MICHAELS STORES INC
Form 3
June 06, 2007

FORM 3

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

OMB APPROVAL

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INITIAL STATEMENT OF BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

(Print or Type Responses)

1. Name and Address of Reporting Person *
Â Cornell Brian C
(Last) (First) (Middle)

8000 BENT BRANCH DRIVE
(Street)

IRVING,Â TXÂ 75063
(City) (State) (Zip)

2. Date of Event Requiring Statement
(Month/Day/Year)
06/04/2007

3. Issuer Name **and** Ticker or Trading Symbol
MICHAELS STORES INC [N/A]

4. Relationship of Reporting Person(s) to Issuer
(Check all applicable)
_____ Director _____ 10% Owner
__X__ Officer (give title below) _____ Other (specify below)
Chief Executive Officer

5. If Amendment, Date Original Filed(Month/Day/Year)

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Beneficially Owned

1.Title of Security (Instr. 4)	2. Amount of Securities Beneficially Owned (Instr. 4)	3. Ownership Form: Direct (D) or Indirect (I) (Instr. 5)	4. Nature of Indirect Beneficial Ownership (Instr. 5)

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

SEC 1473 (7-02)

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Table II - Derivative Securities Beneficially Owned (*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 4)	2. Date Exercisable and Expiration Date (Month/Day/Year)		3. Title and Amount of Securities Underlying Derivative Security (Instr. 4)		4. Conversion or Exercise Price of Derivative Security	5. Ownership Form of Derivative Security: Direct (D) or Indirect (I) (Instr. 5)	6. Nature of Indirect Beneficial Ownership (Instr. 5)
	Date Exercisable	Expiration Date	Title	Amount or Number of Shares			

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
Cornell Brian C 8000 BENT BRANCH DRIVE IRVING,Â TXÂ 75063	Â	Â	Â Chief Executive Officer	Â

Signatures

/s/ Robert L. Estep, Attorney-in-Fact for Brian C. Cornell, Chief Executive Officer	06/06/2007
**Signature of Reporting Person	Date

Explanation of Responses:

No securities are beneficially owned

* If the form is filed by more than one reporting person, *see* Instruction 5(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

Â

Remarks:

NoÂ securitiesÂ wereÂ beneficiallyÂ ownedÂ onÂ theÂ commencementÂ ofÂ employment.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *See* Instruction 6 for procedure.

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—

230,385

Other long-term assets

29,297

3,525

129,848

(8,493
)

154,177

Intercompany receivable

38,559

—

586,588

(625,147
)

—

Investment in subsidiaries

1,251,408

—

—

(1,251,408
)

—

Total

$
1,619,611

$
34,648

$
1,478,490

$
(1,885,048
)

$
1,247,701

LIABILITIES AND EQUITY

Accounts payable

$
46,208

$
7,146

$
81,883

$
—

$
135,237

Accrued expenses

42,223

1,362

50,909

—

94,494

Current portion of long-term debt

22

—

375

—

397

Total current liabilities

88,453

8,508

133,167

—

230,128

Long-term debt

394,564

—

447

—

395,011

Intercompany payable

575,187

49,960

—

(625,147
)

—

Losses in excess of investment in subsidiaries

—

—

21,014

(21,014
)

—

Other long-term obligations

2,158

—

68,941

(8,493
)

62,606

Total Central Garden & Pet shareholders’ equity (deficit)

559,249

(24,527
)

1,254,921

(1,230,394
)

559,249

Noncontrolling interest

—

707

—

—

707

Total equity (deficit)

559,249

(23,820
)

1,254,921

(1,230,394
)

559,956

Total

$
1,619,611

$
34,648

$

1,478,490

$
(1,885,048
)

$
1,247,701

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CONSOLIDATING CONDENSED BALANCE SHEET
December 26, 2015
(in thousands)

	Parent	Non-Guarantor Subsidiaries	Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS					
Cash and cash equivalents	$918	$ 5,034	$3,054	$—	$ 9,006
Restricted cash	11,939	—	—	—	11,939
Short term investments	—	—	—	—	—
Accounts receivable, net	68,141	7,398	119,818	—	195,357
Inventories	128,587	17,253	270,618	—	416,458
Prepaid expenses and other	35,085	962	23,826	—	59,873
Total current assets	244,670	30,647	417,316	—	692,633
Land, buildings, improvements and equipment, net	49,227	3,787	110,934	—	163,948
Goodwill	—	—	209,089	—	209,089
Other long-term assets	54,866	3,540	89,198	(2,065)	145,539
Intercompany receivable	33,348	—	456,706	(490,054)	—
Investment in subsidiaries	1,092,134	—	—	(1,092,134)	—
Total	$1,474,245	$ 37,974	$1,283,243	$(1,584,253)	$ 1,211,209
LIABILITIES AND EQUITY					
Accounts payable	$51,305	$ 9,085	$68,701	$—	$ 129,091
Accrued expenses	41,384	1,520	46,143	—	89,047
Current portion of long-term debt	262	—	30	—	292
Total current liabilities	92,951	10,605	114,874	—	218,430
Long-term debt	435,835	—	58	—	435,893
Intercompany payable	444,900	45,154	—	(490,054)	—
Losses in excess of investment in subsidiaries	—	—	17,536	(17,536)	—
Other long-term obligations	2,159	—	57,911	(2,065)	58,005
Total Central Garden & Pet shareholders' equity (deficit)	498,400	(18,266)	1,092,864	(1,074,598)	498,400
Noncontrolling interest	—	481	—	—	481
Total equity (deficit)	498,400	(17,785)	1,092,864	(1,074,598)	498,881
Total	$1,474,245	$ 37,974	$1,283,243	$(1,584,253)	$ 1,211,209

