FARMER BROTHERS CO
Form 10-K
September 14, 2016

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

FORM 10-K
(Mark One)
þ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended June 30, 2016
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number: 001-34249
FARMER BROS. CO.
(Exact Name of Registrant as Specified in Its Charter)

| Delaware | 95-0725980 |
|---|---|
| (State of Incorporation) | (I.R.S. Employer Identification No.) |

13601 North Freeway, Suite 200, Fort Worth, Texas 76177
(Address of Principal Executive Offices; Zip Code)

888-998-2468
Registrant's telephone number, including area code

Securities registered pursuant to Section 12(b) of the Act:

| Title of Each Class | Name of Each Exchange on Which Registered |
|---|---|
| Common Stock, $1.00 par value | The NASDAQ Global Select Market |

Securities registered pursuant to Section 12(g) of the Act: None
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES ¨ NO þ
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES ¨ NO þ
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 þ 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 þ NO ¨
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨
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 ¨ Accelerated filer þ Non-accelerated filer ¨ Smaller reporting company ¨
(Do not check if a smaller reporting company)
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).
YES ¨ NO þ
The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the closing price at which the Farmer Bros. Co. common stock was sold on December 31, 2015 was $278.4 million.
As of September 12, 2016 the registrant had 16,781,561 shares outstanding of its common stock, par value $1.00 per share, which is the registrant's only class of common stock.
DOCUMENTS INCORPORATED BY REFERENCE
Specified portions of the registrant's definitive proxy statement to be filed with the U.S. Securities and Exchange Commission ("SEC") pursuant to Regulation 14A in connection with the registrant's 2016 Annual Meeting of Stockholders (the "Proxy Statement") are incorporated by reference into Part III of this report. Such Proxy Statement will be filed with the SEC not later than 120 days after the conclusion of the registrant's fiscal year ended June 30, 2016.

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report and other documents we file with the SEC contain forward-looking statements that are based on current expectations, estimates, forecasts and projections about us, our future performance, our financial condition, our products, our business strategy, our beliefs and our management's assumptions. In addition, we, or others on our behalf, may make forward-looking statements in press releases or written statements, or in our communications and discussions with investors and analysts in the normal course of business through meetings, webcasts, phone calls and conference calls. These forward-looking statements can be identified by the use of words like "anticipates," "estimates," "projects," "expects," "plans," "believes," "intends," "will," "could," "may," "assumes" and other words of similar meaning. T statements are based on management's beliefs, assumptions, estimates and observations of future events based on information available to our management at the time the statements are made and include any statements that do not relate to any historical or current fact. These statements are not guarantees of future performance and they involve certain risks, uncertainties and assumptions that are difficult to predict. Actual outcomes and results may differ materially from what is expressed, implied or forecast by our forward-looking statements due in part to the risks, uncertainties and assumptions set forth below in Part I, Item 1A, Risk Factors of this report, as well as those discussed elsewhere in this report and other factors described from time to time in our filings with the SEC. Reference is made in particular to forward-looking statements regarding construction, relocation to and operation of our new Texas facility, the timing and success of our relocation plan, product sales, expenses, earnings per share (EPS), and liquidity and capital resources. We intend these forward-looking statements to speak only at the date of this report and do not

undertake to update or revise these statements, whether as a result of new information, future events, changes in assumptions or otherwise, except as required under federal securities laws and the rules and regulations of the SEC.

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PART I

Item 1. Business

Overview

Farmer Bros. Co., a Delaware corporation (including its consolidated subsidiaries unless the context otherwise requires, the “Company,” “we,” “us,” “our” or “Farmer Bros.”), is a national coffee roaster, wholesaler and distributor of coffee, tea and culinary products. We serve a wide variety of customers, from small independent restaurants and foodservice operators to large institutional buyers like restaurant and convenience store chains, hotels, casinos, hospitals, and gourmet coffee houses, as well as grocery chains with private brand and consumer-branded coffee products. With a robust product line, including organic, Direct Trade, Direct Trade Verified Sustainable coffees or DTVS and other sustainably-produced coffees, iced and hot teas, cappuccino, spices, and baking/biscuit mixes, among others, we offer a comprehensive approach to our customers by providing not only a breadth of high-quality products, but also value-added services such as market insight, beverage planning, and equipment placement and service. We were founded in 1912, incorporated in California in 1923, and reincorporated in Delaware in 2004. We operate in one business segment.

Corporate Relocation

In an effort to make the Company more competitive and better positioned to capitalize on growth opportunities, in fiscal 2015 we began the process of relocating our corporate headquarters, product development lab, and manufacturing and distribution operations from Torrance, California to a new facility housing these operations currently under construction in Northlake, Texas (the “New Facility”).

Closure and Sale of the Torrance Facility

We began the process of closing our Torrance facility in the spring of 2015 in phases, as follows:

- Manufacturing and Distribution. In the fourth quarter of fiscal 2015, we transitioned our coffee roasting, grinding and packaging functions from our Torrance, California production facility and consolidated them with our Houston, Texas and Portland, Oregon production facilities, and moved our Houston distribution operations to our Oklahoma City, Oklahoma distribution center.
- Corporate Headquarters. During the first half of fiscal 2016, we transferred our primary administrative offices from Torrance to temporary leased offices in Fort Worth, Texas near the New Facility, including the transfer or new hire of approximately 140 employees.
- Sale of Spice Assets. In order to focus on our core product offerings, in the second quarter of fiscal 2016, we completed the sale of certain assets associated with our manufacture, processing and distribution of raw, processed and blended spices and certain other culinary products (collectively, the “Spice Assets”) to Harris Spice Company Inc. (“Harris”). We provided certain post-closing transition services to Harris which concluded during the fourth quarter of fiscal 2016. The sale of the Spice Assets does not represent a strategic shift for us and is not expected to have a material impact on our results of operations because we will continue to sell a complete portfolio of spice and other culinary products purchased from Harris under a supply agreement to our direct-store-delivery, or DSD, customers.
- Sale of the Torrance Facility. In the fourth quarter of fiscal 2016, we entered into a purchase and sale agreement to sell the Torrance facility. Subsequent to the fiscal year end, the sale of the Torrance facility closed on July 15, 2016. We have agreed to lease back the Torrance facility on a triple net basis through October 31, 2016, subject to two one-month extensions, at our option. As of June 30, 2016, the Torrance facility continued to house certain administrative functions and serve as a distribution facility and branch warehouse pending transition of the remaining Torrance operations to our other facilities.

Construction of the New Facility

In the first quarter of fiscal 2016, we entered into a lease agreement, (as amended the "Lease Agreement"), for the New Facility to be constructed by the lessor, at its expense. The Lease Agreement included an option to purchase the New Facility at a purchase price based on a percentage of the total project cost as of the closing date. In the fourth quarter of

fiscal 2016, we exercised the purchase option to acquire the partially constructed New Facility with a targeted closing date in the first quarter of fiscal 2017. Construction of and relocation to the New Facility are expected to be completed in the third quarter of fiscal 2017.

Products

We are a national coffee roaster, wholesaler and distributor of coffee, tea and culinary products manufactured under supply agreements, under our owned brands, as well as under private labels on behalf of certain customers. Our product categories consist of the following:

- a robust line of roast and ground coffee, including organic, Direct Trade, DTVS and other sustainably-produced offerings;
- frozen liquid coffee;
- flavored and unflavored iced and hot teas;
- culinary products including gelatins and puddings, soup bases, dressings, gravy and sauce mixes, pancake and biscuit mixes, jellies and preserves, and coffee-related products such as coffee filters, sugar and creamers;
- spices; and
- other beverages including cappuccino, cocoa, granitas, and ready-to-drink iced coffee.

Our owned brand products are sold primarily into the foodservice channel. Our primary brands include Farmer Brothers™, Artisan Collection by Farmer Brothers™, Superior® and Metropolitan™. Our Artisan coffee products include Direct Trade, Fair Trade Certified™, Rainforest Alliance Certified™, organic and proprietary blends. In addition, we sell whole bean and roast and ground flavored and unflavored coffee products under the Un Momento®, Collaborative Coffee™, Cain's™ and McGarvey® brands at retail. Our roast and ground coffee products are sold in traditional packaging, including bags and fractional packages, as well as single-serve packaging. For a description of the amount of net sales attributed to each of our product categories in fiscal 2016, 2015 and 2014, see Management's Discussion and Analysis of Financial Conditions and Results of Operations—Results of Operations included in Part II, Item 7 of this report.

Business Strategy

Overview

We develop great tasting products delivered with concierge service with the goal of a positive impact on our customers and the planet. Through our sustainability, stewardship, environmental efforts, and leadership we are not only committed to serving the finest products available, considering the cost needs of the customer, but also insist on their sustainable cultivation, manufacture and distribution whenever possible.

In order to achieve our mission, we have had to grow existing capabilities and develop new ones over the years. More recently, we have undertaken initiatives such as, but not limited to, the following:

- develop new products in response to demographic and other trends to better compete in areas such as premium coffee and tea;
- rethink aspects of our Company culture to improve productivity and employee engagement and to attract talent;
- embrace sustainability across our operations, in the quality of our products, as well as, how we treat our coffee growers; and
- ensure our systems and processes provide the highest quality products at a competitive cost, protection from cyber-risk, and a safe environment for our employees and partners.

