FARMER BROTHERS CO
Form 10-Q
November 09, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2015
OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to
Commission file number: 001-34249
FARMER BROS. CO.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	95-0725980
(State of Incorporation)	(I.R.S. Employer Identification No.)

13601 North Freeway, Suite 200, Fort Worth, Texas 76177
(Address of Principal Executive Offices; Zip Code)
888-998-2468
(Registrant's Telephone Number, Including Area Code)

20333 South Normandie Avenue, Torrance, California 90502
(Former Address, if Changed Since Last Report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES ý NO ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	¨	Accelerated filer	ý
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ¨ NO ý

As of November 6, 2015 the registrant had 16,676,199 shares outstanding of its common stock, par value $1.00 per share, which is the registrant's only class of common stock.

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FARMER BROS. CO.
CONSOLIDATED BALANCE SHEETS (UNAUDITED)
(In thousands, except share and per share data)

	September 30, 2015	June 30, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$22,765	$15,160
Restricted cash	1,274	1,002
Short-term investments	22,837	23,665
Accounts and notes receivable, net	42,973	40,161
Inventories	56,744	50,522
Income tax receivable	797	535
Prepaid expenses	3,685	4,640
Total current assets	151,075	135,685
Property, plant and equipment, net	90,271	90,201
Goodwill and intangible assets, net	6,641	6,691
Other assets	7,612	7,615
Deferred income taxes	751	751
Total assets	$256,350	$240,943
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$38,892	$27,023
Accrued payroll expenses	23,451	23,005
Short-term borrowings under revolving credit facility	154	78
Short-term obligations under capital leases	2,904	3,249
Short-term derivative liabilities	3,632	3,977
Deferred income taxes	1,390	1,390
Other current liabilities	6,539	6,152
Total current liabilities	76,962	64,874
Accrued pension liabilities	47,506	47,871
Accrued postretirement benefits	23,505	23,471
Accrued workers' compensation liabilities	10,964	10,964
Other long-term liabilities—capital leases	2,059	2,599
Other long-term liabilities (Note 11)	3,609	225
Deferred income taxes	909	928
Total liabilities	$165,514	$150,932
Commitments and contingencies (Note 15)		
Stockholders' equity:		
Preferred stock, $1.00 par value, 500,000 shares authorized and none issued	$—	$—
Common stock, $1.00 par value, 25,000,000 shares authorized; 16,676,403 and 16,658,148 issued and outstanding at September 30, 2015 and June 30, 2015, respectively	16,676	16,658
Additional paid-in capital	39,696	38,143
Retained earnings	105,790	106,864
Unearned ESOP shares	(11,234)	(11,234)
Accumulated other comprehensive loss	(60,092)	(60,420)
Total stockholders' equity	$90,836	$90,011

Total liabilities and stockholders’ equity	$256,350	$240,943

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

FARMER BROS. CO.
CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
(In thousands, except share and per share data)

	Three Months Ended September 30,	
	2015	2014
Net sales	$133,445	$135,984
Cost of goods sold	82,866	87,863
Gross profit	50,579	48,121
Selling expenses	36,441	38,450
General and administrative expenses	9,465	7,009
Restructuring and other transition expenses	5,450	—
Net (gains) losses from sales of assets	(214)	61
Operating expenses	51,142	45,520
(Loss) income from operations	(563)	2,601
Other (expense) income:		
Dividend income	293	294
Interest income	104	89
Interest expense	(121)	(207)
Other, net	(875)	(64)
Total other (expense) income	(599)	112
(Loss) income before taxes	(1,162)	2,713
Income tax (benefit) expense	(88)	198
Net (loss) income	$(1,074)	$2,515
Net (loss) income per common share—basic	$(0.07)	$0.16
Net (loss) income per common share—diluted	$(0.07)	$0.16
Weighted average common shares outstanding—basic	16,269,368	16,003,802
Weighted average common shares outstanding—diluted	16,269,368	16,130,745

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

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FARMER BROS. CO.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME (UNAUDITED)
(In thousands)

	Three Months Ended September 30,	
	2015	2014
Net (loss) income	$(1,074)	$2,515
Other comprehensive (loss) income, net of tax:		
Unrealized (losses) gains on derivative instruments designated as cash flow hedges	(4,640)	3,332
Losses (gains) on derivative instruments designated as cash flow hedges reclassified to cost of goods sold	4,968	(4,710)
Total comprehensive (loss) income, net of tax	$(746)	$1,137

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

FARMER BROS. CO.
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(In thousands)

	Three Months Ended September 30,	
	2015	2014
Cash flows from operating activities:		
Net (loss) income	$(1,074)	$2,515
Adjustments to reconcile net (loss) income to net cash provided by (used in)operating activities:		
Depreciation and amortization	5,295	6,256
Provision for doubtful accounts	44	7
Restructuring and other transition expenses, net of payments	2,889	—
Deferred income taxes	(19)	29
Net (gains) losses from sales of assets	(214)	61
ESOP and share-based compensation expense	1,229	1,258
Net losses (gains) on derivative instruments and investments	5,839	(4,569)
Change in operating assets and liabilities:		
Restricted cash	(272)	—
Purchases of trading securities held for investment	(518)	(936)
Proceeds from sales of trading securities held for investment	1,202	1,315
Accounts and notes receivable	(1,805)	(3,949)
Inventories	(6,446)	(897)
Income tax receivable	(262)	30
Derivative assets, net	(5,094)	5,389
Prepaid expenses and other assets	966	712
Accounts payable	11,493	(3,899)
Accrued payroll expenses and other current liabilities	(1,514)	(6,463)
Accrued postretirement benefits	34	(230)
Other long-term liabilities	(365)	(452)
Net cash provided by (used in) operating activities	$11,408	$(3,823)
Cash flows from investing activities:		
Purchases of property, plant and equipment	(3,781)	(4,930)
Proceeds from sales of property, plant and equipment	538	98
Net cash used in investing activities	$(3,243)	$(4,832)
Cash flows from financing activities:		
Proceeds from revolving credit facility	—	13,860
Repayments on revolving credit facility	(28)	(12,040)
Payment of financing costs	(8)	—
Payments of capital lease obligations	(865)	(957)
Proceeds from stock option exercises	341	581
Net cash (used in) provided by financing activities	$(560)	$1,444
Net increase (decrease) in cash and cash equivalents	$7,605	$(7,211)
Cash and cash equivalents at beginning of period	$15,160	11,993
Cash and cash equivalents at end of period	$22,765	$4,782

