FLOWERS FOODS INC
Form 10-Q
November 08, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended October 6, 2012

OR

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

For the transition period from to

Commission file number 1-16247

FLOWERS FOODS, INC.

(Exact name of registrant as specified in its charter)

GEORGIA	**58-2582379**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

1919 FLOWERS CIRCLE, THOMASVILLE, GEORGIA

(Address of principal executive offices)

31757

(Zip Code)

229/226-9110

(Registrant s telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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

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

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

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

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

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

TITLE OF EACH CLASS	OUTSTANDING AT NOVEMBER 2, 2012
Common Stock, $.01 par value	138,181,007

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Forward-Looking Statements

Statements contained in this filing and certain other written or oral statements made from time to time by the company and its representatives that are not historical facts are forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. Forward-looking statements relate to current expectations regarding our future financial condition and results of operations and are often identified by the use of words and phrases such as anticipate, believe, continue, could, estimate, expect, intend, may, plan, predict, project, shoul to, is expected to or will continue, or the negative of these terms or other comparable terminology. These forward-looking statements are based upon assumptions we believe are reasonable.

Forward-looking statements are based on current information and are subject to risks and uncertainties that could cause our actual results to differ materially from those projected. Certain factors that may cause actual results, performance, liquidity, and achievements to differ materially from those projected are discussed in this report and may include, but are not limited to:

unexpected changes in any of the following: (i) general economic and business conditions; (ii) the competitive setting in which we operate, including, advertising or promotional strategies by us or our competitors, as well as changes in consumer demand; (iii) interest rates and other terms available to us on our borrowings; (iv) energy and raw materials costs and availability and hedging counter-party risks; (v) relationships with or increased costs related to our employees, independent distributors and third party service providers; and (vi) laws and regulations (including environmental and health-related issues), accounting standards or tax rates in the markets in which we operate;

the loss or financial instability of any significant customer(s);

our ability to execute our business strategy, which may involve integration of recent acquisitions or the acquisition or disposition of assets at presently targeted values;

our ability to operate existing, and any new, manufacturing lines according to schedule;

the level of success we achieve in developing and introducing new products and entering new markets;

changes in consumer behavior, trends and preferences, including health and whole grain trends, and the movement toward more inexpensive store-branded products;

our ability to implement new technology and customer requirements as required;

the credit and business risks associated with independent distributors and our customers which operate in the highly competitive retail food and foodservice industries, including the amount of consolidation in these industries;

changes in pricing, customer and consumer reaction to pricing actions, and the pricing environment among competitors within the industry;

consolidation within the baking industry and related industries;

any business disruptions due to political instability, armed hostilities, incidents of terrorism, natural disasters, technological breakdowns, product contamination or the responses to or repercussions from any of these or similar events or conditions and our ability to insure against such events; and

regulation and legislation related to climate change that could affect our ability to procure our commodity needs or that necessitate additional unplanned capital expenditures.

The foregoing list of important factors does not include all such factors, nor necessarily present them in order of importance. In addition, you should consult other disclosures made by the company (such as in our other filings with the Securities and Exchange Commission (SEC) or in company press releases) for other factors that may cause actual results to differ materially from those projected by the company. Please refer to Part I, Item 1A., *Risk Factors*, of the company s Form 10-K filed on February 29, 2012 for additional information regarding factors that could affect the company s results of operations, financial condition and liquidity.

We caution you not to place undue reliance on forward-looking statements, as they speak only as of the date made and are inherently uncertain. The company undertakes no obligation to publicly revise or update such statements, except as required by law. You are advised, however, to consult any further public disclosures by the company (such as in our filings with the SEC or in company press releases) on related subjects.

We own or have rights to trademarks or trade names that we use in connection with the operation of our business, including our corporate names, logos and website names. In addition, we own or have the rights to copyrights, trade secrets and other proprietary rights that protect the content of our products and the formulations for such products. Solely for convenience, some of the trademarks, trade names and copyrights referred to in this Form 10-Q are listed without the ©, ® and symbols, but we will assert, to the fullest extent under applicable law, our rights to our copyrights, trademarks and trade names.

