

FARMER BROTHERS CO  
Form 10-Q  
February 10, 2014

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

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

For the quarterly period ended December 31, 2013

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number: 001-34249

FARMER BROS. CO.  
(Exact Name of Registrant as Specified in Its Charter)  
Delaware  
(State of Incorporation)

95-0725980  
(I.R.S. Employer Identification No.)

20333 South Normandie Avenue, Torrance, California 90502  
(Address of Principal Executive Offices; Zip Code)  
310-787-5200  
(Registrant's telephone number, including area code)

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

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

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

|                         |   |                           |                                     |
|-------------------------|---|---------------------------|-------------------------------------|
| Large accelerated filer | <input type="checkbox"/>  | Accelerated filer         | <input checked="" type="checkbox"/> |
| Non-accelerated filer   | <input checked="" type="checkbox"/> (Do not check if a smaller reporting company) | Smaller reporting company | <input type="checkbox"/>            |

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

As of February 7, 2014 the registrant had 16,459,933 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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## PART I - FINANCIAL INFORMATION (UNAUDITED)

## Item 1. Financial Statements

## FARMER BROS. CO.

## CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(In thousands, except share and per share data)

|   | December 31,<br>2013 | June 30, 2013 |
|---|----------------------|---------------|
| <b>ASSETS</b>   |                      |               |
| Current assets:   |                      |               |
| Cash and cash equivalents   | \$7,864              | \$2,678       |
| Restricted cash   | 3,576                | 8,084         |
| Short-term investments  | 20,553               | 20,546        |
| Accounts and notes receivable, net  | 46,368               | 43,922        |
| Inventories   | 62,568               | 60,867        |
| Income tax receivable   | 158                  | 409           |
| Prepaid expenses  | 3,490                | 3,243         |
| Total current assets  | 144,577              | 139,749       |
| Property, plant and equipment, net  | 94,589               | 92,159        |
| Intangible assets, net  | 5,845                | 6,277         |
| Other assets  | 6,760                | 5,484         |
| Deferred income taxes   | 467                  | 467           |
| Total assets  | \$252,238            | \$244,136     |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                      |               |
| Current liabilities:  |                      |               |
| Accounts payable  | \$29,482             | 27,740        |
| Accrued payroll expenses  | 20,230               | 19,757        |
| Short-term borrowings under revolving credit facility   | 8,523                | 9,654         |
| Short-term obligations under capital leases   | 3,413                | 3,409         |
| Short-term derivative liability   | 7,125                | 9,896         |
| Deferred income taxes   | 923                  | 923           |
| Other current liabilities   | 5,519                | 5,171         |
| Total current liabilities   | 75,215               | 76,550        |
| Long-term borrowings under revolving credit facility  | 10,000               | 10,000        |
| Long-term derivative liability  | 210                  | 1,129         |
| Accrued postretirement benefits   | 15,406               | 16,076        |
| Other long-term liabilities—capital leases  | 7,657                | 8,759         |
| Accrued pension liabilities   | 43,769               | 43,800        |
| Accrued workers' compensation liabilities   | 7,818                | 5,132         |
| Deferred income taxes   | 983                  | 852           |
| Total liabilities   | \$161,058            | \$162,298     |
| Commitments and contingencies   |                      |               |
| 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; 16,464,055 and 16,454,422 issued and outstanding at December 31, 2013 and June 30, 2013, respectively | 16,464               | 16,454        |
| Additional paid-in capital  | 32,103               | 34,654        |
| Retained earnings   | 100,593              | 94,080        |
| Unearned ESOP shares  | (16,035              | ) (20,836     |
| Less accumulated other comprehensive loss   | (41,945              | ) (42,514     |

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|  |           |           |
|--|-----------|-----------|
| Total stockholders' equity                 | \$91,180  | \$81,838  |
| Total liabilities and stockholders' equity | \$252,238 | \$244,136 |

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

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## FARMER BROS. CO.

## CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(In thousands, except share and per share data)

|  | Three Months Ended December 31, |            | Six Months Ended December 31, |            |
|--|---------------------------------|------------|-------------------------------|------------|
|  | 2013                            | 2012       | 2013                          | 2012       |
| Net sales  | \$142,151                       | \$135,705  | \$270,712                     | \$254,858  |
| Cost of goods sold                                 | 86,713                          | 85,352     | 165,802                       | 159,884    |
| Gross profit                                       | 55,438                          | 50,353     | 104,910                       | 94,974     |
| Selling expenses                                   | 38,991                          | 40,765     | 76,326                        | 78,036     |
| General and administrative expenses                | 10,724                          | 9,041      | 19,970                        | 17,810     |
| Operating expenses                                 | 49,715                          | 49,806     | 96,296                        | 95,846     |
| Income (loss) from operations                      | 5,723                           | 547        | 8,614                         | (872)      |
| Other (expense) income:                            |                                 |            |                               |            |
| Dividend income                                    | 258                             | 284        | 526                           | 543        |
| Interest income                                    | 110                             | 99         | 218                           | 191        |
| Interest expense                                   | (393)                           | (463)      | (765)                         | (920)      |
| Other, net   | (587)                           | (7,656)    | (1,370)                       | (2,711)    |
| Total other expense                                | (612)                           | (7,736)    | (1,391)                       | (2,897)    |
| Income (loss) before taxes                         | 5,111                           | (7,189)    | 7,223                         | (3,769)    |
| Income tax expense (benefit)                       | 402                             | (32)       | 709                           | 409        |
| Net income (loss)                                  | \$4,709                         | \$(7,157)  | \$6,514                       | \$(4,178)  |
| Net income (loss) per common share—basic           | \$0.30                          | \$(0.46)   | \$0.41                        | \$(0.27)   |
| Net income (loss) per common share—diluted         | \$0.29                          | \$(0.46)   | \$0.41                        | \$(0.27)   |
| Weighted average common shares outstanding—basic   | 15,847,958                      | 15,548,094 | 15,825,100                    | 15,519,980 |
| Weighted average common shares outstanding—diluted | 15,964,682                      | 15,548,094 | 15,904,456                    | 15,519,980 |

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

FARMER BROS. CO.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (UNAUDITED)

(In thousands)

|   | Three Months Ended December<br>31, |           | Six Months Ended December 31, |           |
|---|------------------------------------|-----------|-------------------------------|-----------|
|   | 2013                               | 2012      | 2013                          | 2012      |
| Net income (loss)   | \$4,709                            | \$(7,157) | ) \$6,514                     | \$(4,178) |
| Other comprehensive income (loss), net of tax:  |                                    |           |                               |           |
| Deferred losses on derivatives designated as<br>cash flow hedges  | (2,260)                            | ) —       | (5,385)                       | ) —       |
| Reclassification of deferred losses on<br>derivatives designated as cash flow hedges to<br>cost of goods sold | 3,735                              | —         | 5,954                         | —         |
| Total comprehensive income (loss), net of tax   | \$6,184                            | \$(7,157) | ) \$7,083                     | \$(4,178) |

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

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

|  | Six Months Ended December 31, |           |
|--|-------------------------------|-----------|
|  | 2013                          | 2012      |
| Cash flows from operating activities:  |                               |           |
| Net income (loss)  | \$6,514                       | \$(4,178) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: |                               |           |
| Depreciation and amortization  | 14,478                        | 16,640    |
| Provision for (recovery of) doubtful accounts  | 168                           | (963)     |
| Deferred income taxes  | 131                           | —         |
| Net gains on sales of assets   | (50)                          | (3,202)   |
| ESOP and share-based compensation expense  | 2,134                         | 1,906     |
| Net losses on derivatives and investments  | 1,949                         | 7,038     |
| Change in operating assets and liabilities:  |                               |           |
| Restricted cash  | 4,508                         | (1,987)   |
| Purchases of trading securities held for investment                                      | (2,963)                       | (4,188)   |
| Proceeds from sales of trading securities held for investment                            | 2,207                         | 3,417     |
| Accounts and notes receivable  | (2,106)                       | (2,053)   |
| Inventories  | (5,608)                       | (2,404)   |
| Income tax receivable  | 251                           | 289       |
| Prepaid expenses and other assets  | (85)                          | 558       |
| Accounts payable   | 2,361                         | 3,885     |
| Accrued payroll expenses and other current liabilities                                   | (2,581)                       | (3,702)   |
| Accrued postretirement benefits  | (670)                         | 351       |
| Other long-term liabilities  | (211)                         | (1,302)   |
| Net cash provided by operating activities  | \$20,427                      | \$10,105  |
| Cash flows from investing activities:  |                               |           |
| Purchases of property, plant and equipment   | (12,128)                      | (6,396)   |
| Proceeds from sales of property, plant and equipment                                     | 333                           | 3,911     |
| Net cash used in investing activities  | \$(11,795)                    | \$(2,485) |
| Cash flows from financing activities:  |                               |           |
| Proceeds from revolving credit facility  | 22,550                        | 15,000    |
| Repayments on revolving credit facility  | (24,300)                      | (19,750)  |
| Payments of capital lease obligations  | (1,821)                       | (1,558)   |
| Proceeds from stock option exercises   | 125                           | —         |
| Net cash used in financing activities  | \$(3,446)                     | \$(6,308) |
| Net increase in cash and cash equivalents  | \$5,186                       | \$1,312   |
| Cash and cash equivalents at beginning of period   | 2,678                         | 3,906     |
| Cash and cash equivalents at end of period   | \$7,864                       | \$5,218   |

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

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 is a direct distributor of coffee to restaurants, hotels, casinos, offices, quick service restaurants ("QSR's"), 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 and six months ended December 31, 2013 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2014. Events occurring subsequent to December 31, 2013 have been evaluated for potential recognition or disclosure in the unaudited consolidated financial statements for the three and six months ended December 31, 2013.

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, 2013, filed with the Securities and Exchange Commission (the "SEC") on October 9, 2013.

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.

Corrections to Consolidated Statement of Cash Flows

Subsequent to the issuance of the Company's consolidated financial statements for the year ended June 30, 2013 the Company identified certain errors in the consolidated statement of cash flows. Accordingly, the Company has corrected the accompanying consolidated statement of cash flows for the six months ended December 31, 2012. Within the presentation of cash flows from operating activities, the Company previously presented purchases and proceeds from sales of trading securities held for investment on a net basis that should have been presented on a gross basis to comply with GAAP. In addition, the Company previously presented a \$7.1 million increase in the Company's derivative liability as a reduction in the net activity in short-term investments that should have been included in the change in "Accrued payroll expenses and other current liabilities." The errors had no impact on the amounts previously reported in the Company's consolidated balance sheets, statements of operations, and statements of comprehensive income (loss). Management has evaluated the materiality of these errors quantitatively and qualitatively and has concluded that the corrections of these errors are immaterial to the statement of cash flows and the financial statements as a whole.



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

The accompanying consolidated statement of cash flows has been corrected for the errors described above. The impact of the adjustments is shown below:

| (In thousands)  | Six Months Ended December 31, 2012 |               |
|---|------------------------------------|---------------|
|   | As Previously Reported             | As Corrected  |
| Cash flows from operating activities:   |                                    |               |
| Net loss  | \$ (4,178                          | ) \$ (4,178 ) |
| Adjustments to reconcile net loss to net cash provided by operating activities: |                                    |               |
| Depreciation and amortization   | 16,640                             | 16,640        |
| Recovery of doubtful accounts   | (963                               | ) (963 )      |
| Deferred income taxes   | —                                  | —             |
| Net gains on sales of assets  | (3,202                             | ) (3,202 )    |
| ESOP and share-based compensation expense                                       | 1,906                              | 1,906         |
| Net losses on derivatives and investments                                       | 7,038                              | 7,038         |
| Change in operating assets and liabilities:                                     |                                    |               |
| Restricted cash   | (1,987                             | ) (1,987 )    |
| Purchases of trading securities held for investment                             | —                                  | (4,188 )      |
| Proceeds from sales of trading securities held for investment                   | —                                  | 3,417         |
| Short-term investments  | (7,854                             | ) —           |
| Accounts and notes receivable   | (2,053                             | ) (2,053 )    |
| Inventories   | (2,404                             | ) (2,404 )    |
| Income tax receivable   | 289                                | 289           |
| Prepaid expenses and other assets   | 558                                | 558           |
| Accounts payable  | 3,885                              | 3,885         |
| Accrued payroll expenses and other current liabilities                          | 3,381                              | (3,702 )      |
| Accrued postretirement benefits   | 351                                | 351           |
| Other long-term liabilities   | (1,302                             | ) (1,302 )    |
| Net cash provided by operating activities                                       | \$ 10,105                          | \$ 10,105     |

#### 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 investments," "Other assets," "Short-term derivative liability," or "Long-term derivative liability." 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.