(continued on next page)

FARMER BROS. CO.
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) (continued from previous page)
(In thousands)

	Three Months Ended September 30,	
	2015	2014
Supplemental disclosure of non-cash investing and financing activities:		
Equipment acquired under capital leases	$9	$42
Net change in derivative assets and liabilities included in other comprehensive income	$328	$(1,378)
Increase in construction-in-progress assets under Texas facility lease	$1,982	$—
Increase in Texas facility lease obligation	$2,768	$—
Non-cash additions to equipment	$150	$17

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

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FARMER BROS. CO.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Note 1. Summary of Significant Accounting Policies
Organization
Farmer Bros. Co., a Delaware corporation (including its consolidated subsidiaries unless the context otherwise requires, the “Company,” or “Farmer Bros.”), is a manufacturer, wholesaler and distributor of coffee, tea and culinary products. The Company's customers include restaurants, hotels, casinos, offices, quick service restaurants (“QSRs”), convenience stores, healthcare facilities and other foodservice providers, as well as private brand retailers in the QSR, grocery, drugstore, restaurant, convenience store and independent coffeehouse channels. The Company was founded in 1912, was incorporated in California in 1923, and reincorporated in Delaware in 2004. The Company operates in one business segment.
Basis of Presentation
The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States (“GAAP”) for complete consolidated financial statements. In the opinion of management, all adjustments (consisting only of normal recurring accruals, unless otherwise indicated) considered necessary for a fair presentation of the interim financial data have been included. Operating results for the three months ended September 30, 2015 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2016. Events occurring subsequent to September 30, 2015 have been evaluated for potential recognition or disclosure in the unaudited consolidated financial statements for the three months ended September 30, 2015.
The accompanying unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2015, filed with the Securities and Exchange Commission (the "SEC") on September 14, 2015.
Use of Estimates
The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. The Company reviews its estimates on an ongoing basis using currently available information. Changes in facts and circumstances may result in revised estimates and actual results may differ from those estimates.
Corporate Relocation Plan
On February 5, 2015, the Company announced a plan approved by the Board of Directors of the Company on February 3, 2015, pursuant to which the Company will close its Torrance, California facility and relocate these operations to a new facility housing the Company's manufacturing, distribution, coffee lab and corporate headquarters (the “Corporate Relocation Plan”). The new facility will be located in Northlake, Texas in the Dallas/Fort Worth area. Expenses related to the Corporate Relocation Plan included in “Relocation and other transition expenses” in the Company's consolidated statements of operations include employee retention and separation benefits, facility-related costs, and other related costs such as travel, legal, consulting and other professional services. In order to receive the retention and/or separation benefits, impacted employees are required to provide service through their retention dates which vary from May 2015 through March 2016 or separation dates which vary from May 2015 through June 2016. A liability for such retention and separation benefits was recorded at the communication date in “Accrued payroll expenses” on the Company's consolidated balance sheets. Facility-related costs and other related costs are recognized in the period when the liability is incurred (see Note 2).
Facility Lease Obligation
On July 17, 2015, the Company entered into a lease agreement (the “Lease Agreement”) with WF-FB NLTX, LLC, a Delaware limited liability company (the “Lessor”), to lease a 538,000 square foot facility to be constructed on 28.2 acres of

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land located in Northlake, Texas (see Note 3). The new facility will be constructed by Lessor, at its expense, in accordance with agreed upon specifications and plans determined as set forth in the Lease Agreement. Due to the Company's involvement in the construction of the facility, as the deemed general contractor, pursuant to Accounting Standards Codification ("ASC") 840, "Leases" ("ASC 840"), the Company is required to capitalize during the construction period the cash and non-cash assets contributed by Lessor for the construction as property, plant and equipment on the Company's consolidated balance sheets, with an offsetting liability for the same amount payable to Lessor.
A portion of the lease arrangement is allocated to land for which the Company will record rent expense during the construction period (see Note 15). The expense associated with the land is determined using the fair value of the leased land at construction commencement and the Company's incremental borrowing rate, and is recognized on a straight-line basis. Once rent payments commence under the Lease Agreement, all amounts in excess of land rent expense will be recorded as a debt-service payment and recognized as interest expense and a reduction of the financing obligation.