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FLOWERS FOODS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Amounts in thousands except share data)

(Unaudited)

	October 6, 2012	December 31, 2011
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 14,137	$ 7,783
Accounts and notes receivable, net of allowances of $888 and $171, respectively	221,581	185,603
Inventories, net:		
Raw materials	29,466	26,626
Packaging materials	18,145	15,820
Finished goods	40,447	31,650
	88,058	74,096
Spare parts and supplies	44,108	39,624
Deferred taxes	20,956	36,264
Other	23,201	35,200
Total current assets	412,041	378,570
Property, Plant and Equipment, net of accumulated depreciation of $799,028 and $735,629, respectively	728,912	685,487
Notes Receivable	100,946	102,322
Assets Held for Sale Distributor Routes	26,162	12,726
Other Assets	15,238	13,932
Goodwill	276,170	219,730
Other Intangible Assets, net	390,848	141,231
Total assets	$ 1,950,317	$ 1,553,998
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Current maturities of long-term debt and capital lease obligations	$ 72,016	$ 42,768
Accounts payable	132,879	115,138
Other accrued liabilities	129,402	110,513
Total current liabilities	334,297	268,419
Long-term liabilities:		

Long-term debt and capital leases	132,818	283,406
4.375% senior notes due April 1, 2022	399,089	
Total long-term debt and capital lease obligations	531,907	283,406
Other Liabilities:		
Post-retirement/post-employment obligations	133,831	155,263
Deferred taxes	38,398	35,375
Other	48,223	52,567
Total other liabilities	220,452	243,205
Stockholders Equity:		
Preferred stock $100 stated par value, 200,000 authorized and none issued		
Preferred stock $.01 stated par value, 800,000 authorized and none issued		
Common stock $.01 stated par value and $.001 current par value, 500,000,000 authorized shares, 152,488,008 shares and 152,488,008 shares issued, respectively	199	199
Treasury stock 14,307,001 shares and 16,506,822 shares, respectively	(196,259)	(221,246)
Capital in excess of par value	568,775	544,065
Retained earnings	581,125	547,997
Accumulated other comprehensive loss	(90,179)	(112,047)
Total stockholders equity	863,661	758,968
Total liabilities and stockholders equity	$ 1,950,317	$ 1,553,998

(See Accompanying Notes to Condensed Consolidated Financial Statements)

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FLOWERS FOODS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Amounts in thousands except per share data)

(Unaudited)

	For the Twelve Weeks Ended		For the Forty Weeks Ended	
	October 6, 2012	**October 8, 2011**	**October 6, 2012**	**October 8, 2011**
Sales	$ 717,282	$ 675,369	$ 2,297,049	$ 2,119,790
Materials, supplies, labor and other production costs (exclusive of depreciation and amortization shown separately below)	382,508	365,706	1,227,144	1,119,851
Selling, distribution and administrative expenses	257,326	239,084	833,829	775,841
Depreciation and amortization	24,757	22,816	76,751	71,706
Income from operations	52,691	47,763	159,325	152,392
Interest expense	(6,708)	(2,838)	(17,014)	(7,359)
Interest income	3,140	3,103	10,487	9,982
Income before income taxes	49,123	48,028	152,798	155,015
Income tax expense	17,892	17,009	55,244	54,625
Net income	$ 31,231	$ 31,019	$ 97,554	$ 100,390
Net Income Per Common Share:				
Basic:				
Net income per common share	$ 0.23	$ 0.23	$ 0.72	$ 0.74
Weighted average shares outstanding	138,027	135,617	136,348	135,384
Diluted:				
Net income per common share	$ 0.22	$ 0.23	$ 0.71	$ 0.73
Weighted average shares outstanding	139,717	137,207	138,110	136,851
Cash dividends paid per common share	$ 0.160	$ 0.150	$ 0.470	$ 0.433

(See Accompanying Notes to Condensed Consolidated Financial Statements)

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FLOWERS FOODS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Amounts in thousands)

(Unaudited)

	For the Twelve Weeks Ended		For the Forty Weeks Ended	
	October 6, 2012	October 8, 2011	October 6, 2012	October 8, 2011
Net income	$ 31,231	$ 31,019	$ 97,554	$ 100,390
Other comprehensive income, net of tax:				
Pension and postretirement plans:				
Amortization of prior service credit included in net income	(36)	(37)	(121)	(122)
Amortization of actuarial loss included in net income	679	381	2,264	1,267
Pension and postretirement plans, net of tax	643	344	2,143	1,145
Derivative instruments:				
Net change in fair value of derivatives	39	(8,078)	2,988	(17,078)
Loss (Gain) reclassified to net income	2,677	(2,054)	16,737	(22,894)
Derivative instruments, net of tax	2,716	(10,132)	19,725	(39,972)
Other comprehensive income (loss), net of tax	3,359	(9,788)	21,868	(38,827)
Comprehensive income	$ 34,590	$ 21,231	$ 119,422	$ 61,563

(See Accompanying Notes to Condensed Consolidated Financial Statements)

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FLOWERS FOODS, INC.