We differentiate ourselves in the marketplace through our product offerings and through our customer service model, which includes:

- a wide variety of coffee product offerings and packaging options across numerous brands and quality tiers;

- beverage equipment placement and service;
- hassle-free inventory and product procurement management;
- DSD service;
- merchandising support; and
- product and menu insights.

Our services are conducted primarily in person through Route Sales Representatives, or RSRs, who develop personal relationships with chefs, restaurant owners and food buyers at their delivery locations. We also provide comprehensive coffee programs to our national account customers, including private brand development, green coffee procurement, hedging, category management, sustainable sourcing and supply chain management.

We distribute our owned brands primarily through our DSD network, while continuing to support and grow our private label and other national account business. Although currently a small portion of our distribution, we also distribute directly to consumers through our website and sell certain products such as Un Momento®, Collaborative Coffee™, Cain's™ and McGarvey® at retail.

Strategic Initiatives

We are focused on the following strategies to reduce costs, streamline our supply chain, improve the breadth of products and services we provide to our customers, and better position the Company to attract new customers:

Reduce Costs to Compete More Effectively

- New Facility. In fiscal 2015, we commenced work on a corporate relocation plan to replace our aging production facility in Torrance, California with a more efficient, state-of-the-art facility to be located in Northlake, Texas. We undertook this endeavor, in part, to pursue improved production efficiency to allow us to provide a more cost-competitive offering of high-quality products. We believe the expected improvements in production efficiency, combined with the wind-down and sale of our Torrance facility, should allow us to operate at a lower cost, generally.
- Third-Party Logistics. During the second half of fiscal 2016, we replaced our long-haul fleet operations with third-party logistics ("3PL"). We expect that this transportation arrangement will reduce our fuel consumption and empty trailer miles, while improving our intermodal and trailer cube utilization.
- Vendor Managed Inventory. During the second half of fiscal 2016, we entered into a vendor managed inventory arrangement with a third party. We anticipate that the use of vendor managed inventory arrangements will result in a reduction in raw material, finished goods and logistics costs, while improving packaging innovation and fulfillment.
- Warehouse Management. Subsequent to the fiscal year end, we entered into an agreement with a third party to provide warehouse management services for our New Facility. We expect the warehouse management services to facilitate cost savings by leveraging the third party's expertise in opening new facilities, implementing lean management practices, improving performance on certain key performance metrics, and standardizing best practices.

Optimize Sales, Pricing and Portfolio of Products

- Pricing and Products. In fiscal 2016, we built capability to more strategically optimize our pricing strategy across product, channel, customer and geographic segments. This process is designed to improve our average margins as well as retention rates. In addition, we continued our prior work optimizing SKU count and identifying opportunities to consolidate suppliers to improve costs and supply chain efficiency.
- DSD Reorganization. During the second half of fiscal 2016, we began to realign our DSD organization by undertaking initiatives intended to streamline communication and decision making, enhance branch organizational structure, and improve customer focus, including initiatives toward a comprehensive training program for all DSD team members to strengthen customer engagement.

- Accelerate Customer Acquisition Efforts. In fiscal 2016, we executed a regional test of our first advertising and lead generation campaign designed to improve our new customer acquisition rate within our DSD network.

Strategic Investment in Assets and Evaluation of Cost Structure

- Asset Utilization. We continue to look for ways to deploy our personnel, systems, assets and infrastructure to create or enhance stockholder value. Areas of focus have included corporate staffing and structure, methods of procurement, logistics, inventory management, supporting technology, and real estate assets.
- Branch Consolidation and Property Sales. In an effort to streamline our branch operations, in the fourth quarter of fiscal 2016, we sold two Northern California branch properties, with a third Northern California property under contract for sale, and we acquired a new branch facility in Hayward, California.
- Acquisitions. One of our investment priorities is exploring acquisitions that we believe will enhance long-term stockholder value and complement or enhance our product, equipment, service and/or distribution offerings to existing and new customer bases. For example, on September 9, 2016, through a newly-formed, wholly-owned subsidiary, we entered into an asset purchase agreement to acquire substantially all of the assets of China Mist Brands, Inc., dba China Mist Tea Company ("China Mist") for an aggregate purchase price of $11.3 million, with $10.8 million to be paid in cash at closing and $0.5 million to be paid as earnout if certain sales levels are achieved in the calendar years of 2017 and 2018. The transaction is expected to close during the second quarter of fiscal 2017. We anticipate that the acquisition of China Mist will give us a greater presence in the high-growth premium tea industry. See Note 24, Subsequent Events, of the Notes to Consolidated Financial Statements included in Part II, Item 8 of this report.

Corporate Capabilities and Alignment to Create Stockholder Value

- Investment in Human Resources. In fiscal 2016, we hired Isaac N. Johnston, Jr. as our Treasurer and Chief Financial Officer and Carolyn Suzanne Gargis as our VP of Human Relations. Each of these individuals brings a proven track record at both large consumer packaged goods operations as well as experience in dealing with smaller and more entrepreneurial companies. In addition, in fiscal 2016, we continued to emphasize greater alignment of employee individual goals with Company goals under our compensation plans in order to focus the entire organization on the effort to create value for our stockholders.

Drive High-Growth Product Categories and Address Broader Customer Needs

- Introduction of Collaborative Coffee™ and Redesign of Un Momento® Branded Retail Products. In an effort to address what we believe to be unmet consumer needs and improve margin within the retail grocery environment, in fiscal 2016 we launched the Collaborative Coffee™ brand into the retail grocery channel and completed a packaging redesign and product portfolio optimization of our Un Momento® retail branded product line. Collaborative Coffee™ offers coffee enthusiasts a super-premium, verified direct trade coffee at an approachable price. Un Momento® delivers Millennial Hispanic consumers appealing flavor variety and premium coffee at an exceptional value.

Expand Sustainability Leadership

- Sustainability. We believe that our collective efforts in measuring our social and environmental impact, creating programs for waste, water and energy reduction, promoting partnerships in our supply chain that aim at supply chain stability and food security, and focusing on employee engagement place us in a unique position to help retailers and foodservice operators create differentiated coffee programs that can include sustainable supply chains, direct trade purchasing, training and technical assistance, recycling and composting networks, and packaging material reductions. During fiscal 2016, we submitted our second third-party verified Carbon Disclosure Project survey for Scope 1, 2 and 3 emissions (direct emissions, indirect emissions from consumption of purchased electricity, heat or steam and other indirect emissions). Further, we published a sustainability report based on the Global Reporting Initiative’s compliance standard.
- LEED® Certified Facilities. Our Portland production and distribution facility was one of the first in the Northwest to achieve LEED® Silver Certification. We anticipate that our corporate offices at the New Facility will also be LEED® certified.

- Expansion of Direct Trade Verified Sustainable Program. In fiscal 2016, we completed our first third-party audit and verification of our DTVS program for sourcing green coffee. DTVS is an impact-based product or raw material sourcing framework that utilizes data-based sustainability metrics to influence an inclusive, collaborative approach to sustainability along the supply chain. To evaluate whether coffee is DTVS, we follow an outcome-based evaluation framework. The outcome of this evaluation weighs on where we invest our resources within our supply chain and has led to an increased level of transparency for us. DTVS represents a growing percentage of our coffee portfolio.
- Green Coffee Traceability. We are committed to the inclusion of more sustainably-sourced coffees in our supply chain. Regulatory and reputational risks can increase when customers, roasters and suppliers cannot see back into their supply chain. To address these concerns, as well as to deepen our commitment to the longevity of the coffee industry, in fiscal 2016 we began requiring our immediate suppliers of green coffee to enhance their reporting of traceability information on each lot of coffee sold to us.

Charitable Activities

We view charitable involvement as a part of our corporate responsibility and sustainability model: Social, Environmental, and Economic Development, or SEED. We endorse and support communities where our customers, employees, businesses, and suppliers are located, and who have enthusiastically supported us over the past 100 years. Our objective is to provide support toward a mission of supply chain stability with a focus on food security. Recipient organizations include those with strong local and regional networks that ensure that families have access to nutritious food. Donations may take the form of corporate cash contributions, product donations, employee volunteerism, and workplace giving (with or without matching contributions).

- Recipient organizations include Feeding America, Mercy Corps, Ronald McDonald House, and local food banks.
- We support industry organizations such as World Coffee Research, which commits to grow, protect, and enhance supplies of quality coffee while improving the livelihoods of the families who produce it, and the Specialty Coffee Association of America ("SCAA") Sustainability Council and the Coalition for Coffee Communities, which are focused on sustainability in coffee growing regions.
- Our employee-driven CAFÉ Crew organizes employee involvement at local charities and fund raisers, including running in the Chicago Marathon in support of Team Ronald McDonald House, riding in the Ride Against Hunger supported by Tarrant Area Food Bank, supporting delivery for Meals on Wheels, and hosting local food drives.
- All of our usable and near expiring products or products with damaged packaging are donated to Feeding America affiliated food banks nationwide, in an effort to fully eliminate edible food waste from the landfill.