Derivative Instruments

The Company purchases various derivative instruments to create economic hedges of its commodity price risk and interest rate risk. These derivative instruments consist primarily of futures and swaps. The Company reports the fair value of derivative instruments on its consolidated balance sheets in "Short-term derivative assets," "Other assets," "Short-term derivative liabilities," or "Long-term derivative liabilities." The Company determines the current and noncurrent classification based on the timing of expected future cash flows of individual trades and reports these amounts on a gross basis. Additionally, the Company reports cash held on deposit in margin accounts for coffee-related derivative instruments on a gross basis on its consolidated balance sheets in "Restricted cash" if restricted from withdrawal due to a net loss position in such margin accounts.
The accounting for the changes in fair value of the Company's derivative instruments can be summarized as follows:

Derivative Treatment	Accounting Method
Normal purchases and normal sales exception	Accrual accounting
Designated in a qualifying hedging relationship	Hedge accounting
All other derivative instruments	Mark-to-market accounting

The Company enters into green coffee purchase commitments at a fixed price or at a price to be fixed ("PTF"). PTF contracts are purchase commitments whereby the quality, quantity, delivery period, price differential to the coffee "C" market price and other negotiated terms are agreed upon, but the date, and therefore the price at which the base "C" market price will be fixed has not yet been established. The coffee "C" market price is fixed at some point after the purchase contract date and before the futures market closes for the delivery month and may be fixed either at the direction of the Company to the vendor, or by the application of a derivative that was separately purchased as a hedge. For both fixed-price and PTF contracts, the Company expects to take delivery of and to utilize the coffee in a reasonable period of time and in the conduct of normal business. Accordingly, these purchase commitments qualify as normal purchases and are not recorded at fair value on the Company's consolidated balance sheets.
The Company accounts for certain coffee-related derivative instruments as accounting hedges in order to minimize the volatility created in the Company's quarterly results from utilizing these derivative contracts and to improve comparability between reporting periods. For a derivative to qualify for designation in a hedging relationship it must meet specific criteria and the Company must maintain appropriate documentation. The Company establishes hedging relationships pursuant to its risk management policies. The hedging relationships are evaluated at inception and on an ongoing basis to determine whether the hedging relationship is, and is expected to remain, highly effective in achieving offsetting changes in fair value or cash flows attributable to the underlying risk being hedged. The Company also regularly assesses whether the hedged forecasted transaction is probable of occurring. If a derivative ceases to be or is no longer expected to be highly effective, or if the Company believes the likelihood of occurrence of the hedged forecasted transaction is no longer probable, hedge accounting is discontinued for that derivative, and future changes in the fair value of that derivative are recognized in "Other, net."

For coffee-related derivative instruments designated as cash flow hedges, the effective portion of the change in fair value of the derivative is reported as accumulated other comprehensive income (loss) ("AOCI") and subsequently reclassified into cost of goods sold in the period or periods when the hedged transaction affects earnings. Any ineffective portion of the derivative instrument's change in fair value is recognized currently in "Other, net." Gains or losses deferred in AOCI associated with terminated derivative instruments, derivative instruments that cease to be highly effective hedges, derivative instruments for which the forecasted transaction is reasonably possible but no longer probable of occurring, and cash flow hedges that have been otherwise discontinued remain in AOCI until the hedged item affects earnings. If it becomes probable that the forecasted transaction designated as the hedged item in a cash flow hedge will not occur, any gain or loss deferred in AOCI is recognized in “Other, net” at that time. For derivative instruments that are not designated in a hedging relationship, and for which the normal purchases and normal sales exception has not been elected, the changes in fair value are reported in “Other, net.”

The following gains and losses on derivative instruments are netted together and reported in “Other, net” in the Company's consolidated statements of operations:

- Gains and losses on all derivative instruments that are not designated as cash flow hedges and for which the normal purchases and normal sales exception has not been elected; and
- The ineffective portion of unrealized gains and losses on derivative instruments that are designated as cash flow hedges.

The fair value of derivative instruments is based upon broker quotes. At September 30, 2015 and June 30, 2015, approximately 95% of the Company's outstanding coffee-related derivative instruments were designated as cash flow hedges (see Note 4).

Coffee Brewing Equipment and Service

The Company classifies certain expenses related to coffee brewing equipment provided to customers as cost of goods sold. These costs include the cost of the equipment as well as the cost of servicing that equipment (including service employees’ salaries, cost of transportation and the cost of supplies and parts) and are considered directly attributable to the generation of revenues from its customers. Accordingly, such costs included in cost of goods sold in the accompanying unaudited consolidated financial statements in each of the three months ended September 30, 2015 and 2014 were $6.5 million. In addition, depreciation expense related to capitalized coffee brewing equipment reported in cost of goods sold in the three months ended September 30, 2015 and 2014 was $2.5 million and $2.6 million, respectively. The Company capitalized coffee brewing equipment (included in machinery and equipment) in the amount of $1.6 million and $3.1 million in the three months ended September 30, 2015 and 2014, respectively.

Revenue Recognition

The Company recognizes sales revenue when all of the following have occurred: (1) delivery; (2) persuasive evidence of an agreement exists; (3) pricing is fixed or determinable; and (4) collection is reasonably assured. Most product sales are made “off-truck” to the Company’s customers at their places of business by the Company’s route sales representatives. Revenue is recognized at the time the Company’s route sales representatives physically deliver products to customers and title passes or when it is accepted by the customer when shipped by third-party delivery.

