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CALLOWAYS NURSERY INC  
Form 10-Q  
February 12, 2001

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended December 31, 2000

Commission File No. 0-19305

CALLOWAY'S NURSERY, INC.  
(Exact name of registrant as specified in its charter)

Texas  
(State or other jurisdiction of  
incorporation or organization)

75-2092519  
(IRS Employer  
Identification Number)

4200 Airport Freeway  
Fort Worth, Texas 76117-6200  
817.222.1122

(Address, including zip code, of principal executive  
offices and 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 [X]                      NO [ ]

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Title                                   | Shares Outstanding as<br>of February 9, 2001 |
|---|--|
| -----                                   | -----  |
| Common Stock, par value \$.01 per share | 6,071,348                                    |

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CALLOWAY'S NURSERY, INC.

FORM 10-Q

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DECEMBER 31, 2000

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### FORWARD-LOOKING STATEMENTS OR INFORMATION

This Form 10-Q Report contains forward-looking statements. We are including this statement for the express purpose of providing Calloway's the protections of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 with respect to all forward-looking statements. Several important factors, in addition to the specific factors discussed in connection with such forward-looking statements individually, could affect future results and could cause those results to differ materially from those expressed in the forward-looking statements contained in this Report.

Our expected future results, products and service performance or other non-historical facts are forward-looking and reflect our current perspective of existing trends and information. These statements involve risks and uncertainties that cannot be predicted or quantified and, consequently, actual results may differ materially from those expressed or implied by such forward-looking statements. Such risks and uncertainties include, among others, the seasonality of our business, geographic concentration, the impact of weather and other growing conditions, the ability to manage growth, the impact of

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competition, the ability to obtain future financing, government regulations, market risks associated with variable-rate debt, and other risks and uncertainties defined from time to time in our Securities and Exchange Commission filings.

Therefore, each reader of this report is cautioned to consider carefully these factors as well as the specific factors discussed with each forward-looking statement in this Report and disclosed in our filings with the Securities and Exchange Commission as such factors, in some cases, have affected, and in the future (together with other factors) could affect, our ability to implement our business strategy and may cause actual results to differ materially from those contemplated by the statements expressed in this Report.

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PART 1. FINANCIAL INFORMATION  
ITEM 1. FINANCIAL STATEMENTS

CALLOWAY'S NURSERY, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)  
(IN THOUSANDS)

|  | ASSETS                               |                       |                      |
|--|--------------------------------------|-----------------------|----------------------|
|  | DECEMBER 31,<br>2000                 | SEPTEMBER 30,<br>2000 | DECEMBER 31,<br>2000 |
| Cash and cash equivalents  | \$ 261                               | \$ 413                | \$                   |
| Accounts receivable  | 907                                  | 1,068                 |                      |
| Inventories  | 11,548                               | 11,932                |                      |
| Prepays and other assets   | 202                                  | 316                   |                      |
|  | 12,918                               | 13,729                |                      |
| Total current assets   |                                      |                       |                      |
| Property and equipment, net                                      | 14,848                               | 14,865                |                      |
| Goodwill, net  | 821                                  | 848                   |                      |
| Deferred income taxes  | 1,406                                | 1,348                 |                      |
| Other assets   | 271                                  | 187                   |                      |
|  | \$ 30,264                            | \$ 30,977             | \$                   |
|  | 30,264                               | 30,977                | 30,977               |
|  | LIABILITIES AND SHAREHOLDERS' EQUITY |                       |                      |
| Accounts payable   | \$ 3,184                             | \$ 4,001              | \$                   |
| Accrued expenses   | 2,910                                | 3,440                 |                      |
| Notes payable, current   | 543                                  | 55                    |                      |
| Current portion of long-term debt                                | 715                                  | 555                   |                      |
| Deferred income taxes, current                                   | 59                                   | 118                   |                      |
|  | 7,411                                | 8,169                 |                      |
| Total current liabilities  |                                      |                       |                      |
| Deferred rent payable  | 1,005                                | 1,056                 |                      |
| Long-term debt, net of current portion                           | 10,106                               | 9,870                 |                      |
|  | 18,522                               | 19,095                |                      |
|  | 18,522                               | 19,095                | 19,095               |
| Commitments and contingencies                                    |                                      |                       |                      |
| Non-voting preferred stock, with mandatory redemption provisions | 1,949                                | 1,877                 |                      |