Industry and Market Leadership

We have made the following investments in an effort to ensure we are well-positioned within the industry to take advantage of category trends, industry insights, and general coffee and tea knowledge to grow our business:

- Coffee Industry Leadership. Through our dedication to the craft of sourcing, blending and roasting coffee, and our participation and/or leadership positions with the SCAA, National Coffee Association, Coalition for Coffee Communities, International Women's Coffee Alliance, International Foodservice Manufacturers Association, Pacific Coast Coffee Association, Roasters Guild and World Coffee Research, we work to help shape the future of the coffee industry. We believe that due to our commitment to the industry, large retail and foodservice operators are drawn to working with us. We were among the first coffee roasters in the nation to receive SCAA certification of a state-of-the-art coffee lab and operate Public Domain®, a specialty coffeehouse in Portland, Oregon. Upon completion, we plan to submit our product development lab at the New Facility for SCAA certification.
- Market Insight and Consumer Research. We have developed a market insight capability internally that reinforces our business-to-business positioning as a thought leader in the coffee industry. We provide trend insights that help our customers create winning products and integrated marketing strategies for their own coffee brands.

Within this, we are focused on understanding key demographic groups such as Millennials and Hispanics, and key channel trends.

Raw Materials and Supplies

Our primary raw material is green coffee, an agricultural commodity traded on the Commodities and Futures Exchange that is subject to price fluctuations. Over the past five years, coffee "C" market price per pound ranged from approximately $1.02 to $2.90. The coffee "C" market price as of June 30, 2016 and 2015 was $1.46 and $1.32 per pound, respectively. Our principal packaging materials include cartonboard, corrugated and plastic. We also use a significant amount of electricity, natural gas, and other energy sources to operate our production and distribution facilities.

We purchase green coffee beans from multiple coffee regions around the world. Although coffee "C" market prices in fiscal 2016 were relatively low compared to historical levels, there can be no assurance that green coffee prices will remain at these levels in the future. Some of the Arabica coffee beans we purchase do not trade directly on the commodity markets. Rather, we purchase these coffee beans on a negotiated basis from coffee brokers, exporters and growers, including Direct Trade, DTVS and Fair Trade Certified™ sources and Rainforest Alliance Certified™ farms. Fair Trade Certified™ provides an assurance that farmer groups are receiving the Fair Trade minimum price and an additional premium for certified organic products through arrangements with cooperatives. Direct Trade and DTVS products provide similar assurance except that the arrangements are provided directly to farmers instead of through cooperatives in an effort to promote investment in better and more sustainable farming practices as well as to ensure a fairer price. Rainforest Alliance Certified™ coffee is grown using methods that help promote and preserve biodiversity, conserve scarce natural resources, and help farmers build sustainable lives. Our business model strives to reduce the impact of green coffee price fluctuations on our financial results and to protect and stabilize our margins, principally through customer arrangements and derivative instruments, as further explained in Note 7, Derivative Instruments, of the Notes to Consolidated Financial Statements included in Part II, Item 8 of this report.

Intellectual Property

We own a number of United States trademarks and service marks that have been registered with the United States Patent and Trademark Office. We also own other trademarks and service marks for which we have filed applications for U.S. registration. We have licenses to use certain trademarks outside of the United States and to certain product formulas, all subject to the terms of the agreements under which such licenses are granted. We believe our trademarks and service marks are integral to customer identification of our products. It is not possible to assess the impact of the loss of such identification. Depending on the jurisdiction, trademarks are generally valid as long as they are in use and/or their registrations are properly maintained and they have not been found to have become generic. Registrations of trademarks can also generally be renewed indefinitely as long as the trademarks are in use. In addition, we own numerous copyrights, registered and unregistered, registered domain names, and proprietary trade secrets, technology, know-how processes and other proprietary rights that are not registered.

Seasonality

We experience some seasonal influences. The winter months are generally the strongest sales months. However, our product line and geographic diversity provide some sales stability during the warmer months when coffee consumption ordinarily decreases. Additionally, we usually experience an increase in sales during the summer and early fall months from seasonal businesses located in vacation areas and from grocery retailers ramping up inventory for the winter selling season. Because of the seasonality of our business, results for any quarter are not necessarily indicative of the results that may be achieved for the full fiscal year.

Distribution

We operate production facilities in Portland, Oregon and Houston, Texas. Distribution takes place out of our Portland facility as well as three separate distribution centers in Northlake, Illinois; Oklahoma City, Oklahoma; and Moonachie, New Jersey. As of June 30, 2016, the Torrance facility continued to house certain administrative functions and serve as a distribution facility and branch warehouse pending transition of the remaining Torrance operations to our other facilities. Upon completion, the New Facility will serve as a production facility and distribution center for our products. Our products reach our customers primarily in two ways: through our nationwide DSD network of 450 delivery routes and 109 branch warehouses as of June 30, 2016, or direct-shipped via common

carriers or third-party distributors.

DSD sales are made "off-truck" to our customers at their places of business by our RSRs who generally are responsible for soliciting, selling and collecting from and otherwise maintaining our customer accounts. Our DSD business includes office coffee services whereby we provide office coffee products, including a variety of coffee brands and blends, brewing and beverage equipment, and foodservice supplies directly to offices. We operate a large fleet of trucks and other vehicles to distribute and deliver our products, and we rely on 3PL service providers for our long-haul distribution. We maintain inventory levels at each branch warehouse to promote minimal interruption in supply. We also sell directly to consumers through our website.

Customers

We serve a wide variety of customers, from small independent restaurants and foodservice operators to large institutional buyers like restaurant and convenience store chains, hotels, casinos, hospitals, and gourmet coffee houses, as well as grocery chains with private brand and consumer-branded coffee products. Although no single customer accounted for 10% or more of our net sales in any of the last three fiscal years, we have several large national account customers, the loss of or reduction in sales to one or more of which would be likely to have a material adverse effect on our results of operations. During fiscal 2016, our top five customers accounted for approximately 19% of our net sales.

Most of our customers rely on us for distribution; however, some of our customers use third-party distribution or conduct their own distribution. Some of our customers are "price" buyers, seeking the low-cost provider with little concern about service, while others find great value in the service programs we provide. We offer a full return policy to ensure satisfaction and extended terms for those customers who qualify.

Competition

The coffee industry is highly competitive, including with respect to price, product quality, service, convenience and innovation, and competition could become increasingly more intense due to the relatively low barriers to entry. We face competition from many sources, including the institutional foodservice divisions of multi-national manufacturers of retail products many of which have greater financial and other resources than we do, such as The J.M. Smucker Company (Folgers Coffee), Dunkin' Brands Group, Inc., The Kraft Heinz Company (Maxwell House Coffee) and Massimo Zanetti Beverage, wholesale foodservice distributors such as Sysco Corporation and US Foods, regional institutional coffee roasters such as S&D Coffee & Tea (Cott Corporation) and Boyd Coffee Company, and specialty coffee suppliers such as Keurig Green Mountain, Inc., Rogers Family Company, Distant Lands Coffee, Mother Parkers Tea & Coffee Inc., Starbucks Corporation and Peet's Coffee & Tea. As many of our customers are small foodservice operators, we also compete with cash and carry and club stores (physical and on-line) such as Costco, Sam's Club and Restaurant Depot and on-line retailers such as Amazon. We also face competition from growth in the single-serve, ready-to-drink coffee beverage and cold-brewed coffee channels, as well as competition from other beverages, such as soft drinks (including highly caffeinated energy drinks), juices, bottled water, teas and other beverages.

We believe our longevity, product quality and offerings, national distribution network, coffee industry and sustainability leadership, market insight, comprehensive approach to customer relationship management, and superior customer service are the major factors that differentiate us from our competitors. We compete well when these factors are valued by our customers, and we are less effective when only price matters. Our customer base is price sensitive, and we are often faced with price competition.

Working Capital

We finance our operations internally and through borrowings under our existing credit facility. For a description of our liquidity and capital resources, see Results of Operations and Liquidity, Capital Resources and Financial Condition included in Part II, Item 7 of this report and Note 18, Other Current Liabilities, of the Notes to Consolidated Financial Statements included in Part II, Item 8 of this report. Our working capital needs are greater in the months leading up to our peak sales period during the winter months, which we typically finance with cash flows from operations. In anticipation of our peak sales period, we typically increase inventory in the first quarter of the fiscal year. We use various techniques including demand forecasting and planning to determine appropriate inventory levels for seasonal demand.

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### Regulatory Environment

The conduct of our businesses, including, among other things, the production, storage, distribution, sale, labeling, quality and safety of our products, and occupational safety and health practices, are subject to various laws and regulations administered by federal, state and local governmental agencies in the United States. Our facilities are subject to various laws and regulations regarding the release of material into the environment and the protection of the environment in other ways. We are not a party to any material legal proceedings arising under these regulations except as described in Note 22, Commitments and Contingencies, of the Notes to Consolidated Financial Statements included in Part II, Item 8 of this report.

### Employees

On June 30, 2016, we employed 1,634 employees, 508 of whom are subject to collective bargaining agreements.