Net (Loss) Income Per Common Share

Net (loss) income per share (“EPS”) represents net (loss) income attributable to common stockholders divided by the weighted-average number of common shares outstanding for the period, excluding unallocated shares held by the Company's Employee Stock Ownership Plan (“ESOP”). Diluted EPS represents net income attributable to common stockholders divided by the weighted-average number of common shares outstanding, inclusive of the dilutive impact of common equivalent shares outstanding during the period. However, nonvested restricted stock awards (referred to as participating securities) are excluded from the dilutive impact of common equivalent shares outstanding in accordance with authoritative guidance under the two-class method. The nonvested restricted stockholders are entitled to participate in dividends declared on common stock as if the shares were fully vested and hence are deemed to be participating securities. Under the two-class method, net income attributable to nonvested restricted stockholders is excluded from net income attributable to common stockholders for purposes of calculating basic and diluted EPS.

Computation of EPS for the three months ended September 30, 2015 excludes a total of 512,842 shares issuable under stock options, because the Company incurred a net loss and including them would be anti-dilutive. Computation of EPS for the three months ended September 30, 2014 includes the dilutive effect of 126,943 shares issuable under stock options with exercise prices below the closing price of the Company’s common stock on the last trading day of the quarter ended September 30, 2014, but excludes 72,756 shares issuable under stock options with exercise prices above the closing price of the Company’s common stock on the last trading day of the quarter ended September 30, 2014, because their inclusion would be anti-dilutive.

Dividends

The Company's Board of Directors has omitted the payment of a quarterly dividend since the third quarter of fiscal 2011. The amount, if any, of dividends to be paid in the future will depend upon the Company's then available cash, anticipated cash needs, overall financial condition, credit agreement restrictions, future prospects for earnings and cash flows, as well as other relevant factors.

Impairment of Goodwill and Indefinite-lived Intangible Assets

The Company performs its annual impairment test of goodwill and/or other indefinite-lived intangible assets as of June 30. Goodwill and other indefinite-lived intangible assets are not amortized but instead are reviewed for impairment annually, as well as on an interim basis if events or changes in circumstances between annual tests indicate that an asset might be impaired. Testing for impairment of goodwill is a two-step process. The first step requires the Company to compare the fair value of its reporting units to the carrying value of the net assets of the respective reporting units, including goodwill. If the fair value of the reporting unit is less than its carrying value, goodwill of the reporting unit is potentially impaired and the Company then completes step two to measure the impairment loss, if any. The second step requires the calculation of the implied fair value of goodwill, which is the residual fair value remaining after deducting the fair value of all tangible and intangible net assets of the reporting unit from the fair value of the reporting unit. If the implied fair value of goodwill is less than the carrying amount of goodwill, an impairment loss is recognized equal to the difference. Indefinite-lived intangible assets are tested for impairment by comparing their fair values to their carrying values. An impairment charge is recorded if the estimated fair value of such assets has decreased below their carrying value. There were no such events or circumstances during the three months ended September 30, 2015 and 2014.

In fiscal 2015, the Company recorded $0.3 million in goodwill in connection with the acquisition of substantially all of the assets of Rae' Launo Corporation relating to its direct-store-delivery and in-room distribution business in the Southeastern United States (the "RLC Acquisition"). As of September 30, 2015, the Company determined that there were no events or circumstances that indicated impairment and, therefore, no goodwill impairment charges were recorded in the three months ended September 30, 2015. The Company had no goodwill recorded at September 30, 2014.

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

The Company reviews the recoverability of its long-lived assets whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Long-lived assets evaluated for impairment are grouped with other assets to the lowest level for which identifiable cash flows are largely independent of the cash flows of other groups of assets and liabilities. The estimated future cash flows are based upon, among other things, assumptions about expected future operating performance, and may differ from actual cash flows. If the sum of the projected undiscounted cash flows (excluding interest) is less than the carrying value of the assets, the assets will be written down to the estimated fair value in the period in which the determination is made. There were no such events or circumstances during the three months ended September 30, 2015 and 2014. The Company may incur certain other non-cash asset impairment costs in connection with the Corporate Relocation Plan.

Self-Insurance

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

The Company accounts for its accrued liability relating to workers' compensation claims on an undiscounted basis. The estimated gross undiscounted workers' compensation liability relating to such claims as of September 30, 2015 and June 30, 2015, respectively, was $13.2 million and $13.4 million, and the estimated recovery from reinsurance was $2.5 million as of September 30, 2015 and June 30, 2015. The short-term and long-term accrued liabilities for workers’ compensation claims are presented on the Company's consolidated balance sheets in "Other current liabilities" and in "Accrued workers' compensation liabilities," respectively. The estimated insurance receivable is included in "Other assets" on the Company's consolidated balance sheets.

Due to its failure to meet the minimum credit rating criteria for participation in the alternative security program for California self-insurers for workers' compensation liability, the Company posted a $7.0 million letter of credit at September 30, 2015 and June 30, 2015 as a security deposit with the State of California Department of Industrial Relations Self-Insurance Plans.

The estimated liability related to the Company's self-insured group medical insurance at September 30, 2015 and June 30, 2015 was $0.9 million and $1.0 million, respectively, recorded on an incurred but not reported basis, within deductible limits, based on actual claims and the average lag time between the date insurance claims are filed and the date those claims are paid.

General liability, product liability and commercial auto liability are insured through a captive insurance program. The Company retains the risk within certain aggregate amounts. Cost of the insurance through the captive program is accrued based on estimates of the aggregate liability claims incurred using certain actuarial assumptions and historical claims experience. The Company's liability reserve for such claims at September 30, 2015 and June 30, 2015 was $1.1 million and $0.8 million, respectively.

The estimated liability related to the Company's self-insured group medical insurance, general liability, product liability and commercial auto liability is included on the Company's consolidated balance sheets in "Other current liabilities."

