BACC 7101

Final Exam

Fall 2011

Name____

See the attached financial statements for Green Mountain Coffee Roasters, Inc. (GMCR).

Exercise 1

As of September 26, 2009, GMCR had reported $99,600,000 in Goodwill on its balance sheet. Based on your reading of the Notes to the Financial Statements, how much of this Goodwill is attributable to each acquisition the company has made?

Company Acquired	Goodwill
Total	$99,600,000

Exercise 2

In Note 5 to the Financial Statements, GMCR disclosed that the company had:

- $90,782,000 in green coffee purchase commitments
- $118,962,000 in fixed price brewer inventory purchase commitments and
- $91,602,000 in production raw materials commitments.

Calculate GMCR's Debt-Asset ratio as of September 26, 2009.

Recalculate GMCR's Debt-Asset ratio as if the above purchase commitments were capitalized on GMCR's balance sheet.

Exercise 3

See the excerpt provided from GMCR’s Note 9. Compute the following ratios for the two reportable segments in 2009:

	SCBU	Keurig
Total Asset Turnover		
Pretax Margin		

Which of the two segments is most profitable? How do you know?

Which of the two segments is most productive? How do you know?

Exercise 4

Compute GMCR's Debt-Asset Ratio for September 27, 2008 and September 26, 2009.

	September 27, 2008	September 26, 2009
Debt-Asset Ratio		

From information given in the attached financial statements, explain the primary reason for the change in GMCR's Debt-Asset Ratio.

Exercise 5

Read Note 13, and then explain, in your own words, why GMCR enters into coffee futures contracts. How do these contracts affect GMCR's net income trends? Cash flow trends?

Explain how the company accounts for changes in the market value of these contracts.

Exercise 6

In September 26, 2009, GMCR received a patent litigation settlement of $17,000,000. Show how this affected GMCR's Pretax Margin and Net Profit Margin

	Pretax Margin	Net Profit Margin
As reported on income statement		
Adjusting for patent litigation settlement		

GREEN MOUNTAIN COFFEE ROASTERS, INC.

CONSOLIDATED BALANCE SHEETS
(Dollars in thousands)

	September 26, 2009	September 27, 2008
Assets		
Current assets:		
Cash and cash equivalents	$241,811	$ 804
Restricted cash and cash equivalents	280	161
Short-term investments	50,000	—
Receivables, less uncollectible accounts and return allowances of $4,792 and $3,002 at September 26, 2009 and September 27, 2008, respectively	91,559	54,782
Inventories	137,294	85,311
Other current assets	6,706	4,886
Deferred income taxes, net	10,151	6,146
Total current assets	537,801	152,090
Fixed assets, net	135,981	97,678
Intangibles, net	36,478	29,396
Goodwill	99,600	73,953
Other long-term assets	3,979	4,531
Total assets	$813,839	$357,648
Liabilities and Stockholders' Equity		
Current liabilities:		
Current portion of long-term debt	$ 5,030	$ 33
Accounts payable	76,961	43,821
Accrued compensation costs	17,264	11,669
Accrued expenses	18,570	14,645
Income tax payable	2,971	2,079
Other short-term liabilities	3,257	673
Total current liabilities	124,053	72,920
Long-term debt	73,013	123,517
Deferred income taxes, net	26,599	21,691
Commitments and contingencies (See Notes 5 and 22)		
Stockholders' equity:		
Preferred stock, $0.10 par value: Authorized—1,000,000 shares; No shares issued or outstanding	—	—
Common stock, $0.10 par value: Authorized—60,000,000 shares; Issued—43,603,684 and 41,690,466 shares at September 26, 2009 and September 27, 2008, respectively	4,360	4,169
Additional paid-in capital	450,596	61,987
Retained earnings	137,162	81,280
Accumulated other comprehensive loss	(1,870)	(419)
ESOP unallocated shares, at cost—12,687 and 27,194 shares at September 26, 2009 and September 27, 2008, respectively	(74)	(161)
Treasury shares, at cost—0 and 5,208,993 shares at September 26, 2009 and September 27, 2008, respectively	—	(7,336)
Total stockholders' equity	590,174	139,520
Total liabilities and stockholders' equity	$813,839	$357,648

The accompanying Notes to Consolidated Financial Statements are an integral part of these financial statements.

GREEN MOUNTAIN COFFEE ROASTERS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollars in thousands except per share data)

	Fifty-two weeks ended September 26, 2009	Fifty-two weeks ended September 27, 2008	Fifty-two weeks ended September 29, 2007
Net sales	$ 803,045	$ 500,277	$ 341,651
Cost of sales	553,281	323,372	210,530
Gross profit	249,764	176,905	131,121
Selling and operating expenses	123,948	92,182	72,641
General and administrative expenses	47,103	39,032	30,293
Patent litigation (settlement) expense	(17,000)	3,279	488
Operating income	95,713	42,412	27,699
Other income (expense)	(662)	(235)	54
Interest expense	(4,693)	(5,705)	(6,176)
Income before income taxes	90,358	36,472	21,577
Income tax expense	(34,476)	(14,173)	(8,734)
Net income	$ 55,882	$ 22,299	$ 12,843
Basic income per share:			
Weighted average shares outstanding	37,993,196	35,924,697	34,875,647
Net income	$ 1.47	$ 0.62	$ 0.37
Diluted income per share:			
Weighted average shares outstanding	40,123,553	38,347,170	37,160,060
Net income	$ 1.39	$ 0.58	$ 0.35

The accompanying Notes to Consolidated Financial Statements are an integral part of these financial statements.

GREEN MOUNTAIN COFFEE ROASTERS, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
FOR EACH OF THE THREE YEARS IN THE PERIOD ENDED SEPTEMBER 26, 2009, (Dollars in thousands)

	Common stock		Additional paid-in capital	Retained earnings	Accumulated other compre-hensive (loss)	ESOP unallocated shares		Treasury stock		Stockholders' Equity
	Shares	Amount				Shares	Amount	Shares	Amount	
Balance at October 1, 2006	39,539,273	$3,953	$ 32,996	$ 46,138	$ (548)	(43,965)	$(263)	(5,208,993)	$(7,336)	$ 74,940
Options exercised	851,259	85	1,912							1,997
Issuance of common stock under employee stock purchase plan	127,642	13	1,113							1,126
Allocation of ESOP shares			145			9,039	55			200
Tax expense from allocation of ESOP shares			(59)							(59)
Stock compensation expense			4,552							4,552
Tax benefit from exercise of options			3,412							3,412
Deferred compensation expense			51							51
Other comprehensive income, net of tax					36					36
Net income	—	—	—	12,843	—	—	—	—	—	12,843
Balance at September 29, 2007	40,518,174	$4,051	$ 44,122	$ 58,981	$ (512)	(34,926)	$(208)	(5,208,993)	$(7,336)	$ 99,098
Options exercised	1,058,319	106	3,522							3,628
Issuance of common stock under employee stock purchase plan	113,973	12	2,014							2,026
Allocation of ESOP shares			153			7,732	47			200
Tax expense from allocation of ESOP shares			(61)							(61)
Stock compensation expense			6,348							6,348
Tax benefit from exercise of options			5,782							5,782
Deferred compensation expense			107							107
Other comprehensive income, net of tax					93					93
Net income	—	—	—	22,299	—	—	—	—	—	22,299
Balance at September 27, 2008	41,690,466	4,169	61,987	81,280	(419)	(27,194)	(161)	(5,208,993)	(7,336)	139,520
Options exercised	1,267,456	127	5,645							5,772
Issuance of common stock under employee stock purchase plan	104,755	10	2,468							2,478
Allocation of ESOP shares			912			14,507	87			999
Issuance of common stock for public equity offering	541,007	54	34,739							34,793
Issuance of common stock from treasury for public equity offering			327,664					5,208,993	7,336	335,000
Stock compensation expense			6,697							6,697
Tax benefit from exercise of options			10,362							10,362
Deferred compensation expense			122							122
Other comprehensive income, net of tax					(1,451)					(1,451)
Net income	—	—	—	55,882	—	—	—	—	—	55,882
Balance at September 26, 2009	43,603,684	$4,360	$450,596	$137,162	$(1,870)	(12,687)	$ (74)	—	$ —	$590,174

The accompanying Notes to Consolidated Financial Statements are an integral part of these financial statements.

GREEN MOUNTAIN COFFEE ROASTERS, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Dollars in thousands)

	Fifty-two weeks ended September 26, 2009	Fifty-two weeks ended September 27, 2008	Fifty-two weeks ended September 29, 2007
Net income	$55,882	$22,299	$12,843
Other comprehensive income, net of tax:			
Deferred (loss) gain on derivatives designated as cash flow hedges	(1,715)	87	10
Loss on derivatives designated as cash flow hedges reclassified to net income	264	6	26
Other comprehensive (loss) gain	(1,451)	93	36
Comprehensive income	$54,431	$22,392	$12,879

The accompanying Notes to Consolidated Financial Statements are an integral part of these financial statements.

GREEN MOUNTAIN COFFEE ROASTERS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)

	Fifty-two weeks ended September 26, 2009	Fifty-two weeks ended September 27, 2008	Fifty-two weeks ended September 29, 2007
Cash flows from operating activities:			
Net income	$ 55,882	$ 22,299	$ 12,843
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	17,987	13,500	10,328
Amortization of intangibles	5,318	4,812	4,811
Loss on disposal of fixed assets	679	201	133
Provision for doubtful accounts	243	1,159	620
Loss on futures derivatives	264	6	26
Tax expense from exercise of non-qualified options and disqualified dispositions of incentive stock options	(399)	(386)	105
Excess tax benefits from equity-based compensation plans	(10,761)	(6,168)	(3,307)
Tax expense from allocation of ESOP shares	(3)	(61)	(59)
Deferred income taxes	1,683	549	145
Deferred compensation and stock compensation	6,819	6,455	4,603
Contributions to the ESOP	1,000	200	200
Changes in assets and liabilities, net of effects of acquisition:			
Receivables	(37,020)	(16,568)	(9,922)
Inventories	(49,792)	(46,402)	(6,983)
Income tax payable	11,653	6,804	5,368
Other current assets	(1,850)	(1,882)	(141)
Other long-term assets, net	1,769	(660)	(52)
Accounts payable	25,834	8,667	8,969
Accrued compensation costs	5,595	4,642	291
Accrued expenses	3,597	4,779	1,856
Net cash provided by operating activities	38,498	1,946	29,834
Cash flows from investing activities:			
Acquisition of certain assets of Tully's Coffee Corporation	(41,361)	—	—
Purchases of short-term investments	(50,000)	—	—
Capital expenditures for fixed assets	(48,298)	(48,718)	(21,844)
Proceeds from disposal of fixed assets	162	407	187
Net cash used for investing activities	(139,497)	(48,311)	(21,657)
Cash flows from financing activities:			
Net change in revolving line of credit	(95,500)	33,500	(12,800)
Proceeds from issuance of common stock under compensation plans	8,253	5,653	3,123
Proceeds from issuance of common stock for public equity offering	386,688	—	—
Financing costs in connection with public equity offering	(16,895)	—	—
Excess tax benefits from equity-based compensation plans	10,761	6,168	3,307
Proceeds from borrowings of long-term debt	50,000	—	45
Deferred financing fees	(1,084)	(907)	—
Repayment of long-term debt	(217)	(63)	(100)
Net cash provided by (used for) financing activities	342,006	44,351	(6,425)
Net increase (decrease) in cash and cash equivalents	241,007	(2,014)	1,752
Cash and cash equivalents at beginning of period	804	2,818	1,066
Cash and cash equivalents at end of period	$ 241,811	$ 804	$ 2,818
Supplemental disclosures of cash flow information:			
Cash paid for interest	$ 5,118	$ 6,087	$ 6,654
Cash paid for income taxes	$ 20,368	$ 6,701	$ 3,184
Fixed asset purchases included in accounts payable and not disbursed at the end of each year	$ 12,509	$ 5,203	$ 7,827
Noncash financing activity:			
Debt assumed in conjunction with acquisition of certain assets of Tully's Coffee Corporation	$ 210	$ —	$ —

The accompanying Notes to Consolidated Financial Statements are an integral part of these financial statements.