### Other

The nature of our business does not provide for maintenance of or reliance upon a sales backlog. None of our business is subject to renegotiation of profits or termination of contracts or subcontracts at the election of the government. We have no material revenues from foreign operations or long-lived assets located in foreign countries.

### Available Information

Our Internet website address is http://www.farmerbros.com (the website address is not intended to function as a hyperlink, and the information contained in our website is not intended to be part of this filing), where we make available, free of charge, through a link maintained on our website under the heading “Investor Relations—SEC Filings,” copies of our annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, including amendments thereto, as soon as reasonably practicable after filing such material electronically or otherwise furnishing it to the SEC. Copies of our Corporate Governance Guidelines, the Charters of the Audit, Compensation, and Nominating and Corporate Governance Committees of the Board of Directors, and our Code of Conduct and Ethics can also be found on our website.

## Item 1A. Risk Factors

You should carefully consider each of the following factors, as well as the other information in this report, in evaluating our business and prospects. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently consider immaterial may also negatively affect our business operations. If any of the following risks actually occurs, our business and financial results could be harmed. In that case, the trading price of our common stock could decline.

Relocation to the New Facility may be unsuccessful or less successful than we presently anticipate, which may adversely affect our business, operating results and financial condition.

We cannot guarantee that we will be successful in implementing the relocation to the New Facility in accordance with our expectations, in a timely manner or at all, which may adversely impact our business, operating results and financial condition. Relocation to the New Facility could disrupt our supply chain and ongoing operations, which could adversely affect our ability to deliver products both on a timely basis and in accordance with customer requirements, the effect of which could delay revenues or result in lost business opportunities. Our existing production facilities in Portland and Houston have been operating at much higher utilization rates than they have historically pending completion of the New Facility. In the event of significant increases in demand that precede the completion of and relocation to the New Facility, we may be required to increase staffing, including through temporary labor and overtime, use third-party manufacturers, lease additional production facilities, or some combination of those alternatives or others to satisfy demand. There can be no assurance that we would be able to identify appropriate third-party providers on a timely basis or at all. In addition, our success depends, in large part, on our ability to attract and retain skilled people. Competition for the best people in many of our key positions may be intense, and we may not be able to attract and retain sufficiently skilled people at the New Facility. Costs associated with the exit from our Torrance facility and the construction and relocation to, and operation of, the New Facility may exceed our expectations, which could interfere with our ability to achieve our business objectives or could cause us to incur indebtedness in amounts in excess of expectations. In addition, failure to satisfy the conditions of governmental incentives relating to the New Facility could result in higher than expected costs.

Increases in the cost of green coffee could reduce our gross margin and profit.

Our primary raw material is green coffee, an agricultural commodity traded on the Commodities and Futures Exchange that is subject to price fluctuations. Although coffee “C” market prices in fiscal 2016 were relatively low compared to historical levels, there can be no assurance that green coffee prices will remain at these levels in the future. The supply and price of green coffee may be impacted by, among other things, weather, natural disasters, real or perceived supply shortages, crop disease (such as coffee rust) and pests, general increase in farm inputs and costs of production, political and economic conditions, labor actions, foreign currency fluctuations, armed conflict in coffee producing nations, acts of terrorism, government actions and trade barriers, and the actions of producer organizations that have historically attempted to influence green coffee prices through agreements establishing export quotas or by restricting coffee supplies. Speculative trading in coffee commodities can also influence coffee prices. Additionally, specialty green coffees tend to trade on a negotiated basis at a premium above the “C” market price which premium, depending on the supply and demand at the time of purchase, may be significant. Increases in the “C” market price may also impact our ability to enter into green coffee purchase commitments at a fixed price or at a price to be fixed whereby the price at which the base “C” market price will be fixed has not yet been established. There can be no assurance that our purchasing practices and hedging activities will mitigate future price risk. As a result, increases in the cost of green coffee could have an adverse impact on our profitability.

Our efforts to secure an adequate supply of quality coffees may be unsuccessful and impact our ability to supply our customers or expose us to commodity price risk.

Maintaining a steady supply of green coffee is essential to keeping inventory levels low while securing sufficient stock to meet customer needs. Some of the Arabica coffee beans we purchase do not trade directly on the commodity markets. Rather, we purchase these coffee beans on a negotiated basis from coffee brokers, exporters and growers. If any of these supply relationships deteriorate, we may be unable to procure a sufficient quantity of high quality coffee beans at prices acceptable to us or at all. Further, non-performance by suppliers could expose us to credit and supply risk under coffee purchase commitments for delivery in the future. In addition, the political situation in many of the

Arabica coffee growing regions, including Africa, Indonesia, and Central and South America, can be unstable, and such instability could affect our

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ability to purchase coffee from those regions. If green coffee beans from a region become unavailable or prohibitively expensive, we could be forced to use alternative coffee beans or discontinue certain blends, which could adversely impact our sales. A raw material shortage could result in a deterioration of our relationship with our customers, decreased revenues or could impair our ability to expand our business.

Changes in green coffee commodity prices may not be immediately reflected in our cost of goods sold and may increase volatility in our results.

We purchase over-the-counter coffee derivative instruments to enable us to lock in the price of green coffee commodity purchases on our behalf or at the direction of our customers under commodity-based pricing arrangements. Although we account for certain coffee-related derivative instruments as accounting hedges, the portion of open hedging contracts that are not 100% effective as cash flow hedges and those that are not designated as accounting hedges are marked to period-end market price and unrealized gains or losses based on whether the period-end market price was higher or lower than the price we locked-in are recognized in our financial results at the end of each reporting period. If the period-end green coffee commodity prices decline below our locked in price for these derivative instruments, we will be required to recognize the resulting losses in our results of operations. Further, changes in commodity prices and the number of coffee-related derivative instruments held could have a significant impact on cash deposit requirements under our broker and counterparty agreements. Such transactions could cause volatility in our results because the recognition of losses and the offsetting gains may occur in different fiscal periods. Rapid, sharp decreases in the cost of green coffee could also force us to lower sales prices before realizing cost reductions in our green coffee inventory.

Our business and results of operations are highly dependent upon sales of roast and ground coffee products. Any decrease in the demand for coffee could materially adversely affect our business and financial results.

Sales of roast and ground coffee represented approximately 61%, 61% and 60% of our net sales in the fiscal years ended June 30, 2016, 2015 and 2014, respectively. Demand for our products is affected by, among other things, consumer tastes and preferences, global economic conditions, demographic trends and competing products. Any decrease in demand for our roast and ground coffee products would cause our sales and profitability to decline.

Price increases may not be sufficient to offset cost increases or may result in volume declines which could adversely impact our revenues and gross margin.

Customers generally pay for our products based either on an announced price schedule or under commodity-based pricing arrangements whereby the changes in green coffee commodity costs are passed through to the customer. The pricing schedule is generally subject to adjustment, either on contractual terms or in accordance with periodic product price adjustments, which may result in a lag in our ability to correlate the changes in our prices with fluctuations in the cost of raw materials and other inputs. Depending on contractual restrictions, we may be unable to pass some or all of these cost increases to our customers by increasing the selling prices of our products. If we are not successful in increasing selling prices sufficiently to offset increased raw material and other input costs, including packaging, direct labor and other overhead, or if our sales volume decreases significantly as a result of price increases, our results of operations and financial condition may be adversely affected.

We rely on co-packers to provide our supply of tea, spice and culinary products. Any failure by co-packers to fulfill their obligations or any termination or renegotiation of our co-pack agreements could adversely affect our results of operations.

We have a number of supply agreements with co-packers that require them to provide us with specific finished goods, including tea, spice and culinary products. For some of our products we essentially rely upon a single co-packer as our sole-source for the product. The failure for any reason of any such sole-source or other co-packer to fulfill its obligations under the applicable agreements with us or the termination or renegotiation of any such co-pack agreement could result in disruptions to our supply of finished goods and have an adverse effect on our results of operations. Additionally, our co-packers are subject to risk, including labor disputes, union organizing activities, financial liquidity, inclement weather, natural disasters, supply constraints, and general economic and political conditions that could limit their ability to timely provide us with acceptable products, which could disrupt our supply of finished goods, or require that we incur additional expense by providing financial accommodations to the co-packer or taking other steps to seek to minimize or avoid supply disruption, such as establishing a new co-pack arrangement with

another provider. A new co-pack arrangement may not be available on terms as favorable to us as our existing co-pack arrangements, if at all.