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CONSOLIDATING CONDENSED BALANCE SHEET
September 24, 2016
(in thousands)

	Parent	Non-Guarantor Subsidiaries	Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS					
Cash and cash equivalents	$82,158	$ 9,695	$1,129	$—	$ 92,982
Restricted cash	10,910	—	—	—	10,910
Accounts receivable, net	59,617	5,156	136,378	—	201,151
Inventories	113,317	11,752	236,935	—	362,004
Prepaid expenses and other assets	20,978	817	25,964	—	47,759
Total current assets	286,980	27,420	400,406	—	714,806
Land, buildings, improvements and equipment, net	41,083	3,897	113,244	—	158,224
Goodwill	15,058	—	216,327	—	231,385
Other long-term assets	30,555	2,980	85,701	(11,458)	107,778
Intercompany receivable	32,778	—	567,374	(600,152)	—
Investment in subsidiaries	1,176,990	—	—	(1,176,990)	—
Total	$1,583,444	$ 34,297	$1,383,052	$(1,788,600)	$ 1,212,193
LIABILITIES AND EQUITY					
Accounts payable	$34,096	$ 3,953	$64,364	$—	$ 102,413
Accrued expenses and other liabilities	47,862	1,410	50,071	—	99,343
Current portion of long term debt	88	—	375	—	463
Total current liabilities	82,046	5,363	114,810	—	202,219
Long-term debt	394,364	—	442	—	394,806
Intercompany payable	553,964	46,188	—	(600,152)	—
Losses in excess of investment in subsidiaries	—	—	16,126	(16,126)	—
Other long-term obligations	56	—	71,983	(11,458)	60,581
Total Central Garden & Pet shareholders' equity (deficit)	553,014	(18,827)	1,179,691	(1,160,864)	553,014
Noncontrolling interest	—	1,573	—	—	1,573
Total equity (deficit)	553,014	(17,254)	1,179,691	(1,160,864)	554,587
Total	$1,583,444	$ 34,297	$1,383,052	$(1,788,600)	$ 1,212,193

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CONSOLIDATING CONDENSED STATEMENT OF CASH FLOWS
Three Months Ended December 24, 2016
(in thousands)

	Parent	Non-Guarantor Subsidiaries	Guarantor Subsidiaries	Eliminations	Consolidated
Net cash provided (used) by operating activities	$(27,540)	$ (4,428)	$ 22,731	$ (4,076)	$ (13,313)
Additions to property, plant and equipment	(1,831)	(110)	(11,027)	—	(12,968)
Payments to acquire companies, net of cash acquired	(60,042)	—	—	—	(60,042)
Proceeds from sale of business, facility and other assets	2	—	7,958	—	7,960
Change in restricted cash and cash equivalents	(71)	—	—	—	(71)
Investment in equity method investee	(2,000)	—	—	—	(2,000)
Other investing activities	(265)	—	—	—	(265)
Intercompany investing activities	(5,781)	—	(19,214)	24,995	—
Net cash used by investing activities	(69,988)	(110)	(22,283)	24,995	(67,386)
Repayments on revolving line of credit	(1,000)	—	—	—	(1,000)
Borrowings on revolving line of credit	1,000	—	—	—	1,000
Repayments of long-term debt	(66)	—	(8)	—	(74)
Excess tax benefits from stock-based awards	4,356	—	—	—	4,356
Repurchase of common stock	(7,913)	—	—	—	(7,913)
Distribution to parent	—	(4,076)	—	4,076	—
Distribution to noncontrolling interest	—	(1,018)	—	—	(1,018)
Payment of contingent consideration	—	—	(860)	—	(860)
Intercompany financing activities	21,223	3,772	—	(24,995)	—
Net cash provided (used) by financing activities	17,600	(1,322)	(868)	(20,919)	(5,509)
Effect of exchange rates on cash	(458)	162	103	—	(193)
Net increase (decrease) in cash and cash equivalents	(80,386)	(5,698)	(317)	—	(86,401)
Cash and cash equivalents at beginning of period	82,158	9,695	1,129	—	92,982
Cash and cash equivalents at end of period	$1,772	$ 3,997	$ 812	$ —	$ 6,581

CONSOLIDATING CONDENSED STATEMENT OF CASH FLOWS
Three Months Ended December 26, 2015
(in thousands)

	Parent	Non-Guarantor Subsidiaries	Guarantor Subsidiaries	Eliminations	Consolidated
Net cash provided (used) by operating activities	$(19,914)	$ (1,065)	$ 25,382	$ (4,884)	$ (481)
Additions to property, plant and equipment	(707)	(226)	(4,323)	—	(5,256)
Payments to acquire companies, net of cash acquired	(68,529)	—	—	—	(68,529)
Change in restricted cash and cash equivalents	1,218	—	—	—	1,218
Other investing activities	(200)	—	—	—	(200)
Intercompany investing activities	(653)	—	(19,321)	19,974	—
Net cash used by investing activities	(68,871)	(226)	(23,644)	19,974	(72,767)
Repayments of long-term debt	(400,065)	—	(7)	—	(400,072)
Borrowings under revolving line of credit	79,000	—	—	—	79,000
Repayments on revolving line of credit	(37,000)	—	—	—	(37,000)
Issuance of long-term debt	400,000				400,000
Excess tax benefits from stock-based awards	900	—	—	—	900
Repurchase of common stock	(1,167)	—	—	—	(1,167)
Distribution to parent	—	(4,884)	—	4,884	—
Distribution to noncontrolling interest	—	(592)	—	—	(592)
Payment of financing costs	(6,324)				(6,324)
Intercompany financing activities	18,261	1,713	—	(19,974)	—
Net cash provided (used) by financing activities	53,605	(3,763)	(7)	(15,090)	34,745
Effect of exchange rates on cash	(182)	66	41	—	(75)
Net increase decrease in cash and cash equivalents	(35,362)	(4,988)	1,772	—	(38,578)
Cash and cash equivalents at beginning of year	36,280	10,022	1,282	—	47,584
Cash and cash equivalents at end of year	$918	$ 5,034	$ 3,054	$ —	$ 9,006

