29, 2001, there were \$4.6 million of borrowings and \$5.4 million of available borrowing capacity under this line. Interest related to this line is based on a rate equal to the prime rate less 0.5% (6% at September 29, 2001).

Excluding the potential impact of any adverse consequences associated with legal matters discussed below and in more detail in Item 3. Legal Proceedings, the Company believes that cash flows from operating activities, funds available under its lines of credit, and arrangements with suppliers will be adequate to fund its presently anticipated working capital requirements for the foreseeable future. The Company anticipates that its capital expenditures will not exceed \$15.0 million for the next 12 months.

The Company is involved in a number of lawsuits, several of which could result in substantial monetary judgments. This litigation includes three significant cases between the Company and Scotts and Pharmacia which are currently set for trial on January 2002, March 2002 and July 2002, respectively. Depending on how and when these lawsuits are resolved, these lawsuits could result in substantial changes to the Company's liquidity position either favorable or unfavorable. The Company is currently exploring a number of possible ways to enhance its liquidity, including, among other things, additional debt financing by the Company or one or more of its subsidiaries and/or an equity offering.

In November 1996, the Company issued \$115 million of 6% subordinated convertible notes. The principal amount of the notes will become due on November 15, 2003, unless converted into common stock by the holders or redeemed by the Company prior to maturity.

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

### **Weather and Seasonality**

Historically, the Company's sales of lawn and garden products have been influenced by weather and climate conditions in the markets it serves. Additionally, the Company's business has historically been highly seasonal. In fiscal 2001, approximately 66% of Garden Products' sales occurred in the first six months of the calendar year. Substantially all of Garden Products' operating income is typically generated in this period which has historically offset the operating losses incurred during the first fiscal quarter of the year.

### **Risk Factors Relating to Forward-Looking Statements**

This Form 10-K/A contains forward-looking statements that involve risks and uncertainties. These forward looking statements include information regarding future financial results, the estimated effect of the termination of the Solaris Agreement and future acquisition activity. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of factors both in and out of our control, including the risks faced by us described below and elsewhere in this Form 10-K/A.

You should carefully consider the risks described below. We have separated the risks into three groups:

risks that relate to Central generally;

risks that relate to Garden Products; and

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risks that relate to Pet Products.

In addition, the risks described below are not the only ones facing us. We have only described the risks we consider to be the most material. However, there may be additional risks that are viewed by us as not material or are not presently known to us.

If any of the events described below were to occur, our business, prospects, financial condition, results of operations and/or cash flows could be materially adversely affected. When we say below that something could or will have a material adverse effect on us, we mean that it could or will have one or more of these effects. In any such case, the price of our common stock could decline, and you could lose all or part of your investment in our company.

### **Risks Relating to Central Generally**

*Our quarterly operating results are susceptible to fluctuations, which could cause our stock price to decline.*

We expect to continue to experience variability in our net sales and net income on a quarterly basis. Factors that may contribute to this variability include:

weather conditions and seasonality during peak gardening seasons;

shifts in demand for lawn and garden products;

shifts in demand for pet products;

changes in product mix, service levels and pricing by us and our competitors;

the effect of acquisitions;

economic stability of retail customers; and

the extent of lost business from the termination of distribution relationships, such as with Scotts, and our ability to offset the loss of gross profit as a result of the terminations through expense reductions and other business growth.

In addition, because our distribution businesses operate on relatively low margins, our operating results in any quarterly period could be affected significantly by slight variations in revenues or operating costs. For the same reason, our quarterly results also may be vulnerable to problems in areas such as collectibility of accounts receivable, inventory control and competitive price pressures. The market price of our common stock could be subject to significant fluctuations in response to these variations in quarterly operating results and other factors.

*Because of intense competition, Central's distribution related sales generate low margins.*

The lawn and garden and pet supply distribution industries in which we operate are characterized by relatively low profit margins. As a result, Central's success is highly dependent upon effective cost and management controls and differentiating its services from those of its competitors. The wholesale lawn and garden and pet supply distribution businesses are highly competitive, with many companies competing principally on the basis of price and service. In addition to competition from other distributors, Central also competes with manufacturers and suppliers that elect to distribute certain of their products directly to retailers, including Central's major customers, and private label product suppliers. For example, beginning in fiscal 2000, Scotts began to distribute Ortho®, Roundup® and Miracle-Gro® directly to certain retailers. Similarly, in 2001, Arch Pool Chemicals and Kal Kan Foods notified Central that they intend to terminate their distribution relationships with Central and distribute their products directly to retailers. There can be no assurance that Central will not encounter increased competition in the future or will not lose business from major manufacturers that elect to sell their products directly to retailers, either of which could adversely affect our operations and financial results.

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*Our ability to grow will depend upon internal expansion and acquisitions.*

As part of our growth strategy, we aggressively pursue the acquisition of other companies, assets and product lines that either complement or expand our existing business. Acquisitions involve a number of special risks, including the diversion of management's attention to the assimilation of the operations and personnel of the acquired companies, adverse short-term effects on our operating results, integration of financial reporting systems and the amortization of acquired intangible assets. Since 1993, Central has completed over 29 acquisitions. There can be no assurance that we can successfully integrate acquired businesses or that such businesses will enhance our business. We have also had preliminary acquisition discussions with, or have evaluated the potential acquisition of, numerous other companies over the last several years. We are unable to predict the likelihood of a material acquisition being completed in the future. We may seek to finance any such acquisition through additional debt or equity financings, which could result in dilution and additional risk for the holders of our common stock.

We anticipate that one or more potential acquisition opportunities, including those that would be material, may become available in the near future. If and when appropriate acquisition opportunities become available, we intend to pursue them actively. No assurance can be given that any acquisition by us will or will not occur, that if an acquisition does occur that it will not materially and adversely affect us or that any such acquisition will be successful in enhancing our business. Our future results of operations will also depend in part on our ability to successfully expand internally by increasing the number of new product lines, and to manage any future growth. No assurance can be given that we will be able to obtain or integrate additional product lines or manage any future growth successfully.

*Our success is dependent upon retaining key personnel.*

Our future performance is substantially dependent upon the continued services of William E. Brown, our Chairman and Chief Executive Officer, Glenn W. Novotny, our President and Chief Operating Officer, and Brooks M. Pennington III, the President of Pennington. The loss of the services of any of these persons could have a material adverse effect upon us. In addition, our future performance depends on our ability to attract and retain skilled employees. There can be no assurance that we will be able to retain our existing personnel or attract additional qualified employees in the future.

*The holders of our Class B stock, through their voting power, can greatly influence control of the Company.*

As of December 5, 2001, William E. Brown, our Chairman and Chief Executive Officer, controls approximately 47.9% of the voting power of our capital stock and, therefore, can effectively control all matters requiring stockholder approval, including the power to elect all of our directors. Holders of Class B stock are entitled to the lesser of ten votes per share or 49% of the total votes cast. Holders of common stock are entitled to one vote for each share owned. The holders of Class B stock have 49% of the combined voting power, subject to the aforementioned voting restrictions. Holders of Class B stock are likely to be able to elect all of our directors, control our management and policies and determine the outcome of any matter submitted to a vote of our stockholders except to the extent that a class vote of the common stock is required by applicable law. The disproportionate voting rights of the common stock and Class B stock could have an adverse effect on the market price of the common stock. Such disproportionate voting rights may make us a less attractive target for a takeover than we otherwise might be, or render more difficult or discourage a merger proposal, a tender offer or a proxy contest, even if such actions were favored by our common stockholders. Accordingly, such disproportionate voting rights may deprive holders of common stock of an opportunity to sell their shares at a premium over prevailing market prices, since takeover bids frequently involve purchases of stock directly from stockholders at such a premium price.

*The products that we manufacture and distribute may subject us to environmental considerations.*

Many of the products that we manufacture and distribute are subject to regulation by federal, state and local authorities. Such regulations are often complex and are subject to change. Environmental regulations may affect us by restricting the manufacturing or use of our products or regulating their disposal. Regulatory or legislative changes may cause future increases in our operating costs or otherwise affect operations. Although we believe we are and have been in substantial compliance with such regulations and have strict internal guidelines on the handling and disposal of our products, there is no assurance that in the future we may not be adversely affected by such

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regulations or incur increased operating costs in complying with such regulations. However, neither the compliance with regulatory requirements nor our environmental procedures can ensure that we will not be subject to claims for personal injury, property damages or governmental enforcement.

*The products that we manufacture could expose us to product liability claims.*

Our business exposes us to potential product liability risks, which are inherent in the manufacture and distribution of certain of our products. Although we generally seek to insure against such risks, there can be no assurance that such coverage is adequate or that we will be able to maintain such insurance on acceptable terms. A successful product liability claim in excess of our insurance coverage could have a material adverse effect on us and could prevent us from obtaining adequate product liability insurance in the future on commercially reasonable terms.

*We have pending litigation which could adversely impact our operating results.*

We are a party to certain legal proceedings including the litigation between us and Scotts and Pharmacia arising out of disputes regarding the termination of the Solaris Agreement and litigation arising from a fire which destroyed our Phoenix, Arizona facility. We are currently unable to determine the total expense or possible loss, if any, that may ultimately be incurred in the resolution of these proceedings. Regardless of the ultimate outcome of these proceedings, they could result in significant diversion of time by our management. The results of these proceedings, including any potential settlements, are uncertain and we cannot assure you that the outcome of these disputes will not adversely affect our operating results. Among the proceedings in which we are involved are three significant cases between us and Scotts and Pharmacia which are currently set for trial on January 2002, March 2002 and July 2002, respectively. Depending on how and when these lawsuits are resolved, these lawsuits could result in substantial changes to the Company's liquidity position either favorable or unfavorable. For more information on our pending litigation, please see Item 3. Legal Proceedings.

**Risks Relating to Garden Products**

*Adverse weather during the peak gardening season can hurt Garden Products and our net sales.*

Because demand for lawn and garden products is significantly influenced by weather, particularly weekend weather during the peak gardening season, our results of operations could be adversely affected by certain weather patterns such as unseasonably cool or warm temperatures, water shortages or floods. During the last several years, our results of operations were negatively affected by severe weather conditions in some parts of the country. Additionally, our business is highly seasonal, with approximately 66% of Garden Products sales in fiscal 2001 occurring during the second and third quarters of the fiscal year. Historically, substantially all of Garden Products operating income is generated in this period.

*An increase in market prices for seeds and grains used to produce bird seed and grass seed or a decrease in demand for bird seed or grass seed could have a negative impact on our operating income.*

Garden Products financial results depend to a large extent on the cost of raw materials and the ability of Garden Products to pass along to its customers increases in these costs. In particular, our Pennington subsidiary is exposed to fluctuation in market prices for commodity seeds and grains, used to produce bird seed and grass seed. Historically, market prices for commodity seeds and grains have fluctuated in response to a number of factors, including changes in United States government farm support programs, changes in international agricultural and trading policies and weather conditions during the growing and harvesting seasons. For example, a significant rise in the white millet acquisition cost in late 2000 and 2001 had a negative impact on profitability of bird feed products in fiscal 2001, although we do not believe this will be a long-term problem. In the event of any increases in raw materials costs, Garden Products would be required to increase sales prices for its products in order to avoid margin deterioration. We cannot assure you as to the timing or extent of Garden Products ability to implement future price adjustments in the event of increased raw material costs or as to whether any price increases implemented by Garden Products may affect the volumes of future shipments.

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In fiscal 2001, Garden Products was adversely affected by a worldwide oversupply of certain grass seeds brought on by a combination of weather issues, generally poor economic conditions in agriculture, and diseases, like hoof and mouth and mad cow, that reduce demand for seed. If the oversupply extends into fiscal 2002, our operating results would suffer.

To protect against changes in market prices, we generally enter into purchase contracts for grains, bird seed and grass seed to cover up to approximately one-third of the purchase requirements for a selling season. Since we hedge only a portion of our purchase requirements, if market prices for grains increase, our cost of production would increase. In contrast, if market prices for grains decrease because of a lack of demand, we may end up purchasing grains and seeds pursuant to the purchase contracts at prices above market.