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY

(Amounts in thousands, except share data)

(Unaudited)

	Common Stock		Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock		Total
	Number of Shares Issued	Par Value				Number of Shares	Cost	
Balances at December 31, 2011	152,488,008	$ 199	$ 544,065	$ 547,997	$ (112,047)	(16,506,822)	$ (221,246)	$ 758,968
Net income				97,554				97,554
Derivative transactions, net of tax					19,725			19,725
Pension and postretirement plans, net of tax					2,143			2,143
Shares issued for acquisition			16,628			2,178,648	29,259	45,887
Exercise of stock options			(165)			690,115	9,277	9,112
Deferred stock issuance			(610)			45,405	610	
Amortization of share-based payment awards			6,834					6,834
Tax benefits related to share based payment awards			1,451					1,451
Performance-contingent restricted stock awards forfeitures and cancellations			606			(45,252)	(606)	
Stock repurchases						(670,742)	(13,587)	(13,587)
Issuance of deferred compensation			(34)			1,647	34	
Dividends paid on vested performance-contingent restricted stock awards and deferred share awards				(255)				(255)
Dividends paid $0.470 per common share				(64,171)				(64,171)
Balances at October 6, 2012	152,488,008	$ 199	$ 568,775	$ 581,125	$ (90,179)	(14,307,001)	$ (196,259)	$ 863,661

(See Accompanying Notes to Condensed Consolidated Financial Statements)

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FLOWERS FOODS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in thousands)

(Unaudited)

	For the Forty Weeks Ended October 6, 2012	For the Forty Weeks Ended October 8, 2011
CASH FLOWS PROVIDED BY (DISBURSED FOR) OPERATING ACTIVITIES:		
Net income	$ 97,554	$ 100,390
Adjustments to reconcile net income to net cash provided by operating activities:		
Stock based compensation	7,012	11,203
(Gain) loss reclassified from accumulated other comprehensive income to net income	24,972	(40,354)
Depreciation and amortization	76,751	71,706
Deferred income taxes	3,155	(10,520)
Provision for inventory obsolescence	804	934
Allowances for accounts receivable	1,995	460
Pension and postretirement plans expense	1,208	249
Other	(1,452)	(87)
Pension contributions	(18,143)	(10,962)
Changes in operating assets and liabilities:		
Accounts and notes receivable, net	(30,518)	(8,376)
Inventories, net	(10,270)	(15,845)
Hedging activities, net	5,627	(24,278)
Other assets	10,343	9,442
Accounts payable	10,761	3,565
Other accrued liabilities	2,430	7,258
NET CASH PROVIDED BY OPERATING ACTIVITIES	182,229	94,785
CASH FLOWS PROVIDED BY (DISBURSED FOR) INVESTING ACTIVITIES:		
Purchase of property, plant and equipment	(49,188)	(65,314)
Proceeds from sale of property, plant and equipment	1,103	2,339
Repurchase of distributor territories	(9,640)	(10,145)
Principal payments from notes receivable	11,056	9,651
Acquisitions, net of cash acquired	(318,426)	(164,485)
Contingent acquisition consideration payments		(5,000)
NET CASH DISBURSED FOR INVESTING ACTIVITIES	(365,095)	(232,954)
CASH FLOWS PROVIDED BY (DISBURSED FOR) FINANCING ACTIVITIES:		
Dividends paid	(64,426)	(58,770)
Exercise of stock options	9,112	12,721
Excess windfall tax benefit related to share-based payment awards	1,544	3,061
Payments for debt issuance costs	(3,877)	
Stock repurchases	(13,587)	(26,598)
Change in bank overdraft	3,287	2,962
Proceeds from debt borrowings	1,179,181	790,400
Debt and capital lease obligation payments	(922,014)	(581,978)
Payment of financing fees		(2,108)
Other		(80)

NET CASH PROVIDED BY FINANCING ACTIVITIES		189,220		139,610
Net increase in cash and cash equivalents		6,354		1,441
Cash and cash equivalents at beginning of period		7,783		6,755
Cash and cash equivalents at end of period	$	14,137	$	8,196