13. Contingencies

The Company may from time to time become involved in legal proceedings in the ordinary course of business. Currently, the Company is not a party to any legal proceedings that management believes would have a material effect on the Company’s financial position or results of operations.

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

Our Company

The Company is a leading innovator, marketer and producer, of quality branded products and distributor of third party products in the pet and lawn and garden supplies industries in the United States. The total pet food, treats and supplies industry in 2015 was estimated by Packaged Facts to have been approximately $50.8 billion in annual retail sales. We estimate the annual retail sales of the pet supplies and consumables and natural pet food markets in the categories in which we participate to be approximately $30.1 billion. The total lawn and garden consumables and decorative products industry in the United States is estimated to be approximately $25.0 billion in annual retail sales, including fertilizer, pesticides, growing media, seeds, mulch, other consumables and decorative products. We estimate the annual retail sales of the lawn and garden consumables and decorative products markets in the categories in which we participate to be approximately $17.6 billion.

Our pet supplies products include products for dogs and cats, including edible bones, premium healthy edible and non-edible chews, super premium dog and cat food and treats, toys, pet carriers, grooming supplies and other accessories; products for birds, small animals and specialty pets, including food, cages and habitats, toys, chews and related accessories; animal and household health and insect control products; live fish and products for fish, reptiles and other aquarium-based pets, including aquariums, furniture and lighting fixtures, pumps, filters, water conditioners, food and supplements, and information and knowledge resources; and products for horses and livestock. These products are sold under the brands including Adams™, Aqueon®, Avoderm®, Bio Spot Active Care™, Cadet®, Farnam®, Four Paws®, Kaytee®, Nylabone®, Pinnacle®, TFH™, Zilla® as well as a number of other brands including Altosid, Comfort Zone®, Coralife®, Interpet, Kent Marine®, Pet Select®, Super Pet®, and Zodiac®.

Our lawn and garden supplies products include proprietary and non-proprietary grass seed; wild bird feed, bird feeders, bird houses and other birding accessories; weed, grass, ant and other herbicide, insecticide and pesticide products; and decorative outdoor lifestyle products including pottery, trellises and other wood products. These products are sold under the brands AMDRO®, Ironite®, Pennington®, and Sevin®, as well as a number of other brand names including Lilly Miller®, Over-N-Out®, Smart Seed® and The Rebels®.

In fiscal 2016, our consolidated net sales were $1,829 million, of which our Pet segment, or Pet, accounted for approximately $1,082 million and our Garden segment, or Garden, accounted for approximately $747 million. In fiscal 2016, our operating income was $129 million consisting of income from our Pet segment of $120 million, income from our Garden segment of $70 million and corporate expenses of $61 million.

We were incorporated in Delaware in May 1992 as the successor to a California corporation that was formed in 1955. Our executive offices are located at 1340 Treat Boulevard, Suite 600, Walnut Creek, California 94597, and our telephone number is (925) 948-4000. Our website is www.central.com. The information on our website is not incorporated by reference in this annual report.

Recent Developments

Fiscal 2017 First Quarter Financial Performance:

- Net sales increased $59.7 million, or 16.6%, to $419.5 million from the prior year quarter. Pet segment sales increased $55.3 million, and Garden segment sales increased $4.4 million.
- Gross margin increased 110 basis points to 28.8% and gross profit increased $20.9 million, with both segments contributing to the increases.
- Selling, general & administrative expense increased $9.7 million to $100.7 million, but declined as a percentage of net sales as compared to the prior year quarter.
- Operating income improved $11.2 million from the prior year quarter, to $19.9 million in the first quarter of fiscal 2017. Adjusting for the gain on the sale of a distribution facility in the fiscal 2017 quarter, operating income increased $9.1 million.
- Our net income in the first quarter of fiscal 2017 was $7.6 million, or $0.15 per diluted share, compared to a net loss of $8.6 million, or $0.18 per diluted share, in the first quarter of fiscal 2016. Non-GAAP net income was $6.3 million,

or $0.12 per diluted share, adjusting for the gain on the sale of the distribution facility in the fiscal 2017 quarter, compared to $0.3 million, or $0.01 per diluted share in the first quarter of fiscal 2016,

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adjusting for the incremental expenses incurred in the prior year period for the refinancing of our $400 million Senior Subordinated Notes.

Segrest, Inc. Acquisition

In October 2016, we purchased Segrest Inc. for a purchase price of $60 million, of which $6 million is in an escrow account, payment of which is contingent upon future events. Segrest is the leading wholesaler of aquarium fish and is expected to strengthen our position in the aquatics category and provide the opportunity for synergies with our existing aquatics business.