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 derivatives                           | 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 price at which the base "C" market price will be fixed

has not yet been

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

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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.

Prior to April 1, 2013, the Company had no derivative instruments that were designated as accounting hedges. Beginning April 1, 2013, the Company implemented procedures following the guidelines of ASC 815, "Derivatives and Hedging" ("ASC 815"), to enable it to account for certain coffee-related derivatives 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 the inception of the hedging relationship 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 prospectively, and future changes in the fair value of the derivative are recognized currently in "Other, net."

For commodity derivatives designated as cash flow hedges, the effective portion of the change in fair value of the derivative is reported as accumulated other comprehensive income ("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's change in fair value is recognized currently in "Other, net." Gains or losses deferred in AOCI associated with terminated derivatives, derivatives that cease to be highly effective hedges, derivatives 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 derivatives 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 derivatives that are designated as cash flow hedges.

The fair value of derivative instruments is based upon broker quotes. At December 31, 2013, approximately 90% of the Company's outstanding coffee-related derivative instruments were designated as cash flow hedges (see Note 2). At December 31, 2012, no derivative instruments were designated as accounting hedges.

#### 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 for the three months ended December 31, 2013 and 2012

are \$6.5 million and \$6.3 million, respectively. Coffee brewing equipment costs included in cost of goods sold for the six months ended December 31, 2013 and 2012 are \$13.0 million and \$12.1 million, respectively. The Company capitalized coffee brewing equipment in the amounts of \$5.8 million and \$4.9 million in the six months ended December 31, 2013 and 2012, respectively. Depreciation expense related to capitalized coffee brewing equipment reported as cost of goods sold in the three months ended December 31, 2013 and 2012 was \$2.9 million and \$3.3 million, respectively. Depreciation expense related to capitalized coffee brewing equipment reported as cost of goods sold in the six months ended December 31, 2013 and 2012 was \$5.7 million and \$6.6 million, respectively.

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

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#### Revenue Recognition

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

The Company sells roast and ground coffee and tea to The J.M. Smucker Company ("J.M. Smucker") pursuant to a co-packing agreement. The Company recognizes revenue from the co-packing arrangement for the sale of tea on a net basis, net of direct costs of revenue, since the Company acts as an agent of J.M. Smucker in such transactions. As of December 31, 2013 and June 30, 2013, the Company had \$0.8 million and \$0.3 million, respectively, of receivables relating to this arrangement which are included in "Other receivables" (see Note 6).

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

Net income (loss) per share ("EPS") represents net income (loss) 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 (loss) 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 (loss) attributable to nonvested restricted stockholders is excluded from net income (loss) attributable to common stockholders for purposes of calculating basic and diluted EPS. Computation of EPS for the three and six months ended December 31, 2013 includes the dilutive effect of 116,724 and 79,356 shares, respectively, issuable under stock options (see Note 12). Computation of EPS for the three and six months ended December 31, 2012 does not include the dilutive effect of 699,317 shares issuable under stock options because their inclusion would be anti-dilutive (see Note 12).

#### Dividends Declared

Although historically the Company has paid a dividend to stockholders, in light of the Company's current financial position, 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, loan agreement restrictions, future prospects for earnings and cash flows, as well as other relevant factors.

#### Impairment of Indefinite-lived Intangible Assets

The Company performs its annual indefinite-lived intangible assets impairment test as of June 30 of each fiscal year. Indefinite-lived intangible assets are not amortized but instead are reviewed for impairment annually by comparing their fair values to their carrying values.

In addition to an annual test, indefinite-lived intangible assets must also be tested on an interim basis if events or circumstances indicate that the estimated fair value of such assets has decreased below their carrying value. There were no such events or circumstances during the six months ended December 31, 2013.

#### Long-Lived Assets, Excluding 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 six months ended December 31, 2013.

Self-Insurance

The Company is self-insured for California workers' compensation claims subject to specific retention levels, and uses historical analysis to determine and record the estimates of expected future expenses resulting from workers' compensation claims in California. The estimated outstanding losses are the accrued cost of unpaid claims. The estimated outstanding losses,

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Farmer Bros. Co.

Notes to Consolidated Financial Statements (continued)

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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 liabilities were \$8.0 million and the estimated recovery from reinsurance was \$1.9 million as of December 31, 2013.

In May 2011, the Company did not meet certain minimum credit rating criteria for participation in the alternative security program for California self-insurers. As a result, the Company was required to post a \$5.9 million letter of credit as a security deposit with the State of California Department of Industrial Relations Self-Insurance Plans. At December 31, 2013, this letter of credit continues to serve as a security deposit but has been reduced to \$5.4 million. General liability, product liability, commercial auto liability and workers' compensation liability (in all states other than California) are insured through a captive insurance program. The Company retains 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. In the three and six months ended December 31, 2013, the Company accrued an additional \$1.3 million in selling expenses and increased its liability reserves for incurred but not reported claims to \$2.0 million at December 31, 2013.

The accrued liability for workers' compensation is presented on the Company's consolidated balance sheets in "Other current liabilities" and in "Accrued workers' compensation liabilities," as appropriate.

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

#### New Accounting Pronouncements

In July 2013, the FASB issued ASU No. 2013-11, "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists" ("ASU 2013-11"). An entity is required to present unrecognized tax benefits as a decrease in net operating loss, similar tax loss or tax credit carryforward if certain criteria are met. The determination of whether a deferred tax asset is available is based on the unrecognized tax benefit and the deferred tax asset that exists at the reporting date and presumes disallowance of the tax position at the reporting date. The guidance will eliminate the diversity in practice in the presentation of unrecognized tax benefits but will not alter the way in which entities assess deferred tax assets for realizability. This update is effective for public companies for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2013 and will be effective for the Company beginning July 1, 2014. Adoption of ASU 2013-11 is not expected to have a material effect on the results of operations, financial position or cash flows of the Company.

## Note 2. 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, in some instances, as much as 24 months prior to the actual delivery date. 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.

At December 31, 2013, approximately 90% of the Company's outstanding coffee-related derivative instruments, representing 46.9 million pounds of forecasted green coffee purchases, were designated as cash flow hedges. At

December 31, 2012 no coffee-related derivative instruments were designated as accounting hedges.

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

For the three and six months ended December 31, 2013, the Company recorded coffee-related net derivative losses in other comprehensive income ("OCI") in the amounts of \$2.3 million and \$5.4 million, respectively. No coffee-related net derivative gains or losses were recorded in OCI for the three and six months ended December 31, 2012.

#### Interest Rate Swap

Effective December 1, 2012, the Company entered into an interest rate swap transaction utilizing a notional amount of \$10.0 million and a maturity date of March 1, 2015. The Company entered into the swap transaction to effectively fix the future interest rate during the applicable period on a portion of its borrowings under the revolving credit facility. The swap transaction is intended to manage the Company's interest rate risk related to its revolving credit facility and requires the Company to pay a fixed rate of 0.48% per annum in exchange for a variable interest rate based on 1-month USD LIBOR-BBA. The interest rate swap is not designated as an accounting hedge.

#### Effect of Derivative Instruments on the Financial Statements

##### Balance Sheet

Fair values of derivative instruments on the consolidated balance sheets (in thousands):

|                                  | Derivatives Designated as<br>Cash Flow Hedges |                  | Derivatives Not Designated as<br>Accounting Hedges |                  |
|----------------------------------|---|------------------|--|------------------|
|                                  | December 31,<br>2013                          | June 30,<br>2013 | December 31,<br>2013                               | June 30,<br>2013 |
| Financial Statement Location:    |   |                  |  |                  |
| Short-term investments:          |   |                  |  |                  |
| Coffee-related derivatives       | \$—   | \$—              | \$—  | \$4              |
| Short-term derivative liability: |   |                  |  |                  |
| Coffee futures                   | \$7,146                                       | \$9,331          | \$(21  | ) \$565          |
| Other current liabilities:       |   |                  |  |                  |
| Interest rate swap               | \$—   | \$—              | \$29   | \$25             |
| Long-term derivative liability:  |   |                  |  |                  |
| Coffee futures                   | \$210   | \$1,129          | \$—  | \$—              |

#### Statement of Operations

For the three and six months ended December 31, 2013, the Company recognized \$0.1 million and \$0.7 million, respectively, in net losses on coffee-related derivative instruments designated as cash flow hedges for ineffectiveness and 10% of the total coffee-related derivative instruments were excluded from the effectiveness assessment since they were not designated as cash flow hedges. Cash flow hedge contracts outstanding as of December 31, 2013 will expire within 23 months.

The following table presents pretax net gains and losses on coffee-related derivative instruments designated as cash flow hedges, as recognized in "Cost of goods sold," "AOCI" and "Other, net" (in thousands):

|  | Three Months Ended<br>December 31, |       | Six Months Ended<br>December 31, |       | Financial<br>Statement<br>Classification |
|--|------------------------------------|-------|----------------------------------|-------|--|
|  | 2013                               | 2012  | 2013                             | 2012  |  |
| Net losses recognized in earnings<br>(effective portion)                             | \$(3,735                           | ) \$— | \$(5,954                         | ) \$— | Cost of goods<br>sold                    |
| Net losses recognized in other<br>comprehensive income (loss)<br>(effective portion) | \$(2,260                           | ) \$— | \$(5,385                         | ) \$— | AOCI                                     |
| Net losses recognized in earnings<br>(ineffective portion)                           | \$(143                             | ) \$— | \$(650                           | ) \$— | Other, net                               |



Farmer Bros. Co.

Notes to Consolidated Financial Statements (continued)

For the three and six months ended December 31, 2013, 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.

Gains and losses on derivatives not designated as accounting hedges are included in "Other, net" in the Company's consolidated statements of operations and in "Net losses (gains) on derivatives and investments" in the Company's consolidated statements of cash flow.

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

| (In thousands)                            | Three Months Ended December 31, |             | Six Months Ended December 31, |             |
|---|---------------------------------|-------------|-------------------------------|-------------|
|   | 2013                            | 2012        | 2013                          | 2012        |
| Net losses on coffee-related derivatives  | \$(347)                         | ) \$(7,859) | ) \$(1,195)                   | ) \$(7,156) |
| Net (losses) gains on investments         | (55)                            | ) 59        | (750)                         | ) 158       |
| Net gains (losses) on interest rate swap  | 2                               | (40)        | ) (4)                         | ) (40)      |
| Net losses on derivatives and investments | (400)                           | ) (7,840)   | ) (1,949)                     | ) (7,038)   |
| Net (losses) gains on sales of assets     | (73)                            | ) (11)      | ) 50                          | 3,202       |
| Other (losses) gains, net                 | (114)                           | ) 195       | 529                           | 1,125       |
| Other, net                                | \$(587)                         | ) \$(7,656) | ) \$(1,370)                   | ) \$(2,711) |

#### 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.

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

The following tables present the Company's net exposure from its offsetting derivative asset and liability positions, as well as cash margins on deposit with each of its counterparties as of the reporting dates indicated:

| Counterparty A       |                        | Gross<br>Amount<br>Reported on<br>Balance<br>Sheet | Netting<br>Adjustments | Cash<br>Collateral<br>Posted<br>(Received) | Net<br>Exposure |
|----------------------|------------------------|--|------------------------|--|-----------------|
| At December 31, 2013 | Derivative Assets      | \$ 229   | \$ (229                | ) \$—                                      | \$—             |
|                      | Derivative Liabilities | \$ 7,564   | \$ (229                | ) \$ 3,576                                 | \$ 3,759        |
| At June 30, 2013     | Derivative Assets      | \$ 4   | \$ (4                  | ) \$—                                      | \$—             |
|                      | Derivative Liabilities | \$ 11,025  | \$ (4                  | ) \$ 8,084                                 | \$ 2,937        |
| Counterparty B       |                        | Gross<br>Amount<br>Reported on<br>Balance<br>Sheet | Netting<br>Adjustments | Cash<br>Collateral<br>Posted<br>(Received) | Net Exposure    |
| At December 31, 2013 | Derivative Assets      | \$—  | \$—                    | \$—  | \$—             |
|                      | Derivative Liabilities | \$ 29  | \$—                    | \$—  | \$ 29           |
| At June 30, 2013     | Derivative Assets      | \$—  | \$—                    | \$—  | \$—             |
|                      | Derivative Liabilities | \$ 25  | \$—                    | \$—  | \$ 25           |

#### Credit-Risk-Related Features

The Company does not have any credit-risk-related contingent features that would require it, in certain circumstances, to post additional collateral in support of its net derivative liability positions. The Company had \$3.6 million and \$8.1 million, respectively, in restricted cash representing cash held on deposit in margin accounts for coffee-related derivative instruments at December 31, 2013 and June 30, 2013 (see Note 5). 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 earnings in the same period or periods in which the hedged forecasted purchases affect earnings, or when it is probable that the hedged forecasted transaction will not occur by the end of the originally specified time period. Based on recorded values at December 31, 2013, \$7.1 million of net losses are expected to be reclassified into earnings within the next twelve months. These recorded values are based on market prices of the commodities as of December 31, 2013. Due to the volatile nature of commodity prices, actual gains or losses realized within the next twelve months will likely differ from these values. These gains or losses are expected to substantially offset net losses or gains that will be realized in earnings from previous unfavorable or favorable market movements associated with underlying hedged transactions.