*Garden Products depends on a few customers, including Wal\*Mart, Lowes and Home Depot, for a significant portion of its net sales.*

Garden Products' largest customer is Wal\*Mart, which accounted for approximately 31%, 36% and 32% of its net sales for fiscal 2001, fiscal 2000 and fiscal 1999, respectively. Garden Products' second largest customer is Home Depot, which accounted for approximately 11%, 7% and 12% of its net sales for fiscal 2001, fiscal 2000 and fiscal 1999, respectively. Sales to Lowe's accounted for approximately 9%, 7% and 8% of its net sales for fiscal 2001, fiscal 2000 and fiscal 1999, respectively. The market share of these three retailers in the lawn and garden industry has increased during the last several years.

During fiscal 2000, Wal\*Mart began to have certain products delivered to its internal distribution centers rather than directly to stores, which adversely affected our revenue from these products. Subsequent to the fiscal 2000 year end, Wal\*Mart informed Central of a number of significant changes in its lawn and garden supplies purchasing programs and procedures for the coming year. These include Wal\*Mart's decision to purchase certain lawn and garden supplies directly from a number of manufacturers whose lawn and garden supplies had previously been sold through Central; a change from store door deliveries of many of the lawn and garden supplies formerly delivered by Central to individual Wal\*Mart stores to a new procedure whereby Central will ship these products to Wal\*Mart distribution centers; and Wal\*Mart's decision not to have Central personnel perform lawn and garden supplies merchandising functions inside Wal\*Mart stores. As a result of these factors, and the closing of 13 distribution centers associated with the Garden Products restructuring, Garden Product's sales of lawn and garden supplies to Wal\*Mart in 2001 declined significantly. The distribution facility closures coupled with the absence of our distributing Scotts products in 2001 has also adversely impacted other customer relationships.

The loss of, or significant adverse change in, the relationship between us and Wal\*Mart, Home Depot or Lowe's could cause our net sales and income from operations to decline. The loss of or reduction in orders from any significant customer, losses arising from customer disputes regarding shipments, fees, merchandise condition or related matters, or our inability to collect accounts receivable from any major customer could reduce our income from operations.

*Our net sales and operating income from distributing other company's garden products decreased significantly in fiscal 2001 due to the termination of our distribution relationship with Scotts and may continue to decrease in the future.*

From October 1, 1995 to September 30, 1999, we distributed Solaris product nationwide, pursuant to an exclusive distribution agreement. Sales of products purchased from Solaris, previously our largest supplier, accounted for approximately 37% of Garden Product's net sales and 27% of Central's net sales during fiscal 1999. In January 1999, Pharmacia sold its Solaris lawn and garden business exclusive of its Roundup® herbicide products for consumer use to Scotts and entered into a separate, long-term, exclusive agreement pursuant to which Pharmacia continues to make Roundup herbicide products for consumer use and Scotts markets the products. Beginning October 1, 1999, Scotts began to distribute Ortho® and Roundup® products through a system that involved a combination of distributors, of which we were the largest, as well as through direct sales by Scotts to certain major retailers. In addition, Scotts began to sell Miracle-Gro® directly to certain retailers.

Effective September 30, 2000, Scotts discontinued its distribution relationship with Central. The affected products included Scotts®, Ortho® and Miracle-Gro® products and consumer Roundup® products manufactured by



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Pharmacia Corporation (formerly known as Monsanto Company) for which Scotts acts as Pharmacia's exclusive sales agent. For Central's fiscal year ended September 30, 2000, the revenue attributable to the affected products was approximately \$176 million. The gross profit associated with these sales in fiscal 2000 was estimated to be \$27 million based on historical customer profitability. Due to the termination of the Scotts distribution relationship, we took actions to downsize our lawn and garden distribution operations to reflect anticipated business levels for the fiscal year 2001. As a result, we recorded charges of \$27.5 million in the fiscal year ending September 30, 2000. We cannot assure you that our lawn and garden distribution operations will be able to operate profitably at the reduced revenue levels forecasted for fiscal 2002. If our current downsizing efforts are not successful, we may be forced to record additional charges in fiscal 2002, which would decrease our operating results further.

The sale of the Solaris business by Pharmacia, the expiration of the Solaris Agreement and termination of the Scotts distribution relationship subject our business to significant uncertainties. These include the resolution of all payments due between us and Pharmacia under the Solaris Agreement, such as the amounts receivable from Pharmacia for cost reimbursements and payments for cost reductions; the amounts payable to Pharmacia for inventory; and responsibility for obsolete inventory and for non-payment by Solaris sub-agents. Scotts and Pharmacia have each initiated litigation against Central arising out of the prior distribution relationship. In addition, Central has filed suit against Scotts and Pharmacia seeking damages and injunctive relief as well as restitution for, among other things, breach of contract and violations of the antitrust laws by Scotts and Pharmacia. Because of the uncertainties inherent in complex litigation, it is not currently possible to make an assessment of the potential impact, losses or gains that may arise out of these cases individually or collectively. Central believes that, in the aggregate, the reconciliation of all accounts and claims with Pharmacia and Scotts, as described above in Item 3. Legal Proceedings, will not result in additional charges to Central. Further, Central believes it has substantial counterclaims and rights of offset against both Scotts and Pharmacia, as well as meritorious defenses, and intends to vigorously contest both suits. However, there can be no assurance that the resolution of this litigation will not have a material adverse effect on its results of operations, financial position and/or cash flows.

*The loss of the Arch Pool Chemicals business may necessitate the closure of additional garden distribution centers.*

In 2001, Arch Pool Chemicals notified Garden Products that it will discontinue its distribution relationship with Garden Products and deliver its product directly to retailers. For fiscal 2001, the revenue attributable to the affected products was approximately \$50.5 million. The gross profit associated with these sales in fiscal 2001 was approximately \$8.0 million. If we are unable to offset the loss of gross profit as a result of the termination through expense reductions and other business growth, our operating income would be adversely impacted and we may be required to close additional underutilized garden distribution centers.

### **Risks Relating to Pet Products**

*Pet Products depends on a few customers, including PETsMART and Petco, for a significant portion of its net sales.*

Pet Products' largest customer is PETsMART, which accounted for approximately 7%, 7% and 6% of Pet Products' net sales for fiscal 2001, fiscal 2000 and fiscal 1999, respectively. Pet Products' second largest customer is Petco, which accounted for approximately 6%, 8% and 5% of Pet Products' net sales for fiscal 2001, fiscal 2000 and 1999, respectively. The loss of, or significant adverse change in, the relationship between Pet Products and PETsMART or Petco could have a material adverse effect on Pet Products' business and financial results. The loss of or reduction in orders from any significant customer, losses arising from customer disputes regarding shipments, fees, merchandise condition or related matters, or Pet Products' inability to collect accounts receivable from any major customer could have a material adverse impact on our business and financial results.

*An increase in market prices for grains could have a negative impact on our operating income.*

Pet Products' financial results depend to a large extent on the cost of raw materials and the ability of Pet Products to pass along to its customers increases in these costs. In particular, our Kaytee subsidiary is exposed to fluctuation in market prices for commodity grains. Historically, market prices for commodity grains have fluctuated in response to a number of factors, including changes in United States government farm support programs, changes in international agricultural and trading policies and weather conditions during the growing and harvesting seasons. In the event of any increases in raw materials costs, Pet Products would be required to increase sales prices for its

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products in order to avoid margin deterioration. There can be no assurance as to the timing or extent of Pet Products' ability to implement future price adjustments in the event of increased raw material costs or as to whether any price increases implemented by Pet Products may affect the volumes of future shipments.

To protect against changes in market prices, we generally enter into purchase contracts for grains and bird seed to cover up to approximately one-third of the purchase requirements for a selling season. Since we hedge only a portion of our purchase requirements, if market prices for grains increase, our cost of production would increase.

*The majority of our pet supply distribution sales are made to independent pet retailers, whose market share has been eroded by the growth of national specialty pet stores.*

Historically, a majority of our pet supply distribution sales have been made to independent pet retailers. In recent years, these independent pet retailers have experienced severe competition from and a loss of market share to national specialty pet retailers, like PETsMART and Petco, and mass merchants, like Wal\*Mart, Kmart and Target. The future success of our pet supply distribution business will depend on our ability to offer competitive costs and value-added services to independent pet dealers and to increase sales to national specialty pet retailers and mass merchants. If independent pet retailers continue to lose market share to national specialty pet retailers and we are unable to expand our business with these pet retailers, Pet Product's net sales will decline and our operating income will suffer.

*The loss of the Kal Kan dog food business may necessitate the closure of certain pet distribution centers.*

Central entered into a Master Services Agreement in May 2000 pursuant to which Kal Kan Foods, Inc. granted Central exclusive nationwide distribution rights for certain of its pet food products. Under the agreement, Central's duties included providing account servicing support to Kal Kan in its direct-sell program to PETsMART as well as the right to distribute the same products on a buy-sell basis to independent pet supply retailers throughout the United States, with certain exceptions. Effective November 2001, Kal Kan terminated its distribution relationship with Pet Products. The gross profit associated with these sales in fiscal 2001 was approximately \$6.7 million. The loss of the Kal Kan business contributed to the decision to close two smaller pet branches during the first quarter of fiscal 2002 with a third facility closure planned for February 2002. If we are unable to offset the loss of gross profit as a result of the termination through expense reductions and other business growth, our operating income would be adversely impacted and we may be required to close additional underutilized pet distribution centers.

**Item 7A. Quantitative and Qualitative Disclosure About Market Risk**

Central is exposed to market risks, which include changes in U.S. interest rates and commodity prices and, to a lesser extent, foreign exchange rates. Central does not engage in financial transactions for trading or speculative purposes.

*Interest Rate Risk.* The interest payable on Central's bank lines of credit is based on variable interest rates and therefore affected by changes in market interest rates. If interest rates on existing variable rate debt had changed by 10% compared to actual rates, interest expense would have increased or decreased by approximately \$1.4 million and \$1.5 million for the years ended September 29, 2001 and September 30, 2000, respectively. In addition, Central has fixed income investments consisting of cash equivalents and short-term investments in marketable debt securities, which are also affected by changes in market interest rates. Central does not use derivative financial instruments in its investment portfolio.

*Commodity Prices.* Central is exposed to fluctuation in market prices for grains and grass seed. To mitigate risk associated with increases in market prices and commodity availability, Central enters into contracts for grains, bird seed and grass seed purchases. Such contracts are primarily entered into to ensure commodity availability to the Company in the future. As of September 29, 2001, the Company had entered into fixed seed purchase commitments for fiscal 2002 totaling approximately \$37.8 million. A 10% change in the market price for grain and grass seed would result in an additional pretax gain or loss of \$3.8 million related to the contracts outstanding as of September 29, 2001. As of September 30, 2000, the Company had entered into fixed seed purchase commitments for fiscal 2001 totaling approximately \$85.1 million. A 10% change in the market price for grain and grass seed would have

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resulted in an additional pretax gain or loss of \$8.5 million related to the contracts outstanding as of September 30, 2000.

*Foreign Currency Risks.* Central has minimal sales outside of the United States and, therefore, has only minimal exposure to foreign currency exchange risks. Purchases made from foreign vendors are primarily made in U.S. dollars and, therefore, the Company has only minimal exposure to foreign currency exchange risk. Central does not hedge against foreign currency risks and believes that foreign currency exchange risk is immaterial.

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**Item 8. Financial Statements and Supplementary Data**

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**INDEPENDENT AUDITORS REPORT**

Board of Directors  
Central Garden & Pet Company  
Lafayette, California

We have audited the accompanying consolidated balance sheets of Central Garden & Pet Company and subsidiaries (the Company) as of September 29, 2001 and September 30, 2000, and the related consolidated statements of operations, shareholders' equity and cash flows for each of the fiscal years in the three-year period ended September 29, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Central Garden & Pet Company and subsidiaries as of September 29, 2001 and September 30, 2000, and the results of their operations and their cash flows for each of the fiscal years in the three-year period ended September 29, 2001 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 14, the accompanying consolidated financial statements have been restated.