Veterinary Products Business

In November 2016, we sold a small veterinary products division, which had sales of $8.6 million in fiscal 2016. The business was not profitable over the last several years.

Use of Non-GAAP Financial Measures

We report our financial results in accordance with U.S. generally accepted accounting principles (GAAP). However, to supplement the financial results prepared in accordance with GAAP, we use non-GAAP financial measures including non-GAAP operating income on a consolidated and segment basis and non-GAAP net income and diluted net income per share. Management believes these non-GAAP financial measures that exclude the impact of specific items (described below) may be useful to investors in their assessment of our ongoing operating performance and provide additional meaningful comparisons between current results and results in prior operating periods.

The reconciliations of these non-GAAP measures to the most directly comparable financial measures calculated and presented in accordance with GAAP are shown in the tables below. We believe that the non-GAAP financial measures provide useful information to investors and other users of our financial statements, by allowing for greater transparency in the review of our financial and operating performance. Management also uses these non-GAAP financial measures in making financial, operating and planning decisions and in evaluating our performance, and we believe these measures similarly may be useful to investors in evaluating our financial and operating performance and the trends in our business from management's point of view. While our management believes that non-GAAP measurements are useful supplemental information, such adjusted results are not intended to replace our GAAP financial results and should be read in conjunction with those GAAP results. We have not provided a reconciliation of non-GAAP guidance measures to the corresponding GAAP measures on a forward-looking basis, because such reconciliation cannot be done without unreasonable efforts due to the potential significant variability and limited visibility of the excluded items discussed below.

Non-GAAP financial measures reflect adjustments based on the following items:

- Gains or losses on disposals of significant plant assets: we have excluded the impact of gains or losses on the disposal of facilities as these represent infrequent transactions that impact comparability between operating periods. We believe the adjustment of these gains or losses supplements the GAAP information with a measure that may be used to help assess the sustainability of our continuing operating performance.
- Loss on early extinguishment of debt: we have excluded the charges associated with the refinancing of our 2018 Notes as the amount and frequency of such charges are not consistent and are significantly impacted by the timing and size of debt financing transactions.
- Tax impact: adjustment represents the impact of the tax effect of the pre-tax non-GAAP adjustments excluded from non-GAAP net income. The tax impact of the non-GAAP adjustments is calculated based on the consolidated effective tax rate on a GAAP basis, applied to the non-GAAP adjustments, unless the underlying item has a materially different tax treatment.
- We have also provided organic net sales, a non-GAAP measure that excludes the impact of businesses purchased or exited in the prior 12 months, because we believe it permits investors to better understand the performance of our historical business without the impact of recent acquisitions or dispositions.

From time to time in the future, there may be other items that we may exclude if we believe that doing so is consistent with the goal of providing useful information to investors and management.

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The non-GAAP adjustments reflect the following:

(1) During the first quarter of fiscal 2017, we recorded a $2.0 million gain in our Garden segment from the sale of a distribution facility resulting from rationalizing our facilities to reduce excess capacity. This adjustment was recorded as part of selling, general and administrative costs in the condensed consolidated statements of operations.

(2) During the first quarter of fiscal 2016, we redeemed our 2018 Notes and issued senior notes due November 2023. As a result of the redemption, we incurred incremental expenses of $14.3 million, comprised of a call premium payment of $8.3 million, a $2.7 million payment of overlapping interest expense for 30 days and a $3.3 million non-cash charge for the write off of unamortized deferred financing costs and discount related to the 2018 Notes. These amounts are included in Interest expense in the condensed consolidated statements of operations.

Operating Income Reconciliation		GAAP to Non-GAAP Reconciliation (in thousands) For the Three Months Ended December 24, 2016	December 26, 2015
GAAP operating income		$19,938	$ 8,773
Sale of distribution facility	(1)	(2,050)	—
Non-GAAP operating income		$17,888	$ 8,773
GAAP operating margin		4.8 %	2.4 %
Non-GAAP operating margin		4.3 %	2.4 %

Net Income and Diluted Net Income Per Share Reconciliation		GAAP to Non-GAAP Reconciliation (in thousands, except per share amounts) For the Three Months Ended December 24, 2016	December 26, 2015
GAAP net income (loss) attributable to Central Garden & Pet		$7,637	$ (8,602)
Sale of distribution facility	(1)	(2,050)	—
2018 notes redemption	(2)	—	14,339
Tax effects of non-GAAP adjustments		734	(5,394)
Total net income (loss) impact from non-GAAP adjustments		(1,316)	8,945
Non-GAAP net income attributable to Central Garden & Pet		$6,321	$ 343
GAAP diluted net income per share		$0.15	$ (0.18)
Non-GAAP diluted net income per share		$0.12	$ 0.01
Shares used in GAAP diluted net earnings per share calculation		51,810	48,566
Shares used in non-GAAP diluted net earnings per share calculation		51,810	50,684

Organic Net Sales Reconciliation

We have provided organic net sales, a non-GAAP measure that excludes the impact of recent acquisitions and dispositions, because we believe it permits investors to better understand the performance of our historical business.

We define organic net sales as net sales from our historical business derived by excluding the net sales from businesses acquired or exited in the preceding 12 months. After an acquired business has been part of our consolidated results for 12 months, the change in net sales thereafter is considered part of the increase or decrease in organic net sales.