(See Accompanying Notes to Condensed Consolidated Financial Statements)

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FLOWERS FOODS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. BASIS OF PRESENTATION

INTERIM FINANCIAL STATEMENTS The accompanying unaudited condensed consolidated financial statements of Flowers Foods, Inc. (the company , us , we , or our) have been prepared by the company s management in accordance with generally accepted accounting principles in th United States of America (GAAP) for interim financial information and applicable rules and regulations of the Securities Exchange Act of 1934, as amended. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for audited financial statements. In the opinion of management, the unaudited condensed consolidated financial statements included herein contain all adjustments (consisting of only normal recurring accruals) necessary to present fairly the company s financial position, the results of its operations and its cash flows. The results of operations for the twelve and forty week periods ended October 6, 2012 and October 8, 2011 are not necessarily indicative of the results to be expected for a full fiscal year. The balance sheet at December 31, 2011 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. These financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the company s Annual Report on Form 10-K for the fiscal year ended December 31, 2011.

ESTIMATES The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The company believes the following critical accounting estimates affect its more significant judgments and estimates used in the preparation of its consolidated financial statements: revenue recognition, derivative instruments, valuation of long-lived assets, goodwill and other intangibles, self-insurance reserves, income tax expense and accruals and pension obligations. These estimates are summarized in the company s Annual Report on Form 10-K for the fiscal year ended December 31, 2011.

REPORTING PERIODS The company operates on a 52-53 week fiscal year ending the Saturday nearest December 31. Fiscal 2012 consists of 52 weeks, with the company s quarterly reporting periods as follows: first quarter ended April 21, 2012 (sixteen weeks), second quarter ended July 14, 2012 (twelve weeks), third quarter ended October 6, 2012 (twelve weeks) and fourth quarter ending December 29, 2012 (twelve weeks).

SEGMENTS The company is one of the largest producers and marketers of bakery products in the United States. The company consists of two business segments: direct-store-delivery segment (DSD segment) and warehouse delivery segment (warehouse segment). The DSD segment focuses on the production and marketing of bakery products to U.S. customers in the Southeast, Mid-Atlantic, Northeast and Southwest as well as select markets in California and Nevada primarily through its DSD system. The warehouse segment produces snack cakes and breads and rolls that are shipped both fresh and frozen to national retail, foodservice, vending, and co-pack customers through their warehouse channels.

SIGNIFICANT CUSTOMER Following is the effect our largest customer, Walmart/Sam s Club, had on the company s sales for the twelve and forty weeks ended October 6, 2012 and October 8, 2011. Walmart is the only customer to account for 10% or more of the company s sales.

	For the Twelve Weeks Ended		For the Forty Weeks Ended	
	October 6, 2012	October 8, 2011	October 6, 2012	October 8, 2011
	(Percent of Sales)		(Percent of Sales)	
DSD	16.9%	17.5%	17.6%	17.9%
Warehouse delivery	2.9	3.8	3.4	3.9
Total	19.8%	21.3%	21.0%	21.8%

SIGNIFICANT ACCOUNTING POLICIES There were no significant changes to our accounting policies from those disclosed in our Form 10-K filed for the year ended December 31, 2011.

ACQUISITION On July 21, 2012, we completed the acquisition of Lepage Bakeries, Inc. and certain of its affiliated companies (collectively, Lepage) for cash, deferred cash payments, and shares of Flowers common stock. This acquisition has been accounted for using the purchase method of accounting, with Flowers as the acquirer and Lepage as the acquiree. As of July 21, 2012, Lepage s results of operations are included in our DSD segment. Additional disclosure is in Note 4, *Acquisitions*.

2. RECENT ACCOUNTING PRONOUNCEMENTS NOT YET ADOPTED

In December 2011, the FASB issued guidance for offsetting (netting) assets and liabilities. This guidance requires entities to disclose both gross information and net information about both instruments and transactions subject to an agreement similar to a master netting agreement. This includes derivatives, sale and repurchase agreements and reverse sale and repurchase agreements, and securities borrowing and securities lending arrangements. These disclosures allow users of the financial statements to understand the effect of those arrangements on a company s financial position. This guidance is effective for annual reporting periods beginning on or after January 1, 2013 and interim periods within those annual periods. These requirements are retrospective for all comparative periods. The company is still analyzing the potential impact of this guidance on the company s consolidated financial statements.