/s/ DELOITTE & TOUCHE LLP

December 7, 2001 (December 4, 2002 as to the effects of the restatement discussed in Note 14)  
San Francisco, California

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**CENTRAL GARDEN & PET COMPANY**  
**CONSOLIDATED BALANCE SHEETS**

	<b>September 29, 2001</b>	<b>September 30, 2000 As Restated (See Note 14)</b>
<b>(dollars in thousands)</b>		
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 8,292	\$ 5,685
Accounts receivable, less allowance for doubtful accounts of \$14,464 and \$8,050	141,791	151,190
Inventories	217,902	239,046
Prepaid expenses and other assets	35,776	22,122
	<u>403,761</u>	<u>418,043</u>
Land, buildings, improvements and equipment:		
Land	4,977	5,194
Buildings and improvements	60,421	56,554
Transportation equipment	5,753	6,138
Machinery and warehouse equipment	65,966	59,325
Office furniture and equipment	32,845	31,335
	<u>169,962</u>	<u>158,546</u>
Less accumulated depreciation and amortization	61,164	46,806
	<u>108,798</u>	<u>111,740</u>
Land, buildings, improvements and equipment net	108,798	111,740
Goodwill	371,987	382,294
Other assets	32,080	33,234
	<u>\$ 916,626</u>	<u>\$ 945,311</u>
	<u>\$ 916,626</u>	<u>\$ 945,311</u>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current liabilities:		
Notes payable	\$ 119,423	\$ 129,239
Accounts payable	127,884	121,705
Accrued expenses	38,412	42,801
Current portion of long-term debt	7,052	5,277
	<u>292,771</u>	<u>299,022</u>
Total current liabilities	292,771	299,022
Long-term debt	151,623	148,242
Deferred income taxes and other long-term obligations	16,917	36,207
Commitments and contingencies		
Shareholders' equity:		
Class B stock	16	16
Common stock	305	304
Additional paid-in capital	526,410	525,793
Retained earnings	73,411	80,554
Treasury stock	(144,827)	(144,827)
	<u>455,315</u>	<u>461,840</u>
Total shareholders' equity	455,315	461,840
	<u>\$ 916,626</u>	<u>\$ 945,311</u>
Total	\$ 916,626	\$ 945,311



See notes to consolidated financial statements.

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**CENTRAL GARDEN & PET COMPANY**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

	Fiscal Year Ended		
	September 29, 2001	September 30, 2000	September 25, 1999
	As Restated (See Note 14) (in thousands, except per share amounts)		
Net sales	\$ 1,122,999	\$ 1,350,878	\$ 1,531,615
Cost of goods sold and occupancy	811,186	1,037,701	1,212,319
	311,813	313,177	319,296
Gross profit			
Selling, general and administrative expenses	297,751	274,077	262,366
Other charges		27,156	2,708
	14,062	11,944	54,222
Income from operations			
Interest expense	(23,247)	(23,140)	(12,680)
Interest income	164	589	593
Other income	1,631	1,176	1,106
	(7,390)	(9,431)	43,241
Income (loss) before income taxes			
Income taxes	(247)	4,053	19,041
	\$ (7,143)	\$ (13,484)	\$ 24,200
Net income (loss)			
Net income (loss) per common share:			
Basic	\$ (0.39)	\$ (0.72)	\$ 0.89
Diluted	\$ (0.39)	\$ (0.72)	\$ 0.88
Weighted average shares outstanding:			
Basic	18,402	18,786	27,328
Diluted	18,402	18,786	27,437



See notes to consolidated financial statements.

**Table of Contents****CENTRAL GARDEN & PET COMPANY****CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY**

	<u>Class B Stock</u>		<u>Common Stock</u>			<u>Retained Earnings</u>	<u>Restricted Stock</u>	<u>Treasury Stock</u>		<u>Total As Restated (See Note 14)</u>
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>	<u>Additional Paid-in Capital</u>	<u>As Restated (See Note 14)</u>	<u>Deferred Compensation</u>	<u>Shares</u>	<u>Amount</u>	
(in thousands, except share amounts)										
Balance, September 26, 1998 (as restated see Note 14)	1,661,762	\$ 16	29,718,530	\$ 298	\$ 519,933	\$ 69,838	\$ (39)	(72,000)	\$ (1,418)	\$ 588,628
Amortization, restricted stock deferred compensation							39			39
Tax benefit from exercise of stock options					120					120
Conversion of Class B stock into common stock	(843)		843							
Issuance of common stock			463,992	4	4,005					4,009
Treasury stock purchases								(10,779,350)	(121,705)	(121,705)
Net income (as restated)						24,200				24,200
Balance, September 25, 1999 (as restated)	1,660,919	16	30,183,365	302	524,058	94,038		(10,851,350)	(123,123)	495,291
Tax benefit from exercise of stock options					14					14
Conversion of Class B stock into common stock	(3,157)		3,157							
Issuance of common stock			230,899	2	1,721					1,723
Treasury stock purchases								(2,890,900)	(21,704)	(21,704)
Net loss (as restated)						(13,484)				(13,484)
Balance, September 30, 2000 (as restated)	1,657,762	16	30,417,421	304	525,793	80,554		(13,742,250)	(144,827)	461,840
Tax benefit from exercise of stock options					95					95
Conversion of Class B stock into common stock	(2,300)		2,300							
Issuance of common stock			112,752	1	522					523
Net loss ( as restated)						(7,143)				(7,143)
Balance, September 29, 2001 (as restated)	1,655,462	\$ 16	30,532,473	\$ 305	\$ 526,410	\$ 73,411	\$	(13,742,250)	\$ (144,827)	\$ 455,315

See notes to consolidated financial statements.

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**CENTRAL GARDEN & PET COMPANY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Fiscal Year Ended		
	September 29, 2001	September 30, 2000	September 25, 1999
	As Restated (See Note 14) (in thousands)		
Cash flows from operating activities:			
Net income (loss)	\$ (7,143)	\$ (13,484)	\$ 24,200
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	28,362	26,035	20,492
Goodwill impairment charge		15,739	
Deferred income taxes		Accumulated depreciation and amortization	(93,154)
	10,251		(92,317)
	53,887	57,251	
<b>OTHER ASSETS</b>			
Deferred income taxes	4,631	195	
Goodwill	61,032	36,003	
Purchased intangibles	19,060	1,922	
Miscellaneous other assets	7,384	7,170	
	92,107	45,290	
<b>TOTAL ASSETS</b>	<b>\$ 641,252</b>	<b>\$ 592,565</b>	

See accompanying notes.

## CUBIC CORPORATION

## CONSOLIDATED BALANCE SHEETS continued

	2008	September 30, (in thousands)	2007
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>			
<b>CURRENT LIABILITIES</b>			
Trade accounts payable	\$	23,288	\$ 27,992
Customer advances		74,963	58,412
Accrued compensation		41,111	38,183
Other current liabilities		44,721	31,787
Income taxes payable		6,017	4,905
Current maturities of long-term debt		6,045	6,138
<b>TOTAL CURRENT LIABILITIES</b>		<b>196,145</b>	<b>167,417</b>
<b>LONG-TERM DEBT</b>		<b>25,700</b>	<b>32,699</b>
<b>OTHER LIABILITIES</b>			
Accrued pension liability		16,451	1,530
Deferred compensation		7,821	8,148
Income taxes payable		6,283	
<b>COMMITMENTS AND CONTINGENCIES</b>			
<b>SHAREHOLDERS EQUITY</b>			
Preferred stock, no par value (in thousands):			
Authorized 5,000 shares			
Issued and outstanding none			
Common stock, no par value (in thousands):			
Authorized 50,000 shares			
2008 Issued 35,673 shares, outstanding 26,727 shares			
2007 Issued 35,665 shares, outstanding 26,720 shares			
		12,485	12,357
Retained earnings		404,868	375,299
Accumulated other comprehensive income		7,570	31,184
Treasury stock at cost (in thousands):			
2008 8,945 shares; 2007 8,945 shares			
		(36,071)	(36,069)
		<b>388,852</b>	<b>382,771</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS EQUITY</b>	<b>\$</b>	<b>641,252</b>	<b>\$ 592,565</b>

See accompanying notes.

## CUBIC CORPORATION

## CONSOLIDATED STATEMENTS OF INCOME

	Years Ended September 30,		
	2008	2007	2006
	(amounts in thousands, except per share data)		
<b>Net sales:</b>			
Products	\$ 478,478	\$ 517,165	\$ 489,286
Services	402,657	372,705	332,100
	881,135	889,870	821,386
<b>Costs and expenses:</b>			
Products	376,213	415,729	411,181
Services	333,268	311,811	276,032
Selling, general and administrative expenses	99,956	95,054	97,166
Restructuring costs	6,203		
Research and development	12,231	5,178	6,112
	827,871	827,772	790,491
<b>Operating income</b>	<b>53,264</b>	<b>62,098</b>	<b>30,895</b>
<b>Other income (expenses):</b>			
Gain on sale of assets	1,238	1,052	7,237
Interest and dividends	6,351	3,431	1,891
Interest expense	(2,745)	(3,403)	(5,112)
Other income (expense)	(653)	1,299	433
Minority interest in loss (income) of subsidiary	(216)	771	985
<b>Income before income taxes</b>	<b>57,239</b>	<b>65,248</b>	<b>36,329</b>
<b>Income taxes</b>	<b>20,385</b>	<b>23,662</b>	<b>12,196</b>
<b>Net income</b>	<b>\$ 36,854</b>	<b>\$ 41,586</b>	<b>\$ 24,133</b>
<b>Basic and diluted net income per common share</b>	<b>\$ 1.38</b>	<b>\$ 1.56</b>	<b>\$ 0.90</b>
<b>Average number of common shares outstanding</b>	<b>26,725</b>	<b>26,720</b>	<b>26,720</b>

See accompanying notes.

## CUBIC CORPORATION

## CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended September 30,		
	2008	2007	2006
	(in thousands)		
<b>Operating Activities:</b>			
Net income	\$ 36,854	\$ 41,586	\$ 24,133
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	9,688	8,854	8,490
Deferred income taxes	(6,203)	745	514
Provision for doubtful accounts	(39)	19	145
Gain on sale of assets	(1,238)	(1,052)	(7,237)
Minority interest in income (loss) of subsidiary	216	(771)	(985)
Changes in operating assets and liabilities, net of effects from acquisitions:			
Accounts receivable	40,495	18,091	5,793
Inventories	(18,748)	(7,610)	1,577
Prepaid expenses	451	(8,048)	(2,051)
Accounts payable and other current liabilities	4,037	9,965	(2,112)
Customer advances	16,952	12,181	2,279
Income taxes	7,835	(2,741)	155
Other items - net	2,355	(2,063)	629
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>92,655</b>	<b>69,156</b>	<b>31,330</b>
<b>Investing Activities:</b>			
Acquisition of businesses, net of cash acquired	(53,776)		(785)
Proceeds from sale of assets	1,779	3,775	8,028
Proceeds from sale of short-term investments	66,160	241,606	4,000
Purchases of short-term investments	(39,070)	(259,935)	(12,850)
Purchases of property, plant and equipment	(8,100)	(6,098)	(9,789)
Other items - net	(2,254)	(139)	(513)
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(35,261)</b>	<b>(20,791)</b>	<b>(11,909)</b>
<b>Financing Activities:</b>			
Change in short-term borrowings		(10,000)	(16,437)
Principal payments on long-term debt	(6,112)	(6,112)	(6,052)
Proceeds from issuance of common stock	128		
Purchases of treasury stock	(2)		(3)
Dividends paid to shareholders	(4,810)	(4,810)	(4,810)
<b>NET CASH USED IN FINANCING ACTIVITIES</b>	<b>(10,796)</b>	<b>(20,922)</b>	<b>(27,302)</b>
Effect of exchange rates on cash	(7,465)	3,740	1,401
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>39,133</b>	<b>31,183</b>	<b>(6,480)</b>
Cash and cash equivalents at the beginning of the year	73,563	42,380	48,860
<b>CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR</b>	<b>\$ 112,696</b>	<b>\$ 73,563</b>	<b>\$ 42,380</b>

See accompanying notes.