Consolidated	GAAP to Non-GAAP Reconciliation (in thousands) For the Three Months Ended December 24, 2016	December 26, 2015	Percentage change	
Reported Net Sales - GAAP	$419.5	$ 359.8	16.6	%
Effect of acquisitions and divestitures	41.8	6.7		
Organic net sales	$377.7	$ 353.1	7.0	%

Pet Segment	GAAP to Non-GAAP Reconciliation (in thousands) For the Three Months Ended December 24, 2016	December 26, 2015	Percentage change	
Reported Net Sales - GAAP	$304.0	$ 248.7	22.2	%
Effect of acquisitions and divestitures	41.8	1.6		
Organic net sales	$262.2	$ 247.1	6.1	%

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Results of Operations
Three Months Ended December 24, 2016
Compared with Three Months Ended December 26, 2015
Net Sales
Net sales for the three months ended December 24, 2016 increased $59.7 million, or 16.6%, to $419.5 million from $359.8 million for the three months ended December 26, 2015. Our branded product sales increased $56.3 million, and sales of other manufacturers' products increased $3.4 million. After taking into account the impact of acquisitions and divestitures, organic net sales increased $24.6 million, or 7.0%, as compared to the fiscal 2016 quarter.
Pet net sales increased $55.3 million, or 22.2%, to $304.0 million for the three months ended December 24, 2016 from $248.7 million for the three months ended December 26, 2015. The increase in net sales was due to two recently acquired businesses which contributed $40.5 million and organic net sales growth of $15.1 million, primarily in our Dog & Cat category. Pet organic net sales increased 6.1%. Pet branded product sales increased $57.7 million, due primarily to the two recent acquisitions and, to a lesser extent, to the organic net sales growth noted above, partially offset by a $2.4 million decrease in sales of other manufacturers' products.
Garden net sales increased $4.4 million, or 4.0%, to $115.5 million for the three months ended December 24, 2016 from $111.1 million for the three months ended December 26, 2015. Garden branded product sales decreased $1.4 million, and sales of other manufacturers' products increased $5.8 million. The sales decrease in branded products was due primarily to a $5.2 million decrease caused by our exit from the holiday decor business in January 2016 partially offset by minor increases in most of the other garden categories in which we participate. The increase in sales of other manufacturer's products was due primarily to increased distribution.
Gross Profit
Gross profit for the three months ended December 24, 2016 increased $20.9 million, or 20.9%, to $120.7 million from $99.8 million for the three months ended December 26, 2015. While both our operating segments contributed to the increase in gross profit, the increase was primarily in the Pet segment due principally to the two most recent acquisitions, owned less than a year, and growth in our dog and cat category. Gross margin increased 110 basis points to 28.8% for the three months ended December 24, 2016 from 27.7% for the three months ended December 26, 2015. The increase was primarily driven by the improved gross margin in the Garden segment, although both segments contributed to the margin increase. In our Garden segment, improved gross margin was due primarily to lower input costs and a favorable product mix. In our Pet segment, the improved gross margin was due primarily to the favorable mix and our recent acquisition.
Selling, General and Administrative Expenses
Selling, general and administrative expenses increased $9.7 million, or 10.7%, to $100.7 million for the three months ended December 24, 2016 from $91.0 million for the three months ended December 26, 2015. As a percentage of net sales, selling, general and administrative expenses decreased to 24.0% for the three months ended December 24, 2016, compared to 25.3% in the comparable prior year quarter. Excluding a $2.0 million gain from the sale of a distribution facility, which is included within warehouse and administrative expenses, the increase in selling, general and administrative expenses would have been $11.8 million and as a percentage of net sales, selling, general and administrative expense would have been 24.5%. Increased expense in the Pet segment and at corporate in the quarter was partially offset by decreased expense in the Garden segment.
Selling and delivery expense increased $3.6 million, or 7.5%, to $50.5 million for the three months ended December 24, 2016 from $46.9 million for the three months ended December 26, 2015. The increase was in our Pet segment due to recent acquisitions and increased selling and delivery expense supporting the increase in sales. Although selling and delivery expense increased in dollar terms, they declined as a percentage of net sales.
Warehouse and administrative expense increased $6.1 million, or 14.1%, to $50.2 million for the quarter ended December 24, 2016 from $44.1 million for the quarter ended December 26, 2015. Excluding a $2.0 million gain from the sale of a distribution facility, warehouse and administrative expense increased $7.2 million. Increased expense in the Pet segment and at corporate was partially offset by decreased expense in the Garden segment. The increased expense was due primarily to recent acquisitions and facility transition costs in the Pet segment and increased

insurance related expense and equity

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compensation expense at corporate, partially offset by the gain on the sale of the distribution facility and reduced expense from the business exited in the prior year in the Garden segment. Corporate expenses are included within administrative expense and relate to the costs of unallocated executive, administrative, finance, legal, human resources, and information technology functions.

Operating Income

Operating income increased $11.1 million to $19.9 million for the three months ended December 24, 2016 from $8.8 million for the three months ended December 26, 2015. Increased sales of $59.7 million and an improved gross margin were partially offset by a $9.7 million increase in selling, general and administrative costs. Operating margin improved to 4.8% for the three months ended December 24, 2016 from 2.4% for the three months ended December 26, 2015 due to an improvement in gross margin and a decrease in selling, general and administrative expenses as a percentage of net sales. Excluding the gain resulting from the sale of a distribution facility, operating income increased $9.1 million and the operating margin was 4.3%.

Pet operating income increased $7.2 million, or 27.5%, to $33.4 million for the three months ended December 24, 2016 from $26.2 million for the three months ended December 26, 2015. The increase was due primarily to increased sales and an improved gross margin partially offset by increased selling, general and administrative expenses. Pet operating margin increased to 11.0% for the three months ended December 24, 2016 from 10.5% for the three months ended December 26, 2015 due to an improved gross margin and lower selling, general and administrative costs as a percentage of net sales.