#### Note 3. Investments

Preferred stock investments as of December 31, 2013 consisted of securities with a fair value of \$10.3 million in an unrealized loss position and securities with a fair value of \$10.2 million in an unrealized gain position. Preferred stock investments as of June 30, 2013 consisted of securities with a fair value of \$7.3 million in an unrealized loss position and \$13.2 million in an unrealized gain position.



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

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

| (In thousands)   | Three Months Ended December |        | Six Months Ended December |         |
|--|-----------------------------|--------|---------------------------|---------|
|  | 31,<br>2013                 | 2012   | 31,<br>2013               | 2012    |
| Total (loss) gain recognized on trading securities held for investment | \$(55                       | ) \$59 | \$(750                    | ) \$158 |
| Less: (Loss) gain on sales of trading securities held for investment   | (24                         | ) 58   | (66                       | ) 158   |
| Unrealized loss (gain) on trading securities held for investment       | \$(31                       | ) \$1  | \$(684                    | ) \$—   |

#### Note 4. 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 quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.
- Level 3—Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

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.

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

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

| December 31, 2013                                | Total    | Level 1  | Level 2 | Level 3 |
|--|----------|----------|---------|---------|
| Preferred stock(1)                               | \$20,553 | \$15,995 | \$4,558 | \$—     |
| Futures, options and other derivative assets(2)  | \$95     | \$95     | \$—     | \$—     |
| Derivatives designated as cash flow hedges:      |          |          |         |         |
| Coffee-related derivative liabilities            | \$7,356  | \$7,356  | \$—     | \$—     |
| Derivatives not designated as accounting hedges: |          |          |         |         |
| Coffee-related derivative liabilities            | \$(21)   | \$(21)   | \$—     | \$—     |
| Derivative liabilities — interest rate swap      | \$29     | \$—      | \$29    | \$—     |

| June 30, 2013                                    | Total    | Level 1  | Level 2 | Level 3 |
|--|----------|----------|---------|---------|
| Preferred stock(1)                               | \$20,542 | \$15,738 | \$4,804 | \$—     |
| Futures, options and other derivative assets(3)  | \$4      | \$—      | \$4     | \$—     |
| Derivatives designated as cash flow hedges:      |          |          |         |         |
| Coffee-related derivative liabilities            | \$10,460 | \$10,460 | \$—     | \$—     |
| Derivatives not designated as accounting hedges: |          |          |         |         |
| Coffee-related derivative liabilities            | \$565    | \$565    | \$—     | \$—     |
| Derivative liabilities — interest rate swap      | \$25     | \$—      | \$25    | \$—     |

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

(2)Included "Cash and cash equivalents" on the consolidated balance sheet.

(3)Included in "Short-term investments" on the consolidated balance sheet.

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

Effective December 1, 2012, the Company entered into an interest rate swap transaction utilizing a notional amount of \$10.0 million and a maturity date of March 1, 2015. The Company entered into the swap transaction to effectively fix the future interest rate during the applicable period on a portion of its borrowings under the revolving credit facility. The swap transaction is intended to manage the Company's interest rate risk related to its revolving credit facility and requires the Company to pay a fixed rate of 0.48% per annum in exchange for a variable interest rate based on 1-month USD LIBOR-BBA.

The Company values its interest rate swap using widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of the interest rate swap. This analysis reflects the contractual terms of the interest rate swap, including the period to maturity, and uses observable market-based inputs, including interest rate curves and implied volatilities.

Valuation of the interest rate swap transaction is based on proprietary curves that take into account both Level 1 and Level 2 inputs. The fair value of the interest rate swap is determined using the market standard methodology of netting the discounted future fixed cash payments and the discounted expected variable cash receipts. The variable cash receipts are based on an expectation of future interest rates (forward curves). These forward curves are market-based, utilizing observable market data. Discount curves for present value purposes are constructed using rates representing estimated costs of funding swap positions for early terminations based on an appropriate observable discount rate.

#### Note 5. Restricted Cash

The Company had \$3.6 million and \$8.1 million, respectively, in restricted cash representing cash held on deposit in margin accounts for coffee-related derivative instruments at December 31, 2013 and June 30, 2013. 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.





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

## Note 6. Accounts and Notes Receivable, Net

|                                 | December 31, 2013 | June 30, 2013 |
|---------------------------------|-------------------|---------------|
| (In thousands)                  |                   |               |
| Trade receivables               | \$46,188          | \$43,965      |
| Other receivables(1)            | 955               | 1,072         |
| Allowance for doubtful accounts | (775              | ) (1,115      |
|                                 | \$46,368          | \$43,922      |

(1) Includes as of December 31, 2013 and June 30, 2013, \$0.8 million and \$0.3 million, respectively, of receivables relating to the co-packing arrangement for J.M. Smucker (see Note 1).

## Note 7. Inventories

|                                | December 31, 2013 | June 30, 2013 |
|--------------------------------|-------------------|---------------|
| (In thousands)                 |                   |               |
| Coffee                         |                   |               |
| Processed                      | \$13,236          | \$12,553      |
| Unprocessed                    | 15,504            | 12,796        |
| Total                          | \$28,740          | \$25,349      |
| Tea and culinary products      |                   |               |
| Processed                      | \$23,159          | \$21,406      |
| Unprocessed                    | 4,787             | 4,194         |
| Total                          | \$27,946          | \$25,600      |
| Coffee brewing equipment parts | \$5,882           | \$9,918       |
| Total inventories              | \$62,568          | \$60,867      |

Inventories are valued at the lower of cost or market. The Company accounts for coffee, tea and culinary products on the last in, first out ("LIFO") basis and coffee brewing equipment manufactured on the first in, first out ("FIFO") basis. The Company regularly evaluates these inventories to determine whether market conditions are correctly reflected in the recorded carrying value. At the end of each quarter, the Company records the expected beneficial effect of the liquidation of LIFO inventory quantities, if any, and records the actual impact at fiscal year-end. An actual valuation of inventory under the LIFO method is made only at the end of each fiscal year based on the inventory levels and costs at that time. If inventory quantities decline at the end of the fiscal year compared to the beginning of the fiscal year, the reduction results in the liquidation of LIFO inventory quantities carried at the cost prevailing in prior years. This LIFO inventory liquidation may result in a decrease or increase in cost of goods sold depending on whether the cost prevailing in prior years was lower or higher, respectively, than the current year cost. Accordingly, interim LIFO calculations must necessarily be based on management's estimates of expected fiscal year-end inventory levels and costs. Because these estimates are subject to many forces beyond management's control, interim results are subject to the final fiscal year-end LIFO inventory valuation. The Company anticipates its inventory levels at June 30, 2014 will be the same as at June 30, 2013 and, therefore, did not record an adjustment to cost of goods sold for the three and six months ended December 31, 2013. The Company recorded \$0.5 million in expected beneficial effect of LIFO inventory liquidation in cost of goods sold in the three and six months ended December 31, 2012, which reduced net loss for the three and six months ended December 31, 2012 by \$0.5 million.



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

Note 8. Employee Benefit Plans

The Company provides pension plans for most full time employees. Generally the plans provide benefits based on years of service and/or a combination of years of service and earnings. The Company sponsors a postretirement defined benefit plan that covers qualified non-union retirees and certain qualified union retirees and provides retiree medical coverage and, depending on the age of the retiree, dental and vision coverage. The Company also provides a postretirement death benefit to certain of its employees and retirees.

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

Single Employer Pension Plans

The Company has a defined benefit pension plan, the Farmer Bros. Salaried Employees Pension Plan (the "Farmer Bros. Plan"), for the majority of its employees who are not covered under a collective bargaining agreement. The Company amended the Farmer Bros. Plan, freezing the benefit for all participants effective June 30, 2011. After the plan freeze, participants do not accrue any benefits under the plan, and new hires are not eligible to participate in the plan.

The Company also has two defined benefit pension plans for certain hourly employees covered under collective bargaining agreements (the "Brewmatic Plan" and the "Hourly Employees' Plan"). In the fourth quarter of fiscal 2013, the Company determined that it would shut down its equipment refurbishment operations in Los Angeles, California and move them to its Oklahoma City distribution center effective August 30, 2013. Due to this shut down, all hourly employees responsible for these operations in Los Angeles were terminated and their pension benefits in the Brewmatic Plan were frozen effective August 30, 2013. As a result, the Company recorded a pension curtailment expense of \$34,000 in the fourth quarter of fiscal 2013.

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

|  | Three Months Ended<br>December 31, |          | Six Months Ended<br>December 31, |          |
|--|------------------------------------|----------|----------------------------------|----------|
|  | 2013                               | 2012     | 2013                             | 2012     |
| (In thousands)                               |                                    |          |                                  |          |
| Service cost                                 | \$ 100                             | \$ 119   | \$ 200                           | \$ 238   |
| Interest cost                                | 1,452                              | 1,449    | 2,904                            | 2,898    |
| Expected return on plan assets               | (1,705                             | ) (1,660 | ) (3,410                         | ) (3,320 |
| Amortization of net (gain) loss*             | 336                                | 387      | 672                              | 774      |
| Amortization of prior service cost (credit)* | —                                  | 5        | —                                | 10       |
| Net periodic benefit cost                    | \$ 183                             | \$ 300   | \$ 366                           | \$ 600   |

\* These amounts represent the estimated portion of the net (gain) loss and net prior service cost (credit) remaining in AOCI that is expected to be recognized as a component of net periodic benefit cost over the current fiscal year.

Weighted-average assumptions used to determine net periodic benefit cost

|  | Fiscal |       |
|--|--------|-------|
|  | 2014   | 2013  |
| Discount rate                                    | 4.50%  | 4.55% |
| Expected long-term rate of return on plan assets | 8.00%  | 8.00% |

Basis used to determine expected long-term rate of return on plan assets

Historical and future projected returns of multiple asset classes were analyzed to develop a risk-free real rate of return and risk premiums for each asset class. The overall rate for each asset class was developed by combining a long-term

inflation component, the risk-free real rate of return, and the associated risk premium. A weighted-average rate of return was developed based on those overall rates and the target asset allocation of the plans.

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

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#### Multiemployer Pension Plans

The Company participates in a multiemployer defined benefit pension plan, the Western Conference of Teamsters Pension Plan (“WCTPP”), that is union sponsored and collectively bargained for the benefit of certain employees subject to collective bargaining agreements. The Company makes contributions to WCTPP generally based on the number of hours worked by the participants in accordance with the provisions of negotiated labor contracts.

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

Effective October 2011, the Company withdrew from the defined benefit pension plan, United Teamsters Pension Fund, and replaced it with the defined contribution pension plan, “United Teamsters Annuity Fund” (“Annuity Fund”), for its employees covered by a certain collective bargaining agreement with a term expiring in 2014. The Company incurred no withdrawal liability related to the withdrawal from the United Teamsters Pension Fund. The Company's contributions to the Annuity Fund are based on the number of compensable hours worked by the Company's employees who participate in the Annuity Fund.

In fiscal 2012, the Company withdrew from the Labor Management Pension Fund and recorded a charge of \$4.3 million associated with withdrawal from this plan, representing the present value of the estimated withdrawal liability expected to be paid in quarterly installments of \$0.1 million over 80 quarters. Installment payments will commence once the final determination of the amount of withdrawal liability is established, which determination may take up to 24 months from the date of withdrawal from the pension plan. Upon withdrawal, the employees covered under this multiemployer pension plan were included in the Company's 401(k) plan (the “401(k) Plan”).