Competition in the coffee industry and beverage category could impact our profitability.
The coffee industry is highly competitive, including with respect to price, product quality, service, convenience and innovation, and competition could become increasingly more intense due to the relatively low barriers to entry. We face competition from many sources, including the institutional foodservice divisions of multi-national manufacturers of retail products many of which have greater financial and other resources than we do, wholesale foodservice distributors, regional institutional coffee roasters, and specialty coffee suppliers. As many of our customers are small foodservice operators, we also compete with cash and carry and club stores and on-line retailers. If we do not succeed in differentiating ourselves through, among other things, our product and service offerings, then our competitive position may be weakened and our sales and profitability may be materially adversely affected. If, due to competitive pressures or contractual restrictions, we are required to reduce prices to attract market share or we are unable to increase prices in response to commodity and other cost increases, our results of operations could be adversely affected if we are not able to increase sales volumes to offset the margin declines. Increased competition in the single-serve, ready-to-drink coffee beverage and cold-brewed coffee channels, as well as competition from other beverages, such as soft drinks (including highly caffeinated energy drinks), juices, bottled water, teas and other beverages, may also have an adverse impact on sales of our coffee products.
We face exposure to other commodity cost fluctuations, which could impact our margins and profitability.
In addition to green coffee, we are exposed to cost fluctuations in other commodities under supply arrangements, including tea, spices, and packaging materials such as cartonboard, corrugated and plastic. We purchase certain finished goods and packaging materials under cost-plus supply arrangements whereby our cost may increase based on an increase in the underlying commodity price. The cost of these commodities depend on various factors beyond our control, including economic and political conditions, foreign currency fluctuations, and global weather patterns. Unlike green coffee, we do not purchase any derivative instruments to hedge cost fluctuations in these other commodities. As a result, to the extent we are unable to pass along such costs to our customers through price increases, our margins and profitability will decrease.
Increase in the cost, disruption of supply or shortage of energy or fuel could affect our profitability.
We operate a large fleet of trucks and other vehicles to distribute and deliver our products, and we rely on 3PL service providers for our long-haul distribution. Certain products are also distributed by third parties or direct shipped via common carrier. In addition, we use a significant amount of electricity, natural gas and other energy sources to operate our production and distribution facilities. An increase in the price, disruption of supply or shortage of fuel and other energy sources that may be caused by increasing demand or by events such as natural disasters, power outages, or the like, could lead to higher electricity, transportation and other commodity costs, including the pass-through of such costs under our agreements with 3PL service providers and other suppliers, that could negatively impact our profitability.
Loss of business from one or more of our large national account customers and efforts by these customers to improve their profitability could have a material adverse effect on our operations.
We have several large national account customers, the loss of or reduction in sales to one or more of which is likely to have a material adverse effect on our results of operations. We generally do not have long-term contracts with our customers. Accordingly, our customers can stop purchasing our products at any time without penalty and are free to purchase products from our competitors. There can be no assurance that our customers will continue to purchase our products in the same quantities as they have in the past. In addition, because of the competitive environment facing many of our customers, they have increasingly sought to improve their profitability through pricing concessions and more favorable trade terms. To the extent we provide pricing concessions or favorable trade terms, our margins would be reduced. If we are unable to continue to offer terms that are acceptable to our customers, they may reduce purchases of our products which would adversely affect our financial performance. Requirements that may be imposed on us by our customers, such as sustainability, inventory management or product specification requirements, may have an adverse effect on our results of operations. Additionally, our customers may face financial difficulties, bankruptcy or other business disruptions that may impact their operations and their purchases from us and may affect their ability to pay us for products which could adversely affect our sales and profitability.

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We rely on information technology and are dependent on enterprise resource planning software in our operations. Any material failure, inadequacy, interruption or security failure of that technology could affect our ability to effectively operate our business.
Our ability to effectively manage our business, maintain financial accuracy and efficiency, comply with regulatory, financial reporting, legal and tax requirements, and coordinate the production, distribution and sale of our products depends significantly on the reliability, capacity and integrity of information technology systems on which we rely. We are also dependent on enterprise resource planning software for some of our information technology systems and support. The failure of these systems to operate effectively and continuously, problems with transitioning to upgraded or replacement systems, including, without limitation, in connection with the relocation to the New Facility, flaws in third-party software, or a breach in security of these systems could result in delays in processing replenishment orders from our branch warehouses, an inability to record input costs or product sales accurately or at all, an impaired understanding of our operations and results, and reduced operational efficiency. Failure to effectively allocate and manage our resources to support our information technology infrastructure could result in transaction errors, processing inefficiencies, the loss of customers, business disruptions, or the loss of sensitive or confidential data through security breach or otherwise. Significant capital investments could be required to remediate any potential problems or to otherwise protect against security breaches or to address problems caused by breaches. In addition, if we are unable to prevent security breaches, we may experience a loss of critical data or suffer financial or reputational damage or penalties because of the unauthorized disclosure of confidential information belonging to us or to our customers or suppliers. Our insurance policies do not cover losses caused by security breaches.
Interruption of our supply chain, including a disruption in operations at any of our production and distribution facilities, could affect our ability to manufacture or distribute products and could adversely affect our business and sales.
We rely on a limited number of production and distribution facilities. A disruption in operations at any of these facilities or any other disruption in our supply chain relating to green coffee supply, service by our 3PL service providers or common carriers, supply of raw materials and finished goods under vendor-managed inventory arrangements, or otherwise, whether as a result of casualty, natural disaster, power loss, telecommunications failure, terrorism, labor shortages, contractual disputes or other causes, could significantly impair our ability to operate our business and adversely affect our relationship with our customers. In such event, we may also be forced to contract with alternative, and possibly more expensive, suppliers or service providers, which would adversely affect our profitability. Additionally, the majority of our green coffee comes through the Ports of Houston and Seattle. Any interruption to port operations, highway arteries, gas mains or electrical service in the areas where we operate or obtain products or inventory could restrict our ability to manufacture and distribute our products for sale and would adversely impact our business.
Our failure to accurately forecast demand for our products or quickly respond to forecast changes could have an adverse effect on our sales.
Based upon our forecasts of customer demand, we set target levels for the manufacture of our products and for the purchase of green coffee in advance of customer orders. If our forecasts exceed demand, we could experience excess inventory and manufacturing capacity and/or price decreases or we could be required to write-down expired or obsolete inventory, which could adversely impact our financial performance. Alternatively, if demand for our products increases more than we currently forecast and we are unable to satisfy increases in demand through our current manufacturing capacity or appropriate third-party providers, or we are unable to obtain sufficient raw materials inventories under vendor-managed inventory arrangements, we may not be able to satisfy customer demand for our products which could have an adverse impact on our sales and reputation.
We depend on the expertise of key personnel. The unexpected loss of one or more of these key employees or difficulty recruiting and retaining qualified personnel could have a material adverse effect on our operations and competitive position.
Our success largely depends on the efforts and abilities of our executive officers and other key personnel. There is limited management depth in certain key positions throughout the Company. We must continue to recruit, retain and motivate management and other employees sufficiently to maintain our current business and support our projected

growth and strategic initiatives. The loss of key employees could adversely affect our operations and competitive position. We do not maintain key person life insurance policies on any of our executive officers.

Investment in acquisitions could disrupt our ongoing business, not result in the anticipated benefits and present risks not originally contemplated.
We have invested and in the future may invest in acquisitions which may involve risks and uncertainties, including the risks involved with entering new product categories or geographic regions, the difficulty in integrating newly-acquired businesses or brands, contingent risks associated with the past operations of or other unanticipated problems arising in any acquired business, the challenges of achieving strategic objectives and other benefits expected from acquisitions, the diversion of our attention and resources from our operations and other initiatives, the potential impairment of acquired assets and liabilities, the performance of underlying products, capabilities or technologies, and the potential loss of key personnel and customers of the acquired businesses. Additionally, any such acquisitions may result in potentially dilutive issuances of our equity securities, the incurrence of additional debt, restructuring charges and the recognition of significant charges for depreciation and amortization related to intangible assets. There can be no assurance that any such acquisitions will be identified or that we will be able to consummate any such acquisitions on terms favorable to us or at all. If any such acquisitions are not successful, our business and results of operations could be adversely affected.
Volatility in the equity markets could reduce the value of our investment portfolio.
The value of our investment portfolio may be adversely affected by interest rate fluctuations, downgrades in credit ratings, illiquidity in the capital markets and other factors which may result in other than temporary declines in the value of our investments. Any of these events could cause us to record impairment charges with respect to our investment portfolio or to realize losses on the sale of investments. We have incurred operating losses in the past and if we incur operating losses in the future on a continual basis, a portion or all of this investment portfolio may be required to be liquidated to fund those losses.
Increased severe weather patterns may increase commodity costs, damage our facilities and disrupt our production capabilities and supply chain.
There is increasing concern that a gradual increase in global average temperatures due to increased concentration of carbon dioxide and other greenhouse gases in the atmosphere have caused and will continue to cause significant changes in weather patterns around the globe and an increase in the frequency and severity of extreme weather events. Major weather phenomena like El Niño and La Niña are dramatically affecting coffee growing countries. The wet and dry seasons are becoming unpredictable in timing and duration, causing improper development of the coffee cherries. A large portion of the global coffee supply comes from Brazil and so the climate and growing conditions in that country carry heightened importance. Decreased agricultural productivity in certain regions as a result of changing weather patterns may affect the quality, limit the availability or increase the cost of key agricultural commodities, such as green coffee and tea, which are important ingredients for our products. We have experienced storm-related damages and disruptions to our operations in the recent past related to both winter storms as well as heavy rainfall and flooding. Increased frequency or duration of extreme weather conditions could also damage our facilities, impair production capabilities, disrupt our supply chain or impact demand for our products. As a result, the effects of climate change could have a long-term adverse impact on our business and results of operations.
Volatility in the equity markets or interest rate fluctuations could substantially increase our pension funding requirements and negatively impact our financial position.
At June 30, 2016, the projected benefit obligation under our single employer defined benefit pension plans exceeded the fair value of plan assets. The difference between the projected benefit obligation and the fair value of plan assets, or the funded status of the plans, significantly affects the net periodic benefit cost and ongoing funding requirements of those plans. Among other factors, changes in interest rates, mortality rates, early retirement rates, mix of plan asset investments, investment returns and the market value of plan assets can affect the level of plan funding, cause volatility in the net periodic benefit cost, increase our future funding requirements and require payments to the Pension Benefit Guaranty Corporation.
Our sales and distribution network is costly to maintain.
Our sales and distribution network requires a large investment to maintain and operate. Costs include the fluctuating cost of gasoline, diesel and oil, costs associated with managing, purchasing, leasing, maintaining and insuring a fleet of delivery vehicles, the cost of maintaining distribution centers and branch warehouses throughout the country, the

cost of our

long-haul distribution, and the cost of hiring, training and managing our sales force. Many of these costs are beyond our control, and many are fixed rather than variable. Some competitors use alternate methods of distribution that fix, control, reduce or eliminate many of the costs associated with our method of distribution.