Garden operating income increased $6.0 million to $2.7 million for the three months ended December 24, 2016 from an expense of $3.3 million for the three months ended December 26, 2015. The increase was due to increased sales and an improved gross margin aided by decreased selling, general and administrative expenses primarily due to lower input costs, a favorable product mix and the gain on the sale of a distribution facility.

Corporate operating expense increased $2.1 million to $16.2 million in the current year quarter from $14.1 million in the fiscal 2016 quarter due primarily to increased insurance related expenses and equity compensation expense.

Net Interest Expense

Net interest expense for the three months ended December 24, 2016 decreased $15.3 million, or 69.1%, to $6.8 million from $22.1 million for the three months ended December 26, 2015. In November 2015, we issued $400 million aggregate principal amount of 2023 Notes and replaced our outstanding 2018 Notes. As a result of our redemption of the 2018 Notes, we recognized incremental interest expense of approximately $14.3 million. Excluding the $14.3 million of incremental expense related to the issuance and redemption of our fixed rate debt in the fiscal 2016 quarter, interest expense decreased $1.0 million to $6.8 million from $7.8 million in the comparable prior year quarter. The decrease was due principally to the lower interest rate on our 2023 Notes.

Debt outstanding on December 24, 2016 was $395.4 million compared to $436.2 million as of December 26, 2015. Our average borrowing rate for the current quarter decreased to 6.3% from 7.2% for the prior year quarter.

Other Expense

Other expense is comprised of income from investments accounted for under the equity method of accounting and foreign currency exchange gains and losses. Other expense increased $0.5 million to $1.0 million for the quarter ended December 24, 2016, from $0.5 million for the quarter ended December 26, 2015 due primarily to equity method losses and related expenses.

Income Taxes

Our effective income tax rate was 35.8% for the quarter ended December 24, 2016 and 37.6% for the quarter ended December 26, 2015. The decrease in the income tax rate was due primarily to projected additional tax incentives in the current year.

Inflation

Our revenues and margins are dependent on various economic factors, including rates of inflation, energy costs, consumer attitudes toward discretionary spending, currency fluctuations, and other macro-economic factors which may impact levels of consumer spending. In certain fiscal periods, we have been adversely impacted by rising input costs related to inflation, particularly relating to grain and seed prices, fuel prices and the ingredients used in our garden controls and fertilizer. Rising costs in those periods have made it difficult for us to increase prices to our retail customers at a pace sufficient to enable us to maintain margins.

During fiscal years 2015 and 2016, commodity costs generally declined, but in past years we have been impacted by volatility in a number of commodities, including grass seed and wild bird feed grains. We continue to monitor commodity prices in order to be in a position to take action to mitigate the impact of increasing raw material costs.

Weather and Seasonality

Our sales of lawn and garden products are influenced by weather and climate conditions in the different markets we serve. Additionally, our Garden segment’s business is highly seasonal. In fiscal 2016, approximately 66% of our Garden segment’s net sales and 58% of our total net sales occurred during our second and third fiscal quarters. Substantially all of the Garden segment’s operating income is typically generated in this period, which has historically offset the operating loss incurred during the first fiscal quarter of the year.

Liquidity and Capital Resources

We have financed our growth through a combination of internally generated funds, bank borrowings, supplier credit, and sales of equity and debt securities to the public.

Our business is seasonal and our working capital requirements and capital resources track closely to this seasonal pattern. Generally, during the first fiscal quarter, accounts receivable reach their lowest level while inventory, accounts payable and short-term borrowings begin to increase. During the second fiscal quarter, receivables, accounts payable and short-term borrowings increase, reflecting the build-up of inventory and related payables in anticipation of the peak lawn and garden selling season. During the third fiscal quarter, inventory levels remain relatively constant while accounts receivable peak and short-term borrowings start to decline as cash collections are received during the peak selling season. During the fourth fiscal quarter, inventory levels are at their lowest, and accounts receivable and payables are substantially reduced through conversion of receivables to cash.

We service two broad markets: pet supplies and lawn and garden supplies. Our pet supplies businesses primarily involve products that have a year round selling cycle with a slight degree of seasonality. As a result, it is not necessary to maintain large quantities of inventory to meet peak demands. Our lawn and garden businesses are highly seasonal with approximately 66% of our Garden segment’s net sales occurring during the second and third fiscal quarters. This seasonality requires the shipment of large quantities of product well ahead of the peak consumer buying periods. To encourage retailers and distributors to stock large quantities of inventory, industry practice has been for manufacturers to give extended credit terms and/or promotional discounts.

Operating Activities

Net cash used by operating activities increased by $12.8 million, from $0.5 million for the three months ended December 26, 2015, to $13.3 million for the three months ended December 24, 2016. The increase in cash used was due primarily to a decrease in cash flow from working capital accounts for the period ended December 24, 2016, primarily receivables and inventory, as compared to the prior year period. We have begun our seasonal inventory build for the upcoming garden season and remain focused on maintaining high fill rates and service levels to our customers.