## CUBIC CORPORATION

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(in thousands except per share amounts)	Comprehensive Income	Treasury Stock	Accumulated Other Comprehensive Income	Retained Earnings	Common Stock	Number of Shares Outstanding
October 1, 2005		\$ (36,066)	\$ 1,667	\$ 319,200	\$ 12,357	26,720
Comprehensive income:						
Net income	\$ 24,133			24,133		
Decrease in minimum pension liability	2,435		2,435			
Foreign currency translation adjustment	4,321		4,321			
Net unrealized losses from cash flow hedges	(8)		(8)			
Comprehensive income	\$ 30,881					
Purchase of treasury stock		(3)				
Cash dividends paid \$.18 per share of common stock				(4,810)		
September 30, 2006		(36,069)	8,415	338,523	12,357	26,720
Comprehensive income:						
Net income	\$ 41,586			41,586		
Decrease in minimum pension liability	13,580		13,580			
Foreign currency translation adjustment	9,189		9,189			
Comprehensive income	\$ 64,355					
Cash dividends paid \$.18 per share of common stock				(4,810)		
September 30, 2007		(36,069)	31,184	375,299	12,357	26,720
Comprehensive income:						
Net income	\$ 36,854			36,854		
Increase in minimum pension liability	(12,383)		(12,383)			
Foreign currency translation adjustment	(11,231)		(11,231)			
Comprehensive income	\$ 13,240					
Adoption of FIN48				(2,475)		
Stock issued under equity incentive plan					128	7
Purchase of treasury stock		(2)				
Cash dividends paid \$.18 per share of common stock				(4,810)		

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September 30, 2008	\$	(36,071)	\$	7,570	\$	404,868	\$	12,485	26,727
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See accompanying notes.

CUBIC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2008

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Nature of the Business: Cubic Corporation (Cubic or the Company) designs, develops and manufactures products which are mainly electronic in nature, provides government services and services related to products previously produced by Cubic and others. The Company's principal lines of business are defense and transportation fare collection systems. Principal customers for defense products and services are the United States and foreign governments. Transportation fare collection systems are sold primarily to large local government agencies in the United States and worldwide.

Principles of Consolidation: The consolidated financial statements include the accounts of Cubic Corporation, its majority-owned subsidiaries and a 50% owned joint venture of which the Company was the primary beneficiary prior to its sale during 2008. All significant intercompany balances and transactions have been eliminated in consolidation. The consolidation of foreign subsidiaries requires translation of their assets and liabilities into U.S. dollars at year-end exchange rates. Statements of income and cash flows are translated at the average exchange rates for each year. Transaction gains and losses on advances to foreign subsidiaries amounted to a \$1.0 million loss in 2008, a gain of \$0.7 million in 2007 and zero in 2006.

Cash Equivalents: The Company considers highly liquid investments with maturity of three months or less when purchased to be cash equivalents.

Concentration of Credit Risk: The Company has established guidelines pursuant to which its cash and cash equivalents are diversified among various money market instruments and investment funds. These guidelines emphasize the preservation of capital by requiring minimum credit ratings assigned by established credit organizations. Diversification is achieved by specifying maximum investments in each instrument type and issuer. The majority of these investments are not on deposit in federally insured accounts.

Fair Value of Financial Instruments: Financial instruments, including cash equivalents, accounts receivable, accounts payable and accrued liabilities, are carried at cost, which management believes approximates the fair value because of the short-term maturity of these instruments. The fair value of long-term debt is based upon quoted market prices for the same or similar debt instruments and approximates the carrying

value of the debt. Receivables consist primarily of amounts due from U.S. and foreign governments for defense products and local government agencies for transportation systems. Due to the nature of its customers, the Company generally does not require collateral. The Company has limited exposure to credit risk as the Company has historically collected substantially all of its receivables from government agencies. The Company generally requires no allowance for doubtful accounts for these customers unless specific contractual circumstances warrant it.

Short-term Investments: Short-term investments include highly liquid, investment grade, institutional money market debt instruments categorized as available-for-sale securities as defined by Statement of Financial Accounting Standards 115, *Accounting for Certain Investments in Debt and Equity Securities*. Any net excess of fair market value over cost would be included in Accumulated Other Comprehensive Income (Loss) on the Consolidated Balance Sheets.

CUBIC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES Continued

We record short-term investments at fair value. At year end, our investment portfolio included the following:

September 30,	2008		2007	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(in thousands)			
Money market preferred stock	\$	\$	\$ 11,600	\$ 11,600
Debt securities purchased at auction			15,600	15,600
	\$	\$	\$ 27,200	\$ 27,200

**Inventories:** Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out (FIFO) method, which approximates current replacement cost. Work in process is stated at the actual production and engineering costs incurred to date, including applicable overhead, and is reduced by charging any amounts in excess of estimated realizable value to cost of sales. Where contracts include advances, performance-based payments and progress payments, the advances are reflected as an offset against any related inventory balances. Costs incurred for certain government contracts include general and administrative costs as allowed by government cost accounting standards. The amounts remaining in inventory at September 30, 2008 and 2007 were \$5.1 million and \$0.7 million respectively.

**Property, Plant and Equipment:** Property, plant and equipment are carried at cost. Depreciation is provided in amounts sufficient to amortize the cost of the depreciable assets over their estimated useful lives. Generally, straight-line methods are used for real property over estimated useful lives ranging from 15 to 39 years or the term of the underlying lease for leasehold improvements. Accelerated methods (declining balance and sum-of-the-years-digits) are used for machinery and equipment over estimated useful lives ranging from five to seven years. Provisions for depreciation of plant and equipment and amortization of leasehold improvements amounted to \$8.3 million, \$7.9 million and \$7.6 million in 2008, 2007 and 2006, respectively.

**Goodwill:** Goodwill is evaluated for potential impairment annually by comparing the fair value of a reporting unit to its carrying value, including recorded goodwill. If the carrying value exceeds the fair value, impairment is measured by comparing the derived fair value of goodwill to its carrying value, and any impairment determined would be recorded in the current period. To date there has been no impairment of the Company's recorded goodwill.

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The changes in the carrying amount of goodwill for the two years ended September 30, 2008 are as follows:

	<b>Transportation Segment</b>		<b>Defense Segment (in thousands)</b>		<b>Total</b>
Balances at October 1, 2006	\$ 8,615	\$	26,135	\$	\$ 34,750
Foreign currency exchange rate changes	747		506		1,253
Balances at September 30, 2007	9,362		26,641		36,003
Goodwill acquired during the year			27,045		27,045
Reduction of acquired tax accrual			(435)		(435)
Foreign currency exchange rate changes	(1,152)		(429)		(1,581)
Balances at September 30, 2008	\$ 8,210	\$	52,822	\$	\$ 61,032

CUBIC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES Continued

Purchased Intangible Assets: The table below summarizes the Company's purchased intangible assets as follows:

(in thousands)	September 30, 2008			September 30, 2007		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Contract and program intangibles	\$ 19,545	\$ (3,139)	\$ 16,406	\$ 4,732	\$ (2,810)	\$ 1,922
Other purchased intangibles	2,787	(133)	2,654			
Total	\$ 22,332	\$ (3,272)	\$ 19,060	\$ 4,732	\$ (2,810)	\$ 1,922

The company's purchased intangible assets are subject to amortization and are being amortized on a combination of straight-line and sum-of-the-years-digits basis over a weighted average period of 6 years. Total amortization expense for 2008, 2007 and 2006, was \$1.3 million, \$0.9 million and \$0.8 million, respectively.

The table below shows expected amortization for purchased intangibles as of September 30, 2008, for each of the next five years (in thousands):

2009	\$ 5,607
2010	4,690
2011	3,642
2012	2,650
2013	1,734
Thereafter	737
	\$ 19,060

Impairment of Long-Lived Assets: The carrying values of long-lived assets other than goodwill are generally evaluated for impairment only if events or changes in facts and circumstances indicate that carrying values may not be recoverable. Any impairment determined would be recorded in the current period and would be measured by comparing the fair value of the related asset to its carrying value. Fair value is generally determined by identifying estimated undiscounted cash flows to be generated by those assets. No impairments have been recorded for the years ended September 30, 2008, 2007 and 2006.

Deferred Compensation: Deferred compensation includes amounts due under an arrangement in which participating members of management may elect to defer receiving payment for a portion of their compensation a minimum of five years or until periods after their respective retirements. Interest on deferred compensation accrues at market rates, until such time as it is paid in full. The interest rate is adjusted semi-annually and was 5.125% at September 30, 2008.



CUBIC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES Continued

Comprehensive Income: Comprehensive income and its components are presented in the statement of changes in shareholders' equity. Accumulated comprehensive income (loss) consisted of the following:

September 30,	2008	(in thousands)	2007
Adjustment to pension liability	\$	(7,436)	\$ 4,947
Foreign currency translation		15,006	26,237
	\$	7,570	\$ 31,184

The adjustment to the pension liability is shown net of a tax benefit of \$4.0 million and a tax provision of \$2.7 million at September 30, 2008 and 2007, respectively. Deferred income taxes are not recognized for translation-related temporary differences of foreign subsidiaries whose undistributed earnings are considered to be permanently invested.

Revenue Recognition: Sales and profits under the Company's long-term fixed-price contracts, which generally require a significant amount of development effort in relation to total contract value, are recognized using the cost-to-cost percentage of completion method of accounting. Sales and profits are recorded based on the ratio of costs incurred to estimated total costs at completion. In the early stages of contract performance, profit is not recognized until progress is demonstrated or contract milestones are reached. For certain other long-term, fixed price production contracts not requiring substantial development effort the Company uses the units-of-delivery percentage of completion method as the basis to measure progress toward completing the contract and recognizing sales.

Sales under cost-reimbursement type contracts are recorded as costs are incurred. Profits are included in earnings based on the ratio of costs incurred to the estimated total costs at completion. Sales of products are recorded when a firm sales agreement is in place, delivery has occurred and collectibility of the fixed or determinable sales price is reasonably assured. Sales for Fixed-Price Service Contracts that do not contain measurable units of work performed are generally recognized on straight-line basis over the contractual service period, unless evidence suggests that the revenue is earned, or obligations fulfilled, in a different manner. Sales for Fixed-Price Service Contracts that contain measurable units of work performed are recognized when the units of work are completed.

Amounts representing contract change orders, claims or other items are included in the contract value only when they can be reliably estimated and realization is considered probable. Incentives or penalties and awards applicable to performance on contracts are considered in estimating

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sales and profits, and are recorded when there is sufficient information to assess anticipated contract performance. Incentive provisions that increase or decrease earnings based solely on a single significant event are not recognized until the event occurs.

Sales and profits on contracts that specify multiple deliverables are allocated to separate units of accounting when there is objective evidence that each accounting unit has value to the customer on a stand-alone basis.

Provisions are made on a current basis to fully recognize any anticipated losses on contracts. Cash received prior to revenue recognition is classified as customer advances on the balance sheet.

CUBIC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES Continued

**Income Taxes:** The provision for income taxes includes federal, state, local, and foreign taxes. Tax credits, primarily for research and development and export programs are recognized as a reduction of the provision for income taxes in the year in which they are available for tax purposes. Deferred income taxes are provided on temporary differences between assets and liabilities for financial reporting and tax purposes as measured by enacted tax rates expected to apply when the temporary differences are settled or realized. Valuation allowances are established for deferred tax assets when the amount of expected future taxable income is not likely to support the use of the deduction or credit. Deferred tax liabilities generally represent deductions that have been taken on tax returns but have not yet been recognized as expense in the financial statements. Annually the Company evaluates the capital requirements of its foreign subsidiaries and determines the amount of excess capital, if any, that is available for distribution. The Company provides for U.S. taxes on the amount determined to be excess capital available for distribution. The Company has not recognized United States tax expense on \$52.4 million of undistributed earnings of its foreign subsidiaries at September 30, 2008, since it intends to reinvest the earnings outside the United States for the foreseeable future.

**Earnings Per Share:** Per share amounts are based upon the weighted average number of shares of common stock outstanding.

**Restructuring Activity:** In the fourth quarter of 2008 the Company reduced its defense segment facility workforce by 139 employees. In addition, 6 corporate office positions were eliminated. Affected employees received severance pay and outplacement assistance, as well as company paid medical coverage for a defined period based on years of service. The cost of this restructuring was \$6.2 million and is reflected in the company's results for the fourth quarter.

The following table presents a rollforward of the Company's restructuring liability, which is included within other current liabilities in the audited consolidated balance sheets (in thousands):

		<b>Employee Separation Expenses</b>
Liability as of September 30, 2007	\$	
Additions		6,203
Cash Payments		(4,523)
Liability as of September 30, 2008	\$	1,680

**Derivative Financial Instruments:** The Company's use of derivative financial instruments is limited to foreign exchange forward and option contracts used to hedge significant contract sales, purchase Commitments and investments that are denominated in currencies other than the functional currency of the subsidiary responsible for the commitment and to hedge net advances to foreign subsidiaries. The purpose of the Company's foreign currency hedging activities is to fix the dollar value of specific commitments, investments, payments to foreign vendors, and the value of foreign currency denominated receipts from customers. At September 30, 2008, the Company had foreign exchange contracts with a notional value of \$135.6 million outstanding.