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

#### Multiemployer Plans Other Than Pension Plans

The Company participates in eight defined contribution multiemployer plans other than pension plans that provide medical, vision, dental and disability benefits for active, union-represented employees subject to collective bargaining agreements. The plans are subject to the provisions of the Employee Retirement Income Security Act of 1974, and provide that participating employers make monthly contributions to the plans in an amount as specified in the collective bargaining agreements. Also, the plans provide that participants make self-payments to the plans, the amounts of which are negotiated through the collective bargaining process. The Company's participation in these plans is governed by the collective bargaining agreements which expire on or before June 30, 2017.

#### 401(k) Plan

The Company's 401(k) Plan is available to all eligible employees who have worked more than 1,000 hours during a calendar year and were employed at the end of the calendar year. Participants in the 401(k) Plan may choose to contribute a percentage of their annual pay subject to the maximum contribution allowed by the Internal Revenue Service. The Company's matching contribution is discretionary based on approval by the Company's Board of Directors. For the calendar years 2012 and 2013, the Company's Board of Directors approved a Company matching contribution of 50% of an employee's annual contribution to the 401(k) Plan, up to 6% of the employee's eligible income. The matching contributions (and any earnings thereon) vest at the rate of 20% for each participant's first 5 years of vesting service, so that the participant is fully vested in his or her matching contribution account after 5 years of vesting service. A participant is automatically vested in the event of death, disability or attainment of age 65 while employed by the Company. Employees are 100% vested in their contributions. For employees subject to a collective

bargaining agreement, the match is only available if so provided in the labor agreement.

The Company recorded matching contributions of \$0.5 million in operating expenses in each of the six months ended December 31, 2013 and 2012.

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

### Postretirement Benefits

The Company sponsors a postretirement defined benefit plan that covers qualified non-union retirees and certain qualified union retirees. The plan provides medical, dental and vision coverage for retirees under age 65 and medical coverage only for retirees age 65 and above. Under this postretirement plan, the Company's contributions toward premiums for retiree medical, dental and vision coverage for participants and dependents are scaled based on length of service, with greater Company contributions for retirees with greater length of service, but subject to a maximum monthly Company contribution.

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

The following table shows the components of net periodic postretirement benefit cost for the three and six months ended December 31, 2013 and 2012 for the postretirement medical and death benefits. Net periodic postretirement benefit cost for the three and six months ended December 31, 2013 was based on employee census information as of July 1, 2013 and asset information as of June 30, 2013.

|   | Three Months Ended December 31, |         | Six Months Ended December 31, |         |
|---|---------------------------------|---------|-------------------------------|---------|
|   | 2013                            | 2012    | 2013                          | 2012    |
| (In thousands)  |                                 |         |                               |         |
| Components of Net Periodic Postretirement Benefit Cost:                                 |                                 |         |                               |         |
| Service cost  | \$(25                           | ) \$493 | \$468                         | \$986   |
| Interest cost   | 163                             | 242     | 405                           | 484     |
| Expected return on plan assets  | —                               | —       | —                             | —       |
| Amortization of net gain  | (445                            | ) 4     | (441                          | ) 8     |
| Amortization of unrecognized transition (asset) obligation                              | —                               | —       | —                             | —       |
| Amortization of prior service cost (credit)   | (440                            | ) (439  | ) (879                        | ) (878  |
| Net periodic postretirement benefit (credit) cost                                       | \$(747                          | ) \$300 | \$(447                        | ) \$600 |
| Weighted-average assumptions used to determine net periodic postretirement benefit cost |                                 |         |                               |         |
|   |                                 | Fiscal  |                               |         |
|   |                                 | 2014    |                               | 2013    |
| Postretirement medical benefit discount rate  |                                 | 4.80%   |                               | 4.20%   |
| Postretirement death benefit discount rate  |                                 | 4.53%   |                               | 4.39%   |

### Note 9. Bank Loan

On September 12, 2011, the Company entered into an Amended and Restated Loan and Security Agreement (the "Loan Agreement") among the Company and Coffee Bean International, Inc. ("CBI"), as Borrowers, certain of the Company's other subsidiaries, as Guarantors, the Lenders party thereto, and Wells Fargo Bank, National Association ("Wells Fargo"), as Agent.

On January 9, 2012, the Loan Agreement was amended in connection with JPMorgan Chase Bank, N.A. ("JPMorgan Chase"), becoming an additional Lender thereunder. On March 18, 2013, the Loan Agreement was amended further ("Amendment No. 2") to amend the definition of "Maximum Credit" available thereunder to \$75.0 million from \$85.0 million. Pursuant to Amendment No. 2, Wells Fargo will provide a commitment of \$53.0 million and JPMorgan Chase will provide a commitment of \$22.0 million.



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

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The Loan Agreement provides for a senior secured revolving credit facility of up to \$75.0 million, with a letter of credit sublimit of \$20.0 million. The revolving credit facility provides for advances of 85% of eligible accounts receivable and 75% of eligible inventory (subject to a \$60.0 million inventory loan limit), as defined. The Loan Agreement provides for interest rates based on modified Monthly Average Excess Availability levels with a range of PRIME + 0.25% to PRIME + 0.75% or Adjusted Eurodollar Rate + 2.0% to Adjusted Eurodollar Rate + 2.5%. The Loan Agreement has an amendment fee of 0.375% and an unused line fee of 0.25%. Outstanding obligations under the Loan Agreement are collateralized by all of the Borrowers' assets, including the Company's preferred stock portfolio. The Loan Agreement expires on March 2, 2015.

The Loan Agreement contains a variety of affirmative and negative covenants of types customary in an asset-based lending facility, including those relating to reporting requirements, maintenance of records, properties and corporate existence, compliance with laws, incurrence of other indebtedness and liens, limitations on certain payments, including the payment of dividends and capital expenditures, and transactions and extraordinary corporate events. The Loan Agreement allows the Company to pay dividends, provided, among other things, certain liquidity requirements are met, the aggregate amount of all such payments in any fiscal year shall not exceed \$7.0 million (\$1.75 million in any fiscal quarter), and no event of default exists or has occurred and is continuing as of the date of any such payment and after giving effect thereto. The Loan Agreement also contains financial covenants requiring the Borrowers to maintain minimum Excess Availability and Total Liquidity levels. The Loan Agreement allows the Lenders to establish reserve requirements, which may reduce the amount of credit otherwise available to the Company, to reflect events, conditions, or risks that would have a reasonable likelihood of adversely affecting the Lender's collateral or the Company's assets, including the Company's green coffee inventory.

Effective December 1, 2012, the Company entered into an interest rate swap transaction utilizing a notional amount of \$10.0 million and a maturity date of March 1, 2015. The Company entered into the swap transaction to effectively fix the future interest rate during the applicable period on a portion of its borrowings under the revolving credit facility. The swap transaction is intended to manage the Company's interest rate risk related to its revolving credit facility and requires the Company to pay a fixed rate of 0.48% per annum in exchange for a variable interest rate based on 1-month USD LIBOR-BBA. As of December 31, 2013, the variable interest rate based on 1-month USD LIBOR-BBA was 0.16%.

The Company has not designated its interest rate swap as an accounting hedge. The Company records the interest rate swap on its consolidated balance sheet at fair value with the changes in fair value recorded as gain or loss in "Other, net" in its consolidated statements of operations. In the three and six months ended December 31, 2013, the Company recorded a gain of \$2,000 and a loss of \$(4,000), respectively, for the change in fair value of its interest rate swap. In the three and six months ended December 31, 2012, the Company recorded a loss of \$40,000 for the change in fair value of its interest rate swap (see Note 2).

On December 31, 2013, the Company was eligible to borrow up to a total of \$68.0 million under the credit facility. As of December 31, 2013, the Company had outstanding borrowings of \$18.6 million, including loan extension fees of \$0.1 million, utilized \$11.2 million of the letters of credit sublimit, and had excess availability under the credit facility of \$38.2 million. In connection with entering into the interest rate swap agreement on December 1, 2012, the Company reclassified \$10.0 million of its borrowings under the revolving credit facility as long-term because the Company intends to repay the borrowings in accordance with the termination date of the swap agreement which extends beyond one year. At December 31, 2013, the weighted average interest rate on the Company's outstanding borrowings under the credit facility was 1.13%. As of December 31, 2013, the Company was in compliance with all restrictive covenants under the credit facility.

#### Note 10. Share-based Compensation

On December 5, 2013, the Company's stockholders approved the Farmer Bros. Co. Amended and Restated 2007 Long-Term Incentive Plan (the "Amended Equity Plan"). The Amended Equity Plan is an amendment and restatement of, and successor to, the Farmer Bros. Co. 2007 Omnibus Plan (the "Omnibus Plan"), and, among other things,

increases the number of shares of the Company's common stock, par value \$1.00 per share, authorized for issuance under the plan by 250,000 from 1,125,000 to 1,375,000. In addition, the Amended Equity Plan provides for the following material changes: limits the types of equity awards available to be granted under the Amended Equity Plan to performance-based options and restricted stock; limits participants in the Amended Equity Plan to directors, officers and other employees of the Company; limits the performance criteria that will be used to establish performance goals under the plan to (i) net sales or revenue; (ii) net income before tax and excluding gain or loss on sale of property, plant and equipment; and/or (iii) cash flow (including, but not limited to, operating cash flow and free cash flow); reduces the maximum number of shares of stock with respect to one or more awards that may be granted to any one participant during any calendar year from 250,000 to 75,000; requires that all options issued to employees include performance criteria or performance goals, unless issued in connection with the commencement of employment as an executive of the Company; provides for forfeiture of unvested awards upon termination of employment or termination of

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

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directorship, except as otherwise determined by the plan administrator; prohibits awards of restricted stock to employees except in connection with the commencement of employment as an executive of the Company; limits the value of restricted stock awards granted to any non-employee director to an amount not more than \$30,000 annually; and prohibits delegation of administration of the plan to another committee or subcommittee of the Board, or authority to grant or amend awards to participants to a committee of one or more members of the Board or one or more officers of the Company.

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

#### Stock Options

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

On November 11, 2013, the Company granted 1,927 shares issuable upon the exercise of NQOs with an exercise price of \$18.68 per share to an eligible employee under the Omnibus Plan prior to its amendment and restatement which vest ratably over a three-year period.

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

Following are the weighted average assumptions used in the Black-Scholes valuation model for NQOs granted during the six months ended December 31, 2013 and 2012:

|                                     | Six Months Ended December 31, |           |   |
|-------------------------------------|-------------------------------|-----------|---|
|                                     | 2013                          | 2012      |   |
| Weighted average fair value of NQOs | \$9.17                        | \$5.54    |   |
| Risk-free interest rate             | 1.7                           | % 0.8     | % |
| Dividend yield                      | —                             | % —       | % |
| Average expected term               | 6.0 years                     | 6.0 years |   |
| Expected stock price volatility     | 50.4                          | % 49.5    | % |

The Company's assumption regarding expected stock price volatility is based on the historical volatility of the Company's stock price. The risk-free interest rate is based on U.S. Treasury zero-coupon issues at the date of grant with a remaining term equal to the expected life of the stock options. The average expected life is based on the midpoint between the vesting date and the end of the contractual term of the award. Currently, management estimates an annual forfeiture rate of 6.5% based on actual forfeiture experience. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

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

The following table summarizes NQO activity for the six months ended December 31, 2013:

| Outstanding NQOs:                              | Number of NQOs | Weighted Average Exercise Price (\$) | Weighted Average Grant Date Fair Value (\$) | Weighted Average Remaining Life (Years) | Aggregate Intrinsic Value (Dollars in thousands)(1) |
|--|----------------|--------------------------------------|---|---|---|
| Outstanding at June 30, 2013                   | 557,427        | \$ 12.81                             | \$ 5.44                                     | 5.1                                     | 1,620   |
| Granted  | 1,927          | \$ 18.68                             | \$ 9.17                                     | 7.0                                     | —   |
| Exercised                                      | (8,765)        | ) \$ 14.24                           | \$ 6.32                                     | —                                       | —   |
| Cancelled/Forfeited                            | (14,835)       | ) \$ 17.26                           | \$ 6.05                                     | —                                       | 64  |
| Outstanding at December 31, 2013               | 535,754        | 14.12                                | 6.27  | 5.1                                     | 5,874   |
| Vested and exercisable, December 31, 2013      | 315,574        | 14.30                                | 5.75  | 4.0                                     | 2,828   |
| Vested and expected to vest, December 31, 2013 | 518,645        | 12.74                                | 6.19  | 4.7                                     | 5,455   |

(1) Aggregate intrinsic value represents the total pretax intrinsic value, based on the Company's closing stock price of \$23.26 at December 31, 2013, representing the last trading day of the fiscal quarter ended December 31, 2013, which would have been received by NQO holders had all award holders exercised their NQOs that were in-the-money as of that date.