Recently Adopted Accounting Standards

In August 2015, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") 2015-15, "Interest—Imputation of Interest (Subtopic 835-30): Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements" ("ASU 2015-15"). ASU 2015-15 incorporates into the Accounting Standards Codification ("ASC") an SEC staff announcement that the SEC staff will not object to an entity presenting the cost of securing a revolving line of credit as an asset, regardless of whether a balance is outstanding. The standard, as issued, did not address revolving lines of credit, which may not have outstanding balances. An entity that repeatedly draws on a revolving credit facility and then repays the balance could present the cost as a deferred asset and reclassify all or a portion of it as a direct deduction from the liability whenever a balance is outstanding. However, the SEC staff's announcement provides a less-cumbersome alternative. Either way, the cost should be amortized over the term of the arrangement. This guidance was effective upon announcement by the SEC on June 18, 2015. The Company adopted this guidance on the effective date. Adoption of ASU 2015-15 did not have a material effect on the results of operations, financial position or cash flows of the Company.

New Accounting Pronouncements

In September 2015, the FASB issued ASU 2015-16, "Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments" ("ASU 2015-16"). ASU 2015-16 eliminates the requirement that an acquirer in a business combination account for measurement-period adjustments retrospectively. Instead, an acquirer will recognize a measurement-period adjustment during the period in which it determines the amount of the adjustment, including the effect on earnings of any amounts it would have recorded in previous periods if the accounting had been completed at the acquisition date. The guidance is effective for public business entities for fiscal years, including interim periods within those fiscal years, beginning after December 15, 2015, with early adoption permitted. ASU 2015-16 is effective for the Company beginning July 1, 2016. Adoption of ASU 2015-16 is not expected to have a material effect on the results of operations, financial position or cash flows of the Company.

In July 2015, the FASB issued ASU 2015-12, "Plan Accounting: Defined Benefit Pension Plans (Topic 960), Defined Contribution Pension Plans (Topic 962), Health and Welfare Benefit Plans (Topic 965), (Part I) Fully Benefit-Responsive Investment Contracts, (Part II) Plan Investment Disclosures, (Part III) Measurement Date Practical Expedient" ("ASU 2015-12"). ASU 2015-12 eliminates requirements that employee benefit plans measure the fair value of fully benefit-responsive investment contracts ("FBRICs") and provide the related fair value disclosures. As a result, FBRICs are measured, presented and disclosed only at contract value. Also, plans will be required to disaggregate their investments measured using fair value by general type, either on the face of the financial statements or in the notes, and self-directed brokerage accounts are one general type. Plans no longer have to disclose the net appreciation/depreciation in fair value of investments by general type or individual investments equal to or greater than 5% of net assets available for benefits. In addition, a plan with a fiscal year end that doesn’t coincide with the end of a calendar month is allowed to measure its investments and investment-related accounts using the month end closest to its fiscal year end. The new guidance for FBRICs and plan investment disclosures should be applied retrospectively. The measurement date practical expedient should be applied prospectively. The guidance is effective for fiscal years beginning after December 15, 2015, with early adoption permitted. ASU 2015-12 is effective for the Company beginning July 1, 2016. Adoption of ASU 2015-12 is not expected to have a material effect on the results of operations, financial position or cash flows of the Company.

In July 2015, the FASB issued ASU 2015-11, “Inventory (Topic 330): Simplifying the Measurement of Inventory” (“ASU 2015-11”). ASU 2015-11 simplifies the subsequent measurement of inventory by requiring inventory to be measured at the lower of cost and net realizable value. Entities will continue to apply their existing impairment models to inventories that are accounted for using last-in first-out or LIFO and the retail inventory method or RIM. Under current guidance, net realizable value is one of several calculations an entity needs to make to measure inventory at the lower of cost or market. ASU 2015-11 is effective for public business entities for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted, and the guidance must be applied prospectively after the date of adoption. ASU 2015-11 is effective for the Company beginning July 1, 2017. Adoption of ASU 2015-11 is not expected to have a material effect on the results of operations, financial position or cash flows of the Company.

In May 2015, the FASB issued ASU 2015-07, “Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)” (“ASU 2015-07”). ASU 2015-07 removes the requirement to categorize investments for which the fair values are measured using the net asset value per share (“NAV”) practical expedient within the fair value hierarchy. It also limits certain disclosures to investments for which the entity has elected to measure the fair value using the practical expedient. ASU 2015-07 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2015, with early adoption permitted.

ASU 2015-07 is effective for the Company beginning July 1, 2016. The Company is in the process of assessing the impact of the adoption of ASU 2015-07 on its consolidated financial statements.

In May 2014, the FASB issued accounting guidance which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers under ASU 2014-09, “Revenue from Contracts with Customers (Topic 606)” (“ASU 2014-09”). ASU 2014-09 will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. On July 9, 2015, the FASB decided to delay the effective date of ASU 2014-09 by one year allowing early adoption as of the original effective date of January 1, 2017. The deferral results in the new revenue standard being effective January 1, 2018. The Company is currently evaluating the impact of ASU 2014-09 on its results of operations, financial position and cash flows.

Note 2. Corporate Relocation Plan

On February 5, 2015, the Company announced the Corporate Relocation Plan pursuant to which the Company will close its Torrance facility and relocate these operations to a new facility housing the Company's manufacturing, distribution, coffee lab and corporate headquarters. Approximately 350 positions are impacted as a result of the Torrance facility closure. The new facility will be located in Northlake, Texas in the Dallas/Fort Worth area. The Company’s decision resulted from a comprehensive review of alternatives designed to make the Company more competitive and better positioned to capitalize on growth opportunities.