GREEN MOUNTAIN COFFEE ROASTERS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Nature of Business and Organization

Green Mountain Coffee Roasters, Inc. (together with its subsidiaries, "the Company" or "GMCR, Inc.") is a leader in the specialty coffee and coffee maker businesses. Green Mountain Coffee Roasters, Inc. is a Delaware company.

The Company manages its operations through two business segments, Specialty Coffee business unit (SCBU) and Keurig business unit (Keurig).

SCBU sells whole bean and ground coffee selections, and K-Cups® in domestic wholesale and retail channels and directly to consumers. In addition, SCBU sells Keurig® single-cup brewing systems and other accessories directly to consumers and more recently to supermarkets.

Keurig is a pioneer and leading manufacturer of gourmet single-cup brewing systems and targets its premium patented single-cup brewing systems for consumers at home (AH) or away-from-home (AFH) mainly in North America. Keurig sells its AFH single-cup brewers to distributors for offices and its AH single-cup brewers to select retailers such as department stores and club stores. Keurig sells coffee, tea and cocoa in K-Cups produced by a variety of roasters, including SCBU, and related accessories to select retailers such as department stores and club stores and also directly to consumers. Keurig earns royalty income from the sale of K-Cups shipped by its licensed roasters.

The Company's fiscal year ends on the last Saturday in September. Fiscal 2009, 2008 and fiscal 2007 represent the years ended September 26, 2009, September 27, 2008, and September 29, 2007, respectively. Each of these fiscal years consists of 52 weeks.

2. Significant Accounting Policies

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the Company to make estimates and assumptions that affect amounts reported in the accompanying consolidated financial statements. Actual results could differ from those estimates.

Basis of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries. All intercompany transactions have been eliminated in consolidation.

Cash and cash equivalents

The Company considers all highly liquid investments purchased with a maturity of three months or less to be cash equivalents. Cash and cash equivalents include money market funds which are carried at cost, plus accrued interest, which approximates fair value. The Company does not believe that it is subject to any unusual credit or market risk.

Short-term Investments

Short-term investments consist of highly liquid investments, primarily certificates of deposit, with maturities over three months from the date of purchase. These assets are carried at cost, plus accrued interest, which approximates fair value due to the short maturity of these instruments.

Inventories

Inventories are stated at the lower of cost or market. Cost is being measured using an adjusted standard cost method which approximates FIFO (first-in first-out). The Company regularly reviews whether the realizable value of inventory is lower than its book value. If the valuation shows that the realizable value is lower than book value, a charge is taken to expense and directly reduces the value of the inventory.

The Company estimates its reserves for inventory obsolescence by examining its inventories on a quarterly basis to determine if there are indicators that the carrying values exceed net realizable value. Indicators that could result in additional inventory write downs include age of inventory, damaged inventory, slow moving products and products at the end of their life cycles. While management believes that the reserve for obsolete inventory is adequate, significant judgment is involved in determining the adequacy of this reserve.

Inventories consist primarily of green and roasted coffee, including coffee in portion packs, purchased finished goods such as coffee brewers and packaging materials.

Financial Instruments

The Company enters into various types of financial instruments in the normal course of business. Fair values are estimated based on assumptions concerning the amount and timing of estimated future cash flows and assumed discount rates reflecting varying degrees of perceived risk. Cash, cash equivalents, accounts receivable, accounts payable and accrued expenses are reported at carrying value and approximate fair value due to the short maturity of these instruments. Long-term debt is also reported at carrying value and approximates fair value due to the fact that the interest rate on the debt is based on variable interest rates (Libor or prime).

The fair value of short-term investments and derivative financial instruments have been determined using market information and valuation methodologies. Changes in assumptions or estimates could affect the determination of fair value, however, management does not believe any such changes would have a material impact on our financial condition, results of operations or cash flows. The fair values of short-term investments and derivative financial instruments are disclosed in Note 15.

Hedging Activities

The Company enters into coffee futures contracts to hedge against price increases in price-to-be-fixed coffee purchase commitments and anticipated coffee purchases. The Company also enters into interest rate swaps to hedge against unfavorable changes in interest rates. These derivative instruments qualify for hedge accounting if the hedging relationship is expected to be highly effective. Effectiveness is determined by how closely the changes in the fair value of the derivative instrument offset the changes in the fair value of the hedged item. If the derivative is determined to qualify for hedge accounting, the effective portion of the change in the fair value of the derivative instrument is recorded in other comprehensive income and recognized in earnings when the related hedged item is sold. The ineffective portion of the change in the fair value of the derivative instrument is recorded directly to earnings. If these derivative instruments do not qualify for hedge accounting, the Company would record the changes in the fair value of the derivative instruments directly to earnings. See Notes 13 and 14.

The Company formally documents hedging instruments and hedged items, and measures at each balance sheet date the effectiveness of its hedges. When it is determined that a derivative is not highly effective, the derivative expires, or is sold or terminated, or the derivative is discontinued because it is unlikely that a forecasted transaction will occur, the Company discontinues hedge accounting prospectively for that specific hedge instrument.

The Company does not engage in speculative transactions, nor does it hold derivative instruments for trading purposes.

Other long-term assets

Other long-term assets consist of deposits and debt issuance costs. Debt issuance costs are being amortized over the respective life of the applicable debt using a method that approximates the effective interest method. Debt issuance costs included in other long-term assets in the accompanying consolidated balance sheet at September 26, 2009, and September 27, 2008, were $2,291,000 and $1,748,000, respectively.

Goodwill and intangibles

Goodwill and indefinite-lived intangibles are tested for impairment annually, and more frequently if indication of impairment arises.

On March 27, 2009, the Company recorded $25.8 million of goodwill for the acquisition of the wholesale business and coffee brand of Tully's Coffee Corporation (Tully's). Goodwill and intangibles related to Tully's are reported in the SCBU segment of the Company. The Company's evaluation of goodwill impairment involves a comparison between the current fair value and the recorded value of the SCBU reporting unit, including goodwill. The Company uses a discounted cash flow model to determine the fair value of the SCBU reporting unit. A number of significant assumptions and estimates are involved in the application of the discounted cash flow model including discount rate, sales volume and prices, costs to produce and working capital changes. The Company considers historical experience and all available information at the time fair value is estimated.

On June 15, 2006, the Company acquired Keurig and recorded $73,900,000 of goodwill. Goodwill from the Keurig acquisition was decreased by $1,400,000 in fiscal 2007 and by $133,000 in fiscal 2009 primarily to reflect updated estimates of R&D tax credits earned by Keurig in the years prior to the Company's merger with Keurig. Goodwill was also decreased by $97,000 in fiscal 2007 and increased by $113,000 in fiscal 2008 due to the final settlements of contingencies related to the merger. Goodwill and intangibles related to Keurig are reported in the Corporate segment of the Company. This goodwill was tested for impairment at the end of fiscal 2009. To complete this impairment test, the Company evaluated the fair value of its Keurig reporting unit using a market capitalization approach.

On June 5, 2001, the Company purchased the coffee business of Frontier Natural Products Co-op (Frontier) and recorded $1,446,000 of goodwill related to this acquisition. There have been no changes in this carrying amount since September 29, 2001. Goodwill related to Frontier is reported in the Corporate segment of the Company. On an annual basis, the Company evaluates the fair value of the reporting unit (SCBU) associated with the Frontier acquisition and compares it to the carrying amount of goodwill. Estimation of fair value is dependent on a number of factors, including the market capitalization of the Company and estimates of the Company's sales of its fair trade and organics products.

Based on the impairment tests performed, there was no impairment of goodwill in fiscal 2009, 2008 and 2007. All intangible assets are being amortized using the straight-line method over their useful lives.

Impairment of Long-Lived Assets

When facts and circumstances indicate that the carrying values of long-lived assets, including fixed assets, may be impaired, an evaluation of recoverability is performed by comparing the carrying value of the assets to projected future cash flows in addition to other quantitative and qualitative analyses. Upon indication that the carrying value of such assets may not be recoverable, the Company recognizes an impairment loss as a charge against current operations. Long-lived assets to be disposed of are reported at the lower of the carrying amount or fair value, less estimated costs to sell. The Company makes judgments related to the expected useful lives of long-lived assets and its ability to realize undiscounted cash flows in excess of the carrying amounts of such assets which are affected by factors such as the ongoing maintenance and improvements of the assets, changes in economic conditions and changes in operating performance. As the Company assesses the ongoing expected cash flows and carrying amounts of its long-lived assets, these factors could cause the Company to realize an impairment charge.

Provision for Doubtful Accounts

Periodically, management reviews the adequacy of its provision for doubtful accounts based on historical bad debt expense results and current economic conditions using factors based on the aging of its accounts receivable. Additionally, the Company may identify additional allowance requirements based on indications that a specific customer may be experiencing financial difficulties. Actual bad debts could differ materially from the recorded estimates.

Advertising costs

The Company expenses the costs of advertising the first time the advertising takes place, except for direct mail campaigns targeted directly at consumers, which are expensed over the period during which they are expected to generate sales. At September 26, 2009, and September 27, 2008, prepaid advertising costs of $1,257,000 and $673,000, respectively, were recorded in other current assets in the accompanying consolidated balance sheet. Advertising expense totaled $30,274,000, $16,992,000, and $11,230,000, for the years ended September 26, 2009, September 27, 2008, and September 29, 2007, respectively.

Fixed assets

Fixed assets are carried at cost, net of accumulated depreciation. Expenditures for maintenance, repairs and renewals of minor items are expensed as incurred. Depreciation is calculated using the straight-line method over the assets' estimated useful lives. The cost and accumulated depreciation for fixed assets sold, retired, or otherwise disposed of are relieved from the accounts, and the resultant gains and losses are reflected in income.