In July 2012, the FASB issued guidance on testing indefinite-lived intangible assets for impairment. The guidance allows an entity the option first to assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that is not more likely than not that the indefinite-lived intangible asset is impaired, then the entity is not required to take further action. However, if an entity concludes otherwise, then it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount. This guidance is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. The company is analyzing the potential impact of this guidance on the company s consolidated financial statements.

3. COMPREHENSIVE INCOME (LOSS)

The company s total comprehensive income presently consists of net income, adjustments for our derivative financial instruments accounted for as cash flow hedges, and various pension and other postretirement benefit related items. Total comprehensive income, determined as net income adjusted by other comprehensive income, was $34.6 million and $119.4 million for the twelve and forty weeks ended October 6, 2012, respectively. Total comprehensive income was $21.2 million and $61.6 million for the twelve and forty weeks ended October 8, 2011, respectively.

During the forty weeks ended October 6, 2012, changes to accumulated other comprehensive loss, net of income tax, were as follows (amounts in thousands):

Accumulated other comprehensive loss, December 31, 2011	$	(112,047)
Derivative instruments transactions:		
Loss reclassified to earnings (materials, labor and other production costs), net of income tax of $10,478		16,737
Net amount of gain recognized on the effective portion of cash flow hedges, net of income tax of $1,870		2,988
Pension and postretirement plans transactions:		
Amortization of actuarial loss, net of income tax of $1,418		2,264
Amortization of prior service credits, net of income tax of $(77)		(121)
Accumulated other comprehensive loss, October 6, 2012	$	(90,179)

Amounts reclassified out of accumulated other comprehensive loss to net income that relate to commodity contracts are presented as an adjustment to reconcile net income to net cash provided by operating activities on the Condensed Consolidated Statements of Cash Flows. The gross amount reported on the Condensed Consolidated Statements of Cash Flows is $25.0 million. This is netted against the deferred tax amount of $9.6 million to yield the net amount of $15.4 million that can be found in the disclosures in Note 7, *Derivatives*, in the Amount of Gain or (Loss) Reclassified from Accumulated OCI Into Income (Effective Portion) table from the production costs disclosure.

The balance in accumulated other comprehensive income (loss) consists of the following:

	October 6, 2012	December 31, 2011
	(Amounts in thousands)	
Derivatives designated as cash flow hedges	$ 4,817	$ (14,908)
Pension and postretirement plans	(94,996)	(97,139)
Total	$ (90,179)	$ (112,047)

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4. ACQUISITIONS

On July 21, 2012, we completed the acquisition of Lepage in two separate but concurrent transactions. Pursuant to the Acquisition Agreement dated May 31, 2012 (the Acquisition Agreement), by and among Flowers, Lobsterco I, LLC, a Maine single-member limited liability company and indirect wholly owned subsidiary of Flowers (Lobsterco I), Lepage, RAL, Inc., a Maine corporation (RAL), Bakeast Company, a Maine general partnership (Bakeast Partnership), Bakeast Holdings, Inc., a Delaware corporation (Bakeast Holdings, and collectively with Lepage, RAL and Bakeast Partnership, the Acquired Entities), and the equityholders of the Acquired Entities named in the Acquisition Agreement (collectively, the Equityholders), Lobsterco I purchased from the Equityholders all of the issued and outstanding shares of the Acquired Entities in exchange for approximately $318.4 million in cash and $17.7 million in deferred cash payments.

Pursuant to the Agreement and Plan of Merger dated May 31, 2012 (the Merger Agreement), by and among Flowers, Lobsterco II, LLC, a Maine single-member limited liability company and indirect wholly owned subsidiary of Flowers (Lobsterco II), Aarow Leasing, Inc., a Maine corporation (Aarow), The Everest Company, Incorporated, a Maine corporation (Everest, and together with Aarow, the Acquired Companies), and the Shareholders, the Acquired Companies merged with and into Lobsterco II (the Merger) and all of the issued and outstanding shares of common stock of the Acquired Companies were exchanged for 2,178,648 shares of Flowers common stock.

Lepage operates three bakeries, two in Lewiston, Maine, and one in Brattleboro, Vermont. Lepage serves customers in the New England and New York markets making fresh bakery products under the Country Kitchen and Barowsky s brands. This acquisition provides a DSD platform to accelerate penetration of Nature s Own and Tastykake brands in the Northeast. The Lepage acquisition will be accounted for as a business combination.