The fair value of NQO grants vested during the six months ended December 31, 2013 was \$0.5 million. As of December 31, 2013 and 2012, there was \$1.0 million and \$1.6 million, respectively, of unrecognized compensation cost related to NQOs. Total compensation expense for NQOs recognized in operating expenses in the three months ended December 31, 2013 and 2012 was \$0.2 million and \$0.3 million, respectively. Total compensation expense for NQOs recognized in the six months ended December 31, 2013 and 2012 was \$0.4 million and \$0.5 million, respectively.

Non-qualified stock options with performance-based and time-based vesting ("PNQs")

On December 12, 2013, the Company granted 107,035 shares issuable upon the exercise of PNQs with an exercise price of \$21.33 per share to eligible employees under the Amended Equity Plan. These PNQs vest over a three-year period with one-third of the total number of shares subject to each such PNQ vesting on the first anniversary of the grant date based on the Company's achievement of a modified net income target for the first fiscal year of the performance period as approved by the Compensation Committee, and the remaining two-thirds of the total number of shares subject to each PNQ vesting on the third anniversary of the grant date based on the Company's achievement of a cumulative modified net income target for all three years during the performance period as approved by the Compensation Committee, in each case, subject to the participant's employment by the Company or service on the Board of Directors of the Company on the applicable vesting date.

Following are the weighted average assumptions used in the Black-Scholes valuation model for PNQs granted during the six months ended December 31, 2013:

|                                     | Six Months Ended December 31, 2013 |   |
|-------------------------------------|------------------------------------|---|
| Weighted average fair value of PNQs | \$ 10.52                           |   |
| Risk-free interest rate             | 1.8                                | % |
| Dividend yield                      | —                                  | % |
| Average expected term               | 6.0 years                          |   |
| Expected stock price volatility     | 50.5                               | % |



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

The following table summarizes PNQ activity for the six months ended December 31, 2013:

| Outstanding PNQs:                              | Number of PNQs | Weighted Average Exercise Price (\$) | Weighted Average Grant Date Fair Value (\$) | Weighted Average Remaining Life (Years) | Aggregate Intrinsic Value (Dollars in thousands) (1) |
|--|----------------|--------------------------------------|---|---|--|
| Outstanding at June 30, 2013                   | —              | —                                    | —   | —                                       | —  |
| Granted  | 107,035        | 21.33                                | 10.52                                       | 7.0                                     | —  |
| Exercised                                      | —              | —                                    | —   | —                                       | —  |
| Cancelled/Forfeited                            | —              | —                                    | —   | —                                       | —  |
| Outstanding at December 31, 2013               | 107,035        | 21.33                                | 10.52                                       | 7.0                                     | 207  |
| Vested and exercisable, December 31, 2013      | —              | —                                    | —   | —                                       | —  |
| Vested and expected to vest, December 31, 2013 | 91,979         | 21.33                                | 10.52                                       | 7.0                                     | 178  |

(1) Aggregate intrinsic value represents the total pretax intrinsic value, based on the Company's closing stock price of \$23.26 at December 31, 2013, representing the last trading day of the fiscal quarter ended December 31, 2013, which would have been received by PNQ holders had all award holders exercised their PNQs that were in-the-money as of that date.

The Company has recorded compensation expense for the PNQs based on its expectation that achievement of the targets for the PNQs is probable. Compensation expense for PNQs recognized in operating expenses in the three and six months ended December 31, 2013 was \$30,000. As of December 31, 2013 there was \$1.1 million in unrecognized compensation cost related to PNQs. No comparable compensation expense was recognized in operating expenses in the three and six months ended December 31, 2012 and there was no unrecognized compensation cost related to PNQs at December 31, 2012

#### Restricted Stock

In the three months ended December 31, 2013, the Company granted 9,200 shares of restricted stock, with a weighted average grant date fair value of \$20.48 per share. In the three months ended December 31, 2012, the Company granted 37,544 shares of restricted stock with a grant date fair value of \$11.81 per share. Shares of restricted stock generally vest at the end of three years for eligible employees and officers who are employees. Shares of restricted stock generally vest ratably over a period of three years for directors.

Compensation expense is recognized on a straight-line basis over the service period based on the estimated fair value of the restricted stock. Total compensation expense recognized in each of the three months ended December 31, 2013 and 2012 was \$0.2 million. Total compensation expense recognized in the six months ended December 31, 2013 and 2012 was \$0.3 million and \$0.4 million, respectively. As of December 31, 2013 and 2012, there was approximately \$0.8 million and \$1.2 million, respectively, of unrecognized compensation cost related to restricted stock.

The following table summarizes restricted stock activity for the six months ended December 31, 2013:

| Outstanding and Nonvested Restricted Stock Awards: | Shares Awarded | Weighted Average Grant Date Fair Value (\$) | Weighted Average Remaining Life (Years) | Aggregate Intrinsic Value (\$ in thousands) |
|--|----------------|---|---|---|
| Outstanding at June 30, 2013                       | 139,360        | 9.87  | 1.9                                     | 1,959                                       |
| Granted  | 9,200          | 20.48                                       | 2.0                                     | 188   |
| Exercised/Released                                 | (27,651)       | 13.36                                       | —                                       | 604   |

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|                                     |         |        |     |       |
|-------------------------------------|---------|--------|-----|-------|
| Cancelled/Forfeited                 | (8,332  | ) 9.45 | —   | —     |
| Outstanding at December 31, 2013    | 112,577 | 9.90   | 1.9 | 2,619 |
| Expected to vest, December 31, 2013 | 94,318  | 9.93   | 1.9 | 2,194 |

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

Note 11. Income Taxes

The Company adjusts its effective tax rate each quarter based on its current estimated annual effective tax rate. The Company also records the tax impact of certain discrete items, unusual or infrequently occurring tax events and the effects of changes in tax laws or rates, in the interim period in which they occur. In addition, the Company evaluates its deferred tax assets quarterly to determine if a valuation allowance is required.

The Company considered whether a valuation allowance should be recorded against deferred tax assets based on the likelihood that the benefits of the deferred tax assets would or would not ultimately be realized in future periods. In making this assessment, significant weight was given to evidence that could be objectively verified such as recent operating results and less consideration was given to less objective indicators such as future earnings projections. After consideration of positive and negative evidence, including the recent history of losses, the Company cannot conclude that it is more likely than not that it will generate future earnings sufficient to realize the Company's deferred tax assets. Accordingly, the Company is maintaining a valuation allowance against its deferred tax assets. The Company decreased its valuation allowance by \$1.8 million in the three months ended December 31, 2013 to \$79.9 million. The valuation allowance at June 30, 2013 was \$82.5 million.

A summary of the income tax expense recorded for the three and six months ended December 31, 2013 and 2012 is as follows:

| (In thousands)   | Three Months Ended December |           | Six Months Ended December |           |
|--|-----------------------------|-----------|---------------------------|-----------|
|  | 31,<br>2013                 | 2012      | 31,<br>2013               | 2012      |
| Income (loss) before taxes                                     | \$5,111                     | \$(7,189) | ) \$7,223                 | \$(3,769) |
| Income tax expense (benefit) at statutory rate                 | 1,738                       | (2,445)   | ) 2,456                   | (1,282)   |
| State income tax expense (benefit), net of federal tax benefit | 374                         | (325)     | ) 587                     | 137       |
| Valuation allowance  | (1,847)                     | ) 2,817   | (2,582)                   | ) 1,315   |
| Other permanent items  | 137                         | (79)      | ) 248                     | 239       |
| Income tax expense (benefit)                                   | \$402                       | \$(32)    | ) \$709                   | \$409     |

As of December 31, 2013 and June 30, 2013, the Company had not recognized the following tax benefits in its consolidated financial statements:

| (In thousands)  | As of<br>December 31,<br>2013 | June 30,<br>2013 |
|---|-------------------------------|------------------|
| Total unrecognized tax benefits*  | \$3,211                       | \$3,211          |
| Unrecognized tax benefits that, if recognized, would affect the Company's effective tax rate, subject to the valuation allowance* | \$3,064                       | \$3,064          |

\* Excluding interest and penalties

The Company believes it is reasonably possible that none of its total unrecognized tax benefits could be released in the next 12 months.





Farmer Bros. Co.

Notes to Consolidated Financial Statements (continued)

## Note 12. Net Income (Loss) Per Common Share

|   | Three Months Ended<br>December 31, |            | Six Months Ended<br>December 31, |            |
|---|------------------------------------|------------|----------------------------------|------------|
|   | 2013                               | 2012       | 2013                             | 2012       |
| (In thousands, except share and per share amounts)                  |                                    |            |                                  |            |
| Net income (loss) attributable to common stockholders—basic         | \$4,676                            | \$(7,089)  | ) \$6,468                        | \$(4,138)  |
| Net income (loss) attributable to nonvested restricted stockholders | 33                                 | (68)       | ) 46                             | (40)       |
| Total net income (loss)   | \$4,709                            | \$(7,157)  | ) \$6,514                        | \$(4,178)  |
| Weighted average shares outstanding—basic                           | 15,847,958                         | 15,548,094 | 15,825,100                       | 15,519,980 |
| Effect of dilutive securities:                                      |                                    |            |                                  |            |
| Shares issuable under stock options                                 | 116,724                            | —          | 79,356                           | —          |
| Weighted average shares outstanding—diluted                         | 15,964,682                         | 15,548,094 | 15,904,456                       | 15,519,980 |
| Net income (loss) per common share—basic                            | \$0.30                             | \$(0.46)   | ) \$0.41                         | \$(0.27)   |
| Net income (loss) per common share—diluted                          | \$0.29                             | \$(0.46)   | ) \$0.41                         | \$(0.27)   |

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations  
Forward-Looking Statements

Certain statements contained in this quarterly report on Form 10-Q are not based on historical fact and are forward-looking statements within the meaning of federal securities laws and regulations. These statements are based on management's current expectations, assumptions, estimates and observations of future events and include any statements that do not directly relate to any historical or current fact. These forward-looking statements can be identified by the use of words like "anticipates," "estimates," "projects," "expects," "plans," "believes," "intends," "will," "assumes," and other words of similar meaning. Owing to the uncertainties inherent in forward-looking statements, actual results could differ materially from those set forth in forward-looking statements. We intend these forward-looking statements to speak only at the time of this report and do not undertake to update or revise these statements as more information becomes available except as required under federal securities laws and the rules and regulations of the Securities and Exchange Commission (the "SEC"). Factors that could cause actual results to differ materially from those in forward-looking statements include, but are not limited to, the relative effectiveness of compensation-based employee incentives in causing improvements in Company performance, the capacity to meet the demands of the Company's large national account customers, the extent of execution of plans for the growth of Company business and achievement of financial metrics related to those plans, the effect of the capital markets as well as other external factors on stockholder value, fluctuations in availability and cost of green coffee, competition, organizational changes, the impact of a weaker economy, business conditions in the coffee industry and food industry in general, our continued success in attracting new customers, variances from budgeted sales mix and growth rates, weather and special or unusual events, changes in the quality or dividend stream of third parties' securities and other investment vehicles in which we have invested our assets, as well as other risks described in this report and other factors described from time to time in our filings with the SEC. The results of operations for the three and six months ended December 31, 2013 and 2012 are not necessarily indicative of the results that may be expected for any future period.

Liquidity and Capital Resources

Credit Facility

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

On January 9, 2012, the Loan Agreement was amended in connection with JPMorgan Chase Bank, N.A. ("JPMorgan Chase"), becoming an additional Lender thereunder. On March 18, 2013, the Loan Agreement was amended further ("Amendment No. 2") to amend the definition of "Maximum Credit" available thereunder to \$75.0 million from \$85.0 million. Pursuant to Amendment No. 2, Wells Fargo will provide a commitment of \$53.0 million and JPMorgan Chase will provide a commitment of \$22.0 million.