The Company expects to close its Torrance facility in phases, and the Company began the process in the spring of 2015. Through April 2015, coffee purchasing, roasting, grinding, packaging and product development took place at the Company’s Torrance, California, Portland, Oregon and Houston, Texas production facilities. In May 2015, the Company moved the coffee roasting, grinding and packaging functions that had been conducted in Torrance to its Houston and Portland production facilities and in conjunction relocated its Houston distribution operations to its Oklahoma City distribution center. Spice blending, grinding, packaging and product development continue to take place at the Company’s Torrance production facility. As of September 30, 2015, distribution continued to take place out of the Company’s Torrance and Portland production facilities, as well as separate distribution centers in Northlake, Illinois; Oklahoma City, Oklahoma; and Moonachie, New Jersey. Effective September 15, 2015, the Company transferred a majority of its primary administrative offices from Torrance to Fort Worth, Texas, where the Company has leased 32,000 square feet of temporary office space. The transfer of the Company’s primary administrative offices to this temporary office space is expected to be completed by the end of the second quarter of fiscal 2016. Construction of and relocation to the new facility are expected to be completed by the end of the second quarter of fiscal 2017. The Company's Torrance facility may be sold as part of the Corporate Relocation Plan.

Based on current assumptions and subject to continued implementation of the Corporate Relocation Plan as planned, the Company estimates that it will incur approximately $25 million in cash costs in connection with the exit of the Torrance facility consisting of $14 million in employee retention and separation benefits, $4 million in facility-related costs and $7 million in other related costs. Expenses related to the Corporate Relocation Plan in the three months ended September 30, 2015 consisted of $3.6 million in employee retention, relocation and separation benefits, $0.7 million in facility-related costs including lease of temporary office space, costs associated with the move of the Company's headquarters, and expenses associated with production transition and relocation of certain distribution centers, and $1.1 million in other related costs including travel, legal, consulting, dedicated project management and other professional services. Facility-related costs in the three months ended September 30, 2015 also included $0.3 million in non-cash depreciation expense associated with the Torrance production facility resulting from the consolidation of coffee production operations with the Houston and Portland production facilities.

Since adoption of the Corporate Relocation Plan through September 30, 2015, the Company has recognized a total of $15.3 million of the estimated $25 million in aggregate cash costs consisting of an aggregate of $10.1 million in employee retention and separation benefits, $0.8 million in facility-related costs and $4.4 million in other related costs. The remainder is expected to be recognized in the balance of fiscal 2016 and the first quarter of fiscal 2017. The Company may incur certain other non-cash asset impairment costs, pension-related costs and postretirement benefit costs in connection with the Corporate Relocation Plan.

The following table sets forth the activity in liabilities associated with the Corporate Relocation Plan for the three months ended September 30, 2015:

(In thousands)	Balances, June 30, 2015	Additions	Payments	Non-Cash Settled	Adjustments	Balances, September 30, 2015
Employee-related costs(1)	$6,156	$3,596	$7,405	$—	$—	$2,347
Facility-related costs(2)	—	730	387	343	—	—
Other(3)	200	1,124	1,124	—	—	200
Total	$6,356	$5,450	$8,916	$343	$—	$2,547
Current portion	6,356					2,547
Non-current portion	—					—
Total	$6,356					$2,547

(1) Included in "Accrued payroll expenses" on the Company's consolidated balance sheets.

(2) Non-cash settled facility-related costs represent depreciation expense associated with the Torrance production facility resulting from the consolidation of coffee production operations with the Houston and Portland production facilities.

(3) Included in "Accounts payable" on the Company's consolidated balance sheets.

Note 3. Facility Lease Obligation

On July 17, 2015, the Company entered into the Lease Agreement pursuant to which the Company will lease a 538,000 square foot facility to be constructed on 28.2 acres of land located in Northlake, Texas. The new facility is expected to include approximately 85,000 square feet for corporate offices, more than 100,000 square feet for manufacturing, and more than 300,000 square feet for distribution, in addition to a coffee lab. The construction of the new facility is estimated to be completed by the end of the second quarter of fiscal 2017.

The new facility will be constructed by Lessor, at its expense, in accordance with agreed upon specifications and plans determined as set forth in the Lease Agreement. Due to the Company's involvement in the construction of the facility, as the deemed general contractor, pursuant to ASC 840, the Company is required to capitalize during the construction period the cash and non-cash assets contributed by Lessor for the construction as property, plant and equipment on the Company’s consolidated balance sheets, with an offsetting liability for the same amount payable to Lessor.

The Company recorded an asset related to the facility lease obligation included in property, plant and equipment of $2.8 million during the three months ended September 30, 2015. The facility lease obligation included in "Other long-term liabilities" on the Company’s consolidated balance sheet was $2.8 million as of September 30, 2015. There were no such amounts recorded at June 30, 2015. As of September 30, 2015 and June 30, 2015, respectively, the Company had recorded $1.1 million and $0.3 million in “Other receivables” representing costs incurred by the Company associated with the new facility that are expected to be reimbursed by Lessor under the Lease Agreement (see Note 7).

A portion of the lease arrangement is allocated to land for which the Company will record rent expense during the construction period (see Note 15). The expense associated with the land is determined using the fair value of the leased land at construction commencement and the Company’s incremental borrowing rate, and is recognized on a straight-line basis. Once rent payments commence under the Lease Agreement, all amounts in excess of land rent expense will be recorded as a debt-service payment and recognized as interest expense and a reduction of the financing obligation. Rent expense for the facility lease obligation included in the Company’s consolidated statements of operations in the three months ended September 30, 2015 and 2014 was $0.1 million and $0, respectively.