The preliminary aggregate purchase price was $382.1 million as described in the table below. We incurred $6.7 million in acquisition-related costs during 2012 for Lepage. These expenses were included in the selling, distribution and administrative line item in the company s consolidated statement of income for the forty weeks ending on October 6, 2012. Acquisition-related costs were $5.1 million for the twelve weeks ending on October 6, 2012.

The following table summarizes the consideration transferred to acquire Lepage and the amounts of identified assets acquired and liabilities assumed based on the estimated fair value at the acquisition date (amounts in thousands):

Fair value of consideration transferred:	
Cash	$ 300,000
Cash paid for preliminary tax adjustment	18,426
Accrued working capital adjustment estimate	158
Deferred payment obligations	17,663
Flowers Foods, Inc. common stock	45,887
Total fair value of consideration transferred	$ 382,134
Recognized amounts of identifiable assets acquired and liabilities assumed:	
Financial assets	$ 11,487
Inventories	4,537
Property, plant, and equipment	60,332
Assets Held for sale Distributor routes	10,000
Identifiable intangible assets estimate	256,400
Deferred income taxes	(1,318)
Financial liabilities	(15,526)
Net recognized amounts of identifiable assets acquired	$ 325,912
Goodwill	$ 56,222

The $18.4 million cash payment for the preliminary tax adjustment is the amount paid to the Lepage equityholders at the closing of the acquisition in connection with certain incremental tax liabilities that will be incurred by those equityholders if the parties jointly make an election under Section 338(h)(10) of the Internal Revenue Code. In the event the parties decide not to make such an election, the payment will be returned to the company. There is an additional $2.1 million preliminary tax adjustment (recorded in the financial liabilities figure in the table above) the company will pay for entity level state taxes.

The $17.7 million obligation for the deferred payments represents the fair value of the fixed payments of $1,250,000 beginning on the first business day of each of the sixteen calendar quarters following the fourth anniversary of the closing of the

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Acquisition (A total of $20.0 million in gross payments). The first payment will be made by Flowers on October 1, 2016 and the final payment will be made on July 1, 2020. The difference between the fair value and the gross payments of $2.3 million is recorded as a reduction to the liability and will be amortized to expense over eight years.

We issued 2,178,648 shares of Flowers common stock to certain equityholders of Lepage with a fair value of $45.9 million. The number of shares issued was calculated by dividing $50.0 million by the average closing price of Flowers Foods, Inc. common stock for the twenty consecutive trading day period ending five trading days prior to the closing. The shares issued to the equityholders were separated into five categories with each category having a different holding period requirement. As a result, each holding period had a fair value assignment based on an implied fair value which was determined using the Black-Scholes call option formula for an option expiring on each restriction lapse date. The estimated exercise price is equal to the stock price on the last trading day before the closing on July 21, 2012 of $20.48. The table below outlines the determination of fair value and provides the assumptions used in the calculation. The fair value of the stock consideration is computed in the following table:

Restriction lapse year	2012	2013	2014	2015	2016	Total
Value of Flowers shares issued (thousands)	$ 25,000	$ 10,000	$ 5,000	$ 5,000	$ 5,000	$ 50,000
Implied Fair Value of Restricted shares (thousands)	$ 23,626	$ 9,154	$ 4,447	$ 4,363	$ 4,297	$ 45,887
Exercise price (per share)	$ 20.48	$ 20.48	$ 20.48	$ 20.48	$ 20.48	
Expected term (yrs)	0.37	1.00	2.00	3.00	4.00	
Volatility (%)	25.0%	25.0%	25.0%	25.0%	25.0%	
Risk-free rate (%)	0.1%	0.2%	0.2%	0.3%	0.4%	
Dividend Yield (%)	3.0%	3.0%	3.0%	3.0%	3.0%	

The following table presents the allocation of intangible assets subject to amortization (amounts in thousands, except amortization periods):

	Amount	Weighted average Amortization years
Customer relationships	69,000	25.0
Non-compete agreements	2,400	4.0
	$ 71,400	24.3

In addition to the amortizable intangible assets, there is an additional $185.0 million in indefinite-lived trademark intangible assets. Goodwill of $56.2 million is allocated to the DSD segment. Approximately $14.4 million of goodwill is deductible for income tax purposes. The primary reasons for the acquisition are to expand the company s footprint into the northeastern United States, to distribute *Country Kitchen* and *Borowsky s* products throughout our distribution network and to distribute *Nature s Own* and *Tastykake* products throughout the Lepage markets.