We are self-insured and our reserves may not be sufficient to cover future claims.

We are self-insured for many risks up to significant deductible amounts. The premiums associated with our insurance continue to increase. General liability, fire, workers' compensation, directors and officers liability, life, employee medical, dental and vision, and automobile risks present a large potential liability. While we accrue for this liability based on historical claims experience, future claims may exceed claims we have incurred in the past. Should a different number of claims occur compared to what was estimated or the cost of the claims increase beyond what was anticipated, reserves recorded may not be sufficient and the accruals may need to be adjusted accordingly in future periods.

Competitors may be able to duplicate our roasting and blending methods, which could harm our competitive position.

We consider our roasting and blending methods essential to the flavor and richness of our coffees and, therefore, essential to our brand. Because our roasting methods cannot be patented, we would be unable to prevent competitors from copying these methods if such methods became known. If our competitors copy our roasts or blends, the value of our brand may be diminished, and we may lose customers to our competitors. In addition, competitors may be able to develop roasting or blending methods that are more advanced than our production methods, which may also harm our competitive position.

Employee strikes and other labor-related disruptions may adversely affect our operations.

We have union contracts relating to a significant portion of our workforce. Although we believe union relations have been amicable in the past, there is no assurance that this will continue in the future or that we will not be subject to future union organizing activity. There are potential adverse effects of labor disputes with our own employees or by others who provide warehousing, transportation (lines, truck drivers, 3PL service providers) or cargo handling (longshoremen), both domestic and foreign, of our raw materials or other products. Strikes or work stoppages or other business interruptions could occur if we are unable to renew collective bargaining agreements on satisfactory terms or enter into new agreements on satisfactory terms, which could impair manufacturing and distribution of our products or result in a loss of sales, which could adversely impact our business, financial condition or results of operations. The terms and conditions of existing, renegotiated or new collective bargaining agreements could also increase our costs or otherwise affect our ability to fully implement future operational changes to enhance our efficiency or to adapt to changing business needs or strategy.

We could face significant withdrawal liability if we withdraw from participation in the multiemployer pension plans in which we participate.

We participate in two multiemployer defined benefit pension plans and one multiemployer defined contribution pension plan for certain union employees. We make periodic contributions to these plans to allow them to meet their pension benefit obligations to their participants. In the event we withdraw from participation in one or more of these plans, we could be required to make an additional lump-sum contribution to the plan. Our withdrawal liability for any multiemployer pension plan would depend on the extent of the plan's funding of vested benefits. Future collective bargaining negotiations may result in our withdrawal from the remaining multiemployer pension plans in which we participate and, if successful, may result in a withdrawal liability, the amount of which could be material to our results of operations and cash flows.

Restrictive covenants in our credit facility may limit our ability to make investments or otherwise restrict our ability to pursue our business strategies.

Our credit facility contains various covenants that limit our ability to, among other things, make investments; incur additional indebtedness; create, incur, assume or permit any liens on our property; pay dividends under certain circumstances; and consolidate, merge, sell or otherwise dispose of all or substantially all of our assets. Our credit facility also contains financial covenants relating to the maintenance of a fixed charge coverage ratio in certain circumstances. Our ability to meet those covenants may be affected by events beyond our control, and there can be no assurance that we will meet those covenants. The breach of any of these covenants could result in a default under the credit facility.

Future impairment charges could adversely affect our operating results.
We perform an asset impairment analysis on an annual basis or whenever events occur that may indicate possible existence of impairment. Failure to achieve our forecasted operating results, due to weakness in the economic environment or other factors, and declines in our market capitalization, among other things, could result in impairment of our intangible assets and goodwill and adversely affect our operating results.
We rely on independent certification for a number of our coffee products. Loss of certification could harm our business.
A number of our Artisan coffee products are independently certified as “Rainforest Alliance,” “Organic” and “Fair Trade.” We must comply with the requirements of independent organizations and certification authorities in order to label our products as certified. The loss of any independent certifications could adversely affect our reputation and competitive position, which could harm our business.
Possible legislation or regulation intended to address concerns about climate change could adversely affect our results of operations, cash flows and financial condition.
Governmental agencies are evaluating changes in laws to address concerns about the possible effects of greenhouse gas emissions on climate. Increased public awareness and concern over climate change may increase the likelihood of more proposals to reduce or mitigate the emission of greenhouse gases. Laws enacted that directly or indirectly affect our suppliers (through an increase in the cost of production or their ability to produce satisfactory products) or our business (through an impact on our inventory availability, cost of goods sold, operations or demand for the products we sell) could adversely affect our business, financial condition, results of operations and cash flows. Compliance with any new or more stringent laws or regulations, or stricter interpretations of existing laws, including increased government regulations to limit carbon dioxide and other greenhouse gas emissions as a result of concern over climate change, could require us to reduce emissions and to incur compliance costs which could affect our profitability or impede the production or distribution of our products, which could affect our results of operations, cash flows and financial condition. In addition, public expectations for reductions in greenhouse gas emissions could result in increased energy, transportation and raw material costs and may require us to make additional investments in facilities and equipment.
Our operating results may have significant fluctuations from period to period which could have a negative effect on our stock price.
Our operating results may fluctuate from period to period as a result of a number of factors, including fluctuations in the price and supply of green coffee, fluctuations in the selling prices of our products, the success of our hedging strategy, competition, changes in consumer preferences, seasonality, our ability to retain and attract customers, our ability to manage inventory and fulfillment operations and maintain gross margin, and period and year-end LIFO inventory adjustments. Fluctuations in our operating results due to these factors or for any other reason could cause our stock price to decline. In addition, price and volume fluctuations in the stock market as a whole may affect the market price of our stock in ways that may be unrelated to our financial performance. Accordingly, we believe that period-to-period comparisons of our operating results are not necessarily meaningful, and such comparisons should not be relied upon as indicators of future performance.
If we experience a deterioration in operating performance, operating losses may recur and, as a result, could lead to increased leverage which may harm our financial condition and results of operations.
We incurred an operating loss in fiscal 2012 and a net loss in fiscal 2013 and 2012. If our current strategies are unsuccessful, we may not achieve the levels of sales and earnings we expect. As a result, we could suffer additional losses in future years and our stock price could decline leading to deterioration in our credit rating, which could limit the availability of additional financing and increase the cost of obtaining financing. In addition, an increase in leverage could raise the likelihood of a financial covenant breach which in turn could limit our access to existing funding under our credit facility.

Our ability to fund the costs associated with the New Facility, satisfy our lease obligations and make payments of principal and interest on our indebtedness depends on our future performance. Should we experience a deterioration in operating performance, we will have less cash inflows from operations available to meet these obligations. In addition, if such deterioration were to lead to the closure of leased facilities, we would need to fund the costs of terminating those leases. If we are unable to generate sufficient cash flows from operations in the future to satisfy these financial obligations, we may be required to, among other things:

- seek additional financing in the debt or equity markets;
- refinance or restructure all or a portion of our indebtedness;
- sell selected assets; or
- reduce or delay planned capital or operating expenditures.

Such measures might not be sufficient to enable us to satisfy our financial obligations. In addition, any such financing, refinancing or sale of assets might not be available on economically favorable terms.

Customer quality control problems may adversely affect our brands thereby negatively impacting our sales.

Our success depends on our ability to provide customers with high-quality products and service. Although we take measures to ensure that we sell only fresh products, we have no control over our products once they are purchased by our customers. Accordingly, customers may prepare our products inconsistent with our standards, or store our products for longer periods of time, potentially affecting product quality. Clean water is critical to the preparation of coffee beverages. We have no ability to ensure that our customers use a clean water supply to prepare coffee beverages. If consumers do not perceive our products and service to be of high quality, then the value of our brands may be diminished and, consequently, our operating results and sales may be adversely affected.

Adverse public or medical opinions about caffeine may harm our business and reduce our sales.