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|  |           |           |       |
|--|-----------|-----------|-------|
| Shareholders' equity:                      |           |           |       |
| Voting convertible preferred stock         | --        | --        |       |
| Preferred stock                            | --        | --        |       |
| Common stock                               | 62        | 62        |       |
| Additional paid-in capital                 | 9,379     | 9,288     |       |
| Retained earnings                          | 1,748     | 2,051     |       |
|  | -----     | -----     | ----- |
|  | 11,189    | 11,401    |       |
| Less: Treasury stock, at cost              | (1,396)   | (1,396)   |       |
|  | -----     | -----     | ----- |
| Total shareholders' equity                 | 9,793     | 10,005    |       |
|  | -----     | -----     | ----- |
| Total liabilities and shareholders' equity | \$ 30,264 | \$ 30,977 | \$    |
|  | =====     | =====     | ===== |

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

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CALLOWAY'S NURSERY, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)  
(AMOUNTS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

|  | THREE MONTHS ENDED<br>DECEMBER 31, |           |
|--|------------------------------------|-----------|
|  | 2000                               | 1999      |
|  | -----                              | -----     |
| Net sales                                    | \$ 11,153                          | \$ 12,980 |
| Cost of goods sold                           | 6,041                              | 7,035     |
|  | -----                              | -----     |
| Gross profit                                 | 5,112                              | 5,945     |
|  | -----                              | -----     |
| Operating expenses                           | 3,744                              | 4,678     |
| Occupancy expenses                           | 778                                | 772       |
| Advertising expenses                         | 447                                | 383       |
| Depreciation and amortization                | 237                                | 209       |
| Interest expense                             | 259                                | 228       |
| Interest income                              | (5)                                | (5)       |
|  | -----                              | -----     |
| Total expenses                               | 5,460                              | 6,265     |
|  | -----                              | -----     |
| Loss before income taxes                     | (348)                              | (320)     |
| Income tax benefit                           | (117)                              | (93)      |
|  | -----                              | -----     |
| Net loss                                     | (231)                              | (227)     |
| Accretion of preferred stock                 | (72)                               | (61)      |
| Retirement of preferred stock                | --                                 | 115       |
|  | -----                              | -----     |
| Net loss attributable to common shareholders | \$ (303)                           | \$ (173)  |
|  | =====                              | =====     |

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|  |       |       |       |       |
|--|-------|-------|-------|-------|
| Weighted average number of common shares outstanding |       |       |       |       |
| Basic  | 6,010 |       | 5,715 |       |
| Diluted  | 6,010 |       | 5,715 |       |
| Net loss per common share                            |       |       |       |       |
| Basic  | \$    | (.05) | \$    | (.03) |
| Diluted  | \$    | (.05) | \$    | (.03) |

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

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CALLOWAY'S NURSERY, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)  
(IN THOUSANDS)

|  | THREE MONTHS ENDED<br>DECEMBER 31, |         |    |       |
|--|------------------------------------|---------|----|-------|
|  | 2000                               | 1999    |    |       |
|  | -----                              | -----   |    |       |
| Cash flows from operating activities:  |                                    |         |    |       |
| Net loss   | \$                                 | (231)   | \$ | (     |
| Adjustments to reconcile net loss to net cash provided by (used for) operating activities: |                                    |         |    |       |
| Depreciation and amortization  |                                    | 237     |    |       |
| Net change in operating assets and liabilities   |                                    | (940)   |    |       |
|  |                                    | -----   |    | ----- |
| Net cash provided by (used for) operating activities                                       |                                    | (934)   |    |       |
|  |                                    | -----   |    | ----- |
| Cash flows from investing activities:  |                                    |         |    |       |
| Additions to property and equipment  |                                    | (193)   |    | (     |
|  |                                    | -----   |    | ----- |
| Net cash used for investing activities   |                                    | (193)   |    | (     |
|  |                                    | -----   |    | ----- |
| Cash flows from financing activities:  |                                    |         |    |       |
| Proceeds from issuance of common stock   |                                    | 91      |    |       |
| Retirement of preferred stock  |                                    | --      |    | (     |
| Borrowings on debt   |                                    | 4,240   |    |       |
| Repayments of debt   |                                    | (3,356) |    | (     |
|  |                                    | -----   |    | ----- |
| Net cash provided by (used for) financing activities                                       |                                    | 975     |    | (     |
|  |                                    | -----   |    | ----- |
| Net decrease in cash and cash equivalents  |                                    | (152)   |    |       |
| Cash and cash equivalents at beginning of period   |                                    | 413     |    |       |
|  |                                    | -----   |    | ----- |