CUBIC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES Continued

The Company accounts for derivatives pursuant to SFAS 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended. This standard requires that all derivative instruments be recognized in the financial statements and measured at fair value regardless of the purpose or intent for holding them. The classification of gains and losses resulting from changes in the fair values of derivatives is dependent on the intended use of the derivative and its resulting designation. The change in fair value of the ineffective portion of a hedge, and changes in fair values of derivatives that are not considered highly effective hedges are immediately recognized in earnings. If the derivative is designated as a fair value hedge, the changes in the estimated fair value of the derivative and the underlying hedged item are recognized in earnings. If the derivative is designated as a cash flow hedge, the effective portions of changes in the fair value of the derivative are recorded in other comprehensive income and are subsequently recognized in earnings when the hedged item affects earnings. Ineffectiveness between the change in fair value of the derivatives and the change in fair value of hedged items was immaterial for the years ended September 30, 2008, 2007 and 2006.

New Accounting Standards: In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), which was effective for the Company on October 1, 2007. The purpose of FIN 48 is to clarify and set forth consistent rules for accounting for uncertain tax positions in accordance with SFAS 109, *Accounting for Income Taxes*. The cumulative effect of applying the provisions of this interpretation are required to be reported separately as an adjustment to the opening balance of retained earnings in the year of adoption. The effect of adopting FIN 48 on the Company's financial condition at September 30, 2008 has been included in the accompanying consolidated financial statements. See Note 8 for further discussion of the effect of adopting FIN 48 on the Company's consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years, which for the Company is the quarter ending December 31, 2008. SFAS 157 defines fair value, establishes a framework and gives guidance regarding the methods used for measuring fair value, and expands disclosures about fair value measurements. Management does not expect that the adoption of SFAS 157 will have a material impact on the Company's results of operations, financial position or cash flows.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115*, effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years, which for the Company is the quarter ending December 31, 2008. This statement permits an entity to choose to measure many financial instruments and certain other items at fair value at specified election dates. Subsequent unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings. Management does not expect that the adoption of SFAS 159 will have a material impact on the Company's results of operations, financial position or cash flows.

In December 2007 the FASB issued SFAS No. 141(R), *Business Combinations*, effective for fiscal years beginning on or after December 15, 2008, which for the Company is the fiscal year beginning October 1, 2009. This statement applies to all transactions or other events in which an entity obtains control of one or more businesses. This statement applies to all business entities, including mutual entities that previously used the

pooling-of-interests method of accounting for some business combinations. Management does not expect that the adoption of SFAS 141(R) will have a material impact on the Company's results of operations, financial position or cash flows.

CUBIC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES Continued

In March 2008 the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement No. 133*, effective for interim periods beginning after November 15, 2008, which for the Company is the quarter ending March 31, 2009. This statement requires enhanced disclosures about an entity's financial position, financial performance, and cash flows. The statement requires that objectives for using derivative instruments be disclosed in terms of underlying risks and accounting designation. Management does not expect that the adoption of SFAS 161 will have a material impact on the Company's results of operations, financial position or cash flows.

Use of Estimates: The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Significant estimates include the estimated total costs at completion of the Company's long-term contracts, estimated discounted cash flows of reporting units used for goodwill impairment testing, and the estimated rates of return and discount rates related to the Company's defined benefit pension plans. Actual results could differ from those estimates.

Risks and Uncertainties: The Company is subject to the normal risks and uncertainties of performing large, multiyear, often fixed-price contracts. In addition, the Company is subject to audit of incurred costs related to many of its U.S. Government contracts. These audits could produce different results than the Company has estimated; however, the Company's experience has been that its costs are acceptable to the government.

NOTE 2 ACQUISITION

On July 29, 2008 the Company acquired all outstanding capital stock from the five shareholders of the privately-held Omega Training Group, Inc., headquartered in Columbus, Georgia. The purchase was for \$61.0 million in cash which was funded from existing cash reserves. Cash consideration paid including costs of the acquisition, net of cash acquired, as of September 30, 2008 totaled \$53.8 million. The Company's additional \$6.1 million obligation in accordance with the agreement is included in other current liabilities at September 30, 2008, and has been subsequently paid. Omega provides training, testing, analysis, logistics and staffing services to U.S. Army locations at the U.S. Army Infantry School at Fort Benning, Fort Bliss, Fort Jackson and Fort Hood. None of these locations are significant customers of the Company's defense segment. Founded in 1990, Omega now has 790 employees. Omega will be managed within the Company's Mission Support Services business.

The following table summarizes the allocation of the purchase price for Omega (in millions):

Goodwill	\$	27.0
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Trade name		2.8
Customer relationships		14.7
Backlog		2.2
Net assets assumed		14.3
Total	\$	61.0

The intangible assets which include trade name, customer relationships, and backlog have a weighted average useful life of 6 years from the date of acquisition. These intangible assets are included in Miscellaneous other assets on the Consolidated Balance sheets. Management expects the purchased intangibles and goodwill to be deductible in its tax returns over a 15 year period, which will generate deferred tax liabilities to the extent the deductions exceed book expense. The operations and assets of Omega for the two month period from July 29, 2008 to September 30, 2008 are included in the defense segment.



CUBIC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 3 INVESTMENTS IN VARIABLE INTEREST ENTITIES

The Company was party to a 50/50 joint venture arrangement with the U.S. subsidiary of Rafael Armament Development Authority Ltd. (Rafael), an Israeli company, to manufacture certain of their products for sale to the U.S. and Israeli defense forces. During the fourth quarter of fiscal year 2008, the Company sold its interest in the joint venture arrangement to Rafael for approximately \$1.8 million, resulting in a gain before applicable income taxes of \$1.2 million, which is included in Gain on sale of assets on the Consolidated Statements of Income. The joint venture generated sales of \$8.3 million, \$6.4 million, and \$1.0 million in 2008, 2007 and 2006, respectively, and generated operating income of \$0.4 million in 2008 and operating losses of \$1.4 million and \$1.9 million in 2007 and 2006, respectively.

Under the provisions of FASB Interpretation No. 46 *Consolidation of Variable Interest Entities*, (FIN46) the Company consolidated the above joint venture, as it was the primary beneficiary of the joint venture arrangement prior to its sale. Minority interest in the net income and loss from this business is reflected in consolidated income.

The Company owns 37.5% of the common stock of Transaction Systems Limited (TranSys), a special-purpose company formed in the United Kingdom to bid on a contract called PRESTIGE (Procurement of Revenue Services, Ticketing, Information, Gates and Electronics), which outsourced most of the functions of the Transport for London (TfL) fare collection system for a period of up to seventeen years. In August 1998, TranSys was awarded the contract and began operations. Cubic and the other 37.5% shareholder participate in the PRESTIGE contract solely through subcontracts from TranSys. All of the work to be performed by TranSys is subcontracted to the two 37.5% shareholders and the arrangement provides for the pass-through of virtually all revenues from TfL to the two shareholders. As a result, TranSys has operated on a break-even basis and is expected to continue to do so. If TranSys were to eventually generate a net income or loss, the shareholders would share in this income or loss in accordance with their percentage ownership in TranSys. The Company's investment in TranSys is immaterial. TranSys is considered a variable interest entity under the provisions of FIN 46; however, the Company does not consolidate TranSys, as it is not considered the primary beneficiary as defined in FIN 46.

In August 2008, TfL notified TranSys that they will be terminating the PRESTIGE fare collection system contract as of August 2010 in accordance with the early termination provision of the contract. As a result of this termination for convenience, upon completion if the contract in 2010, the operations of TranSys will cease.

Financing for the project was provided by a syndicate of banks which participated in creating the project's financial structure. Debt servicing began in 2003 and will continue until the end of the contract in August 2010, at which time TfL is obligated to pay TranSys an amount sufficient to repay the loan, subject to a possible withhold, as described below. This debt is guaranteed by TfL and is nonrecourse to the shareholders of TranSys.

The contract termination notice triggers a requirement for TranSys to engage an independent engineer to produce a report on the state of the assets associated with the PRESTIGE system. The engineer has to deliver a report eleven months before the end of the contract, stating whether,

in their opinion, the fare collection system assets are able to pass a Performance Test for a period of two years beyond the contract termination. The Performance Test requires the assets to perform at contractual minimum levels with broadly the same level of maintenance as that performed under the contract. If the engineer determines that the assets may fail the Performance Test then TranSys and its subcontractors have an eleven month period to carry out the necessary remediation of the assets.

## CUBIC CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

## NOTE 3 INVESTMENTS IN VARIABLE INTEREST ENTITIES Continued

Following the termination of the contract in August 2010, the same engineer will deliver a Supplementary Report which is a follow up assessment to take into account the remediation efforts of TranSys and its subcontractors, and to give an opinion on the remaining level of remediation work required in order to allow the system to pass the Performance Test for the two year period. The contract allows TfL to withhold an amount up to approximately £40 million (currently approximately \$60 million) from its final payment to TranSys pending the delivery of the Supplementary Report and the completion of any remediation work identified in the report. This process is not expected to take longer than six months and TfL would be required to pay interest on any funds withheld.

TranSys is required to repay the banks in August 2010 and, to the extent that there is a funding shortfall in TranSys because of a withhold by TfL, the 37.5% shareholders are each required to provide TranSys with 50% of the cash required to fully repay the debt until the funds are returned to TranSys by TfL, at which time the shareholders would be repaid by TranSys. While there is the possibility that TfL will withhold some amount from TranSys upon contract termination, Cubic management does not believe this will be necessary. In recent years the fare collection system has consistently exceeded the contractual performance levels and Cubic management believes that sufficient costs have been included in its estimated costs to complete the contract to continue this level of performance for the required period. In addition, since Cubic has been selected as the successor contractor to the PRESTIGE contract, management believes TfL will have no reason to withhold funds to assure any required remediation will be completed.

The Company has provided certain performance guarantees to various parties related to the PRESTIGE contract and TranSys, including TfL, the banks and the TranSys shareholders. The other TranSys shareholders have provided similar performance guarantees to the same parties and to Cubic.

Summarized unaudited financial information for TranSys is as follows:

September 30,	2008	(in millions)		2007
<b>Balance Sheets:</b>				
Cash	\$	43.7	\$	66.1
Other current assets		116.3		121.4
Noncurrent unbilled contract accounts receivable		171.6		222.5
<b>Total Assets</b>	<b>\$</b>	<b>331.6</b>	<b>\$</b>	<b>410.0</b>
Current liabilities	\$	33.9	\$	66.4
Long-term debt		297.7		343.6
Equity				
<b>Total Liabilities and Equity</b>	<b>\$</b>	<b>331.6</b>	<b>\$</b>	<b>410.0</b>
<b>Years ended September 30,</b>	<b>2008</b>	<b>2007</b>		<b>2006</b>

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(in millions )

**Statement of Operations:**

Sales	\$	215.3	\$	210.8	\$	118.6
Operating profit	\$		\$		\$	
Net income	\$		\$		\$	

## CUBIC CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

## NOTE 4 ACCOUNTS RECEIVABLE

The components of accounts receivable under long-term contracts are as follows:

September 30,	2008	(in thousands)	2007
<b>U.S. Government Contracts:</b>			
Amounts billed	\$ 60,016		\$ 55,362
Recoverable costs and accrued profits on progress completed not billed	50,600		61,620
	110,616		116,982
<b>Commercial Customers:</b>			
Amounts billed	47,209		45,692
Recoverable costs and accrued profits on progress completed not billed	126,853		151,768
	174,062		197,460
	284,678		314,442
Less unbilled amounts not currently due commercial customers	(19,930)		(16,650)
	\$ 264,748		\$ 297,792

A portion of recoverable costs and accrued profits on progress completed is billable under progress payment provisions of the related contracts. The remainder of these amounts is billable upon delivery of products or furnishing of services, with an immaterial amount subject to retainage provisions of the contracts. It is anticipated that substantially all of the unbilled portion of receivables identified as current assets will be billed and collected under progress billing provisions of the contracts or upon completion of performance tests and/or acceptance by the customers during fiscal 2009.