The fair value of trade receivables is $7.4 million. The gross amount receivable is $7.5 million of which $0.1 million is determined to be uncollectible. We did not acquire any other class of receivables as a result of the acquisition.

On May 20, 2011, a wholly owned subsidiary of the company acquired Tasty Baking Company (Tasty). Tasty operates two bakeries in Pennsylvania and serves customers primarily in the northeastern United States with an extensive line of *Tastykake* branded snacks. The results of Tasty s operations are included in the company s consolidated financial statements as of May 20, 2011 and are included in the company s DSD segment. The acquisition facilitated our expansion into new geographic markets and increased our manufacturing capacity. In addition, the *Tastykake* brand increased our position in the branded snack cake category.

The aggregate purchase price was $172.1 million, including the payoff of certain indebtedness, Tasty transaction expenses and change in control payments. The change in control payments were accrued because they were not paid at closing. During the forty weeks ended October 6, 2012, the company paid a portion of the accrued change in control payments. The acquisition was completed through a short-form merger following the company s tender offer through a wholly owned subsidiary for all of the outstanding shares of common stock of Tasty for $4.00 per share in cash, without interest and less any applicable withholding tax. Each share of Tasty not accepted for payment in the tender offer was converted into the right to receive $4.00 per share in cash as consideration, without interest and less any applicable withholding taxes.

The company incurred $6.2 million of acquisition-related costs during 2011 related to Tasty. These expenses were included in the selling, distribution and administrative expense line item in the company s consolidated statement of income for the 52 weeks ended December 31, 2011.

The following table summarizes the consideration transferred to acquire Tasty and the amounts of identified assets acquired and liabilities assumed based on the estimated fair value at the merger date (amounts in thousands):

Fair value of consideration transferred:		
Total tender, merger consideration, debt cash payments and change in control payments	$	172,109
Recognized amounts of identifiable assets acquired and liabilities assumed:		
Financial assets	$	44,153
Inventories		7,789
Property, plant, and equipment		99,796
Identifiable intangible assets		51,419
Deferred income taxes		15,516
Financial liabilities		(66,359)
Net recognized amounts of identifiable assets acquired	$	152,314
Goodwill	$	19,795

The following table presents the allocation of the intangible assets subject to amortization (amounts in thousands, except for amortization periods):

		Amount	Weighted average Amortization years
Trademarks	$	36,409	40.0
Customer relationships		13,487	25.0
Distributor relationships		1,523	15.0
	$	51,419	35.3

Goodwill of $19.8 million is allocated to the DSD segment. The primary reasons for the acquisition are to expand the company s footprint into the northeastern United States, distribute *TastyKake* products throughout our distribution network and to distribute *Nature s Own* products throughout the legacy Tasty distribution network. None of the intangible assets, including goodwill, are deductible for tax purposes. Goodwill increased by $0.2 million during the twelve weeks ended July 14, 2012.

The fair value of the assets acquired includes trade receivables of $17.3 million. The gross amount receivable is $20.2 million, of which $2.9 million is expected to be uncollectible. The company did not acquire any other class of receivable as a result of the merger with Tasty.

Acquisitions Pro Forma

We recognized revenues for Lepage during the quarter ended October 6, 2012 of $39.2 million. Income from operations for Lepage for the quarter ended October 6, 2012 was $6.7 million. We recorded Lepage s activity at the beginning of our third quarter. Therefore, there are no pro forma disclosures for the quarter in the table below.

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The following unaudited pro forma consolidated results of operations have been prepared as if the acquisitions of Lepage and Tasty occurred at the beginning of fiscal 2011 (amounts in thousands, except per share data):

	For the Twelve Weeks Ended October 8, 2011	For the Forty Weeks Ended October 8, 2011	For the Forty Weeks Ended October 6, 2012
Sales:			
As reported	$ 675,369	$ 2,119,790	$ 2,297,049
Pro forma	$ 718,891	$ 2,341,667	$ 2,396,569
Net income:			
As reported	$ 31,019	$ 100,390	$ 97,554
Pro forma	$ 35,545	$ 104,984	$ 97,503
Basic net income per common share:			
As reported	$ 0.23	$ 0.74	$ 0.72
Pro forma	$ 0.26	$ 0.76	$ 0.71
Diluted net income per common share:			
As reported	$ 0.23	$ 0.73	$ 0.71
Pro forma	$ 0.26	$ 0.76	$ 0.70