The Company follows an industry-wide practice of purchasing and loaning coffee brewing and related equipment to wholesale customers. These assets are also carried at cost, net of accumulated depreciation.

Depreciation costs of manufacturing and distribution assets are included in cost of sales. Depreciation costs of other assets, including equipment on loan to customers, are included in selling and operating expenses.

Revenue recognition

Revenue from wholesale and consumer direct sales is recognized upon product delivery, and in some cases upon product shipment. The Company has no contractual obligation to accept returns for damaged product nor does it guarantee product sales. Title, risk of loss, damage and insurance responsibility for the products pass from the Company to the buyer upon accepted delivery of the products from the Company's contracted carrier. The Company will at times agree to accept returns or issue credits for products that are clearly damaged in transit.

Sales of single-cup coffee brewers are recognized net of an estimated allowance for returns. The Company estimates the allowance for returns using an average return rate based on historical experience. Royalty revenue is recognized upon shipment of K-Cups by roasters as set forth under the terms and conditions of various licensing agreements.

In addition, the Company's customers can earn certain incentives, which are netted against sales or recorded in operating and selling expenses in the consolidated income statements. These incentives include, but are not limited to, cash discounts, funds for promotional and marketing activities, and performance based incentive programs.

Warranty

We provide for the estimated cost of product warranties, primarily using historical information and repair or replacement costs, at the time product revenue is recognized.

Cost of Sales

The Company records external shipping and handling expenses in cost of sales.

Income taxes

The Company recognizes deferred tax assets and liabilities for the expected future tax benefits or consequences of temporary differences between the financial statement carrying amounts of existing assets and liabilities, and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled.

In the first quarter of fiscal 2008, the Company adopted new accounting guidance on the accounting for uncertainty in income taxes. The Company uses a more-likely-than-not measurement attribute for all tax positions taken or expected to be taken on a tax return in order for those tax positions to be recognized in the financial statements.

Stock-based compensation

The Company measures the cost of employee services received in exchange for an award of equity instruments (usually stock options) based on the grant-date fair value of the award. That cost is recognized over the period during which an employee is required to provide service in exchange for the award.

The Company measures the fair value of stock options using the Black-Scholes model and certain assumptions, including the expected life of the stock options, an expected forfeiture rate and the expected volatility of its common stock. The expected life of options is estimated based on options vesting periods, contractual lives and an analysis of the Company's historical experience. The expected forfeiture rate is based on the Company's historical experience. The Company uses a blended historical volatility to estimate expected volatility at the measurement date.

Significant customer credit risk and supply risk

The majority of the Company's customers are located in the North America. Concentration of credit risk with respect to accounts receivable is limited due to the large number of customers in various channels comprising the Company's customer base. The Company does not require collateral from customers as ongoing credit evaluations of customers' payment histories are performed. The Company maintains reserves for potential credit losses and such losses, in the aggregate, have not exceeded management's expectations.

Keurig procures the brewers it sells from a third-party brewer manufacturer. Purchases from this brewer manufacturer amounted to approximately $176,567,000 and $91,669,000 in fiscal 2009 and 2008, respectively. Keurig processes the majority of its orders sold through retailers for the at-home channel through a fulfillment company. Revenue processed by this fulfillment company amounted to $282,533,000 and $88,617,000 and receivables amounted to $46,276,000 and $19,598,000 at September 26, 2009, September 27, 2008, respectively.

Research & Development

Research and development expenses are charged to income as incurred. These expenses amounted to $6,100,000 in fiscal 2009, $4,100,000 in fiscal 2008 and $3,300,000 in fiscal 2007. These costs primarily consist of salary and consulting expenses and are recorded in selling and operating expenses in each respective segment of the Company.

Reclassification

The Company has revised the classification of its treasury shares for the periods ending September 27, 2008, and September 29, 2007 on its Consolidated Balance Sheets and Consolidated Statement of Changes In Stockholders' Equity to reflect the Company's July 7, 2007 stock dividend of two shares of the Company's common stock for each outstanding share of common stock with respect to its treasury shares, as well as to include in the presentation of its capital stock disclosure of both the issued and the issued and outstanding shares of common stock as of such dates. The Company has never used treasury shares for issuance upon the exercising of options.

Pending accounting pronouncements

In December 2007, the Financial Accounting Standards Board (FASB) issued new accounting guidance on business combinations and noncontrolling interests in consolidated financial statements. This new guidance retains the fundamental requirements in previous guidance for business combinations requiring that the use of the purchase method be used for all business combinations. The acquirer is required to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date. Additionally, business combinations will now require that acquisition costs to be expensed as incurred, the recognition of contingencies, restructuring costs associated with a business combination must generally be expensed and changes in deferred tax asset valuation allowances and income tax uncertainties after the acquisition date generally will affect income tax expense. This guidance applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008, which is fiscal year 2010 for the Company. For acquisitions completed prior to September 27, 2009, the new guidance requires that changes in deferred tax asset valuation allowances and acquired income tax uncertainties after the measurement period must be recognized in earnings rather than as an adjustment to the cost of the acquisition. On November 13, 2009, the Company acquired the wholesale coffee and beverage business of Timothy's Coffees of the World, Inc. This acquisition will be reported in accordance with this new accounting guidance. During fiscal 2009, the Company incurred approximately $400,000 of acquisition related expenses which are classified as general and administrative expense in the Statement of Operations. See Note 25.

In February 2008, the FASB issued an update to delay the implementation of fair value measurements for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. This deferral extends the effective date to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years, which is fiscal year 2010 for the Company. The Company implemented fair value measurements for financial assets and liabilities in the first quarter of fiscal 2009. The Company is currently assessing the impact of fair value for nonfinancial assets and nonfinancial liabilities, but does not expect it to have a material impact on its financial statements.

In December 2007, the FASB clarified guidance on noncontrolling interests in consolidated financial statements. The clarification establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. The amount of net income attributable to the noncontrolling interest will be included in the statement of operations. It clarifies that changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains its controlling financial interest. In addition, this guidance requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. This update is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008, which is fiscal 2010 for the Company. The effect of adoption on the Company's financial statements will depend primarily on the materiality of non-controlling interests arising in future transactions.

3. Stock Split

On May 19, 2009, the Company announced that its Board of Directors had approved a three-for-two stock split effected in the form of a stock dividend of one share for every two issued shares. The stock dividend was distributed on June 8, 2009, to stockholders of record at the close of business on May 29, 2009. The par value of the common stock remained unchanged at $0.10 per share. All share and per share data presented in this report have been adjusted to reflect this stock split.

On July 6, 2007, the Company announced that its Board of Directors had approved a three-for-one stock split effected in the form of a 200% stock dividend for all issued shares. The stock split shares were distributed on July 27, 2007, to stockholders of record at the close of business on July 17, 2007. The par value of the common stock remained unchanged at $0.10 per share. All share and per share data presented in this report have been adjusted to reflect this stock split.

4. Acquisition of Certain Assets of Tully's Coffee Corporation

On September 15, 2008, the Company entered into an Asset Purchase Agreement (the "Agreement") with Tully's Coffee Corporation, a Washington corporation, and its wholly-owned subsidiary, Tully's Bellaccino, LLC, a Washington limited liability company (collectively "Tully's") to acquire the Tully's coffee brand and certain assets of its wholesale business. The transaction was completed on March 27, 2009. Since the date of acquisition, Tully's results from operations have been included in the Company's consolidated financial statements.

Tully's wholesale business division distributes handcrafted coffees and related products via office coffee services, food service distributors, and over 5,000 supermarkets located primarily in the western states. The Company expects the geographic region encompassed by the Tully's brand to create an advantaged opportunity for the Company to accelerate growth in the west coast by capitalizing on Tully's brand recognition and the loyalty of its customer base. The purchase price exceeded the fair value of the acquired net assets and, accordingly, $25,780,000 was allocated to goodwill, all of which is tax deductible.

Total consideration under the terms of the Agreement amounted to approximately $40,300,000 in cash. The Agreement contains customary representations, warranties and covenants given by the parties. Under the terms of the Agreement, $3,500,000 of the purchase price was placed in escrow at the closing and will be available to satisfy indemnification claims by the Company under the Agreement for a period of up to 12 months from the completion date.

The total net cash disbursement associated with the Agreement was $41,361,000. This includes $40,300,000 of cash consideration paid to Tully's for the assets associated with its wholesale business and brand and direct acquisition costs of approximately $1,061,000. The Company also assumed approximately $210,000 in debt which was recorded as a noncash transaction.

The allocation of the purchase price based on fair value of the acquired assets less liabilities assumed is as follows:

Inventories	$ 2,191,000
Fixed assets	1,527,000
Intangible assets	12,400,000
Goodwill	25,243,000
Total	$41,361,000

In addition, the Company recorded goodwill related to assumed debt of $210,000 and exit and transition related accruals of $327,000. Exit and transition related accruals included the costs associated with the plan to relocate the Tully's manufacturing facility to a new location which is expected to be completed no later than one year from the acquisition date.

Amortizable intangible assets acquired on March 27, 2009, include approximately $10,300,000 for identifiable customer relationships with an average life of 13 years, approximately $2,000,000 for the Tully's trade name with an average life of 10 years and approximately $100,000 for non-compete agreements with an average life of 5 years. The weighted-average amortization period for these assets is 12.5 years and will be amortized on a straight-line basis over their respective useful lives. Amortization of intangibles expense (gross of tax) is anticipated to be approximately $1,012,000 in fiscal years 2010 through 2013 and approximately $1,002,000 in fiscal 2014.

5. Inventories

Inventories consist of the following:

	September 26, 2009	September 27, 2008
Raw materials and supplies	$ 26,015,000	$19,494,000
Finished goods	111,279,000	65,817,000
	$137,294,000	$85,311,000

Inventory values above are presented net of $704,000 and $440,000 of obsolescence reserves at September 26, 2009, and September 27, 2008, respectively.

At September 26, 2009, the Company had approximately $90,782,000 in green coffee purchase commitments, of which approximately 46% had a fixed price. These commitments extend through 2011. The value of the variable portion of these commitments was calculated using an average “c” price of coffee of $1.33 per pound at September 26, 2009. In addition to its green coffee commitments, the Company had approximately $118,962,000 in fixed price brewer inventory purchase commitments and $91,602,000 in production raw materials commitments at September 26, 2009. The Company believes based on relationships established with its suppliers, that the risk of non-delivery on such purchase commitments is remote.