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Cash and cash equivalents at end of period \$ 261 \$

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

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### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

#### 1. BASIS OF PRESENTATION

These interim unaudited consolidated financial statements were prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). In management's opinion, all adjustments considered necessary for a fair presentation of the financial position at December 31, 2000, and the results of operations and cash flows for the three-month periods ended December 31, 2000 and 1999 have been made. Such adjustments are of a normal recurring nature.

Because of seasonal and other factors, the results of operations and cash flows for the three-month period ended December 31, 2000 are not necessarily indicative of expected results of operations and cash flows for the fiscal year ending September 30, 2001.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the SEC rules and regulations referred to above. Accordingly, these financial statements should be read in conjunction with the audited financial statements and related notes for the fiscal year ended September 30, 2000 included in the Form 10-K covering such period.

#### 2. RECLASSIFICATIONS

Certain amounts for fiscal 2000 have been reclassified to conform to the fiscal 2001 presentation.

#### 3. INVENTORIES

Inventories consist of the following (amounts in thousands):

|                 | December 31,<br>2000 | September 30,<br>2000 | December 31,<br>1999 |
|-----------------|----------------------|-----------------------|----------------------|
|                 | -----                | -----                 | -----                |
| Finished goods  | \$ 4,305             | \$ 4,757              | \$ 3,136             |
| Work in process | 6,850                | 6,817                 | 5,280                |
| Supplies        | 393                  | 358                   | 401                  |
|                 | -----                | -----                 | -----                |
|                 | \$ 11,548            | \$ 11,932             | \$ 8,817             |
|                 | =====                | =====                 | =====                |

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## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

### 4. SEGMENT INFORMATION

The Company has two reportable segments: (i) Retail, and (ii) Growing and Wholesale.

The following is a tabulation of business segment information as of and for the three-month periods ended December 31, 2000 and 1999. Intersegment elimination information is included to reconcile segment data to the condensed consolidated financial statements. Amounts are in thousands:

|   | Three month<br>period ended<br>December 31,<br>2000 | Three month<br>period ended<br>December 31,<br>1999 |
|---|---|---|
|   | -----   | -----   |
| REVENUES  |   |   |
| From external customers                           |   |   |
| Retail  | \$ 9,855  | \$ 10,889   |
| Growing and Wholesale                             | 1,298   | 2,091   |
|   | -----   | -----   |
| Totals  | 11,153  | 12,980  |
|   | -----   | -----   |
| From other operating segments                     |   |   |
| Retail  | --  | --  |
| Growing and Wholesale                             | 221   | 479   |
|   | -----   | -----   |
| Totals  | 221   | 479   |
| Elimination of intersegment sales                 | (221)   | (479)   |
|   | -----   | -----   |
| Total consolidated net sales                      | \$ 11,153   | \$ 12,980   |
|   | =====   | =====   |
| INCOME (LOSS) BEFORE INCOME TAXES                 |   |   |
| Retail  | \$ (275)  | \$ 157  |
| Growing and Wholesale                             | (98)  | (394)   |
|   | -----   | -----   |
| Totals  | (373)   | (237)   |
| Recognition (elimination) of intersegment profits | 25  | (83)  |
|   | -----   | -----   |
| Total consolidated loss before income taxes       | \$ (348)  | \$ (320)  |
|   | =====   | =====   |
|   | -----   | -----   |
|   | December 31,<br>2000                                | December 31,<br>1999                                |
|   | -----   | -----   |
| TOTAL ASSETS                                      |   |   |
| Retail  | \$ 19,492   | \$ 17,487   |
| Growing and Wholesale                             | 10,772  | 8,905   |
|   | -----   | -----   |
| Totals  | \$ 30,264   | \$ 26,392   |