These amounts have been calculated after applying the company s accounting policies and adjusting the results to reflect additional depreciation and amortization that would have been charged assuming the fair value adjustments to property, plant, and equipment, and amortizable intangible assets had been applied. In addition, pro forma adjustments have been made for the interest incurred for financing the acquisitions with either the credit facility or the senior notes and to conform Tasty s revenue recognition policies to ours. Lepage s revenue recognition policy was consistent with ours and adjustments are not required. Taxes have also been adjusted for the effect of the items discussed. These pro forma results of operations have been prepared for comparative purposes only, and they do not purport to be indicative of the results of operations that actually would have resulted had the acquisition occurred on the date indicated or that may result in the future.

5. GOODWILL AND OTHER INTANGIBLES

The changes in the carrying amount of goodwill for the forty weeks ended October 6, 2012, are as follows (amounts in thousands):

	DSD	Warehouse delivery	Total
Balance as of December 31, 2011	$ 212,629	$ 7,101	$ 219,730
Increase in goodwill related to acquisitions (Note 4, *Acquisition*)	56,440		56,440
Balance as of October 6, 2012	$ 269,069	$ 7,101	$ 276,170

As of October 6, 2012 and December 31, 2011, the company had the following amounts related to amortizable intangible assets (amounts in thousands):

	October 6, 2012			December 31, 2011		
Asset	Cost	Accumulated Amortization	Net Value	Cost	Accumulated Amortization	Net Value
Trademarks	$ 71,677	$ 8,677	$ 63,000	$ 71,677	$ 6,790	$ 64,887
Customer relationships	157,921	22,539	135,382	88,921	18,162	70,759
Non-compete agreements	4,274	1,570	2,704	1,874	1,397	477
Distributor relationships	4,123	861	3,262	4,123	649	3,474
Supply agreement	1,050	1,050		1,050	916	134
Total	$ 239,045	$ 34,697	$ 204,348	$ 167,645	$ 27,914	$ 139,731

There are $186.5 million of indefinite lived intangible assets separately identified from goodwill.

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Aggregate amortization expense for the twelve and forty weeks ending October 6, 2012 and October 8, 2011 were as follows (amounts in thousands):

	Amortization expense
For the twelve weeks ended October 6, 2012	$ 2,504
For the twelve weeks ended October 8, 2011	$ 1,905
For the forty weeks ended October 6, 2012	$ 6,749
For the forty weeks ended October 8, 2011	$ 5,271

Estimated net amortization of intangibles for the remainder of fiscal 2012 and the next four years is as follows (amounts in thousands):

	Amortization of intangibles, net
Remainder of 2012	$ 2,504
2013	$ 10,831
2014	$ 10,691
2015	$ 10,498
2016	$ 10,124

6. FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying value of cash and cash equivalents, accounts receivable and short-term debt approximates fair value because of the short-term maturity of the instruments. Notes receivable are entered into in connection with the purchase of distributors territories by independent distributors. These notes receivable are recorded in the consolidated balance sheet at carrying value which represents the closest approximation of fair value. In accordance with GAAP, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. As a result, the appropriate interest rate that should be used to estimate the fair value of the distributor notes is the prevailing market rate at which similar loans would be made to distributors with similar credit ratings and for the same maturities. However, the company finances approximately 2,800 territory loans all with varied financial histories and credit risks. Considering the diversity of credit risks among the independent distributors, the company has no method to accurately determine a market interest rate to apply to the notes. The territories are generally financed for up to ten years and the distributor notes are collateralized by the independent distributors territories. The Tasty sales distribution routes are primarily owned by independent sales distributors that purchased the exclusive right to sell and distribute *Tastykake* products in defined geographical territories. The company maintains a wholly-owned subsidiary to assist in financing route purchase activities if requested by new independent sales distributors, using the route and certain associated assets as collateral. These notes receivable earn interest based on Treasury or LIBOR yields plus a spread.

Interest income for the distributor notes receivable was as follows (amounts in thousands):

	Interest Income
For the twelve weeks ended October 6, 2012	$ 3,140
For the twelve weeks ended October 8, 2011	$ 3,103
For the forty weeks ended October 6, 2012	$ 10,487
For the forty weeks ended October 8, 2011	$ 9,982

At October 6, 2012 and December 31, 2011, respectively, the carrying value of the distributor notes was as follows (amounts in thousands):

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