## NOTE 5 INVENTORIES

Inventories are classified as follows:

September 30,	2008	(in thousands)	2007
Finished products	\$ 172		\$ 240
Work in process and inventoried costs under long-term contracts	64,179		25,005
Customer advances	(20,783)		
Materials and purchased parts	1,550		2,097
	\$ 45,118		\$ 27,342

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At September 30, 2008 and 2007, work in process and inventoried costs under long-term contracts included approximately \$1.6 million and \$8.4 million, respectively, in costs incurred outside the scope of work on several contracts in the defense segment. Management believes it is probable these costs, plus a profit margin, will be recovered under contract change orders within the next year. \$5.2 million of the September 30, 2007 balance related to a contract claim with the U.S. Navy for which a contract modification was received in November 2008 and is, therefore, no longer at risk.

## CUBIC CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

## NOTE 6 FINANCING ARRANGEMENTS

Long-term debt consists of the following:

September 30,	2008	2007
	(in thousands)	
Unsecured notes payable to a group of insurance companies, with annual principal payments of \$4,000,000 due in November. Interest at 6.31% is payable semiannually in November and May.	\$ 24,000	\$ 28,000
Unsecured note payable to an insurance company, with annual principal payments of \$1,428,571 due in November. Interest at 6.11% is payable semiannually in November and May.	1,429	2,857
Mortgage note from a UK financial institution, with quarterly installments of principal and interest at 6.5%	6,316	7,980
	31,745	38,837
Less current portion	(6,045)	(6,138)
	\$ 25,700	\$ 32,699

The terms of the notes payable and other financial instruments include provisions that require and/or limit, among other financial ratios and measurements, the permitted levels of working capital, debt and tangible net worth and coverage of fixed charges. The Company has also provided certain performance guarantees to various parties related to the PRESTIGE contract and the TranSys arrangement. As consideration for the performance guarantee, the Company has agreed to certain financial covenants including limits on working capital, debt, tangible net worth and cash flow coverage. At September 30, 2008, the most restrictive covenant under these agreements leaves consolidated retained earnings of \$170 million available for the payment of dividends to shareholders, purchases of the Company's common stock and other charges to shareholders' equity. To date, there have been no covenant violations.

The Company maintains a short-term borrowing arrangement totaling 6 million British pounds (equivalent to approximately \$10.7 million) with a U.K. financial institution to help meet the short-term working capital requirements of its subsidiary, Cubic Transportation Systems Ltd. Any outstanding balances are guaranteed by Cubic Corporation, are repayable on demand, and bear interest at the bank's base rate, as defined, plus one percent. At September 30, 2008, no amounts were outstanding under this borrowing arrangement.

The Company maintains a short-term borrowing arrangement in New Zealand totaling \$0.5 million New Zealand dollars (equivalent to approximately \$0.3 million) to help meet the short-term working capital requirements of its subsidiary in that country. At September 30, 2008, no amounts were outstanding under this borrowing arrangement.





CUBIC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 6 FINANCING ARRANGEMENTS Continued

The Company has a \$150 million revolving line of credit arrangement with a group of U.S. banks which expires in March 2010. Commitment fees associated with this financing arrangement are 0.15% of the unutilized balance per annum. As of September 30, 2008 the Company had no short-term debt outstanding under this line of credit and \$24.1 million in outstanding letters of credit.

Maturities of long-term debt for each of the five years in the period ending September 30, 2013, are as follows: 2009 \$6.0 million; 2010 \$4.6 million; 2011 \$4.6 million; 2012 \$4.6 million; 2013 \$4.6 million.

Interest paid amounted to \$2.8 million, \$3.6 million, and \$4.7 million in 2008, 2007 and 2006, respectively.

As of September 30, 2008 the Company had letters of credit and bank guarantees outstanding totaling \$74.5 million, which guarantee either the Company's performance or customer advances under certain contracts. In addition, the Company had financial letters of credit outstanding totaling \$6 million as of September 30, 2008, which primarily guarantee the Company's payment of certain self-insured liabilities. The Company has never had a drawing on a letter of credit instrument, nor are any anticipated; therefore, the fair value of these instruments is estimated to be zero.

The Company's self-insurance arrangements are limited to certain workers' compensation plans, automobile liability, and product liability claims primarily related to a business the Company sold in 1993. Under these arrangements, the Company self-insures only up to the amount of a specified deductible for each claim. Self-insurance liabilities included in other current liabilities on the balance sheet amounted to \$5.4 million and \$3.3 million as of September 30, 2008 and 2007, respectively.

NOTE 7 COMMITMENTS

The Company leases certain office, manufacturing and warehouse space, and miscellaneous computer and other office equipment under noncancelable operating leases expiring in various years through 2018. These leases, some of which may be renewed for periods up to 10 years, generally require the lessee to pay all maintenance, insurance and property taxes. Several leases are subject to periodic adjustment based on price indices or cost increases. Rental expense, net of sublease income, for all operating leases amounted to \$6.2 million, \$6.7 million, and \$6.9 million in 2008, 2007 and 2006, respectively.

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Future minimum payments, net of minimum sublease income, under noncancelable operating leases with initial terms of one year or more consist of the following at September 30, 2008 (in thousands):

2009	\$	5,573
2010		3,462
2011		2,753
2012		2,145
2013		825
Thereafter		339
	\$	15,097

## CUBIC CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

## NOTE 8 INCOME TAXES

Significant components of the provision for income taxes are as follows:

Years ended September 30,	2008	2007 (in thousands)	2006
<b>Current:</b>			
Federal	\$ 8,474	\$ 9,695	\$ 4,623
State	2,063	2,793	1,526
Foreign	16,051	10,429	5,533
<b>Total current</b>	<b>26,588</b>	<b>22,917</b>	<b>11,682</b>
<b>Deferred (credit):</b>			
Federal	(5,440)	670	(594)
State	(1,078)	352	325
Foreign	315	(277)	783
<b>Total deferred</b>	<b>(6,203)</b>	<b>745</b>	<b>514</b>
<b>Total income tax expense</b>	<b>\$ 20,385</b>	<b>\$ 23,662</b>	<b>\$ 12,196</b>

Deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities, and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. Significant components of the Company's deferred tax assets and liabilities are as follows:

September 30,	2008	2007 (in thousands)
<b>Deferred tax assets:</b>		
Accrued employee benefits	\$ 9,796	\$ 7,608
Allowance for doubtful accounts	1,833	1,896
Long-term contracts and inventory valuation reductions	14,185	8,401
Allowances for loss contingencies	4,506	4,257
Deferred compensation	3,145	3,205
Book over tax depreciation	2,295	2,155
Adjustment to pension liability	4,003	
Other	1,498	
<b>Deferred tax assets</b>	<b>41,261</b>	<b>27,522</b>
<b>Deferred tax liabilities:</b>		
Adjustment to pension liability		2,665
Amortization of goodwill and intangibles	3,726	2,972
Prepaid expenses	2,007	1,925
State taxes	1,316	975

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Other	2,499	298
Deferred tax liabilities	9,548	8,835
Net deferred tax asset	\$ 31,713	\$ 18,687

## CUBIC CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

## NOTE 8 INCOME TAXES Continued

The reconciliation of income tax computed at the U.S. federal statutory tax rate to income tax expense is as follows:

Years ended September 30,	2008	2007 (in thousands)	2006
Tax at federal statutory rate	\$ 20,034	\$ 22,837	\$ 12,715
State income taxes, net of federal tax effect	640	2,044	1,203
Income exclusion on export sales		(192)	(727)
Nondeductible expenses	152	157	292
Reversal of reserve accrued for tax contingencies	(1,205)	(911)	(1,060)
Tax effect from foreign earnings repatriation	3,856	2,626	1,660
Tax effect from foreign subsidiaries	(2,651)	(1,368)	(866)
Tax credits and other	(441)	(1,531)	(1,021)
	\$ 20,385	\$ 23,662	\$ 12,196

The Company is subject to ongoing audits from various taxing authorities in the jurisdictions in which it does business. As of September 30, 2008, the Company's open tax years in significant jurisdictions include 2005-2008 in both the U.S. and the U.K. The Company believes it has adequately provided for uncertain tax issues not yet resolved with federal, state and foreign tax authorities. Although not probable, the most adverse resolution of these issues could result in additional charges to earnings in future periods. Based upon a consideration of all relevant facts and circumstances, the company does not believe the ultimate resolution of uncertain tax issues for all open tax periods will have a materially adverse effect upon its results of operations or financial condition. As of September 30, 2008 and 2007 the Company had income tax reserves of \$6.3 million and \$5.4 million, respectively, included in Non-current Income Taxes Payable at September 30, 2008, and Current Income Taxes Payable at September 30, 2007.

As indicated in the table above, in 2008, 2007 and 2006 the Company was able to reverse \$1.2 million, \$0.9 million and \$1.1 million, respectively, of tax reserves established in previous years due to the resolution of uncertain tax issues.

The Company made income tax payments, net of refunds, totaling \$18.2 million, \$26.2 million and \$11.6 million in 2008, 2007 and 2006, respectively.

Income before income taxes includes the following components:

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Years ended September 30,	2008	2007 (in thousands)	2006
United States	\$ 4,920	\$ 33,412	\$ 17,346
Foreign	52,319	31,836	18,983
Total	\$ 57,239	\$ 65,248	\$ 36,329

## CUBIC CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

## NOTE 8 INCOME TAXES Continued

Management evaluates the Company's capital requirements in its foreign subsidiaries on an annual basis to determine what level of capital is needed for the long-term operations of the businesses. U.S. taxes are provided on the amount of capital that is determined to be in excess of the long-term requirements of the business and is, therefore, available for distribution. In 2008, management determined that 11 million British Pounds (\$21.7 million) was excess capital in the U.K. and 7 million New Zealand Dollars (\$5.0 million) was excess capital in New Zealand and paid dividends of those amounts to the U.S. parent company in 2008. U.S. taxes provided on these dividends amounted to approximately \$3.9 million in 2008. The remainder of the capital in the Company's foreign operations is considered indefinitely reinvested; therefore, no additional amount for taxes due upon repatriation has been provided.

Undistributed earnings of all the Company's foreign subsidiaries amounted to approximately \$52.4 million at September 30, 2008. Those earnings are considered to be indefinitely reinvested, and accordingly, no provision for U.S. federal and state income taxes has been provided thereon. Upon distribution of those earnings in the form of dividends or otherwise, the Company would be subject to both U.S. income taxes and withholding taxes payable to the foreign countries, but would also be able to offset unrecognized foreign tax credit carryforwards. Determination of the total amount of unrecognized deferred U.S. income tax liability is not practicable because of the complexities associated with its hypothetical calculation.

Effective October 1, 2007, the Company adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 prescribes a more-likely-than-not threshold for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance in de-recognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, accounting for income taxes in interim periods and income tax disclosures. The cumulative effects of applying this interpretation were to increase non-current tax liabilities by \$5.0 million, decrease retained earnings by \$2.5 million and increase net deferred income tax assets by \$2.5 million as of October 1, 2007.

The Company has recorded liabilities for unrecognized tax benefits related to permanent and temporary tax adjustments which totaled \$5.8 million at September 30, 2008 and \$10.0 million at October 1, 2008, after the adjustment to the beginning balance of retained earnings. The net decrease in the liability of \$4.2 million resulted from the following:

Years ended September 30,	2008 (in thousands)
Balance at October 1, 2007	\$ 10,001
Increase (decrease) related to tax positions in prior years	
Recognition of benefits from change in tax method of accounting	(1,577)
Recognition of benefits from expiration of statutes	(2,673)
Tax positions related to the current year	1,008
Decreases related to settlements with taxing authorities	(914)
Balance at September 30, 2008	\$ 5,845





CUBIC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 8 INCOME TAXES Continued

At September 30, 2008, the amount of unrecognized tax benefits from permanent tax adjustments that, if recognized, would affect the effective rate was \$2.9 million, and \$2.9 million would decrease goodwill. Over the next year, the Company does not expect a significant increase or decrease in the unrecognized tax benefits recorded as of September 30, 2008. The amount of net interest and penalties recognized as a component of income tax expense during the years ended September 30, 2008, 2007 and 2006 was not material. Interest and penalties accrued at September 30, 2008 amounted to \$0.5 million.