Investing Activities

Net cash used in investing activities decreased $5.4 million, from $72.8 million for the three months ended December 26, 2015 to $67.4 million during the three months ended December 24, 2016. The decrease in cash used in investing activities was due primarily to decreased acquisition activity in the current year compared to the prior year, as well as an increase in proceeds from the sale of a small veterinary division and a distribution facility in our Garden segment during the first fiscal quarter of 2017. In October 2016, we acquired Segrest Inc., a wholesaler of aquarium fish, for a purchase price of $60 million, of which $6 million is in an escrow account managed by an independent trustee and is payable in the future contingent upon future events. We made two acquisitions during the first fiscal quarter of 2016. On September 30, 2015, we acquired Hydro-Organics Wholesale Inc., an organic fertilizer company, for approximately $7.8 million cash and approximately $2.6 million of estimated contingent future performance-based payments. In December 2015, we purchased the pet bedding business and certain other assets of DMC for approximately $61 million. The decreased acquisition activity in the current year period was partially offset by an increase in capital expenditures of approximately $7.7 million in the current year period compared to the prior year period.

Financing Activities

Net cash used by financing activities increased $40.3 million, from $34.7 million of cash provided by financing activities for the three months ended December 26, 2015, to $5.5 million of cash used for the three months ended December 24, 2016. The increase in cash used by financing activities was due primarily to lower net borrowings under our asset backed loan facility in the current year period compared to the prior year period, as well as an increase in taxes paid for shares withheld in connection with the net share settlement of vested restricted stock and exercised options. These uses of cash were partially offset by the payment of financing costs associated with the issuance of our 2023 Notes, subsequent redemption of our 2018 Notes and amendment of our asset backed loan facility during the three months ended December 26, 2015, as well as an increase in cash flows from excess tax benefits from stock based awards due to the increase in stock option exercise activity during the current year period.

We expect that our principal sources of funds will be cash generated from our operations and, if necessary, borrowings under our $400 million asset backed loan facility. Based on our anticipated cash needs, availability under our asset backed loan facility and the scheduled maturity of our debt, we believe that our sources of liquidity should be adequate to meet our working capital, capital spending and other cash needs for at least the next 12 months. However, we cannot assure you that these sources will continue to provide us with sufficient liquidity and, should we require it, that we will be able to obtain financing on terms satisfactory to us, or at all.

We believe that cash flows from operating activities, funds available under our asset backed loan facility, and arrangements with suppliers will be adequate to fund our presently anticipated working capital and capital expenditure requirements for the foreseeable future. We anticipate that our capital expenditures, which are related primarily to replacements and expansion of and upgrades to plant and equipment and also investment in our continued implementation of a scalable enterprise-wide information technology platform, will be approximately $40 million to $45 million over the next 12 months.

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

At December 24, 2016, our total debt outstanding was $395.4 million, as compared with $436.2 million at December 26, 2015.

Senior Notes and Redemption of Senior Subordinated Notes

On November 2015, we issued $400 million aggregate principal amount of 6.125% senior notes due November 2023. In December 2015, we used the net proceeds from the offering, together with available cash, to redeem our $400 million aggregate principal amount of 8.25% senior subordinated notes due March 1, 2018 at a price of 102.063% of

the principal amount and to pay fees and expenses related to the offering.
We incurred approximately $6.3 million of debt issuance costs in conjunction with these transactions, which included underwriter fees and legal, accounting and rating agency expenses. The debt issuance costs will be amortized over the term of the 2023 Notes.

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As a result of our redemption of the 2018 Notes, we incurred a call premium payment of $8.3 million, overlapping interest expense for 30 days of approximately $2.7 million and a $3.3 million non-cash charge for the write off of unamortized deferred financing costs and discount related to the 2018 Notes. These amounts are included in interest expense in the consolidated statements of operations.

The 2023 Notes require semiannual interest payments, which commenced on May 15, 2016. The 2023 Notes are unconditionally guaranteed on a senior basis by each of our existing and future domestic restricted subsidiaries which are borrowers under or guarantors of our senior secured revolving credit facility. The 2023 Notes are unsecured senior obligations and are subordinated to all of our existing and future secured debt, including our Credit Facility, to the extent of the value of the collateral securing such indebtedness.

We may redeem some or all of the 2023 Notes at any time, at our option, prior to November 15, 2018 at the principal amount plus a “make whole” premium. At any time prior to November 15, 2018, we may also redeem, at our option, up to 35% of the original aggregate principal amount of the notes with the proceeds of certain equity offerings at a redemption price of 106.125% of the principal amount of the notes. We may redeem some or all of the 2023 Notes, at our option, at any time on or after November 15, 2018 for 104.594%, on or after November 15, 2019 for 103.063%, on or after November 15, 2020 for 101.531% and on or after November 15, 2021 for 100%, plus accrued and unpaid interest.

The holders of the 2023 Notes have the right to require us to repurchase all or a portion of the 2023 Notes at a purchase price equal to 101% of the principal amount of the notes repurchased, plus accrued and unpaid interest upon the occurrence of a change of control.

The 2023 Notes contain customary high yield covenants, including covenants limiting debt incurrence and restricted payments, subject to certain baskets and exceptions. We were in compliance with all covenants as of December 24, 2016.

Asset-Based Loan Facility Amendment

In April 2016, we entered into an amended and restated credit agreement which provides up to a $400 million principal amount senior secured asset-based revolving credit facility, with up to an additional $200 million principal amount available with the consent of the Lenders if we exercise the accordion feature set forth therein (collectively, the “Amended Credit Facility”). The Amended Credit Facility matures on April 22, 2021. We may borrow, repay and reborrow amounts under the Amended Credit Facility until its maturity date, at which time all amounts outstanding under the Amended Credit Facility must be repaid in full. As of December 24, 2016, there were no borrowings outstanding and no letters of credit outstanding under the Amended Credit Facility. There were other letters of credit of $2.6 million outstanding as of December 24, 2016.