6. Fixed Assets

Fixed assets consist of the following:

	Useful Life in Years	September 26, 2009	September 27, 2008
Production equipment	1-15	$ 91,343,000	$ 68,783,000
Equipment on loan to wholesale customers	3-7	13,278,000	12,269,000
Computer equipment and software	1-10	34,018,000	24,020,000
Land	Indefinite	1,391,000	1,391,000
Building and building improvements	4-30	15,412,000	14,744,000
Furniture and fixtures	1-15	9,064,000	6,598,000
Vehicles	4-5	1,181,000	1,070,000
Leasehold improvements	1-20 or remaining life of lease, whichever is less	9,197,000	7,135,000
Construction-in-progress		27,332,000	11,843,000
Total fixed assets		202,216,000	147,853,000
Accumulated depreciation		(66,235,000)	(50,175,000)
		$135,981,000	$ 97,678,000

Total depreciation and amortization expense relating to all fixed assets was $17,987,000, $13,500,000, and $10,328,000 for fiscal 2009, 2008, and 2007, respectively.

Assets classified as construction-in-progress are not depreciated, as they are not ready for production use. All assets classified as construction-in-progress on September 26, 2009, are expected to be in production use before the end of fiscal 2010.

During fiscal 2009, 2008 and 2007, $597,000, $550,000, and $444,000, respectively, of interest expense was capitalized.

The Company regularly undertakes a review of its fixed assets records. In fiscal 2009, 2008 and 2007, the Company recorded impairment charges related to obsolete equipment amounting to $548,000, $32,000, and $125,000, respectively. In fiscal 2009, 2008 and 2007, the impairment charges were recorded in other income (expense) on the Consolidated Statement of Operations, under the SCBU segment of the Company.

7. Intangible Assets

Intangible assets consist of the following:

	September 26, 2009		September 27, 2008	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Intangible assets subject to amortization				
Acquired technology	$21,317,000	$ (9,587,000)	$21,317,000	$ (7,401,000)
Customer and roaster agreements	19,700,000	(7,820,000)	19,700,000	(5,444,000)
Customer relationships	10,367,000	(428,000)	67,000	(22,000)
Trade names	3,456,000	(633,000)	1,456,000	(371,000)
Non-compete agreements	374,000	(268,000)	274,000	(180,000)
Total	$55,214,000	$(18,736,000)	$42,814,000	$(13,418,000)

For intangible assets subject to amortization, the Company calculates amortization expense over the period of expected economic benefit. Total amortization expense was $5,318,000 for fiscal 2009 and $4,812,000 for fiscal 2008 and fiscal 2007.

The estimated useful lives of the intangible assets subject to amortization are 7-10 years for acquired technology, 8-10 years for customer and roaster agreements, 7-13 year for customer relationships, 9-10 years for trade names and 2-5 years for non-complete agreements.

The estimated aggregate amortization expense over each of the next five years is as follows:

2010	$ 5,605,000
2011	$ 5,564,000
2012	$ 5,261,000
2013	$ 5,180,000
2014	$ 4,571,000

8. Income Taxes

The provision for income taxes for the years ended September 26, 2009, September 27, 2008, and September 29, 2007, consists of the following:

	September 26, 2009	September 27, 2008	September 29, 2007
Current tax expense:			
Federal	$25,257,000	$10,935,000	$6,943,000
State	6,497,000	2,010,000	1,409,000
Foreign	837,000	523,000	—
Total current	32,591,000	13,468,000	8,352,000
Deferred tax expense:			
Federal	2,008,000	849,000	453,000
State	(123,000)	(144,000)	(71,000)
Total deferred	1,885,000	705,000	382,000
Total tax expense	$34,476,000	$14,173,000	$8,734,000

Net deferred tax liabilities consist of the following:

	September 26, 2009	September 27, 2008
Deferred tax assets:		
Section 263A capitalized expenses	$ 1,456,000	$ 838,000
Deferred hedging losses	1,265,000	284,000
Vermont VEPC tax credit	—	268,000
Deferred compensation	3,930,000	2,441,000
Other reserves and temporary differences	3,897,000	2,583,000
Research and development tax credit carryforwards	524,000	389,000
Gross deferred tax assets	11,072,000	6,803,000
Deferred tax liabilities:		
Prepaid expenses	(397,000)	—
Depreciation	(16,602,000)	(10,238,000)
Intangible assets	(10,521,000)	(12,110,000)
Gross deferred tax liabilities	(27,520,000)	(22,348,000)
Net deferred tax liabilities	$(16,448,000)	$(15,545,000)

A reconciliation for continuing operations between the amount of reported income tax expense and the amount computed using the U.S. Federal Statutory rate of 35% is as follows:

	September 26, 2009	September 27, 2008	September 29, 2007
Tax at U.S. Federal Statutory rate	$31,612,000	$12,400,000	$7,336,000
Increase (decrease) in rates resulting from:			
Qualified stock option compensation accounting under FAS123R	643,000	699,000	648,000
State taxes, net of federal benefit	4,950,000	1,801,000	723,000
Section 199 deduction	(1,921,000)	(906,000)	(243,000)
Other	(808,000)	179,000	270,000
Tax at effective rates	$34,476,000	$14,173,000	$8,734,000

The total amount of unrecognized tax benefits at September 26, 2009, and September 27, 2008, was $444,000 and $554,000, respectively. The unrecognized tax benefits relate to foreign tax credits at the federal level and research and development credits at the state level. During 2009, the company released $378,000 of this reserve related to R&D credits, $174,000 of which applied to credits earned by Keurig prior to the acquisition and impacted goodwill. The amount of unrecognized tax benefits at September 26, 2009, that would impact the effective tax rate if resolved in favor of the Company is $341,000. Any release of the reserve related to R&D credits earned prior to the Company's acquisition of Keurig (currently $103,000) will be an adjustment to the statement of operations in the period released. The Company included $15,000 of interest and penalties in its reserve.

A reconciliation of increases and decreases in unrecognized tax benefits is as follows:

Gross tax contingencies—September 27, 2008	$ 554,000
Gross decreases to tax positions in prior periods	(378,000)
Gross increases to current period tax positions	268,000
Gross tax contingencies, September 26, 2009	$ 444,000

At September 26, 2009, and September 27, 2008, the Company has state research and development credit carryforwards of $807,000 and $598,000 respectively, expiring at various dates through 2023. During fiscal 2008, the Company fully utilized its remaining federal net operating loss ("NOL") and federal research and development credit carryforwards.

The federal research and development tax credit expired on December 31, 2007, but was reinstated on October 3, 2008. The Company claimed a tax credit (and reserved against it) through December 31, 2007. The Company reported an additional $86,000 of federal tax credit and an associated $17,000 reserve as a discrete item in the first quarter of 2009 to recognize this retroactive extension. With this exception, the Company does not expect a significant increase or decrease to the total amount of unrecognized tax benefits within the next 12 months.

9. Segment Reporting

The Company manages its operations through two business segments: Specialty Coffee business unit (SCBU) and Keurig business unit (Keurig). SCBU sells whole bean and ground coffee selections, and K-Cups, Keurig single cup brewers and other accessories mainly in domestic wholesale and retail channels. Keurig sells their single cup brewers, coffee, cocoa and tea in K-Cups produced by a variety of licensed roasters, including SCBU, and related accessories mainly in domestic wholesale and retail channels. Throughout this report, unless otherwise noted, the information provided is on a consolidated basis.

The Company evaluates performance based on several factors, including business segment income before taxes. The operating segments do not share manufacturing or distribution facilities, except for brewer fulfillment at our Knoxville facility, and most administrative functions such as accounting and information services are decentralized. In the event any materials and/or services are provided to one segment by the other, the transaction is valued at estimated market price and eliminated in consolidation. The costs of the Company's manufacturing operations are captured within the SCBU segment while the Keurig segment does not have manufacturing facilities and purchases its saleable products from third parties, including the SCBU. The Company's property, plant and equipment, inventory and accounts receivable are captured and reported discretely within each operating segment.

Expenses not specifically related to either operating segment are shown separately as "Corporate". Corporate expenses are comprised mainly of the compensation and other related expenses of the Company's Chief Executive Officer, Chief Financial Officer, Chief Information Officer, Corporate General Counsel and Secretary, Vice President Human Resources, Vice President of Corporate Social Responsibility, Vice President of Environmental Affairs and other selected employees who perform duties related to our entire enterprise. Corporate expenses also include interest expense, amortization of identifiable intangibles related to the acquisition of Keurig, as well as certain corporate legal expenses and compensation of the board of directors. In addition, fiscal 2009 Corporate expenses are offset by $17,000,000 of proceeds received from the Kraft litigation settlement. Corporate assets include the cash proceeds from the fiscal 2009 equity offering and goodwill and intangible assets related to the Keurig business unit.

For the fiscal year ended September 26, 2009 (Dollars in thousands)	SCBU	Keurig	Corporate	Eliminations	Consolidated
Sales to unaffiliated customers	$382,495	$420,550	$ —	$ —	$803,045
Intersegment sales	$ 91,401	$ 72,860	$ —	$(164,261)	$ —
Net sales	$473,896	$493,410	$ —	$(164,261)	$803,045
Income before taxes	$ 52,623	$ 47,514	$ (7,582)	$ (2,197)	$ 90,358
Total assets	$489,821	$157,067	$383,957	$(217,006)	$813,839
Stock compensation	$ 2,325	$ 1,951	$ 2,421	$ —	$ 6,697
Interest expense	$ —	$ —	$ 4,693	$ —	$ 4,693
Property additions	$ 46,245	$ 3,580	$ —	$ —	$ 49,825
Depreciation and amortization	$ 16,508	$ 1,985	$ 4,812	$ —	$ 23,305

For the fiscal year ended September 27, 2008 (Dollars in thousands)	SCBU	Keurig	Corporate	Eliminations	Consolidated
Sales to unaffiliated customers	$285,894	$214,383	$ —	$ —	$500,277
Intersegment sales	$ 34,158	$ 39,191	$ —	$(73,349)	$ —
Net sales	$320,052	$253,574	$ —	$(73,349)	$500,277
Income before taxes	$ 27,823	$ 32,588	$ (23,503)	$ (436)	$ 36,472
Total assets	$252,127	$ 86,680	$103,349	$(84,508)	$357,648
Stock compensation	$ 1,978	$ 2,519	$ 1,851	$ —	$ 6,348
Interest expense	$ —	$ —	$ 5,705	$ —	$ 5,705
Property additions	$ 45,173	$ 3,545	$ —	$ —	$ 48,718
Depreciation and amortization	$ 11,792	$ 1,708	$ 4,812	$ —	$ 18,312

For the fiscal year ended September 29, 2007 (Dollars in thousands)	SCBU	Keurig	Corporate	Eliminations	Consolidated
Sales to unaffiliated customers	$230,487	$111,164	$ —	$ —	$341,651
Intersegment sales	$ 11,471	$ 23,607	$ —	$(35,078)	$ —
Net sales	$241,958	$134,771	$ —	$(35,078)	$341,651
Income before taxes	$ 22,453	$ 16,771	$ (17,366)	$ (281)	$ 21,577
Total assets	$153,423	$ 40,382	$108,048	$(37,326)	$264,527
Stock compensation	$ 1,690	$ 1,565	$ 1,037	$ —	$ 4,292
Interest expense	$ —	$ —	$ 6,176	$ —	$ 6,176
Property additions	$ 19,715	$ 2,129	$ —	$ —	$ 21,844
Depreciation and amortization	$ 8,798	$ 1,660	$ 4,811	$ —	$ 15,269

10. Warranty reserve

The Company offers a one-year warranty on all Keurig brewers it sells. Keurig provides for the estimated cost of product warranties, primarily using historical information and repair or replacement costs, at the time product revenue is recognized. During fiscal 2007, the Company experienced higher warranty returns associated with a defective component for specific brewers manufactured during calendar 2006. The defective component was replaced with an improved component for all brewers beginning in January 2007. Replacement costs amounted to $1,600,000, of which $1,400,000 was recovered from the component manufacturer. This recovery was reflected in Keurig's fiscal 2007 cost of sales.