NOTE 9 PENSION, PROFIT SHARING AND OTHER RETIREMENT PLANS

The Company has profit sharing and other defined contribution retirement plans that provide benefits for most employees in the U.S. An employee is eligible to participate in these plans after six months to one year of service, and may make additional contributions to the plans from their date of hire. These plans provide for full vesting of benefits over periods from zero to five years. More than half of the Company contributions to these plans are discretionary with the Board of Directors. Company contributions to the plans aggregated \$14.2 million, \$13.6 million and \$11.6 million in 2008, 2007 and 2006, respectively.

Approximately one-fourth of the Company's non-union employees in the U.S. are covered by a noncontributory defined benefit pension plan. The Company amended the plan to freeze plan benefits as of December 31, 2006 (curtailment). The effect of the curtailment is that no new benefits will be accrued after that date. The financial impact of this curtailment is reflected in the following disclosures. Approximately one-half of the Company's European employees are covered by a contributory defined benefit pension plan. The Company's funding policy provides that contributions will be at least equal to the minimum amounts mandated by statutory requirements. September 30 is used as the measurement date for these plans.

The unrecognized amounts recorded in accumulated other comprehensive income will be subsequently recognized as net periodic pension cost, consistent with the Company's historical accounting policy for amortizing those amounts. Actuarial gains and losses that arise in future periods and are not recognized as net periodic pension cost in those periods will be recognized as increases or decreases in other comprehensive income, net of tax, in the period they arise. Actuarial gains and losses recognized in other comprehensive income are adjusted as they are subsequently recognized as a component of net periodic pension cost.

CUBIC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 9 PENSION, PROFIT SHARING AND OTHER RETIREMENT PLANS Continued

The following table sets forth changes in the projected benefit obligation and fair value of plan assets and the funded status for these defined benefit plans:

September 30,	2008	(in thousands)	2007
<b>Change in benefit obligations:</b>			
Net benefit obligation at the beginning of the year	\$ 164,075		\$ 168,500
Service cost	3,520		5,056
Interest cost	9,761		9,581
Actuarial gain	(19,898)		(21,405)
Participant contributions	1,211		1,185
Gross benefits paid	(5,148)		(4,584)
Foreign currency exchange rate changes	(8,081)		5,742
Net benefit obligation at the end of the year	145,440		164,075
<b>Change in plan assets:</b>			
Fair value of plan assets at the beginning of the year	162,542		136,345
Actual return on plan assets	(24,913)		19,209
Employer contributions	3,380		6,372
Participant contributions	1,211		1,185
Gross benefits paid	(5,148)		(4,584)
Administrative expenses	(809)		(693)
Foreign currency exchange rate changes	(7,274)		4,711
Fair value of plan assets at the end of the year	128,989		162,545
Unfunded status of the plans	(16,451)		(1,530)
Unrecognized net actuarial (gain) loss	11,439		(7,612)
Net amount recognized	\$ (5,012)		\$ (9,142)
<b>Amounts recognized in Accumulated OCI</b>			
Liability adjustment to OCI	\$ (11,439)		\$ 7,612
Deferred tax asset (liability)	4,003		(2,665)
Accumulated other comprehensive income (loss)	\$ (7,436)		\$ 4,947

## CUBIC CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

## NOTE 9 PENSION, PROFIT SHARING AND OTHER RETIREMENT PLANS Continued

The accumulated benefit obligation (ABO) for all defined benefit pension plans was approximately \$133.6 million at September 30, 2008. For the defined benefit pension plan in which the ABO was in excess of the fair value of plan assets, the projected benefit obligation, ABO and fair value of plan assets were as follows:

September 30,	2008	(in thousands)	2007
Projected benefit obligation	\$ 91,988		\$ 102,162
Accumulated benefit obligation	91,988		102,162
Fair value of plan assets	82,534		101,816

The components of net periodic pension cost were as follows:

Years ended September 30,	2008	2007	2006
		(in thousands)	
Service cost	\$ 3,520	\$ 5,056	\$ 8,041
Interest cost	9,761	9,581	8,930
Expected return on plan assets	(12,706)	(11,323)	(9,687)
Amortization of:			
Prior service cost		7	27
Actuarial loss	(243)	458	2,393
Curtailment charge			131
Administrative expenses	112	114	127
Net pension cost	\$ 444	\$ 3,893	\$ 9,962

Years ended September 30,	2008	2007	2006
Weighted-average assumptions used to determine benefit obligation at September 30:			
Discount rate	7.3%	6.2%	5.6%
Rate of compensation increase	4.8%	4.4%	4.5%
Weighted-average assumptions used to determine net periodic benefit cost for the years ended September 30:			
Discount rate	6.2%	5.6%	5.4%
Expected return on plan assets	8.0%	8.1%	8.2%
Rate of compensation increase	4.4%	4.5%	4.5%



## CUBIC CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

## NOTE 9 PENSION, PROFIT SHARING AND OTHER RETIREMENT PLANS Continued

The Company's pension plans weighted average asset allocations by asset category as of September 30 were as follows:

	2008	2007
Equity securities	71%	74%
Debt securities	22%	21%
Real estate	5%	4%
Other	2%	1%
Total	100%	100%

The Company has the responsibility to formulate the investment policies and strategies for the plans' assets. The overall policies and strategies include: maintain the highest possible return commensurate with the level of assumed risk, preserve benefit security for the plans' participants, and minimize the necessity of Company contributions by maintaining a ratio of plan assets to liabilities in excess of 1.0.

The Company does not involve itself with the day-to-day operations and selection process of individual securities and investments, and, accordingly, has retained the professional services of investment management organizations to fulfill those tasks. The investment management organizations have investment discretion over the assets placed under their management. The Company provides each investment manager with specific investment guidelines relevant to its asset class. The table below presents the ranges for each major category of the plans' assets at September 30, 2008:

Asset Category	Allocation Range
Equity securities	35% to 65%
Debt securities	15% to 65%
Other, primarily cash and cash equivalents	0% to 40%

The pension plans held no positions in Cubic Corporation common stock as of September 30, 2008 and 2007.

The Company expects to contribute approximately \$3.2 million to its pension plans in 2009.

The following pension benefit payments, which reflect expected future service, as appropriate, are expected to be paid (in thousands):

2009	\$6,572
2010	7,282
2011	7,742
2012	8,384
2013	8,822
2014-2018	54,212

CUBIC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 10 LEGAL MATTERS

In 1991, the government of Iran commenced an arbitration proceeding against the Company seeking \$12.9 million for reimbursement of payments made for equipment that was to comprise an Air Combat Maneuvering Range pursuant to a sales contract and an installation contract executed in 1977, and an additional \$15 million for unspecified damages. The Company contested the action and brought a counterclaim for compensatory damages of \$10.4 million. In May 1997, the arbitral tribunal awarded the government of Iran \$2.8 million, plus simple interest at the rate of 12% per annum from September 21, 1991 through May 5, 1997. In December 1998, the United States District Court granted a motion by the government of Iran confirming the arbitral award but denied Iran's request for additional interest and costs. Both parties have appealed. In October 2004, the 9<sup>th</sup> Circuit Court of Appeals issued a decision in the case of two interveners who are attempting to claim an attachment on the amount that was awarded to Iran in the original arbitration. The Court denied one of the interveners' liens but confirmed the second one's lien. Iran asked the U.S. Supreme Court to review the 9<sup>th</sup> Circuit decision and to void the initial judgment against it. In 2006, the Supreme Court returned the case to the 9<sup>th</sup> Circuit for reconsideration, suggesting that the claimed lien cannot be enforced. The Court of Appeal then ruled that the lien was valid under the Terrorism Risk Insurance Act and Iran's petition for review by the Supreme Court was granted; therefore, while the dispute between Iran and Cubic is on hold in the 9<sup>th</sup> Circuit the obligation upon Cubic to pay is stayed. Under current United States law and policy, any payment to the Revolutionary Government of Iran must first be licensed by the U.S. government. The Company is unaware of the likelihood of the U.S. government granting such a license. The Company is continuing to pursue its appeal in the 9<sup>th</sup> Circuit case against Iran, and management believes that a license from the U.S. government would be required in any case to make payment to or on behalf of Iran. However, in light of the 9<sup>th</sup> Circuit Court's decision in the related interveners' case, in 2004 the Company established a reserve of \$6 million for the estimated potential liability and will continue to accrue interest on this amount until the ultimate outcome of the case is determined.

In January 2005, a bus fare collection system customer in North America issued a cure notice to the Company, alleging that its performance was not in accord with the contract. After unsuccessful negotiations with the customer, in March 2005, the Company filed for a temporary restraining order requesting that the customer be restrained from further interfering with the Company's performance and from issuing a termination notice. The next business day, the customer issued a letter terminating the contract for default. In April 2005, the customer filed a claim for breach of contract, seeking damages for all actual, consequential and liquidated damages sustained as well as attorney's fees. The contract limits liability to the contract value of \$8.2 million, but the customer appears to be attempting to avoid that limitation. In May 2005, the Company filed an answer and general denial and subsequently filed a verified petition alleging breach of contract and other substantive claims, claiming the amount owed under the contract of \$4.2 million, plus interest and attorney's fees. Management believes that both the customer's default notice and claim for damages are unsupported and the Company is vigorously defending against the allegations. Based on the advice of counsel, management believes the Company had substantially completed the contract prior to termination and that the remaining contract value is due and that the Company will prevail at trial; therefore, no liability has been recorded for the former customer's claim as of September 30, 2008. However, due to the uncertainty of collecting the outstanding receivable balance an allowance for doubtful accounts of \$4.2 million was established and all costs incurred in the performance of the contract and costs incurred outside the scope of the contract were expensed in the year ended September 30, 2005.

CUBIC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 10 LEGAL MATTERS Continued

In June 2005, a company that Cubic had an alleged agreement with, to potentially bid on a portion of automated fare collection contracts, filed a court claim for breach of contract, fraud, negligent misrepresentation, theft of trade secrets, and other related allegations. The claim seeks \$15.0 million in compensatory damages, punitive damages, disgorgement of profits and a permanent injunction. In November 2008 the Company agreed to settle this claim for a nominal amount. Documents are expected to be finalized in December 2008.

In May 2007 the Company filed a claim with the U.S. Navy for \$6.2 million arising out of allegedly defective specifications, the late delivery of government-furnished equipment and the Navy's attempt to unilaterally impose additional contract requirements in connection with a contract whose initial award value was \$31.8 million. In February 2008, the Navy asserted a counter-claim seeking a \$4.1 million reduction in the contract price because it allegedly relaxed certain specifications, provided more government-furnished equipment than was required and had to revise certain equipment and manuals furnished by the Company. In November 2008 a negotiated settlement agreement was reached whereby the Company will receive payment of approximately \$4.0 million for its additional costs incurred in performance of the contract and will furnish additional equipment in satisfaction of the customer's requirements. The settlement also resolves the Navy's \$4.1 million counterclaim. In the year ended September 30, 2008, inventoried costs related to this claim were reduced to the settlement amount and a provision was made for the Company's remaining obligations arising from the settlement agreement.

From time-to-time, agencies of the U.S. and foreign governments may investigate whether the Company's operations are being conducted in accordance with applicable regulatory requirements. Such investigations, whether relating to government contracts or conducted for other reasons, could result in administrative, civil or criminal liabilities, including repayments, fines or penalties being imposed upon the Company, or could lead to suspension or debarment from future government contracting. Government investigations often take years to complete and most result in no adverse action against the Company.

The Company is not a party to any other material pending proceedings and management considers all other matters to be ordinary proceedings incidental to the business. Management believes the outcome of these proceedings and the proceedings described above will not have a materially adverse effect on the Company's financial position.

NOTE 11 BUSINESS SEGMENT INFORMATION

**Description of the types of products and services from which each reportable segment derives its revenues:**





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The Company has two primary business segments: transportation systems and defense. The transportation systems segment designs, produces, installs and services electronic revenue collection systems for mass transit projects, including railways and buses. The defense segment performs work under U.S. and foreign government contracts relating to electronic defense systems and equipment, computer simulation training, development of training doctrine, and field operations and maintenance. Products include customized range instrumentation and training systems, simulators, communications and surveillance systems, avionics systems, power amplifiers and receivers.