The Amended Credit Facility is subject to a borrowing base, calculated using a formula based upon eligible receivables and inventory, minus certain reserves and subject to restrictions. As of December 24, 2016, the borrowing base and remaining borrowing availability was $329.1 million. Borrowings under the Amended Credit Facility bear interest at an index based on LIBOR or, at the option of the Company, the Base Rate (defined as the highest of (a) the SunTrust prime rate, (b) the Federal Funds Rate plus 0.5% and (c) one-month LIBOR plus 1.00%), plus, in either case, an applicable margin based on our consolidated senior leverage ratio. Such applicable margin for LIBOR-based borrowings fluctuates between 1.25% - 1.5% and was 0.0% as of December 24, 2016, and such applicable margin for Base Rate borrowings fluctuates between 0.25% - 0.5% and was 0.0% as of December 24, 2016. As of December 24, 2016, the applicable interest rate related to Base Rate borrowings was 4.0%, and the applicable interest rate related to LIBOR-based borrowings was 2.0%.

We incurred approximately $1.2 million of debt issuance costs in conjunction with this transaction, which included underwriter fees, legal and accounting expenses. The debt issuance costs will be amortized over the term of the Amended Credit Facility.

The Amended Credit Facility contains customary covenants, including financial covenants which require us to maintain a minimum fixed charge coverage ratio of 1.00:1.00 upon reaching certain borrowing levels. The Amended Credit Facility is secured by substantially all of our assets. We were in compliance with all financial covenants under the Amended Credit Facility during the period ended December 24, 2016.

Off-Balance Sheet Arrangements

There have been no material changes to the information provided in our Annual Report on Form 10-K for the fiscal year ended September 24, 2016 regarding off-balance sheet arrangements.

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Contractual Obligations
There have been no material changes outside the ordinary course of business in our contractual obligations set forth in the Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources in our Annual Report on Form 10-K for the fiscal year ended September 24, 2016.
New Accounting Pronouncements
Refer to Footnote 1 in the notes to the condensed consolidated financial statements for new accounting pronouncements.
Critical Accounting Policies, Estimates and Judgments
There have been no material changes to our critical accounting policies, estimates and assumptions or the judgments affecting the application of those accounting policies since our Annual Report on Form 10-K for the fiscal year ended September 24, 2016.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There has been no material change in our exposure to market risk from that discussed in our Annual Report on Form 10 K for the fiscal year ended September 24, 2016.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures. Our Chief Executive Officer and principal financial officer have reviewed, as of the end of the period covered by this report, the "disclosure controls and procedures" (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) that ensure that information relating to the Company required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported in a timely and proper manner and that such information is accumulated and communicated to our management, including our Chief Executive Officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure. Based upon this review, such officers concluded that our disclosure controls and procedures were effective as of December 24, 2016.
(b) Changes in Internal Control Over Financial Reporting. Our management, with the participation of our Chief Executive Officer and our principal financial officer have evaluated whether any change in our internal control over financial reporting occurred during the first quarter of fiscal 2017. Based on that evaluation, management concluded that there has been no change in our internal control over financial reporting during the first quarter of fiscal 2017 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.
PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we are involved in certain legal proceedings in the ordinary course of business. Currently, we are not a party to any legal proceedings that management believes would have a material effect on our financial position or results of operations.

Item 1A. Risk Factors

There have been no material changes from the risk factors previously disclosed in Item 1A to Part I of our Form 10-K for the fiscal year ended September 24, 2016.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Explanation of Responses:

The following table sets forth the repurchases of any equity securities during the fiscal quarter ended December 24, 2016 and the dollar amount of authorized share repurchases remaining under our stock repurchase program.

Period	Total Number of Shares (or Units) Purchased		Average Price Paid per Share (or Units)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs (1)
September 25, 2016 - October 29, 2016	74,388	(2)	$ 24.48	—	$ 34,968,000
October 30, 2016 - November 26, 2016	463	(2)	$ 25.18	—	$ 34,968,000
November 27, 2016 - December 24, 2016	52,828	(2)	$ 28.02	—	$ 34,968,000
Total	127,679		$ 25.95	—	$ 34,968,000

(1) During the third quarter of fiscal 2011, our Board of Directors authorized a $100 million share repurchase program. The program has no expiration date and expires when the amount authorized has been used or the Board withdraws its authorization. The repurchase of shares may be limited by certain financial covenants in our credit facility and indenture that restrict our ability to repurchase our stock.

(2) Shares purchased during the period indicated represent withholding of a portion of shares to cover taxes in connection with the vesting of restricted stock.

Item 3. Defaults Upon Senior Securities

Not applicable

Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other Information

Not applicable

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Item 6. Exhibits

4.1	Fifth Supplemental Indenture, dated as of December 23, 2016, by and among the Company, certain guarantors named therein and Wells Fargo Bank, National Association, as trustee, relating to the 6.125% Senior Notes due 2023.
31.1	Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Acting Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350.
32.2	Certification of Acting Principal Financial Officer Pursuant to 18 U.S.C. Section 1350.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

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SIGNATURES

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

CENTRAL GARDEN & PET COMPANY
Registrant

Dated: February 2, 2017

/s/ GEORGE C. ROETH
George C. Roeth
President and Chief Executive Officer
(Principal Executive Officer)

/s/ HOWARD MACHEK
Howard Machek
Senior Vice President and Chief Accounting Officer
(Principal Financial Officer)