The Lease Agreement contains a purchase option exercisable at any time by the Company on or before ninety days prior to the scheduled completion date with an option purchase price equal to 103% of the total project cost as of the date of the option closing if the option closing occurs on or before July 17, 2016. The option purchase price will increase by 0.35% per month thereafter up to and including the date which is the earlier of (A) ninety days after the scheduled completion date and (B) December 31, 2016. The obligation to pay rent will commence on December 31, 2016, if the option remains unexercised. The decision of whether to exercise the option or not will depend upon, among other things, whether the Company can sell the Torrance facility at an acceptable price.

The initial term of the lease is for 15 years from the rent commencement date with six options to renew, each with a renewal term of 5 years. The annual base rent under the Lease Agreement will be an amount equal to:

- the product of 7.50% and (a) the total estimated budget for the project, or (b) all construction costs outlined in the final budget on or prior to the scheduled completion date; or
- the product of 7.50% and the total project costs, to the extent that all components of the document delivery and completion requirement are fully satisfied on or prior to the scheduled completion date.

Annual base rent will increase by 2% during each year of the lease term.

On July 17, 2015, the Company also entered into a Development Management Agreement (“DMA”) with Stream Realty Partners-DFW, L.P., a Texas limited partnership (“Developer”).

Pursuant to the DMA, the Company retained the services of Developer to manage, coordinate, represent, assist and advise the Company on matters concerning the pre-development, development, design, entitlement, infrastructure, site preparation and construction of the facility. The term of the DMA is from July 17, 2015 until final completion of the project. Pursuant to the DMA, the Company will pay Developer:

- a development fee of 3.25% of all development costs;
- an oversight fee of 2% of any amounts paid to the Company-contracted parties for any oversight by Developer of Company-contracted work;
- an incentive fee, the amount of which will be determined by the parties, if final completion occurs prior to the scheduled completion date; and
- an amount equal to $2.6 million as additional fee in respect of development services.

Note 4. Derivative Instruments

Derivative Instruments Held

Coffee-Related Derivative Instruments

The Company is exposed to commodity price risk associated with its PTF green coffee purchase contracts, which are described further in Note 1. The Company utilizes futures contracts and options to manage exposure to the variability in expected future cash flows from forecasted purchases of green coffee attributable to commodity price risk. Certain of these coffee-related derivative instruments utilized for risk management purposes have been designated as cash flow hedges, while other coffee-related derivative instruments have not been designated as cash flow hedges or do not qualify for hedge accounting despite hedging the Company's future cash flows on an economic basis.

Farmer Bros. Co.
Notes to Consolidated Financial Statements
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The following table summarizes the notional volumes for the coffee-related derivative instruments held by the Company at September 30, 2015 and June 30, 2015:

(In thousands)	September 30, 2015	June 30, 2015
Derivative instruments designated as cash flow hedges:		
Long coffee pounds	35,588	32,288
Derivative instruments not designated as cash flow hedges:		
Long coffee pounds	1,728	1,954
Total	37,316	34,242

Cash flow hedge contracts outstanding as of September 30, 2015 will expire within 22 months.
Effect of Derivative Instruments on the Financial Statements
Balance Sheets
Fair values of derivative instruments on the Company's consolidated balance sheets:

	Derivative Instruments Designated as Cash Flow Hedges		Derivative Instruments Not Designated as Accounting Hedges	
(In thousands)	September 30, 2015	June 30, 2015	September 30, 2015	June 30, 2015
Financial Statement Location:				
Short-term derivative assets(1):				
Coffee-related derivative instruments	$31	$128	$5	$25
Long-term derivative assets(1):				
Coffee-related derivative instruments	$69	$136	$—	$2
Short-term derivative liabilities(1):				
Coffee-related derivative instruments	$3,496	$4,128	$241	$2
Long-term derivative liabilities(2):				
Coffee-related derivative instruments	$641	$163	$—	$—

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

Statements of Operations
The following table presents pretax net gains and losses for the Company's coffee-related derivative instruments designated as cash flow hedges, as recognized in "AOCI," "Cost of goods sold" and "Other, net":

	Three Months Ended September 30,		Financial Statement Classification
(In thousands)	2015	2014	
Net (losses) gains recognized in accumulated other comprehensive (loss) income (effective portion)	$(4,640)	$3,332	AOCI
Net (losses) gains recognized in earnings (effective portion)	$(4,968)	$4,710	Cost of goods sold
Net losses recognized in earnings (ineffective portion)	$(356)	$(51)	Other, net

For the three months ended September 30, 2015 and 2014, there were no gains or losses recognized in earnings as a result of excluding amounts from the assessment of hedge effectiveness or as a result of reclassifications to earnings following the discontinuance of any cash flow hedges.

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

Gains and losses on derivative instruments not designated as accounting hedges are included in “Other, net” in the Company's consolidated statements of operations and in “Net losses (gains) on derivative instruments and investments” in the Company's consolidated statements of cash flows.
Net gains and losses recorded in "Other, net" are as follows:

	Three Months Ended September 30,	
(In thousands)	2015	2014
Net (losses) gains on coffee-related derivative instruments	$(727)	$49
Net losses on investments	(147)	(190)
Net losses on derivative instruments and investments(1)	(874)	(141)
Other (losses) gains, net	(1)	77
Other, net	$(875)	$(64)

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(1) Excludes net (losses) gains on coffee-related derivative instruments designated as accounting hedges recorded in cost of goods sold in the three months ended September 30, 2015 and 2014.