The changes in the carrying amount of product warranty reserves for fiscal 2009 are as follows:

Year ended September 26, 2009	
Balance at September 27, 2008	$ 648,000
Provision charged to income, net of reimbursements	3,082,000
Usage	(3,006,000)
Balance at September 26, 2009	$ 724,000

The changes in the carrying amount of product warranty reserves for fiscal 2008 are as follows:

Year ended September 27, 2008	
Balance at September 29, 2007	$ 815,000
Provision charged to income	2,322,000
Usage	(2,489,000)
Balance at September 27, 2008	$ 648,000

11. Long-term debt

The Company maintains a Revolving Credit Agreement (the "Credit Facility") with Bank of America, N.A. (Bank of America) and other lenders. On December 3, 2007, the Company amended its Credit Facility to increase the facility from $125,000,000 to $225,000,000, extend the expiration date of the Credit Facility from June 15, 2011, to December 3, 2012, and amend certain financial covenants. Additionally, on June 29, 2009, the Company exercised its increase option and further amended certain financial covenants. The increase was in the form of a $50,000,000 term loan and will be amortized at a rate of 10% annually with payments beginning on September 30, 2009. The Company paid fees to its lenders for amendments to the Credit Facility of $1,000,000 in the fourth quarter of fiscal 2009, $711,000 in the first quarter of fiscal 2008 and $112,000 in the fourth quarter of fiscal 2008. The Company also incurred $168,000 in other financing fees related to these amendments.

At September 26, 2009, and September 27, 2008, $28,000,000 and $123,500,000 were outstanding under the Credit Facility, respectively. Additionally, a $50,000,000 term loan was outstanding under the Credit Facility at September 26, 2009. The Credit Facility is secured by all assets of the Company. The Credit Facility contains various negative covenants, including limitations on: liens; investments; loans and advances; indebtedness; mergers, consolidations and acquisitions; asset sales; dividends and distributions or repurchases of the Company's capital stock; transactions with affiliates; certain burdensome agreements; and changes in the Company's lines of business.

The Credit Facility is subject to the following financial covenants: a funded debt to adjusted EBITDA covenant and a fixed charge coverage ratio. On June 29, 2009, the Company amended the credit agreement which removed the capital expenditures limitation covenant and adjusted the definition of the fixed charge coverage ratio to modify the capital expenditures captured in the definition of 50% of unfinanced capital expenditures.

The borrowings under the Credit Facility bear interest at prime or Libor rates, plus a margin based on a performance price structure. At September 26, 2009, the interest rate charged on the $28,000,000 revolver borrowings under the Credit Facility was 1.25% (one-month Libor plus 100 basis points). The interest rates charged on the term loan at September 26, 2009, were 5.75% (Prime plus 250 basis points) on $1,250,000 and 3.75% (one-month Libor plus 350 basis points) on $48,750,000. However, the rate charged on $75,700,000 of the $76,750,000 Libor-based borrowings was fixed through swap agreements (see below). Therefore, the rate paid by the Company on that portion of the debt was in effect 6.41% (3.80% plus spread).

At September 27, 2008, interest rates charged on the Credit Facility were as follows: 5.25% (Prime rate plus 25 basis points) on $6,500,000 and 4.45% (one month Libor plus 125 basis points) on $117,000,000. However, the rate charged on $78,446,667 of the $117,000,000 one-month Libor was fixed through swap agreements (see below). Therefore, the rate paid by the Company on that portion of the debt was in effect 5.11% (3.86% plus 125 basis points).

Interest on Libor loans is paid in arrears on the maturity date of such loans. The variable portion of the Credit Facility accrues interest daily and is paid quarterly, in arrears. The Company also pays a commitment fee on the average daily unused portion of the Credit Facility.

At September 26, 2009, and September 27, 2008, the Company also had $345,000 in outstanding letters of credit for leased office space and $9,655,000 available under the Credit Facility to issue letters of credit.

The Company is party to interest rate swap agreements. The notional amounts of these swaps at September 26, 2009, and September 27, 2008, was $75,700,000 and $78,466,667, respectively. The effect of these swaps was to limit the interest rate exposure to a fixed rate at September 26, 2009, as follows: 5.44% versus the 30-day Libor rate on $25,700,000; 2.35% versus the 30-day Libor rate on $30,000,000; and 3.87% versus the 30-day Libor rate on $20,000,000. The swap's notional amounts will decrease progressively in future periods and terminates on various dates from June 2010 through December 2012.

In accordance with the swap agreements and on a monthly basis, interest expense is calculated based on the floating 30-day Libor rate and the fixed rate. If interest expense calculated is greater based on the 30-day Libor rate, the lender pays the difference to the Company; if interest expense as calculated is greater based on the fixed rate, the Company pays the difference to the lender. In fiscal years 2009, 2008 and 2007, the Company paid $2,151,000, $1,050,000 and $66,000, respectively, in additional interest expense pursuant to the swap agreements.

The fair market value of the interest rate swaps are the estimated amount that the Company would receive or pay to terminate the agreements at the reporting date, taking into account current interest rates and the credit worthiness of the counterparty. At September 26, 2009 and September 27, 2008, the Company estimates it would have paid $3,257,000 and $634,000 (gross of tax), respectively, had it terminated the agreements. The Company designates the swap agreements as cash flow hedges and the fair value of these swaps are classified in accumulated other comprehensive income.

	September 26, 2009	September 27, 2008
Revolving line of credit	$28,000,000	$123,500,000
Term loan	50,000,000	—
Office equipment capital leases	43,000	50,000
	78,043,000	123,550,000
Less current portion	5,030,000	33,000
	$73,013,000	$123,517,000

Manufacturing and Office Equipment Capital Leases

The Company leases manufacturing equipment, copiers and fax machines. These leases require monthly installments of principal and interest totaling approximately $4,300. Maturities vary from October 2009 to July 2012.

Maturities

Maturities of long-term debt for years subsequent to September 26, 2009, are as follows:

Fiscal Year	
2010	$ 5,030,000
2011	5,009,000
2012	5,004,000
2013	63,000,000
2014	—
	$78,043,000

12. Equity offering

On August 12, 2009, the Company issued 5,750,000 shares of common stock at $67.25 per share, of which 5,208,993 shares were issued from treasury. Net proceeds were approximately $369,793,000, net of underwriting discount and other offering expenses. The Company used the proceeds to repay debt and for general corporate purposes.

13. Coffee price hedging

The Company regularly enters into coffee futures contracts to hedge forecasted purchases of green coffee and therefore designates these contracts as cash flow hedges. At September 26, 2009, the Company held outstanding futures contracts covering 1,125,000 pounds of coffee with a fair market value of $90,000. At September 26, 2009, deferred gains on futures contracts designated as cash flow hedges amounted to $121,000 ($72,000, net of taxes). These futures contracts are hedging coffee purchases forecasted to take place in the next six months and the related gains will be reflected in cost of sales in the first three fiscal quarters of 2010, when the related finished goods inventory is sold. The deferred gains are classified as other comprehensive income (a component of equity). At September 27, 2008, deferred losses on futures contracts designated as cash flow hedges amounted to $70,000 ($43,000, net of taxes).

The total losses on coffee futures contracts that were included in cost of sales in fiscal 2009, 2008 and 2007 amounted to $443,000 ($264,000 net of tax), $9,000 ($6,000 net of tax) and $45,000 ($26,000 net of tax), respectively. The fair market value for the futures is calculated at the end of each fiscal quarter, in consideration of information provided by a major financial institution, based on the market prices of identical (or similar) instruments that are regularly traded in readily observable markets.

14. Financial Instruments

The Company is exposed to certain risks relating to ongoing business operations. The primary risks that are mitigated by financial instruments are interest rate risk and commodity price risk. The Company uses interest rate swaps to mitigate interest rate risk associated with the Company's variable-rate borrowings and regularly enters into coffee futures contracts to hedge price-to-be-established coffee purchase commitments of green coffee with the objective of minimizing cost risk due to market fluctuations. The Company does not hold or issue derivative financial instruments for trading purposes.

The Company designates the swap agreements and coffee futures contracts as cash flow hedges and measures the effectiveness of these derivative instruments at each balance sheet date. The changes in the fair value of these instruments are classified in accumulated other comprehensive income (OCI). Gains and losses on these instruments are reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. If it is determined that a derivative is not highly effective, the gains and losses will be reclassified into earnings upon determination.

The Company has interest rate swap agreements with Bank of America N.A. (Bank of America) and Sovereign Bank. During fiscal 2009, 2008 and 2007, the Company paid $2,151,000, $1,050,000 and $66,000, respectively, pursuant to the swap agreements, which increased interest expense.

The following table summarizes the interest rate swaps outstanding at September 26, 2009:

Hedged Transaction	Notional Amount of Underlying Debt	Fixed Rate Received	Maturity	Fair Value of Swap
30-day LIBOR	$30,000,000	2.35%	2010	$ (438,000)
30-day LIBOR	$25,700,000	5.44%	2011	$(1,551,000)
30-day LIBOR	$20,000,000	3.87%	2013	$(1,268,000)
	$75,700,000			$(3,257,000)

The following table summarized the coffee futures contracts outstanding at September 26, 2009:

Coffee Pounds	Average Contract Price	"C" Price	Maturity	Fair Value of Futures Contract
1,125,000	$1.20	$1.28	December 2009	$90,000
1,125,000				$90,000

The following table discloses the fair value of the Company's financial instruments included in the Consolidated Balance Sheets:

Fair Value of Derivative Instruments (Net of Tax)

	September 26, 2009	September 27, 2008	Balance Sheet Classification
Coffee Futures	$ 90,000	$ (39,000)	Other current assets (Other current liabilities)
Interest Rate Swaps	$(3,257,000)	$(634,000)	Other short-term liabilities
Total	$(3,167,000)	$(673,000)	

The following table discloses the effect of the Company's financial instruments included in the Consolidated Statement of Operations:

Effect of Derivatives Instruments on Earnings (Gross of Tax) for Fiscal 2009

	Amount of Gain or (Loss) in OCI	Location of Gain or (Loss) Reclassified from OCI into Income	Amount of Gain or (Loss) Reclassified from OCI into Income
Coffee Futures	$ (251,000)	Cost of Sales	$(443,000)
Interest Rate Swaps	$(2,624,000)	Interest Expense	$ —
Total Derivatives	$(2,875,000)		$(443,000)

Effect of Derivatives Instruments on Earnings (Gross of Tax) for Fiscal 2008

	Amount of Gain or (Loss) in OCI	Location of Gain or (Loss) Reclassified from OCI into Income	Amount of Gain or (Loss) Reclassified from OCI into Income
Coffee Futures	$ (79,000)	Cost of Sales	$(9,000)
Interest Rate Swaps	$237,000	Interest Expense	$ —
Total Derivatives	$158,000		$(9,000)

The Company estimates the deferred losses of coffee futures will be reclassified to net income within the next nine months, which is consistent with the period over which the Company hedges its exposure to the variability in future cash flows. The Company hedges a portion of its exposure to the variability in interest rates through the maturity date of its credit facility.