The Loan Agreement provides for a senior secured revolving credit facility of up to \$75.0 million, with a letter of credit sublimit of \$20.0 million. The revolving credit facility provides for advances of 85% of eligible accounts receivable and 75% of eligible inventory (subject to a \$60.0 million inventory loan limit), as defined. The Loan Agreement provides for interest rates based on modified Monthly Average Excess Availability levels with a range of PRIME + 0.25% to PRIME + 0.75% or Adjusted Eurodollar Rate + 2.0% to Adjusted Eurodollar Rate + 2.5%. The Loan Agreement has an amendment fee of 0.375% and an unused line fee of 0.25%. Outstanding obligations under the Loan Agreement are collateralized by all of the Borrowers' assets, including the Company's preferred stock portfolio. The term of the Loan Agreement expires on March 2, 2015.

The Loan Agreement contains a variety of affirmative and negative covenants of types customary in an asset-based lending facility, including those relating to reporting requirements, maintenance of records, properties and corporate existence, compliance with laws, incurrence of other indebtedness and liens, limitations on certain payments, including the payment of dividends and capital expenditures, and transactions and extraordinary corporate events. The Loan Agreement allows us to pay dividends, provided, among other things, certain liquidity requirements are met, the aggregate amount of all such payments in any fiscal year shall not exceed \$7.0 million (\$1.75 million in any fiscal quarter), and no event of default exists or has occurred and is continuing as of the date of any such payment and after giving effect thereto. The Loan Agreement also contains financial covenants requiring the Borrowers to maintain

minimum Excess Availability and Total Liquidity levels. The Loan Agreement allows the Lenders to

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establish reserve requirements, which may reduce the amount of credit otherwise available to us, to reflect events, conditions, or risks that would have a reasonable likelihood of adversely affecting the Lender's collateral or our assets, including our green coffee inventory.

The Loan Agreement provides that an event of default includes, among other things, subject to certain grace periods: (i) payment defaults; (ii) failure by any guarantor to perform any guarantee in favor of Lender; (iii) failure to abide by loan covenants; (iv) default with respect to other material indebtedness; (v) final judgment in a material amount not discharged or stayed; (vi) any change of control; (vii) bankruptcy or insolvency; and (viii) the failure of the Farmer Bros. Co. Employee Stock Ownership Benefit Trust, created by the Company to implement the Farmer Bros. Co. Employee Stock Ownership Plan ("ESOP"), to be duly qualified under Section 401(a) of the Internal Revenue Code of 1986, as amended, or exempt from federal income taxation, or if the ESOP engages in a material non-exempt prohibited transaction.

Effective December 1, 2012, we entered into an interest rate swap transaction utilizing a notional amount of \$10.0 million and a maturity date of March 1, 2015. We entered into the swap transaction to effectively fix the future interest rate during the applicable period on a portion of our borrowings under the revolving credit facility. The swap transaction is intended to manage our interest rate risk related to our borrowings under the revolving credit facility and requires us to pay a fixed rate of 0.48% per annum in exchange for a variable interest rate based on 1-month USD LIBOR-BBA. As of December 31, 2013, the variable interest rate based on 1-month USD LIBOR-BBA was 0.16%. We have not designated our interest rate swap as an accounting hedge. We record the interest rate swap on our consolidated balance sheet at fair value with the changes in fair value recorded as gain or loss in "Other, net" in our consolidated statements of operations. In the three and six months ended December 31, 2013, we recorded a gain of \$2,000 and a loss of \$(4,000), respectively, for the change in fair value of our interest rate swap. In the three and six months ended December 31, 2012, we recorded a loss of \$(40,000) for the change in fair value of our interest rate swap.

On December 31, 2013, we were eligible to borrow up to a total of \$68.0 million under the credit facility. As of December 31, 2013, we had outstanding borrowings of \$18.6 million, including loan extension fees of \$0.1 million, utilized \$11.2 million of the letters of credit sublimit, and had excess availability under the credit facility of \$38.2 million. In connection with entering into the interest rate swap agreement on December 1, 2012, we reclassified \$10.0 million of our borrowings under the credit facility as long-term because we intend to repay the borrowings in accordance with the termination date of the swap agreement which extends beyond one year. The weighted average interest rate on our outstanding borrowings under the credit facility was 1.13% at December 31, 2013. We believe that the carrying value of our outstanding borrowings under the credit facility approximates fair value at December 31, 2013 as the credit facility bears interest at a variable interest rate based on prevailing market conditions. As of December 31, 2013, we were in compliance with all restrictive covenants under the Loan Agreement.

As of January 31, 2014, we had estimated outstanding borrowings of \$15.8 million, including loan extension fees of \$0.1 million, utilized \$11.2 million of the letters of credit sublimit, and had excess availability under the credit facility of \$39.7 million. As of January 31, 2014, the weighted average interest rate on our outstanding borrowings under the credit facility was 1.18%.

#### Liquidity

We generally finance our operations through cash flows from operations and borrowings under our revolving credit facility described above. As of December 31, 2013, we had \$7.9 million in cash and cash equivalents, \$3.6 million in restricted cash representing cash held on deposit in margin accounts for coffee-related derivative instruments and \$20.6 million in short-term investments. We believe our revolving credit facility, to the extent available, in addition to our cash flows from operations and other liquid assets, are sufficient to fund our working capital and capital expenditure requirements for the next 12 months.

We generate cash from operating activities primarily from cash collections related to the sale of our products. Net cash provided by operating activities was \$20.4 million in the six months ended December 31, 2013 compared to \$10.1 million in the six months ended December 31, 2012. The increase in net cash provided by operating activities in the six months ended December 31, 2013 was primarily due to a higher level of cash inflows from operating activities and a lower level of non-operational gains such as net gains on sales of assets.

Net cash used in investing activities was \$11.8 million in the six months ended December 31, 2013 compared to \$2.5 million in the six months ended December 31, 2012, primarily due to increased capital expenditures and decreased cash inflows from sales of fixed assets in the six months ended December 31, 2013.

Net cash used in financing activities was \$3.4 million in the six months ended December 31, 2013 compared to \$6.3 million in the six months ended December 31, 2012. Net cash used in financing activities in the six months ended December 31, 2013 included net repayments on our credit facility of \$(1.8) million, compared to net repayments of \$(4.8) million in the six months ended December 31, 2012.

In the six months ended December 31, 2013, we capitalized \$12.1 million in property, plant and equipment purchases which included \$5.9 million in expenditures to replace normal wear and tear of coffee brewing equipment, \$0.3 million in building and facility improvements, \$4.6 million in expenditures for vehicles, and machinery and equipment, and \$1.3 million in information technology related expenditures.

Our expected capital expenditures for fiscal 2014 include expenditures to replace normal wear and tear of coffee brewing equipment, vehicles, and machinery and equipment, and are expected to increase approximately 33% from fiscal 2013 levels.

Our working capital is composed of the following:

| (In thousands)      | December 31, 2013 | June 30, 2013 |
|---------------------|-------------------|---------------|
| Current assets      | \$144,577         | \$139,749     |
| Current liabilities | 75,215            | 76,550        |
| Working capital     | \$69,362          | \$63,199      |

Liquidity Information:

| (In thousands)       | Six Months Ended December 31, |         |
|----------------------|-------------------------------|---------|
|                      | 2013                          | 2012    |
| Capital expenditures | \$12,128                      | \$6,396 |

Results of Operations

Net sales in the three months ended December 31, 2013 increased \$6.4 million, or 4.8%, to \$142.1 million from \$135.7 million in the three months ended December 31, 2012, primarily due to increases in sales of our coffee and tea products. Net sales in the six months ended December 31, 2013 increased \$15.8 million, or 6.2%, to \$270.7 million as compared to \$254.9 million in the six months ended December 31, 2012, primarily due to increases in sales of our coffee and tea products.

Cost of goods sold in the three months ended December 31, 2013 increased \$1.4 million, or 1.6%, to \$86.7 million, or 61.0% of net sales, from \$85.4 million, or 62.9% of net sales, in the three months ended December 31, 2012. The decrease in cost of goods sold as a percentage of net sales in the three months ended December 31, 2013 was primarily due to a 29% decrease in the average cost of green coffee purchased, partially offset by \$3.7 million in coffee-related derivative losses reclassified into cost of goods sold. Cost of goods sold in the six months ended December 31, 2013 increased \$5.9 million, or 3.7%, to \$165.8 million, or 61.2% of net sales, from \$159.9 million, or 62.7% of net sales in the six months ended December 31, 2012. The decrease in cost of goods sold as a percentage of net sales in the six months ended December 31, 2013 was primarily due to a 26% decrease in the average cost of green coffee purchased, partially offset by \$6.0 million in coffee-related derivative losses reclassified into cost of goods sold.

We anticipate that inventory levels at June 30, 2014 will be greater than at June 30, 2013 and, therefore, did not record any adjustment to cost of goods sold to reflect the effect of the liquidation of LIFO inventory quantities in the results of operations for the three and six months ended December 31, 2013. Cost of goods sold in the three and six months ended December 31, 2012 includes the expected beneficial effect of the liquidation of LIFO inventory quantities in the amount of \$0.5 million.

Gross profit in the three months ended December 31, 2013 increased \$5.0 million, or 10.1%, to \$55.4 million from \$50.4 million in the three months ended December 31, 2012, primarily due to the increase in net sales. Gross margin increased to 39.0% in the three months ended December 31, 2013 from 37.1% in the three months ended December 31, 2012, primarily due to a 29% decrease in the average cost of green coffee purchased in the three months ended December 31, 2013. The increases in gross profit and gross margin were partially offset by \$3.7 million in coffee-related derivative losses reclassified into cost of goods sold matching the hedged transactions that affected earnings in the three months ended December 31, 2013. Gross profit in the six months ended December 31, 2013 increased \$9.9 million, or 10.5%, to \$104.9 million, as compared to \$95.0 million in the six months ended





December 31, 2012, primarily due to the increase in net sales. Gross margin increased to 38.8% in the six months ended December 31, 2013 from 37.3% in the comparable period of the prior fiscal year, primarily due to a 26% decrease in the average cost of green coffee purchased. The increases in gross profit and gross margin were partially offset by \$6.0 million in coffee-related derivative losses reclassified into cost of goods sold matching the hedged transactions that affected earnings in the six months ended December 31, 2013. Gross profit in the three and six months ended December 31, 2012 included the expected beneficial effect of the liquidation of LIFO inventory quantities in the amount of \$0.5 million.

In the three months ended December 31, 2013, operating expenses decreased \$0.1 million, or 0.2%, to \$49.7 million, or 35.0% of net sales, from \$49.8 million, or 36.7% of net sales, in the three months ended December 31, 2012. The decrease in operating expenses in the three months ended December 31, 2013 was primarily due a \$1.8 million decrease in selling expenses partially offset by a \$1.7 million increase in general and administrative expenses as compared to the three months ended December 31, 2012. Operating expenses in the six months ended December 31, 2013 increased \$0.5 million, or 0.5%, to \$96.3 million, or 35.6% of net sales, from \$95.8 million, or 37.6% of net sales in the six months ended December 31, 2012. The increase in operating expenses in the six months ended December 31, 2013 was primarily due to a \$2.2 million increase in general and administrative expenses partially offset by a \$1.7 million decrease in selling expenses. The decrease in selling expenses in the three and six months ended December 31, 2013 was primarily due to the absence of startup costs for national customers and the absence of expenses related to sales training and storm-related expenses as compared to the same periods in the prior fiscal year. In addition, insurance recovery of storm-related losses in the six months ended December 31, 2013 also contributed to the decrease in selling expenses. The decrease in selling expenses was partially offset by a \$1.3 million increase in additional accruals for incurred but not reported self-insurance claims. The increase in general and administrative expenses in the three and six months ended December 31, 2013 was primarily due to the increase in accrual for anticipated bonus payments to eligible employees as compared to the same periods in the prior fiscal year.

Income from operations in the three months ended December 31, 2013 was \$5.7 million compared to \$0.5 million in the three months ended December 31, 2012, primarily due to the improvement in gross profit and lower selling expenses partially offset by the increase in general and administrative expenses. Income from operations in the six months ended December 31, 2013 was \$8.6 million compared to loss from operations of \$(0.9) million in the six months ended December 31, 2012, primarily due to the improvement in gross profit and lower selling expenses partially offset by the increase in general and administrative expenses.