### **Measurement of segment profit or loss and segment assets:**



The Company evaluates performance and allocates resources based on total segment operating profit or loss. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies. Intersegment sales and transfers are immaterial.

CUBIC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 11 BUSINESS SEGMENT INFORMATION Continued

**Factors management used to identify the Company's reportable segments:**



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The Company's reportable segments are business units that offer different products and services. The reportable segments are each managed separately because they develop and manufacture distinct products with different customer bases.

Business segment financial data is as follows:

Years ended September 30,	2008	2007 (in millions)	2006
<b>Sales:</b>			
Transportation systems	\$ 272.3	\$ 236.6	\$ 243.9
Defense	607.8	641.1	562.8
Other	1.0	12.2	14.7
<b>Total sales</b>	<b>\$ 881.1</b>	<b>\$ 889.9</b>	<b>\$ 821.4</b>
<b>Operating income:</b>			
Transportation systems	\$ 43.0	\$ 20.1	\$ 2.8
Defense	18.3	44.2	31.4
Restructuring activity	(6.2)		
Unallocated corporate expenses and other	(1.8)	(2.2)	(3.3)
<b>Total operating income</b>	<b>\$ 53.3</b>	<b>\$ 62.1</b>	<b>\$ 30.9</b>
<b>Assets:</b>			
Transportation systems	\$ 144.5	\$ 170.6	\$ 207.8
Defense	357.2	293.1	255.1
Corporate and other	139.6	128.9	85.2
<b>Total assets</b>	<b>\$ 641.3</b>	<b>\$ 592.6</b>	<b>\$ 548.1</b>
<b>Depreciation and amortization:</b>			
Transportation systems	\$ 1.8	\$ 2.2	\$ 2.6
Defense	7.4	6.1	5.3
Corporate and other	0.5	0.5	0.6
<b>Total depreciation and amortization</b>	<b>\$ 9.7</b>	<b>\$ 8.8</b>	<b>\$ 8.5</b>
<b>Expenditures for long-lived assets:</b>			
Transportation systems	\$ 1.0	\$ 1.8	\$ 0.9
Defense	4.8	4.3	8.5
Corporate and other	2.3		0.4
<b>Total expenditures for long-lived assets</b>	<b>\$ 8.1</b>	<b>\$ 6.1</b>	<b>\$ 9.8</b>

CUBIC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 11 BUSINESS SEGMENT INFORMATION Continued

Years ended September 30,	2008	2007	2006
		(in millions)	
<b>Geographic Information:</b>			
Sales (a):			
United States	\$ 532.3	\$ 606.6	\$ 566.8
United Kingdom	189.6	153.1	120.2
Canada	25.4	26.5	28.6
Australia	43.0	26.9	27.3
Middle East	37.8	17.2	18.6
Far East	38.1	43.4	26.1
Other	14.9	16.2	33.8
Total sales	\$ 881.1	\$ 889.9	\$ 821.4

(a) Sales are attributed to countries or regions based on the location of customers.

Long-lived assets, net:			
United States	\$ 47.4	\$ 48.0	\$ 48.3
United Kingdom	12.0	14.1	12.5
Other foreign countries	1.9	2.0	1.8
Total long-lived assets, net	\$ 61.3	\$ 64.1	\$ 62.6

Defense segment sales include \$477.8 million, \$484.4 million and \$427.2 million in 2008, 2007 and 2006, respectively, of sales to U.S. Government agencies. Transportation systems sales include \$110.7 million, \$71.4 million, and \$49.7 million of sales to TranSys in 2008, 2007 and 2006, respectively. No other single customer accounts for 10% or more of the Company's revenue.

NOTE 12 SUMMARY OF QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

The following is a summary of the quarterly results of operations for the years ended September 30, 2008 and 2007:



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	Quarter Ended			
	December 31	March 31	June 30	September 30
(in thousands, except per share data)				
<u>Fiscal 2008</u>				
Net sales	\$ 202,722	\$ 210,280	\$ 232,892	\$ 235,241
Operating income	17,088	13,886	11,475	10,815
Net income	10,676	9,646	8,478	8,054
Net income per share	0.40	0.36	0.32	0.30
<u>Fiscal 2007</u>				
Net sales	\$ 202,935	\$ 230,041	\$ 233,749	\$ 223,145
Operating income	11,691	17,799	16,560	16,048
Net income	8,325	11,211	11,177	10,873
Net income per share	0.31	0.42	0.42	0.41

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders of Cubic Corporation

We have audited the accompanying consolidated balance sheets of Cubic Corporation as of September 30, 2008 and 2007, and the related consolidated statements of income, changes in shareholders' equity and cash flows for each of the three years in the period ended September 30, 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Cubic Corporation at September 30, 2008 and 2007, and the consolidated results of its operations and its cash flows for each of the three years in the period ended September 30, 2008, in conformity with U.S. generally accepted accounting principles.

As disclosed in Note 9 in the notes to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 158, *Employers Accounting for Defined Benefit Pensions and Other Postretirement Plans*, an amendment to SFAS No. 87, 88, 106, and 132(R) during the year ended September 30, 2007.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Cubic Corporation's internal control over financial reporting as of September 30, 2008, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated December 2, 2008 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

San Diego, CA

December 2, 2008

**Item 9. DISAGREEMENTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.**

None.

**Item 9a. CONTROLS AND PROCEDURES.**

*Evaluation of Disclosure Controls and Procedures* The Company's management conducted an evaluation, under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of September 30, 2008. Based on this evaluation, the Company's management, including the Chief Executive Officer and Chief Financial Officer, concluded that the Company's disclosure controls and procedures are effective in providing reasonable assurance that information required to be disclosed in the reports the Company files and submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported as and when required.

In designing and evaluating the Company's disclosure controls and procedures, the Company's management recognizes that any controls, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

***Management's Report on Internal Control over Financial Reporting***

Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. In order to evaluate the effectiveness of internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act, management has conducted an assessment, including testing, using the criteria in Internal Control - Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's system of internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of Omega Training Group, Inc. (Omega), acquired in the fourth quarter of 2008. Omega is included in the consolidated financial statements of Cubic Corporation and constituted \$72.0 million and \$9.6 million of total assets and liabilities, respectively, as of September 30, 2008 and \$12.6 million and \$2.3 million of total revenues and operating income, respectively, for the fiscal year then ended. Management did not assess the effectiveness of internal control over financial reporting at the entity listed above due to the timing of the acquisition.

***Changes in Internal Controls Over Financial Reporting*** There were no changes in the Company's internal control over financial reporting that occurred during the fourth fiscal quarter of 2008 that have materially affected, or are

reasonably likely to materially affect the Company's internal control over financial reporting. The Company acquired Omega in the fourth quarter of 2008, as mentioned in the preceding paragraph; however, the Company does not believe this acquisition will have a material affect on the Company's internal control over financial reporting.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders of Cubic Corporation

We have audited Cubic Corporation's internal control over financial reporting as of September 30, 2008, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Cubic Corporation's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

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

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

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

As indicated in the accompanying Management's Report on Internal Control Over Financial Reporting, management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of Omega Training Group, Inc., which is included in the 2008 consolidated financial statements of Cubic Corporation and constituted \$72.0 million and \$9.6 million of total assets and total liabilities, respectively, as of September 30, 2008 and \$12.6 million and \$1.4 million of total revenues and net income, respectively, for the fiscal year then ended. Our audit of internal control over financial reporting of Cubic Corporation also did not include an evaluation of internal control over financial reporting of the entity listed above.

In our opinion, Cubic Corporation maintained, in all material respects, effective internal control over financial reporting as of September 30, 2008, based on the COSO criteria.



We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Cubic Corporation as of September 30, 2008 and 2007, and the related statements of income, shareholders' equity, and cash flows for each of the three years in the period ended September 30, 2008 of Cubic Corporation and our report dated December 2, 2008 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

San Diego, California  
December 2, 2008

**PART III**

**Item 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.**

Certain information regarding directors and executive officers is incorporated herein by reference from our definitive Proxy Statement, which will be filed no later than 30 days prior to the date of the Annual Meeting of Shareholders.

The Company has adopted a code of ethics that applies to its principle executive officer, principle financial officer, and its principle accounting officer. Such code of ethics appears on our web site at: <http://www.cubic.com/corp1/invest/governance.html>.

**Item 11. EXECUTIVE COMPENSATION.**

Information regarding executive compensation is incorporated herein by reference from our definitive Proxy Statement, which will be filed no later than 30 days prior to the date of the Annual Meeting of Shareholders.

**Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.**

Information regarding security ownership of certain beneficial owners and management is incorporated herein by reference from our definitive Proxy Statement, which will be filed no later than 30 days prior to the date of the Annual Meeting of Shareholders.

**Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.**

Information regarding certain relationships and related transactions is incorporated herein by reference from our definitive Proxy Statement, which will be filed no later than 30 days prior to the date of the Annual Meeting of Shareholders.

**Item 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.**

Information regarding principal accountant fees and services is incorporated herein by reference from our definitive Proxy Statement, which will be filed no later than 30 days prior to the date of the Annual Meeting of Shareholders.





**PART IV**

**Item 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES**

(a) Documents filed as part of this Report:

(1) The following consolidated financial statements of Cubic Corporation, as referenced in Item 8:

Consolidated Balance Sheets

September 30, 2008 and 2007

Consolidated Statements of Income

Years ended September 30, 2008, 2007 and 2006

Consolidated Statements of Changes in Shareholders' Equity

Years ended September 30, 2008, 2007 and 2006

Consolidated Statements of Cash Flows

Years ended September 30, 2008, 2007 and 2006

Notes to Consolidated Financial Statements

September 30, 2008

(2) The following consolidated financial statement schedules of Cubic Corporation and subsidiaries, as referenced in Item 15(d):

None are required under the applicable accounting rules and regulations of the Securities and Exchange Commission.

(b) Exhibits:

- 3.1 Amended and Restated Certificate of Incorporation. Incorporated by reference from Form 10-Q for the quarter ended June 30, 2006, file No. 1-8931, Exhibit 3.1.
- 3.2 Bylaws. Incorporated by reference to Form 10-K filed for the fiscal year ended September 30, 2004, file No. 1-8931, Exhibit 3(ii).
- 10.1 2005 Equity Incentive Plan. Incorporated by reference from Form 10-K filed for the fiscal year ended September 30, 2005, file No. 1-8931, Exhibit 10.1
- 10.2 Amended Transition Protection Plan. Incorporated by reference from Form 10-K filed for the fiscal year ended September 30, 2007, file No. 1-8931, Exhibit 10.2
- 10.3 Credit Agreement dated March 10, 2005. Incorporated by reference from Form 10-Q for the quarter ended March 31, 2005, file No. 1-8931, Exhibit 10.
- 10.4 Revised Deferred Compensation Plan. Incorporated by reference to Form 10-Q for the quarter ended March 31, 2008, file No. 1-8931, Exhibit 10.4
- 21.1 List of Subsidiaries
- 23.1 Consent of Independent Registered Accounting Firm.
- 31.1 Section 302 Certifications.
- 32.1 Section 906 Certifications.

**SIGNATURES**

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

(Registrant)	CUBIC CORPORATION
12/2/08	/s/ Walter J. Zable
Date	WALTER J. ZABLE, President

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

12/2/08	/s/ Walter J. Zable
Date	WALTER J. ZABLE, President, Chief Executive Officer and Chairman of the Board of Directors

12/2/08	/s/ Walter C. Zable
Date	WALTER C. ZABLE, Vice President and Vice Chairman of the Board of Directors

12/2/08	/s/ Raymond L. deKozan
Date	RAYMOND L. deKOZAN, Director, Senior Group Vice President

12/2/08	/s/ Raymond E. Peet
Date	RAYMOND E. PEET, Director

12/2/08	/s/ John H. Warner
Date	JOHN H. WARNER, Director

12/2/08	/s/ Robert S. Sullivan
Date	ROBERT S. SULLIVAN, Director

12/2/08	/s/ Bruce G. Blakley
Date	BRUCE G. BLAKLEY, Director

12/2/08	/s/ William W. Boyle
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Date WILLIAM W. BOYLE,  
Director, Senior Vice President and  
Chief Financial Officer

*12/2/08* /s/ Mark A. Harrison  
Date MARK A. HARRISON,  
Vice President and Corporate  
Controller (Principal Accounting  
Officer)