Coffee contains caffeine and other active compounds, the health effects of some of which are not fully understood. A number of research studies conclude or suggest that excessive consumption of caffeine may lead to increased adverse health effects. An unfavorable report or other negative publicity or litigation on the health effects of caffeine or other compounds present in coffee could significantly reduce the demand for coffee which could harm our business and reduce our sales. In addition, we could be subject to litigation relating to the existence of such compounds in our coffee which could be costly and adversely affect our business.

Instances or reports linking us to food safety issues could harm our business and lead to potential product recalls or product liability claims.

Selling products for human consumption involves inherent legal risks. Instances or reports of food safety issues involving our products, whether or not accurate, such as unclean water supply, food-borne illnesses, food tampering, food contamination or mislabeling, could damage the value of our brands, negatively impact sales of our products, and potentially lead to product recalls, product liability claims, litigation or damages. A significant product liability claim against us, whether or not successful, or a widespread product recall may reduce our sales and harm our business.

Government regulations affecting the conduct of our business could increase our operating costs, reduce demand for our products or result in litigation.

The conduct of our business is subject to various laws and regulations. These laws and regulations and interpretations thereof are subject to change as a result of political, economic or social events. Such changes may include changes in: food and drug laws, including the Food Safety Modernization Act of 2011 which requires, among other things, that food facilities conduct contamination hazard analyses, implement risk-based preventive controls and develop track-and-trace capabilities; laws relating to product labeling, advertising and marketing practices; laws regarding ingredients used in our products; and increased regulatory scrutiny of, and increased litigation involving, product claims and concerns regarding the effects on health of ingredients in, or attributes of, our products. Any new laws and regulations or changes in existing laws and regulations or the interpretations thereof could require us to change certain of our operational processes and procedures, or implement new ones, and may increase our operating and compliance costs. If we fail to comply with applicable laws and

regulations, we may be subject to civil remedies, including fines, injunctions, recalls or seizures, as well as potential criminal sanctions, which could have a material adverse effect on our results of operations.

Significant additional labeling or warning requirements may increase our costs and adversely affect sales of the affected products.

Various jurisdictions may seek to adopt significant additional product labeling (such as requiring labeling of products that contain genetically modified organisms) or warning requirements or limitations on the availability of our products relating to the content or perceived adverse health consequences of certain of our products. If these types of requirements become applicable to one or more of our major products, they may inhibit sales of such products. In addition, for example, we are subject to the California Safe Drinking Water and Toxic Enforcement Act of 1986 (commonly known as “Proposition 65”), a law which requires that a specific warning appear on any product sold in California that contains a substance listed by that State as having been found to cause cancer or birth defects. The Council for Education and Research on Toxics (“CERT”) has filed suit against a number of companies as defendants, including our subsidiary, Coffee Bean International, Inc., which sell coffee in California for allegedly failing to issue clear and reasonable warnings in accordance with Proposition 65 that the coffee they produce, distribute and sell contains acrylamide. Any action under Proposition 65 would likely seek statutory penalties and costs of enforcement, as well as a requirement to provide warnings and other notices to customers or remove acrylamide from finished products (which may be impossible). If we were required to add warning labels to any of our products or place warnings in certain locations where our products are sold, sales of those products could suffer not only in those locations but elsewhere. Any change in labeling requirements for our products also may lead to an increase in packaging costs or interruptions or delays in packaging deliveries.

Litigation pending against us could expose us to significant liabilities and damage our reputation.

We are currently party to various legal and other proceedings, and additional claims may arise in the future. See Note 22, Commitments and Contingencies, of the Notes to Consolidated Financial Statements included in Part II, Item 8 of this report. Regardless of the merit of particular claims, litigation may be expensive, time-consuming, operationally disruptive and distracting to management, and could negatively affect our brand name and image and subject us to statutory penalties and costs of enforcement. We can provide no assurances as to the outcome of any litigation or the resolution of any other claims against us. An adverse outcome of any litigation or other claim could negatively affect our financial condition, results of operations or liquidity.

Compliance with regulations affecting publicly traded companies has resulted in increased costs and may continue to result in increased costs in the future.

As a publicly traded company, we are subject to laws, accounting and reporting requirements, tax rules and other regulations and requirements, including those imposed by the SEC and NASDAQ. Our efforts to comply with these requirements and regulations have resulted in, and are likely to continue to result in, increased expenses and a diversion of substantial management time and attention from revenue-generating activities to compliance activities. Because these laws and regulations are subject to varying interpretations, their application in practice may evolve over time as new guidance becomes available. This evolution may result in continuing uncertainty regarding compliance matters and additional costs necessitated by ongoing revisions to our disclosure and governance practices. Failure to comply with such regulations could have a material adverse effect on our business and stock price.

Concentration of ownership among our principal stockholders may dissuade potential investors from purchasing our stock, may prevent new investors from influencing significant corporate decisions and may result in a lower trading price for our stock than if ownership of our stock was less concentrated.

As of September 12, 2016, members of the Farmer family or entities controlled by the Farmer family (including trusts) beneficially owned approximately 32.4% of our outstanding common stock, including members of the Farmer family or entities controlled by the Farmer family (including trusts) comprising a group for purposes of Section 13 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”) identified in a Schedule 13D/A filed with the SEC on September 8, 2016. As a result, these stockholders, acting together, may be able to influence the outcome of stockholder votes, including votes concerning the election and removal of directors, the amendment of our charter documents, and approval of significant corporate transactions. This level of concentrated ownership may have the effect of delaying or preventing a change in the management or voting control of the Company. In addition, this

significant concentration of share ownership

may adversely affect the trading price of our common stock if investors perceive disadvantages in owning stock in a company with such concentrated ownership.

Future sales of shares by existing stockholders could cause our stock price to decline.

All of our outstanding shares are eligible for sale in the public market, subject in certain cases to limitations under Rule 144 of the Securities Act of 1933, as amended (the "Securities Act"). Also, shares subject to outstanding options and restricted stock under our long-term incentive plan are eligible for sale in the public market to the extent permitted by the provisions of various vesting agreements, our stock ownership guidelines, and Rule 144 under the Securities Act. If these shares are sold, or if it is perceived that they will be sold in the public market, the trading price of our common stock could decline.

Anti-takeover provisions could make it more difficult for a third party to acquire us.

Our Board of Directors has the authority to issue up to 500,000 shares of preferred stock and to determine the price, rights, preferences, privileges and restrictions, including voting rights, of those shares without any further vote or action by stockholders. The rights of the holders of our common stock may be subject to, and may be adversely affected by, the rights of the holders of any preferred stock that may be issued in the future. The issuance of preferred stock may have the effect of delaying, deterring or preventing a change in control of the Company without further action by stockholders and may adversely affect the voting and other rights of the holders of our common stock.

Further, certain provisions of our charter documents, including a classified board of directors, provisions eliminating the ability of stockholders to take action by written consent, and provisions limiting the ability of stockholders to raise matters at a meeting of stockholders without giving advance notice, may have the effect of delaying or preventing changes in control or management of the Company, which could have an adverse effect on the market price of our stock. In addition, our charter documents do not permit cumulative voting, which may make it more difficult for a third party to gain control of our Board of Directors. Further, we are subject to the anti-takeover provisions of Section 203 of the Delaware General Corporation Law, which will prohibit us from engaging in a "business combination" with an "interested stockholder" for a period of three years after the date of the transaction in which the person became an interested stockholder, even if such combination is favored by a majority of stockholders, unless the business combination is approved in a prescribed manner. The application of Section 203 also could have the effect of delaying or preventing a change in control or management.

Item 1.B. Unresolved Staff Comments

None.

## Item 2. Properties

Our current production and distribution facilities are as follows:

| Location | Approximate Square Feet | Purpose | Status |
|---|---|---|---|
| Northlake, TX(1) | 538,000 | Under construction | Leased |
| Houston, TX | 330,877 | Manufacturing and warehouse | Owned |
| Portland, OR | 114,000 | Manufacturing and distribution | Leased |
| Northlake, IL | 89,837 | Distribution and warehouse | Leased |
| Oklahoma City, OK | 142,115 | Distribution and warehouse | Owned |
| Moonachie, NY | 41,404 | Distribution and warehouse | Leased |
| Torrance, CA(2) | 665,000 | Distribution and warehouse | Leased |

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(1) Upon completion, the New Facility will house our manufacturing, distribution, product development lab and corporate headquarters. In the fourth quarter of fiscal 2016, we exercised the purchase option under the Lease Agreement to acquire the partially constructed New Facility with a targeted closing date in the first quarter of fiscal 2017. Construction of and relocation to the New Facility are expected to be completed in the third quarter of fiscal 2017. In the interim, we have leased 32,000 square feet of temporary office space in Fort Worth, Texas near the New Facility to house our primary administrative offices. See Note 4, New Facility Lease Obligation, of the Notes to Consolidated Financial Statements included in Part II, Item 8 of this report.

(2) We sold the Torrance facility on July 15, 2016, subject to a lease back as described in Note 24, Subsequent Events, of the Notes to Consolidated Financial Statements included in Part II, Item 8 of this report. As of June 30, 2016, the Torrance facility continued to house certain administrative functions and serve as a distribution facility and a branch warehouse pending transition of the remaining Torrance operations to our other facilities.