Total other expense in the three and six months ended December 31, 2013 was \$0.6 million and \$1.4 million, respectively, compared to \$7.7 million and \$2.9 million in the three and six months ended December 31, 2012, respectively. The decrease in total other expense in the three and six months ended December 31, 2013 was primarily due to the implementation of procedures following the guidelines of ASC 815, "Derivatives and Hedging" ("ASC 815"), beginning in April 2013 which enabled us to account for certain coffee-related derivative instruments as accounting hedges. As a result, beginning in April 2013, gains and losses from derivative instruments designated as accounting hedges are deferred in AOCI and recognized in cost of goods sold in the period or periods when the hedged transaction affects earnings. Gains and losses from derivative instruments not designated as accounting hedges are immediately recognized in "Other, net." Total other expense in the three and six months ended December 31, 2013 included \$0.3 million and \$1.2 million in net losses on coffee-related derivatives, respectively, as compared to \$7.9 million and \$7.2 million in the three and six months ended December 31, 2012, respectively. Total other expense in the six months ended December 31, 2012 included \$3.2 million in net gains on sales of assets, primarily real estate. Net losses from coffee-related derivative instruments not designated as accounting hedges recorded in "Other, net" in the three and six months ended December 31, 2013 were \$0.2 million and \$0.5 million, respectively. For the three and six months ended December 31, 2013, we recognized \$0.1 million and \$0.7 million in losses on coffee-related derivative instruments designated as cash flow hedges due to ineffectiveness.

In the three months ended December 31, 2013, we recorded income tax expense of \$0.4 million compared to income tax benefit of \$(32,000) in the three months ended December 31, 2012. In the six months ended December 31, 2013, we recorded income tax expense of \$0.7 million compared to \$0.4 million in the six months ended December 31, 2012.

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As a result of the foregoing factors, net income in the three months ended December 31, 2013 was \$4.7 million, or \$0.29 per diluted common share, compared to net loss of \$(7.2) million, or \$(0.46) per diluted common share, in the three months ended December 31, 2012. Net income in the six months ended December 31, 2013 was of \$6.5

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million, or \$0.41 per diluted common share, as compared to net loss of \$(4.2) million, or \$(0.27) per diluted common share, in the six months ended December 31, 2012.

#### Non-GAAP Financial Measures

In addition to net income (loss) determined in accordance with GAAP, we use certain non-GAAP financial measures, including "EBITDAE" and "EBITDAE Margin," in assessing our operating performance. We believe these non-GAAP financial measures serve as appropriate measures to be used in evaluating the performance of our business.

We define "EBITDAE" as net income (loss) excluding the impact of income taxes, interest expense, depreciation and amortization expense, ESOP and share-based compensation expense, non-cash impairment losses, pension withdrawal expense, and "Other, net," which includes net gains and losses from derivatives and investments, and net gains and losses on sales of assets. We reference this particular non-GAAP financial measure frequently in our decision-making because it provides supplemental information that facilitates internal comparisons to the historical operating performance of prior periods. In addition, we base certain of our forward-looking estimates on EBITDAE to facilitate quantification of planned business activities and enhance subsequent follow-up with comparisons of actual to planned EBITDAE. We define "EBITDAE Margin" as EBITDAE expressed as a percentage of net sales. EBITDAE and EBITDAE Margin as defined by us may not be comparable to similarly titled measures reported by other companies. We do not intend for non-GAAP financial measures to be considered in isolation or as a substitute for other measures prepared in accordance with GAAP.

Set forth below is a reconciliation of reported net income (loss) to EBITDAE:

| (In thousands)                            | Three Months Ended December 31, |            | Six Months Ended December 31, |            |   |
|---|---------------------------------|------------|-------------------------------|------------|---|
|   | 2013                            | 2012       | 2013                          | 2012       |   |
| Net income (loss), as reported(1)(2)      | \$4,709                         | \$(7,157 ) | \$6,514                       | \$(4,178 ) |   |
| Income tax expense (benefit)              | 402                             | (32 )      | 709                           | 409        |   |
| Interest expense (benefit)                | 393                             | 463        | 765                           | 920        |   |
| Depreciation and amortization expense     | 7,054                           | 8,300      | 14,478                        | 16,640     |   |
| ESOP and share-based compensation expense | 1,230                           | 1,083      | 2,134                         | 1,906      |   |
| Other, net(2)                             | 587                             | 7,656      | 1,370                         | 2,711      |   |
| EBITDAE                                   | \$14,375                        | \$10,313   | \$25,970                      | \$18,408   |   |
| EBITDAE Margin                            | 10.1                            | % 7.6      | % 9.6                         | % 7.2      | % |

(1) Includes \$0.5 million in beneficial effect of LIFO inventory liquidation in the three and six months ended December 31, 2012.

(2) Includes: (a) \$0.1 million in net gains from sales of assets in the three and six months ended December 31, 2013; and (b) \$3.2 million in net gains from sales of assets, primarily real estate, and \$0.8 million in recovery of a note receivable previously deemed uncollectible in the six months ended December 31, 2012. Excludes \$2.3 million and \$5.4 million in losses from coffee-related derivatives which have been recorded in OCI in the three and six months ended December 31, 2013.

#### Item 3. Quantitative and Qualitative Disclosures About Market Risk

##### Interest Rate Risk

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



The following table demonstrates the impact of varying interest rate changes based on our preferred securities holdings and market yield and price relationships at December 31, 2013. This table is predicated on an “instantaneous” change in the general level of interest rates and assumes predictable relationships between the prices of our preferred securities holdings and the yields on U.S. Treasury securities. At December 31, 2013, we had no futures contracts or put options with respect to our preferred securities portfolio designated as interest rate risk hedges.

|                       | Market Value of Preferred Securities at December 31, 2013 | Change in Market Value |
|-----------------------|---|------------------------|
| Interest Rate Changes | (In thousands)  |                        |
| -150 basis points     | \$21,582  | \$1,029                |
| -100 basis points     | \$21,287  | \$734                  |
| Unchanged             | \$20,553  | \$—                    |
| +100 basis points     | \$19,622  | \$(931)                |
| +150 basis points     | \$19,141  | \$(1,412)              |

The Loan Agreement for our revolving credit facility provides for interest rates based on modified Monthly Average Excess Availability levels with a range of PRIME + 0.25% to PRIME + 0.75% or Adjusted Eurodollar Rate + 2.0% to Adjusted Eurodollar Rate + 2.5%. Effective December 1, 2012, we entered into an interest rate swap transaction utilizing a notional amount of \$10.0 million and a maturity date of March 1, 2015. We entered into the swap transaction to effectively fix the future interest rate during the applicable period on a portion of our borrowings under our revolving credit facility. In connection with entering into the interest rate swap agreement on December 1, 2012, we reclassified \$10.0 million of our borrowings under the revolving credit facility as long-term because we intend to repay the borrowings in accordance with the termination date of the swap agreement which extends beyond one year. The swap transaction is intended to manage our interest rate risk related to our borrowings under our revolving credit facility and requires us to pay a fixed rate of 0.48% per annum in exchange for a variable interest rate based on 1-month USD LIBOR-BBA. As of December 31, 2013, the variable interest rate based on 1-month USD LIBOR-BBA was 0.16%.

We have not designated our interest rate swap as an accounting hedge. We record the interest rate swap on our consolidated balance sheet at fair value with the changes in fair value recorded as gain or loss in "Other, net" in our consolidated statements of operations. In the three and six months ended December 31, 2013, we recorded a gain of \$2,000 and a loss of \$(4,000), respectively, for the change in fair value of our interest rate swap. In the three and six months ended December 31, 2012, we recorded a loss of \$(40,000) for the change in fair value of our interest rate swap.

As of December 31, 2013, we had outstanding borrowings of \$18.6 million, including loan extension fees of \$0.1 million, utilized \$11.2 million of the letters of credit sublimit, and had excess availability under the credit facility of \$38.2 million. The weighted average interest rate on our outstanding borrowings under the credit facility at December 31, 2013 was 1.13%.

The following table demonstrates the impact of interest rate changes on our annual interest expense under the revolving credit facility based on the outstanding balance and interest rate as of December 31, 2013:

| Interest Rate Changes | Interest Rate | Annual Interest Expense (In thousands) |
|-----------------------|---------------|--|
| -100 basis points     | 0.13          | % \$ 24                                |
| -50 basis points      | 0.63          | % \$ 117                               |
| Unchanged             | 1.13          | % \$ 210                               |
| +50 basis points      | 1.63          | % \$ 303                               |
| +100 basis points     | 2.13          | % \$ 396                               |
| Commodity Price Risk  |               |  |

We are exposed to commodity price risk arising from changes in the market price of green coffee. We value green coffee inventory on the last in, first out basis. In the normal course of business we hold a large green coffee inventory and enter into

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forward commodity purchase agreements with suppliers. We are subject to price risk resulting from the volatility of green coffee prices. Due to competition and market conditions, volatile price increases cannot always be passed on to our customers.

We routinely purchase exchange traded coffee contracts to enable us to lock in green coffee prices within a pre-established range, and hold a mix of futures contracts and options to help hedge against volatility in green coffee prices. Prior to April 1, 2013, none of our derivative instruments was designated as an accounting hedge. Beginning April 1, 2013, we implemented procedures following the guidelines of ASC 815 to enable us to account for certain coffee-related derivatives as accounting hedges in order to minimize the volatility created in our quarterly results from utilizing these derivative contracts and to improve comparability between reporting periods.

When coffee-related futures contracts are designated as cash flow hedges, we formally document the hedging instruments and hedged items, and measure at each balance sheet date the effectiveness of our hedges. Beginning in the fourth quarter of fiscal 2013, the effective portion of the change in fair value of the derivative is reported as AOCI and subsequently reclassified into cost of goods sold in the period or periods when the hedged transaction affects earnings. In the three and six months ended December 31, 2013, we reclassified \$3.7 million and \$6.0 million in net losses into cost of goods sold from AOCI. Any ineffective portion of the derivative's change in fair value is recognized currently in "Other, net." Gains or losses deferred in AOCI associated with terminated derivatives, derivatives that cease to be highly effective hedges, derivatives for which the forecasted transaction is reasonably possible but no longer probable of occurring, and cash flow hedges that have been otherwise discontinued remain in AOCI until the hedged item affects earnings. If it becomes probable that the forecasted transaction designated as the hedged item in a cash flow hedge will not occur, we recognize any gain or loss deferred in AOCI in "Other, net" at that time. For the three and six months ended December 31, 2013, we recognized in "Other, net" \$(0.5) million in losses on coffee-related derivative instruments designated as cash flow hedges due to ineffectiveness.

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."

For the three and six months ended December 31, 2013, we recorded net (losses) gains from coffee-related derivative instruments not designated as accounting hedges in "Other, net" in the amounts of \$(0.2) million and \$0.5 million, respectively (see Note 2 to the consolidated financial statements).

The following table summarizes the potential impact as of December 31, 2013 to net income and OCI from a hypothetical 10% change in coffee commodity prices. The information provided below relates only to the coffee-related derivative instruments and does not represent the corresponding changes in the underlying hedged items:

|                                       | Increase (Decrease) to Net<br>Income                     |                                       | Increase (Decrease) to OCI         |                                       |
|---------------------------------------|--|---------------------------------------|------------------------------------|---------------------------------------|
|                                       | 10% Increase in<br>Underlying Rate<br><br>(In thousands) | 10% Decrease<br>in Underlying<br>Rate | 10% Increase in<br>Underlying Rate | 10% Decrease<br>in Underlying<br>Rate |
| Coffee-related derivative instruments | \$5,400  | \$(5,400                              | ) \$616                            | \$(616 )                              |

Item 4. Controls and Procedures

Disclosure Controls and Procedures

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

As of December 31, 2013, our management, with the participation of our Chief Executive Officer and Chief Financial Officer, carried out an evaluation of the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15(e) promulgated under the Exchange Act. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were not effective as of December 31, 2013. This conclusion was based on the material weakness identified in our internal control over financial reporting related to our accounting for postretirement benefit obligations, as described below.

Changes in Internal Control Over Financial Reporting

As described in Item 9A of our Annual Report on Form 10-K for the fiscal year ended June 30, 2013 filed with the SEC on October 9, 2013, our management identified a material weakness in our internal control over our accounting for postretirement benefit obligations. Our controls did not properly identify the failure to apply generally accepted accounting principles with respect to the accounting for death benefits and the related cash surrender value of life insurance, and did not properly detect when changes or amendments to other postretirement benefit plans occurred that should have resulted in changes to the related benefit plan obligations. As a result, material errors to the recorded postretirement benefit liability, postretirement death benefit liability and cash surrender value of life insurance purchased to fund the postretirement death benefit occurred and were not timely detected. As a result, our management concluded that, as of June 30, 2013, our internal control over financial reporting was not effective due to this material weakness.