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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RESULTS OF OPERATIONS AND FINANCIAL CONDITION  
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INTRODUCTION

In September 1999 we completed the acquisition of Cornelius Nurseries, Inc. and affiliated companies (the "Cornelius Acquisition"). The quarters ended December 31, 2000 and 1999 include the results of operations of the Cornelius Acquisition.

(Amounts in millions, except per share a

| First quarter highlights (unaudited)         | Fiscal 2001 | Fiscal 2000 |
|--|-------------|-------------|
| Consolidated net sales                       | 11.2        | 13.0        |
| Retail segment sales                         | 9.9         | 10.9        |
| Wholesale and growing segment sales          | 1.5         | 2.6         |
| Less: internal sales                         | (.2)        | (.5)        |
| Sales increase (decrease)                    | (14%)       | 137%        |
| Same-store sales increase (decrease)         | (11%)       | 17%         |
| Number of retail stores (end of quarter)     | 20          | 20          |
| Gross profit margin                          | 46%         | 46%         |
| Loss before income taxes                     | (.3)        | (.3)        |
| Net loss per share (basic and diluted)       | (.05)       | (.03)       |
| Cash flows provided by (used for) operations | (.9)        | .9          |
| Retail inventories                           | 3.7         | 2.7         |
| Growing and Wholesale inventories            | 7.8         | 6.1         |
| Current ratio                                | 1.76        | 1.46        |
| Property, plant and equipment (net)          | 14.8        | 14.1        |
| Long-term debt (including current portion)   | 10.8        | 9.6         |

Quarter Ended December 31, 2000 Compared with Quarter Ended December 31, 1999

The Company's operating results for its first fiscal quarter were about the same as the comparable quarter one year ago despite soft demand for nursery products.

Sales declined by 14%. Both the Retail and the Wholesale and Growing segments saw sales decline. Same-store sales (sixteen Calloway's stores in Dallas-Fort Worth and three Cornelius stores in Houston) declined 11%. The decline in Retail sales was primarily attributable to reduced consumer demand resulting from wet weather in the Company's market areas. The decline in Wholesale and Growing sales was partially related to the decline in Retail sales; in addition, the



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Company is changing the production and sales focus of its Turkey Creek Farms operation to produce a higher proportion of items suitable for sale to specialty garden centers, including the Company's own Calloway's and Cornelius Retail stores. Those items are currently Work In Process, and will become Finished Goods over the course of Fiscal 2001 and Fiscal 2002.

Gross margins remained about the same at 46%.

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Operating Expenses declined by 20%, from \$4.7 million to approximately \$3.7 million. Most of that decrease resulted from decreased labor and related costs, a direct result of management's program to consolidate administrative functions across the organization.

Advertising Expenses rose 17%, from \$383,000 to \$447,000 primarily due to increased newspaper advertising rates.

Occupancy Expenses were substantially unchanged at \$778,000 for the quarter. The Company did not open any new leased stores during fiscal 2000 (though it did open a new store for which the property is owned).

Depreciation and Amortization Expenses rose 13% from \$209,000 to \$237,000 as a result of capital additions (including one new retail store) completed and placed in service during fiscal 2000.

Interest Expense rose 14%, from \$228,000 to \$259,000 as a result of borrowings made during fiscal 2000 to construct a retail store and to refinance certain long-term debt.

During the first quarter of fiscal 2000 there was a Retirement of Preferred Stock that resulted in a credit of \$115,000 that was included in Net Loss Attributable to Common Shareholders. There was not a comparable transaction for the first quarter for fiscal 2001, but there was a charge for Accretion of Preferred Stock in both quarters, as there will be for each quarter until the Preferred Stock is retired. These charges for Accretion of Preferred Stock and credits for Retirement of Preferred Stock account for the difference between Net Loss and Net Loss Attributable to Common Shareholders in each of the quarters ended December 31, 2000 and 1999, respectively.