The Company is exposed to credit loss in the event of nonperformance by the other parties to these financial instruments, however nonperformance is not anticipated.

15. Fair Value Measurements

The Company measures fair value as the selling price that would be received for an asset, or paid to transfer a liability, in the principal or most advantageous market on the measurement date. The hierarchy established by the FASB prioritizes fair value measurements based on the types of inputs used in the valuation technique. The inputs are categorized into the following levels:

Level 1 – Observable inputs such as quoted prices in active markets for identical assets or liabilities

Level 2 – Inputs other than quoted prices that are observable, either directly or indirectly, for identical or similar assets and liabilities in active or non-active markets

Level 3 – Unobservable inputs not corroborated by market data, therefore requiring the entity to use the best available information, including management assumptions

The following table discloses the level used by fair value measurements at September 26, 2009:

	Fair Value Measurements Using			Balance Sheet Classification
	Level 1	Level 2	Level 3	
Short-term Investment	$—	$ 50,000,000	$—	Short-term investments
Derivatives	$—	$ 90,000	$—	Other current assets
Derivatives	$—	$ (3,257,000)	$—	Other short-term liabilities
Total	$—	$(46,833,000)	$—	

The following table discloses the level used by fair value measurements at September 27, 2008:

	Fair Value Measurements Using			Balance Sheet Classification
	Level 1	Level 2	Level 3	
Derivatives	$—	$(673,000)	$—	Other short-term liabilities
Total	$—	$(673,000)	$—	

Derivative financial instruments include coffee futures contracts and interest rate swap agreements. Short-term investments include certificates of deposit. To determine fair value, the Company utilizes the market approach valuation technique for the coffee futures contracts and certificates of deposit and the income approach for the interest rate swap agreements. The Company uses Level 2 inputs that are based on market data of identical (or similar) instruments that are in observable markets. All derivatives on the balance sheet are recorded at fair value with changes in fair value recorded in other comprehensive income for temporary valuation adjustments and in the statement of operations for settlement of contracts.

16. Employee Compensation Plans

Stock Option Plans

On May 20, 1999, the Company registered on Form S-8 the 1999 Stock Option Plan (the "1999 Plan"). Under this plan, 2,250,000 shares of common stock are available for grants of both incentive and non-qualified stock options. Grants under the 1999 Plan generally expire 10 years after the grant date, or earlier if employment terminates. At September 26, 2009 and September 27, 2008, options for 0 shares and 303 shares of common stock were available for grant under the plan, respectively.

On September 25, 2001, the Company registered on Form S-8 the 2000 Stock Option Plan (the "2000 Plan"). Under this plan, 3,600,000 shares of common stock are available for grants of both incentive and non-qualified stock options. Grants under the 2000 Plan generally expire 10 years after the grant date, or earlier if employment terminates. At September 26, 2009 and September 27, 2008, options for 27 shares and 258 shares of common stock were available for grant under the plan, respectively.

On March 16, 2006, stockholders of the Company approved the Company's 2006 Incentive Plan (the "2006 Plan"). The 2006 Plan was amended on March 13, 2008, to which the total shares of common stock authorized for issuance increased to 2,400,000 from 1,350,000 at fiscal 2007 year end. Awards other than stock options are limited to a total of 270,000 over the life of the 2006 Plan. At September 26, 2009 and September 27, 2008, options for 234,603 shares and 599,463 shares of common stock were available for grant under the plan, respectively.

In connection with the acquisition of Keurig, the Company assumed the existing outstanding unvested option awards of the Keurig, Incorporated Fifth Amended and Restated 1995 Stock Option Plan (the "1995 Plan") and the Keurig, Incorporated 2005 Stock Option Plan (the "2005 Plan"). No shares under either the 1995 Plan or the 2005 Plan were eligible for post-acquisition awards. At September 26, 2009, and September 27, 2008, 31,845 and 49,383 options out of the 462,303 options for shares of common stock granted were outstanding under 1995 Plan, respectively. At September 26, 2009, and September 27, 2008, 176,630 options and 240,860 options out of the 496,859 options granted for shares of common stock were outstanding under the 2005 Plan, respectively. All awards assumed in the acquisition were initially granted with a four-year vesting schedule and continue to vest in accordance with their existing terms.

On May 3, 2007, Mr. Lawrence Blanford commenced his employment as the President and Chief Executive Officer of the Company. Pursuant to the terms of the employment, the Company made an inducement grant on May 4, 2007, to Mr. Blanford of a non-qualified option to purchase 315,000 shares of the Company's common stock, with an exercise price equal to fair market value on the date of the grant. The shares subject to the option will vest in 20% installments on each of the first five anniversaries of the date of the grant, provided that Mr. Blanford remains employed with the Company on each vesting date.

On November 3, 2008, Ms. Michelle Stacy commenced her employment as the President of Keurig, Incorporated. Pursuant to the terms of the employment, the Company made an inducement grant on November 3, 2009, to Ms. Stacy of a non-qualified option to purchase 52,500 shares of the Company's common stock, with an exercise price equal to fair market value on the date of the grant. The shares subject to the option will vest in 25% installments on each of the first four anniversaries of the date of the grant, provided that Ms. Stacy remains employed with the Company on each vesting date.

On February 9, 2009, Mr. Howard Malovany commenced his employment as the Vice President, Corporate General Counsel and Secretary of the Company. Pursuant to the terms of the employment, the Company made an inducement grant on February 9, 2009, to Mr. Malovany of a non-qualified option to purchase 52,500 shares of the Company's common stock, with an exercise price equal to fair market value on the date of the grant. The shares subject to the option will vest in 25% installments on each of the first four anniversaries of the date of the grant, provided that Mr. Malovany remains employed with the Company on each vesting date.

Under the 1999 Plan and the 2000 Plan, the option price for each incentive stock option shall not be less than the fair market value per share of common stock on the date of grant, with certain provisions which increase the option price to 110% of the fair market value of the common stock if the grantee owns in excess of 10% of the Company's common stock at the date of grant. Under the 1999 Plan, the option price for each non-qualified stock option shall not be less than 85% of the fair market value of the common stock at the date of grant. The 2000 Plan does not have restrictions on the pricing of non-qualified grants. The 2006 Plan requires the exercise price for all awards requiring exercise to be no less than 100% of fair market value per share of common stock on the date of grant, with certain provisions which increase the option price to 110% of the fair market value of the common stock if the grantee owns in excess of 10% of the Company's common stock at the date of grant. Options under the 1999 Plan, the 2000 Plan and the 2006 Plan become exercisable over periods determined by the Board of Directors, generally in the range of four to five years.

Option activity is summarized as follows:

	Number of Shares	Average Exercise Price
Outstanding at September 27, 2008	4,713,917	9.26
Granted	500,394	28.17
Exercised	(1,267,457)	6.14
Canceled	(43,676)	19.00
Outstanding at September 26, 2009	3,903,178	12.99
Exercisable at September 26, 2009	2,178,395	$ 8.40

The following table summarizes information about stock options expected to vest at September 26, 2009:

Range of exercise price	Number of options outstanding	Weighted average remaining contractual life (in years)	Weighted average exercise price	Intrinsic value at September 26, 2009
$ 0.49 - $68.93	3,852,345	6.66	12.87	$216,094,000

The following table summarizes information about stock options exercisable at September 26, 2009:

Range of exercise price	Number of options exercisable	Weighted average remaining contractual life (in years)	Weighted average exercise price	Intrinsic value at September 26, 2009
$ 0.49 - $28.32	2,178,395	5.49	8.40	$131,825,000

Compensation expense is recognized only for those options expected to vest, with forfeitures estimated based on the Company's historical employee turnover experience and future expectations.

The Company uses a blend of recent and historical volatility to estimate expected volatility at the measurement date. The expected life of options is estimated based on options vesting periods, contractual lives and an analysis of the Company's historical experience.

Income before income taxes was reduced by $6,697,000, $6,348,000 and $4,292,000 (gross of tax), respectively, due to the recognition of stock compensation expense for the years ended September 26, 2009, September 27, 2008, and September 29, 2007, respectively. Net of tax, stock compensation expense was $4,731,000, $4,755,000 and $3,335,000 for the years ended September 26, 2009, September 27, 2008, and September 29, 2007, respectively.

Total unrecognized share-based compensation costs related to unvested stock options expected to vest were approximately $13,033,000 as of September 26, 2009, which related to approximately 1,674,000 shares. This unrecognized cost is expected to be recognized over a weighted average period of approximately 2 years at September 26, 2009. The intrinsic values of options exercised during fiscal 2009 and fiscal 2008 were approximately $35,151,000 and $22,217,000, respectively. The Company's policy is to issue new shares upon exercise of stock options.

The grant-date fair value of employee share options and similar instruments is estimated using the Black-Scholes option-pricing model with the following assumptions for grants issued during fiscal 2009: an expected life averaging 6 years; an average volatility of 52%; no dividend yield; and a risk-free interest rate averaging 2%. The weighted-average fair value of options granted during fiscal 2009 was $13.71.

The following assumptions were used for option grants issued during fiscal 2008: an expected life averaging 6 years; an average volatility of 45%; no dividend yield; and a risk-free interest rate averaging 3%. The weighted-average fair value of options granted during fiscal 2008 was $9.63.

The following assumptions were used for option grants issued during fiscal 2007: an expected life averaging 6 years; an average volatility of 39%; no dividend yield; and a risk-free interest rate averaging 5%. The weighted-average fair value of options granted during fiscal 2007 was $6.43.