To remediate the material weakness described above, we are currently evaluating the controls and procedures we will design and put in place to address this material weakness and plan to implement appropriate measures as part of this effort. These controls and procedures may include:

- engagement of independent consultants to review the Company's other postretirement benefit obligation controls and to make recommendations to address the design gaps in these controls;
  - retention of additional knowledgeable accounting personnel to review the accuracy of data and plan information provided to actuaries engaged to perform valuation services;
  - design of processes to facilitate improved interaction among human resources, external actuaries and accounting personnel; and
  - additional focused training of our finance personnel in the area of accounting and reporting for our other postretirement obligations, including any changes in the relevant accounting guidance and timely adoption thereof.
- However, the material weakness will not be considered remediated until the applicable remedial controls are implemented and operate for a sufficient period of time and management has concluded, through testing, that these controls are operating effectively.

Except as described above, there has been no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) promulgated under the Exchange Act) during our fiscal quarter ended December 31, 2013, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.



Part II - OTHER INFORMATION

Item 6. Exhibits

See Exhibit Index.

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SIGNATURES

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

FARMER BROS. CO.

By: /S/MICHAEL H. KEOWN  
Michael H. Keown  
President and Chief Executive Officer  
(chief executive officer)  
Date: February 10, 2014

By: /s/MARK J. NELSON  
Mark J. Nelson  
Treasurer and Chief Financial Officer  
(principal financial and accounting officer)  
Date: February 10, 2014

EXHIBIT INDEX

- 3.1 Certificate of Incorporation (filed as Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2009 filed with the SEC on May 11, 2009 and incorporated herein by reference).
- 3.2 Amended and Restated Bylaws (filed as Exhibit 3.2 to the Company's Current Report on Form 8-K filed with the SEC on April 25, 2011 and incorporated herein by reference).
- 4.1 Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock (filed as Exhibit 4.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2010 filed with the SEC on May 10, 2010 and incorporated herein by reference).
- 4.2 Rights Agreement, dated March 17, 2005, by and between Farmer Bros. Co. and Wells Fargo Bank, N.A., as Rights Agent (filed as Exhibit 4.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2010 filed with the SEC on May 10, 2010 and incorporated herein by reference).
- 4.3 Specimen Stock Certificate (filed herewith).
- 10.1 Amended and Restated Loan and Security Agreement, dated September 12, 2011, by and among Farmer Bros. Co. and Coffee Bean International, Inc., as Borrowers, Coffee Bean Holding Co., Inc. and FBC Finance Company, as Guarantors, the Lenders party thereto, and Wells Fargo Bank, National Association, as Agent (filed as Exhibit 10.12 to the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2011 filed with the SEC on September 12, 2011 and incorporated herein by reference).
- 10.2 Amendment No. 1 to Amended and Restated Loan and Security Agreement, effective January 9, 2012, by and among Farmer Bros. Co. and Coffee Bean International, Inc., as Borrowers, Coffee Bean Holding Co., Inc. and FBC Finance Company, as Guarantors, the Lenders party thereto, and Wells Fargo Bank, National Association, as Agent (filed as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2011 filed with the SEC on February 8, 2012 and incorporated herein by reference).
- 10.3 Amendment No. 2 to Amended and Restated Loan and Security Agreement, dated as of March 18, 2013, by and among Farmer Bros. Co. and Coffee Bean International, Inc., as Borrowers, Coffee Bean Holding Co., Inc. and FBC Finance Company, as Guarantors, the Lenders party thereto, and Wells Fargo Bank, National Association, as Agent (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on March 20, 2013 and incorporated herein by reference).
- 10.4 Letter Agreement regarding Waiver of Event of Default, dated October 3, 2013, by and among Farmer Bros. Co. and Coffee Bean International, Inc., as Borrowers, Coffee Bean Holding Co., Inc. and FBC Finance Company, as Guarantors, the Lenders party thereto, and Wells Fargo Bank, National Association, as Agent (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on October 4, 2013 and incorporated herein by reference).
- 10.5 ISDA Master Agreement, dated as of November 19, 2012, by and between Farmer Bros. Co. and Wells Fargo Bank, N.A. (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on November 26, 2012 and incorporated herein by reference).
- 10.6 Schedule to the ISDA Master Agreement, dated as of November 19, 2012, by and between Farmer Bros. Co. and Wells Fargo Bank, N.A. (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K filed

with the SEC on November 26, 2012 and incorporated herein by reference).

10.7 Farmer Bros. Co. Pension Plan for Salaried Employees (filed as Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2012 filed with the SEC on November 5, 2012 and incorporated herein by reference).\*

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- 10.8 Amendment No. 1 to Farmer Bros. Co. Retirement Plan effective June 30, 2011 (filed as Exhibit 10.14 to the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2011 filed with the SEC on September 12, 2011 and incorporated herein by reference).\*
- 10.9 Action of the Administrative Committee of the Farmer Bros. Co. Qualified Employee Retirement Plans amending the Farmer Bros. Co. Retirement Plan, effective as of December 6, 2012 (filed as Exhibit 10.7 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2012 filed with the SEC on February 6, 2013 and incorporated herein by reference).\*
- 10.10 Farmer Bros. Co. 2005 Incentive Compensation Plan (filed herewith).\*
- 10.11 Farmer Bros. Co. Amended and Restated Employee Stock Ownership Plan, as adopted by the Board of Directors on December 9, 2010 and effective as of January 1, 2010 (filed as Exhibit 10.12 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2010 filed with the SEC on February 9, 2011 and incorporated herein by reference).\*
- 10.12 Action of the Administrative Committee of the Farmer Bros. Co. Qualified Employee Retirement Plans amending the Farmer Bros. Co. Amended and Restated Employee Stock Ownership Plan, effective as of January 1, 2012 (filed as Exhibit 10.7 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2012 filed with the SEC on November 5, 2012 and incorporated herein by reference).\*
- 10.13 ESOP Loan Agreement including ESOP Pledge Agreement and Promissory Note, dated March 28, 2000, between Farmer Bros. Co. and Wells Fargo Bank, N.A., Trustee for the Farmer Bros Co. Employee Stock Ownership Plan (filed as Exhibit 10.13 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2010 filed with the SEC on February 9, 2011 and incorporated herein by reference).
- 10.14 Amendment No. 1 to ESOP Loan Agreement, dated June 30, 2003, between Farmer Bros. Co. and Wells Fargo Bank, N.A., Trustee for the Farmer Bros Co. Employee Stock Ownership Plan (filed as Exhibit 10.14 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2010 filed with the SEC on February 9, 2011 and incorporated herein by reference).
- 10.15 ESOP Loan Agreement No. 2 including ESOP Pledge Agreement and Promissory Note, dated July 21, 2003 between Farmer Bros. Co. and Wells Fargo Bank, N.A., Trustee for the Farmer Bros Co. Employee Stock Ownership Plan (filed as Exhibit 10.15 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2010 filed with the SEC on February 9, 2011 and incorporated herein by reference).
- 10.16 Employment Agreement, dated March 9, 2012, by and between Farmer Bros. Co. and Michael H. Keown (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on March 13, 2012 and incorporated herein by reference).\*
- 10.17 Second Amended and Restated Employment Agreement, effective as of February 13, 2012, by and between Farmer Bros. Co. and Jeffrey A. Wahba (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on February 17, 2012 and incorporated herein by reference).\*
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Consulting Services Agreement, effective as of March 1, 2013, between Farmer Bros. Co. and Jeffrey A. Wahba (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on February 28, 2013 and incorporated herein by reference).\*

10.19 Letter Agreement by and between Farmer Bros. Co. and Jeffrey A. Wahba (filed as Exhibit 10.7 to the Company's Current Report on Form 8-K filed with the SEC on April 4, 2013 and incorporated herein by reference).\*

10.20 Employment Agreement, dated as of April 4, 2012, by and between Farmer Bros. Co. and Thomas W. Mortensen (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K/A filed with the SEC on April 10, 2012 and incorporated herein by reference).\*

10.21 Amended and Restated Employment Agreement, effective as of February 13, 2012, by and between Farmer Bros. Co. and Patrick G. Criteser (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the SEC on February 17, 2012 and incorporated herein by reference).\*

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- 10.22 Resignation Agreement, dated as of July 20, 2012, by and between Farmer Bros. Co. and Larry B. Garrett (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K/A filed with the SEC on July 24, 2012 and incorporated herein by reference).\*
- 10.23 Employment Agreement, dated as of April 1, 2013, by and between Farmer Bros. Co. and Mark J. Nelson (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on April 4, 2013 and incorporated herein by reference).\*
- 10.24 Separation Agreement, dated as of December 12, 2013, by and between Farmer Bros. Co. and Hortensia R. Gomez (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on December 18, 2013 and incorporated herein by reference).\*
- 10.25 Farmer Bros. Co. 2007 Omnibus Plan, as amended (as approved by the stockholders at the 2012 Annual Meeting of Stockholders on December 6, 2012) (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on December 12, 2012 and incorporated herein by reference).\*
- 10.26 Farmer Bros. Co. Amended and Restated 2007 Long-Term Incentive Plan (as approved by the stockholders at the 2013 Annual Meeting of Stockholders on December 5, 2013) (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the SEC on December 11, 2013 and incorporated herein by reference).\*
- 10.27 Form of Farmer Bros. Co. 2007 Omnibus Plan Stock Option Grant Notice and Stock Option Agreement (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the SEC on April 4, 2013 and incorporated herein by reference).\*
- 10.28 Form of Farmer Bros. Co. Amended and Restated 2007 Long-Term Incentive Plan Stock Option Grant Notice and Stock Option Agreement (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the SEC on December 18, 2013 and incorporated herein by reference).\*
- 10.29 Form of Farmer Bros. Co. 2007 Omnibus Plan Restricted Stock Award Grant Notice and Restricted Stock Award Agreement (filed as Exhibit 10.3 to the Company's Current Report on Form 8-K filed with the SEC on April 4, 2013 and incorporated herein by reference).\*
- 10.30 Form of Farmer Bros. Co. Amended and Restated 2007 Long-Term Incentive Plan Restricted Stock Award Grant Notice and Restricted Stock Award Agreement (filed as Exhibit 10.3 to the Company's Current Report on Form 8-K filed with the SEC on December 18, 2013 and incorporated herein by reference).\*
- 10.31 Stock Ownership Guidelines for Directors and Executive Officers (filed as Exhibit 10.4 to the Company's Current Report on Form 8-K filed with the SEC on April 4, 2013 and incorporated herein by reference).\*
- 10.32 Form of Award Letter (Fiscal 2012) under Farmer Bros. Co. 2005 Incentive Compensation Plan (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on September 24, 2012 and incorporated herein by reference).\*
- 10.33 Form of Target Award Notification Letter (Fiscal 2013) under Farmer Bros. Co. 2005 Incentive Compensation Plan (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on September 28, 2012 and incorporated herein by reference).\*

- 10.34 Form of Award Letter (Fiscal 2013) under Farmer Bros. Co. 2005 Incentive Compensation Plan (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on October 15, 2013 and incorporated herein by reference).\*
- 10.35 Form of Target Award Notification Letter (Fiscal 2014) under Farmer Bros. Co. 2005 Incentive Compensation Plan (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the SEC on October 15, 2013 and incorporated herein by reference).\*
- 10.36 Form of Change in Control Severance Agreement for Executive Officers of the Company (with schedule of executive officers attached) (filed as Exhibit 10.6 to the Company's Current Report on Form 8-K filed with the SEC on April 4, 2013 and incorporated herein by reference).\*



- 10.37 Form of Indemnification Agreement for Directors and Officers of the Company, as adopted on December 5, 2013 (with schedule of indemnitees attached) (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on December 11, 2013 and incorporated herein by reference).\*
- 31.1 Principal Executive Officer Certification Pursuant to Securities Exchange Act Rules 13a-14 and 15d-14 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
- 31.2 Principal Financial and Accounting Officer Certification Pursuant to Securities Exchange Act Rules 13a-14 and 15d-14 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
- 32.1 Principal Executive Officer Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).
- 32.2 Principal Financial and Accounting Officer Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).
- 101 The following financial statements from the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2013, formatted in eXtensible Business Reporting Language: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations, (iii) Consolidated Statements of Comprehensive Income (Loss), (iv) Consolidated Statements of Cash Flows and (v) Notes to Consolidated Financial Statements (furnished herewith).

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\* Management contract or compensatory plan or arrangement.