Inventories rose 31%, from \$8.8 million at December 31, 1999 to \$11.5 million at December 31, 2000. Retail inventories rose 37% and Wholesale and Growing inventories rose 28%. The increase in Retail inventories was primarily attributable to the continued addition of new items to existing product lines. Such new items are introduced to provide higher gross margins and the potential for increased sales. The increase in Wholesale and Growing inventories was primarily attributable to a proportional increase in the quantity of merchandise produced at the Turkey Creek Farms operation that are suitable for sale to specialty garden centers, including the Company's own Calloway's and Cornelius Retail stores. Such items are expected to be more profitable to produce and sell than the items they replaced. Those items are currently Work In Process, and will become Finished Goods over the course of Fiscal 2001 and Fiscal 2002.

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CAPITAL RESOURCES AND LIQUIDITY  
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Cash Flows Used For Operating Activities were approximately \$934,000, compared to Cash Flows Provided By Operating Activities of approximately \$916,000 for the

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comparable period in fiscal 2000. The primary cause of the difference was the payment of approximately \$1.4 million in estimated Federal Income Tax during the period based on the taxable income for fiscal 2000. There was no such payment during fiscal 2000 due to the existence of Net Operating Loss Carryforwards, which have now been substantially used.

Cash flows Used For Investing Activities of approximately \$193,000 were below the \$376,000 for the comparable quarter in fiscal 2000. There was no store construction activity during the fiscal 2001 quarter, while the first quarter of fiscal 2000 saw construction work beginning on a new retail store that eventually opened in April 2000.

Cash flows Provided By Financing Activities totaled approximately \$975,000 for the quarter, compared to Cash Flows Used for Financing Activities of approximately \$551,000 for the comparable quarter one year ago.

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During the first quarter of fiscal 2001 the Company entered into two notes payable totaling approximately \$3.8 million. One of the two notes was for approximately \$2.6 million, and it refinanced approximately \$2.5 million of a separate real estate note payable, reducing the balance from approximately \$4.5 million to approximately \$2.0 million, extending the maturity date, and providing a fixed interest rate instead of a variable interest rate. The second note payable was for approximately \$1.2 million, and it replaced a construction loan of approximately \$0.8 million, extending the maturity date and providing a fixed interest rate instead of a variable interest rate.

During the first quarter of fiscal 2001 the Company made net borrowings of approximately \$488,000 under its revolving line of credit arrangement, compared to net repayments of approximately \$463,000 for the comparable period in fiscal 2000. The Company uses the revolving line of credit for a few months each year to provide working capital during slower seasons.

We anticipate that cash flows from operations and our \$5,000,000 revolving line of credit arrangement will be sufficient to meet our working capital needs.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Calloway's is exposed to certain market risks, including fluctuations in interest rates. We do not enter into transactions designed to mitigate such market risks for trading or speculative purposes. As of December 31, 2000, we had no foreign exchange contracts and/or options outstanding.

We manage our interest rate risk by balancing (a) the amount of variable-rate long-term debt with (b) the amounts due under long-term leases, which typically have fixed rental payments that do not fluctuate with interest rate changes. For our variable-rate debt, interest rate changes generally do not affect the fair market value of such debt, but do impact future earnings and cash flows, assuming other factors are held constant.

At December 31, 2000 Calloway's had variable rate debt of \$9.5 million. In addition, we had future minimum lease payments under noncancellable operating leases of \$13.7 million. Holding other variables, such as debt levels, constant, a one percentage point increase in interest rates would be expected to have an estimated impact on pre-tax earnings and cash flows for next year of approximately \$95,000 for the variable-rate debt.

PART 2. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

None.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS.

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

None.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) Exhibits:

None.

(b) Reports on Form 8-K:

None.

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.

Dated: February 9, 2001

CALLOWAY'S NURSERY, INC.

By /s/ James C. Estill

-----  
James C. Estill, President and  
Chief Executive Officer

By /s/ Daniel G. Reynolds

-----  
Daniel G. Reynolds, Vice President  
and Chief Financial Officer