Offsetting of Derivative Assets and Liabilities

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

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

(In thousands)		Gross Amount Reported on Balance Sheet	Netting Adjustments	Cash Collateral Posted	Net Exposure
September 30, 2015	Derivative assets	$105	$(105)	$—	$—
	Derivative liabilities	$4,378	$(105)	$1,274	$2,999
June 30, 2015	Derivative assets	$291	$(291)	$—	$—
	Derivative liabilities	$4,292	$(291)	$1,001	$3,000

Credit-Risk-Related Features

The Company does not have any credit-risk-related contingent features that would require it to post additional collateral in support of its net derivative liability positions. At September 30, 2015 and June 30, 2015, the Company had $1.3 million and $1.0 million in restricted cash representing cash held on deposit in margin accounts for coffee-related derivative instruments. Changes in commodity prices and the number of coffee-related derivative instruments held could have a significant impact on cash deposit requirements under the Company's broker and counterparty agreements.

Cash Flow Hedges

Changes in the fair value of the Company's coffee-related derivative instruments designated as cash flow hedges, to the extent effective, are deferred in AOCI and reclassified into cost of goods sold in the same period or periods in which the hedged forecasted purchases affect earnings, or when it is probable that the hedged forecasted transaction will not occur by the end of the originally specified time period. Based on recorded values at September 30, 2015, $8.0 million of net losses on coffee-related derivative instruments designated as cash flow hedges are expected to be reclassified into cost of goods sold within the next twelve months. These recorded values are based on market prices of the commodities as of September 30, 2015. Due to the

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volatile nature of commodity prices, actual gains or losses realized within the next twelve months may likely differ from these values.

Note 5. Investments

The following table shows gains and losses on trading securities held for investment by the Company:

	Three Months Ended September 30,	
(In thousands)	2015	2014
Total losses recognized from trading securities held for investment	$(147)	$(190)
Less: Realized (losses) gains from sales of trading securities held for investment	(1)	15
Unrealized losses from trading securities held for investment	$(146)	$(205)

Note 6. Fair Value Measurements

The Company groups its assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

- Level 1—Valuation is based upon quoted prices for identical instruments traded in active markets.
- Level 2—Valuation is based upon inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Inputs include quoted prices for similar instruments in active markets, and quoted prices for similar instruments in markets that are not active. Level 2 includes those financial instruments that are valued with industry standard valuation models that incorporate inputs that are observable in the marketplace throughout the full term of the instrument, or can otherwise be derived from or supported by observable market data in the marketplace.
- Level 3—Valuation is based upon one or more unobservable inputs that are significant in establishing a fair value estimate. These unobservable inputs are used to the extent relevant observable inputs are not available and are developed based on the best information available. These inputs may be used with internally developed methodologies that result in management’s best estimate of fair value.

Securities with quotes that are based on actual trades or actionable bids and offers with a sufficient level of activity on or near the measurement date are classified as Level 1. Securities that are priced using quotes derived from implied values, indicative bids and offers, or a limited number of actual trades, or the same information for securities that are similar in many respects to those being valued, are classified as Level 2. If market information is not available for securities being valued, or materially-comparable securities, then those securities are classified as Level 3. In considering market information, management evaluates changes in liquidity, willingness of a broker to execute at the quoted price, the depth and consistency of prices from pricing services, and the existence of observable trades in the market.

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

(In thousands)	Total	Level 1	Level 2	Level 3
September 30, 2015				
Preferred stock(1)	$22,837	$19,535	$3,302	$—
Derivative instruments designated as cash flow hedges:				
Coffee-related derivative assets	$100	$100	$—	$—
Coffee-related derivative liabilities	$4,137	$4,137	$—	$—
Derivative instruments not designated as accounting hedges:				
Coffee-related derivative assets	$5	$5	$—	$—
Coffee-related derivative liabilities	$241	$241	$—	$—

June 30, 2015	Total	Level 1	Level 2	Level 3
Preferred stock(1)	$23,665	$19,132	$4,533	$—
Derivative instruments designated as cash flow hedges:				
Coffee-related derivative assets	$264	$264	$—	$—
Coffee-related derivative liabilities	$4,290	$4,290	$—	$—
Derivative instruments not designated as accounting hedges:				
Coffee-related derivative assets	$27	$27	$—	$—
Coffee-related derivative liabilities	$2	$2	$—	$—

(1) Included in "Short-term investments" on the Company's consolidated balance sheets.

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

Note 7. Accounts and Notes Receivable, Net

(In thousands)	September 30, 2015	June 30, 2015
Trade receivables	$40,949	$38,783
Other receivables(1)	2,711	2,021
Allowance for doubtful accounts	(687)	(643)
Accounts and notes receivable, net	$42,973	$40,161

(1) As of September 30, 2015 and June 30, 2015, respectively, includes $1.1 million and $0.3 million in costs incurred by the Company associated with the new facility that are expected to be reimbursed by Lessor under the Lease Agreement.

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

Note 8. Inventories

(In thousands)	September 30, 2015	June 30, 2015
Coffee:		
Processed	$16,471	$13,837
Unprocessed	14,372	11,968
Total	$30,843	$25,805
Tea and culinary products:		
Processed	$18,018	$17,022
Unprocessed	2,512	2,764
Total	$20,530	$19,786
Coffee brewing equipment parts		