Employee Stock Purchase Plan

On October 5, 1998, the Company registered on Form S-8 the 1998 Employee Stock Purchase Plan. On March 13, 2008, the plan was amended and renamed the Amended and Restated Employee Stock Purchase Plan (ESPP). Under this plan, eligible employees may purchase shares of the Company's common stock, subject to certain limitations, at the lesser of 85 percent of the beginning or ending withholding period fair market value as defined in the plan. There are two six-month withholding periods in each fiscal year. At September 26, 2009, and September 27, 2008, options for 727,820 and 832,575 shares of common stock were available for purchase under the plan, respectively.

The grant-date fair value of employees' purchase rights granted during fiscal 2009 under the Company's ESPP is estimated using the Black-Scholes option-pricing model with the following assumptions: an expected life equal to 6 months; an average volatility of 66%; no dividend yield; and an average risk-free interest rate equal to 1.0%. The weighted-average fair value of purchase rights granted during fiscal 2009 was $9.49.

The assumptions used for fiscal 2008 ESPP grants were: an expected life equal to 6 months; an average volatility of 59%; no dividend yield; and an average risk-free interest rate equal to 3%. The weighted-average fair value of purchase rights granted during fiscal 2008 was $6.68.

The assumptions used for fiscal 2007 ESPP grants were: an expected life equal to 6 months; an average volatility of 36%; no dividend yield; and an average risk-free interest rate equal to 5%. The weighted-average fair value of purchase rights granted during fiscal 2007 was $2.69.

17. Defined Contribution Plan

The Company has a defined contribution plan which meets the requirements of section 401(k) of the Internal Revenue Code. As of January 1, 2008, the defined contribution plan of the Keurig subsidiary was merged into the Company's defined contribution plan. All regular full-time employees of the Company who are at least eighteen years of age and work a minimum of 36 hours per week are eligible to participate in the plan. The plan allows employees to defer a portion of their salary on a pre-tax basis and the Company contributes 50% of amounts contributed by employees up to 6% of their salary. Company contributions to the plan amounted to $1,525,000, $1,245,000, and $856,000, for the years ended September 26, 2009, September 27, 2008, and September 29, 2007, respectively.

Prior to January 1, 2008, the Keurig subsidiary of the Company had a separate defined contribution plan that met the requirements of section 401(k) of the Internal Revenue Code. All regular full-time employees of Keurig who were at least eighteen years of age and had completed three months of service were eligible to participate in the plan. The plan allowed employees to defer a portion of their salary on a pre-tax basis and the Company contributed 50% of amounts contributed by employees up to 6% of their salary. Company contributions to the Keurig plan amounted to $62,000 for the fiscal quarter ended December 29, 2007, and $296,000 for the fiscal year ended September 29, 2007.

18. Employee Stock Ownership Plan

On September 14, 2000, the Board of Directors of the Company adopted a resolution establishing the Green Mountain Coffee, Inc., Employee Stock Ownership Plan (the "ESOP") and the related Green Mountain Coffee, Inc., Employee Stock Ownership Trust (the "Trust"). The ESOP is qualified under sections 401(a) and 4975(e)(7) of the Internal Revenue Code. All employees of the Company (not including its Keurig subsidiary prior to 2009) with one year or more of service who are at least twenty-one years of age are eligible to participate in the Plan, in accordance with the terms of the Plan. The Company may, at its discretion, contribute shares of Company stock or cash that is used to purchase shares of Company stock. Company contributions are credited to eligible participants' accounts pro-rata based on their compensation. Plan participants become vested in their Plan benefits ratably over four years from the date of hire of the employee.

In April 2001, a total of 56,250 shares were purchased at a cost of $197,000 in the open market and distributed directly to participants. On April 16, 2001, the Company made a $2,000,000 loan to the Trust to provide funds for the open-market purchases of the Company's common stock. This loan bears interest at an annual rate of 8.5% and provides for annual repayments to the Company. The maturity date of the loan is the last business day of the Company's fiscal 2010 year. Between April 19, 2001, and August 21, 2001, the Trust purchased 332,100 shares of the Company's common stock at an average price of $6.03 per share. The fair value of unearned ESOP shares at September 26, 2009, and September 27, 2008, was $875,000 or $68.93 per share and $703,000 or $25.87 a share, respectively.

Compensation costs for the ESOP recorded by the Company were $1,000,000 for the year ended September 26, 2009, and $200,000 for each of the years ended September 27, 2008, and September 29, 2007.

After the close of 2008 and 2007 calendar years, 7,732 shares and 9,039 shares were transferred from the unallocated ESOP pool of shares and allocated to participants' accounts, respectively. At September 26, 2009, 14,507 shares had been committed to be released to participants' accounts at the end of the calendar 2009 year.

19. Deferred Compensation Plan

The 2002 Deferred Compensation Plan, amended in December 2007, permits certain highly compensated officers and employees of the Company and non-employee directors to defer eligible compensation payable for services rendered to the Company. Participants may elect to receive deferred compensation in the form of cash payments or shares of Company Common Stock on the date or dates selected by the participant or on such other date or dates specified in the Deferred Compensation Plan. The Deferred Compensation Plan is in effect for compensation earned on or after September 29, 2002. As of September 26, 2009, and September 27, 2008, 124,578 shares and 127,988 shares of Common Stock were available for future issuance under this Plan, respectively. As of September 26, 2009, and September 27, 2008, rights to acquire 25,422 and 22,012 shares of Common Stock were outstanding under this Plan, respectively.

20. Patent Litigation Settlement

On October 23, 2008, Keurig entered into a Settlement and License Agreement with Kraft Foods, Inc., Kraft Foods Global, Inc., and Tassimo Corporation (collectively "Kraft") providing for a complete settlement of Keurig's previously filed lawsuit against Kraft. Pursuant to the terms of the Settlement and License Agreement, Kraft paid to Keurig a lump sum of $17,000,000 and Keurig grants to Kraft and its affiliates a limited, non-exclusive, perpetual, worldwide, fully paid up license of certain Keurig patents.

21. Related party transactions

The Company uses travel services provided by Heritage Flight, a charter air services company acquired in September 2002 by Mr. Stiller, the Company's former CEO and current Chairman of the Board. During fiscal years 2009, 2008, and 2007, the Company was billed a total of $230,000, $305,000, and $234,000, respectively, by Heritage Flight for travel services provided to various employees of the Company.

22. Commitments, Lease Contingencies and Contingent Liabilities

Leases

The Company leases office and retail space, production, distribution and service facilities, and certain equipment under various non-cancelable operating leases, with terms ranging from one to twenty years. Property leases normally require payment of a minimum annual rental plus a pro-rata share of certain landlord operating expenses. Total rent expense under all operating leases was $6,759,000, $5,208,000, and $3,693,000 in fiscal 2009, 2008, and 2007, respectively.

Minimum future lease payments under non-cancellable operating leases for years subsequent to September 26, 2009, are as follows:

Fiscal Year	Operating Leases
2010	$ 5,243,000
2011	5,385,000
2012	4,657,000
2013	3,476,000
2014	3,284,000
Thereafter	5,926,000
Total minimum lease payments	$27,971,000

Stock Appreciation Rights

In conjunction with its purchase of Keurig's stock in 2002, the Company had issued Stock Appreciation Rights (SARs). Upon consummation of a liquidity event involving the stock of Keurig as defined in the SARs agreement, the Company would be required to record an expense equal to the difference between the value of Keurig's stock and the price paid by the Company when it acquired Keurig stock in 2002. The Merger was not considered a liquidity event, and therefore no payments under these SARs agreements were made upon consummation of the Merger. However, the agreement remains in effect and, under certain circumstances, if the Company were to sell Keurig, the sale may trigger a liquidity event under the agreement. At September 26, 2009, the Company estimated that it would have been required to record an expense equal to $7,006,000, had a liquidity event occurred.

23. Earnings per share

The following table illustrates the reconciliation of the numerator and denominator of basic and diluted income per share from continuing operations (dollars in thousands, except share and per share data):

	Year Ended		
	September 26, 2009	September 27, 2008	September 29, 2007
Numerator—basic and diluted earnings per share:			
Net income	$ 55,882	$ 22,299	$ 12,843
Denominator:			
Basic earnings per share—weighted average shares outstanding	37,993,196	35,924,697	34,875,647
Effect of dilutive securities—stock options	2,130,357	2,422,473	2,284,413
Diluted earnings per share—weighted average shares outstanding	40,123,553	38,347,170	37,160,060
Basic earnings per share	$ 1.47	$ 0.62	$ 0.37
Diluted earnings per share	$ 1.39	$ 0.58	$ 0.35

For the fiscal years ended September 26, 2009, September 27, 2008, and September 29, 2007, 216,000, 351,000, and 639,000 options for shares of common stock, respectively, have been excluded in the calculation of diluted earnings per share because they were antidilutive.

24. Unaudited Quarterly Financial Data

The following table presents the quarterly information for fiscal 2009 (dollars in thousands, except per share data). Each fiscal quarter comprises 13 weeks.

Fiscal 2009	December 27, 2008	March 28, 2009	June 27, 2009	September 26, 2009
Net sales	$196,980	$193,351	$190,509	$222,205
Gross profit	$ 53,350	$ 61,981	$ 64,081	$ 70,352
Net income	$ 14,384	$ 12,983	$ 14,140	$ 14,375
Earnings per share:				
Basic	$ 0.39	$ 0.35	$ 0.38	$ 0.35
Diluted	$ 0.36	$ 0.33	$ 0.36	$ 0.34

The following table presents the quarterly information for fiscal 2008 (dollars in thousands, except per share data). Each fiscal quarter comprises 13 weeks.

Fiscal 2008	December 29, 2007	March 29, 2008	June 28, 2008	September 27, 2008
Net sales	$126,445	$120,877	$118,120	$134,835
Gross profit	$ 43,289	$ 44,713	$ 42,494	$ 46,409
Net income	$ 2,925	$ 5,957	$ 6,329	$ 7,088
Earnings per share:				
Basic	$ 0.08	$ 0.17	$ 0.18	$ 0.20
Diluted	$ 0.08	$ 0.16	$ 0.16	$ 0.18

25. Subsequent events

On November 13, 2009, the Company entered into a Share Purchase Agreement to acquire the wholesale coffee and beverage business of Timothy's Coffees of the World, Inc. (Timothy's). In this acquisition, the Company acquired all of the issued and outstanding stock of Timothy's for a cash purchase price of approximately $157,000,000, in U.S. dollars, subject to adjustment. The transaction was financed using cash on hand. The purchase price is subject to a working capital adjustment and certain other adjustments to be settled within 120 days of the closing. The acquisition includes the Timothy's World Coffee brand and wholesale business and does not include the retail business. Timothy's will be maintained as a wholly-owned Canadian subsidiary, with operations integrated into the SCBU segment. Since the Share Purchase Agreement was consummated subsequent to the end of the Company's reporting period, Timothy's results of operations are not included in the Consolidated Statement of Operations contained herein.

The initial accounting for this acquisition was incomplete as of the date in which the Company's financial statements were issued. Accordingly, the Company will provide the required disclosures in the financial statements for the first quarter ending December 26, 2009, including the acquisition-date fair value of each major class of assets and liabilities acquired, any contingent consideration and the total amount of goodwill acquired and deductible for tax purposes.

The Company incurred approximately $400,000 of acquisition-related expenses in the fourth quarter of fiscal 2009, which are classified as general and administrative expense.

On November 2, 2009, Peet's Coffee & Tea, Inc. (Peet's) and Diedrich Coffee, Inc. (Diedrich) announced entering into an agreement under which Peet's would acquire Diedrich for $26.00 per share in a cash-and-stock transaction. On November 22, 2009, in response to a proposal from the Company to acquire Diedrich for $30.00 per share in cash, Peet's increased its proposal to $32.00 per share, also in a cash-and-stock transaction. On November 23, 2009, the Company submitted a revised proposal to acquire Diedrich for $32.00 per share in cash, to be effected pursuant to a cash tender offer in a transaction with a total enterprise value of approximately $265 million. As of the filing of this Form 10-K, the Diedrich Board of Directors has determined that our revised offer constitutes a superior proposal, as defined in the existing merger agreement between Diedrich and Peet's. Upon entering into a definitive merger agreement between the Company and Diedrich, the Company would proceed with a cash tender offer to acquire all outstanding shares of Diedrich. The Company anticipates that it would finance an acquisition of Diedrich through cash on hand and the existing credit facility.

The Company has performed an evaluation of subsequent events through November 25, 2009, which is the date the financial statements were issued.

Formulas

Cash Flow Analysis

Free Cash Flow No. 1 = Operating Cash Flows – net capital expenditures

Free Cash Flow No. 2 = Operating Cash Flows – Investing Cash Flows

Activity Analysis

Short-term (Operating) Activity Ratios

$$\text{Inventory Turnover} = \frac{\text{Cost of Goods Sold}}{\text{Average Inventory}}$$

$$\text{Average No. of Days' Inventory in Stock} = \frac{365}{\text{Inventory Turnover}}$$

$$\text{Receivables Turnover} = \frac{\text{Sales}}{\text{Average Trade Receivables}}$$

$$\text{Average No. of Days' Receivables Outstanding} = \frac{365}{\text{Receivables Turnover}}$$

$$\text{Payables Turnover} = \frac{\text{Purchases}}{\text{Average Accounts Payable}}$$

Compute Purchases as cost of goods sold + change in inventory

$$\text{Average No. of Days' Payables Outstanding} = \frac{365}{\text{Payables Turnover}}$$

$$\text{Working Capital Turnover} = \frac{\text{Sales}}{\text{Average Working Capital}}$$

Long-term (Investment) Activity Ratios

$$\text{Fixed Asset Turnover} = \frac{\text{Sales}}{\text{Average Fixed Assets}}$$

$$\text{Total Asset Turnover} = \frac{\text{Sales}}{\text{Average Total Assets}}$$

Liquidity Analysis

Length of Cash Cycle

Operating cycle = Average No. of Days Inventory in Stock + Average No. Days Receivables Outstanding

Cash cycle = Average No. of Days Inventory in Stock + Average No. of Days Receivables Outstanding – Average No. of Days Payables Outstanding.

Working Capital Ratios and Defensive Intervals

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

$$\text{Quick Ratio} = \frac{\text{Cash + Marketable Securities + Accounts Receivable}}{\text{Current Liabilities}}$$

$$\text{Cash Ratio} = \frac{\text{Cash + Marketable Securities}}{\text{Current Liabilities}}$$

$$\text{Cash Flow from Operations Ratio} = \frac{\text{Cash Flow from Operations}}{\text{Current Liabilities}}$$

$$\text{Defensive Interval} = 365 \times \frac{\text{Cash + Marketable Securities + Accounts Receivable}}{\text{Projected Expenditures}}$$

Long-Term Debt and Solvency Analysis

Debt Ratios

$$\text{Debt to Total Assets} = \frac{\text{Total Debt (Current and Long-term)}}{\text{Total Assets}}$$

$$\text{Debt to Equity} = \frac{\text{Total Debt (Current and Long-term)}}{\text{Total Equity}}$$

Interest Coverage Ratios

$$\text{Times Interest Earned} = \frac{\text{Earnings Before Interest and Taxes (EBIT)}}{\text{Interest Expense}}$$

$$\text{Fixed Charge Coverage} = \frac{\text{Earnings Before Fixed Charges and Taxes}}{\text{Fixed Charges}}$$

$$\text{Times Interest Earned (Cash Basis)} = \frac{\text{Adjusted Operating Cash Flow}}{\text{Interest Expense}}$$

Adjusted Operating Cash Flow = Cash from operations + fixed charges + tax payments

$$\text{Fixed Charge Coverage Ratio (Cash Basis)} = \frac{\text{Adjusted Operating Cash Flow}}{\text{Fixed Charges}}$$

Adjusted Operating Cash Flow = Cash from operations + fixed charges + tax payments

Capital Expenditure and CFO-to-Debt Ratios

$$\text{Capital Expenditure Ratio} = \frac{\text{Cash from Operations (CFO)}}{\text{Capital Expenditures}}$$

$$\text{CFO to Debt} = \frac{\text{Cash from Operations (CFO)}}{\text{Total Debt}}$$

Profitability Analysis

Return on Sales

$$\text{Gross Margin} = \frac{\text{Gross Profit}}{\text{Net Sales}}$$

$$\text{Operating Margin} = \frac{\text{Operating Income}}{\text{Net Sales}}$$

$$\text{Margin before Interest and Taxes} = \frac{\text{Earnings Before Interest and Taxes (EBIT)}}{\text{Net Sales}}$$

$$\text{Pretax Margin} = \frac{\text{Earnings Before Taxes (EBT)}}{\text{Net Sales}}$$

$$\text{Net Profit Margin (Return on Sales)} = \frac{\text{Net Income}}{\text{Net Sales}}$$

$$\text{Contribution Margin Ratio} = \frac{\text{Contribution}}{\text{Net Sales}} \text{ or } \frac{\text{1 - Variable Costs}}{\text{Net Sales}}$$

Contribution = Sales – variable costs

Return on Investment

$$\text{Return on Assets (ROA)} = \frac{\text{Net Income + After-Tax Interest Cost}}{\text{Average Total Assets}} \text{ or }$$

$$\frac{\text{Earnings before Interest and Taxes (EBIT)}}{\text{Average Total Assets}}$$

$$\text{Return on Total Capital (ROTC)} = \frac{\text{EBIT}}{\text{Average (Total Debt + Stockholders' Equity)}} \text{ or }$$

$$\frac{\text{Net Income + After-Tax Interest Expense}}{\text{Average (Total Debt + Stockholders' Equity)}}$$

$$\text{Return on Equity (ROE)} = \frac{\text{Pretax Income}}{\text{Average Stockholders' Equity}} \text{ or } \frac{\text{Net Income}}{\text{Average Stockholders' Equity}}$$

$$\text{Return on Common Equity (ROCE)} = \frac{\text{Net Income - Preferred Dividends}}{\text{Average Common Equity}}$$

Operating and Financial Leverage

Operating Leverage

$$\text{Contribution Margin Ratio} = \frac{\text{Contribution}}{\text{Net Sales}} \text{ or } \frac{\text{1 - Variable Costs}}{\text{Net Sales}}$$

Contribution = Sales – variable costs

$$\text{Operating Leverage Effect (OLE)} = \frac{\text{Contribution Margin Ratio}}{\text{Return on Sales}} = \frac{\text{Contribution}}{\text{Operating Income}}$$

% Change in Income = OLE x % Change in Sales

Financial Leverage

$$\text{Financial Leverage Effect (FLE)} = \frac{\text{Operating Income}}{\text{Net Income}}$$

Total Leverage Effect (TLE) = OLE x FLE

Analysis of Firm Performance

Disaggregation of ROA

$$\begin{array}{ccccc} \text{ROA} & = & \text{Total Asset Turnover} & \text{X} & \text{Return on Sales} \\ \frac{\text{Operating Income}}{\text{Average Assets}} & = & \frac{\text{Net Sales}}{\text{Average Assets}} & \text{X} & \frac{\text{Operating Income}}{\text{Net Sales}} \end{array}$$

Relationship of ROA to ROE

$$\text{ROE} = \text{ROA} + \left[(\text{ROA} - \text{Cost of Debt}) \times \frac{\text{Debt}}{\text{Equity}}\right] = \left(\text{ROA} - \frac{\text{Interest Cost}}{\text{Assets}}\right) \times \frac{\text{Assets}}{\text{Equity}}$$

Disaggregation of ROE

$$\begin{array}{ccccccc} \text{ROE} & = & \text{Profitability} & \text{X} & \text{Activity} & \text{X} & \text{Solvency} \\ \frac{\text{Net Income}}{\text{Equity}} & = & \frac{\text{Net Income}}{\text{Net Sales}} & \text{X} & \frac{\text{Net Sales}}{\text{Assets}} & \text{X} & \frac{\text{Assets}}{\text{Equity}} \end{array}$$

$$\begin{array}{ccccc} \text{Taxes} & \text{X} & \text{Financing} & \text{X} & \text{Operations} \\ \frac{\text{Net Income}}{\text{EBT}} & \text{X} & \frac{\text{EBT}}{\text{EBIT}} & & \frac{\text{EBIT}}{\text{Net Sales}} \end{array}$$

When computing Activity & Solvency, use Average Assets and Average Equity.

Earnings per Share

Simple Capital Structure

$$\text{Basic EPS} = \frac{\text{Earnings Available for Common Shares}}{\text{Weighted Average Common Shares Outstanding}}$$

Earnings Available for Common Shares = Net Income – Preferred Dividends

Complex Capital Structure

$$\text{Diluted EPS} = \frac{\text{Adjusted Income Available for Common Shares}}{\text{Weighted Average Common and Potential Common Shares Outstanding}}$$

Adjustments for Options and Warrants

$$\text{Incremental Shares} = \frac{\text{Average Market Price - Exercise Price}}{\text{Average Market Price}} \times \text{N}$$

N = number of shares issuable on exercise.

Other Ratios

Cash Flow per Share

EBITDA per Share

Book Value per Share

Price-to-Earnings

Price-to-Book Value

Dividend Payout Ratio = $\frac{\text{Dividends}}{\text{Net Income}}$

Inventories

Ending Inventory = Beginning Inventory + Purchases – Cost of Goods Sold

$\text{Inventory}_{\text{FIFO}} = \text{Inventory}_{\text{LIFO}} + \text{LIFO Reserve}$

Depreciation

Relative Age (%) = $\frac{\text{Accumulated Depreciation}}{\text{Ending Gross Investment}}$

Average Depreciable Life = $\frac{\text{Ending Gross Investment}}{\text{Depreciation Expense}}$

Average Age = $\frac{\text{Accumulated Depreciation}}{\text{Depreciation Expense}}$