As of June 30, 2016, we stage our products in 109 branch warehouses throughout the contiguous United States. These branch warehouses and our distribution centers, taken together, represent a vital part of our business, but no individual branch warehouse is material to the business as a whole. Our branch warehouses vary in size from approximately 1,000 to 50,000 square feet.

Approximately 52% of our facilities are leased with a variety of expiration dates through 2021. The lease on the Portland facility expires in 2018 and has options to renew up to an additional 10 years.

We calculate our utilization for all of our production facilities on an aggregate basis based on the number of product pounds manufactured during the actual number of production shifts worked during an average week, compared to the number of product pounds that could be manufactured based on the maximum number of production shifts that could be operated during the week (assuming three shifts per day, seven days per week), in each case, based on our current product mix. Utilization rates for our production facilities were approximately 90%, 66% and 65% during the fiscal years ended June 30, 2016, 2015 and 2014, respectively. The higher utilization rate in fiscal 2016 was primarily due to wind-down of production at our Torrance facility and the addition of those production volumes to our Portland and Houston production facilities.

We believe that our Portland and Houston production facilities, together with our existing distribution centers and branch warehouses, will provide adequate capacity for our current operations pending completion of the New Facility. In the event of significant increases in demand that precede the completion of and relocation to the New Facility, we may be required to increase staffing, including through temporary labor and overtime, use third-party manufacturers, lease additional production facilities or some combination of those alternatives or others to satisfy demand.

## Item 3. Legal Proceedings

For information regarding legal proceedings in which we are involved, see Note 22, Commitments and Contingencies, of the Notes to Consolidated Financial Statements included in Part II, Item 8 of this report.

Item 4. Mine Safety Disclosures
Not applicable.

## PART II

### Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

#### Market Information

Our common stock trades on the NASDAQ Global Select Market under the symbol “FARM.” The following table sets forth the quarterly high and low sales prices of our common stock as reported by NASDAQ for each quarter during the last two fiscal years.

| | Year Ended June 30, 2016 | | Year Ended June 30, 2015 | |
|---|---|---|---|---|
| | High | Low | High | Low |
| 1st Quarter | $ 28.16 | $ 20.90 | $ 29.10 | $ 20.29 |
| 2nd Quarter | $ 32.94 | $ 26.99 | $ 31.86 | $ 26.01 |
| 3rd Quarter | $ 31.63 | $ 24.04 | $ 32.50 | $ 22.72 |
| 4th Quarter | $ 32.50 | $ 26.69 | $ 25.96 | $ 23.39 |

On September 12, 2016, the last sale price reported on NASDAQ for our common stock was $33.46 per share.

#### Holders

As of September 12, 2016, there were approximately 2,250 holders of record. Determination of holders of record is based upon the number of record holders and individual participants in security position listings. This does not include persons whose stock is in nominee or “street name” accounts through brokers.

#### Dividends

The Company’s Board of Directors has omitted the payment of a quarterly dividend since the third quarter of fiscal 2011. The amount, if any, of dividends to be paid in the future will depend upon the Company’s then available cash, anticipated cash needs, overall financial condition, credit agreement restrictions, future prospects for earnings and cash flows, as well as other relevant factors. For a description of the credit agreement restrictions on the payment of dividends, see Liquidity, Capital Resources and Financial Condition included in Part II, Item 7 of this report, and Note 15, Bank Loan, of the Notes to Consolidated Financial Statements included in Part II, Item 8 of this report.

#### Equity Compensation Plan Information

This information appears in Equity Compensation Plan Information included in Part III, Item 12 of this report.

#### Performance Graph

The following graph depicts a comparison of the total cumulative stockholder return on our common stock for each of the last five fiscal years relative to the performance of the Russell 2000 Index, the Value Line Food Processing Index and a peer group index. The graph assumes an initial investment of $100.00 at the beginning of the five year period and that all dividends paid by companies included in these indices have been reinvested.

Because no published peer group is similar to the Company's portfolio of business, the Company created a peer group index that includes the following companies: B&G Foods, Inc., Boulder Brands, Inc., Coffee Holding Co. Inc., Dunkin' Brands Group, Inc., National Beverage Corp., SpartanNash Company, Inventure Foods, Inc. and Treehouse Foods, Inc. The companies in the peer group index are in the same industry as Farmer Bros. Co. with product offerings that overlap with the Company's product offerings. Boulder Brands, Inc. is no longer a public company and has been excluded from the peer group index in fiscal 2016.

The historical stock price performance of the Company’s common stock shown in the performance graph below is not necessarily indicative of future stock price performance. The Russell 2000 Index, the Value Line Food Processing Index and the peer group index are included for comparative purposes only. They do not necessarily reflect management's opinion that such indices are an appropriate measure for the relative performance of the stock involved, and they are not intended to forecast or be indicative of possible future performance of our common stock.

Comparison of Five-Year Cumulative Total Return
Farmer Bros. Co., Russell 2000 Index, Value Line Food Processing Index and Peer Group Index
(Performance Results Through June 30, 2016)

| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|---|
| Farmer Bros. Co. | $100.00 | $78.50 | $138.66 | $213.12 | $231.76 | $316.17 |
| Russell 2000 Index | $100.00 | $97.92 | $121.63 | $150.38 | $160.61 | $150.70 |
| Value Line Food Processing Index | $100.00 | $108.65 | $130.34 | $159.51 | $170.55 | $202.07 |
| Peer Group Index | $100.00 | $119.31 | $144.21 | $160.87 | $175.66 | $215.12 |

Source: Value Line Publishing, LLC

Item 6. Selected Financial Data

The following selected consolidated financial data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations, Risk Factors, and our consolidated financial statements and the notes thereto included elsewhere in this report. The historical results do not necessarily indicate results expected for any future period.

| | Year Ended June 30, | | | | |
|---|---|---|---|---|---|
| (In thousands, except per share data) | 2016 | 2015 | 2014 | 2013 | 2012 |
| Consolidated Statement of Operations Data: | | | | | |
| Net sales | $544,382 | $545,882 | $528,380 | $513,869 | $498,701 |
| Cost of goods sold | $335,907 | $348,846 | $332,466 | $328,693 | $332,309 |
| Restructuring and other transition expenses(1) | $16,533 | $10,432 | $— | $— | $— |
| Net gains from sale of Spice Assets(2) | $(5,603 ) | $— | $— | $— | $— |
| Net (gains) losses from sales of assets | $(2,802 ) | $394 | $(3,814 ) | $(4,467 ) | $(268 ) |
| Income (loss) from operations | $8,179 | $3,284 | $8,916 | $372 | $(21,846 ) |
| Income (loss) from operations per common share—diluted | $0.49 | $0.20 | $0.56 | $0.02 | $(1.41 ) |
| Income tax (benefit) expense(3) | $(79,997 ) | $402 | $705 | $(825 ) | $(347 ) |
| Net income (loss)(4) | $89,918 | $652 | $12,132 | $(8,462 ) | $(26,576 ) |
| Net income (loss) per common share—basic | $5.45 | $0.04 | $0.76 | $(0.54 ) | $(1.72 ) |
| Net income (loss) per common share—diluted | $5.41 | $0.04 | $0.76 | $(0.54 ) | $(1.72 ) |
| Cash dividends declared per common share | $— | $— | $— | $— | $— |

| | June 30, | | | | |
|---|---|---|---|---|---|
| (In thousands) | 2016 | 2015 | 2014 | 2013 | 2012 |
| Consolidated Balance Sheet Data: | | | | | |
| Total assets(5) | $368,991 | $240,943 | $266,177 | $244,136 | $257,916 |
| Deferred income taxes | $80,786 | $751 | $414 | $467 | $861 |
| Capital lease obligations(6) | $2,359 | $5,848 | $9,703 | $12,168 | $15,867 |
| Long-term borrowings under revolving credit facility | $— | $— | $— | $10,000 | $— |
| Earn-out payable-RLC acquisition(7) | $100 | $200 | $— | $— | $— |
| Long-term derivative liabilities | $— | $25 | $— | $1,129 | $— |
| Total liabilities(8) | $186,397 | $150,932 | $151,313 | $162,298 | $174,364 |

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(1) See Note 3, Corporate Relocation Plan, of the Notes to Consolidated Financial Statements included in Part II, Item 8 of this report.

(2) See Note 5, Sale of Spice Assets, of the Notes to Consolidated Financial Statements included in Part II, Item 8 of this report.

(3) Includes non-cash income tax benefit of $80.3 million in fiscal 2016 from the release of valuation allowance on deferred tax assets. See Note 20, Income Taxes, of the Notes to Consolidated Financial Statements included in Part II, Item 8 of this report.

(4) Includes: (a) beneficial effect of liquidation of LIFO inventory quantities of $4.2 million, $4.9 million, $0, $1.1 million and $14.2 million in fiscal 2016, 2015, 2014, 2013 and 2012, respectively; and (b) $5.6 million in impairment losses on goodwill and intangible assets and $4.6 million in pension withdrawal expense in fiscal 2012.

(5) Includes $28.1 million in assets at June 30, 2016 recorded in "Property, plant and equipment" to offset New Facility lease obligation recorded in "Other long-term liabilities"related the New Facility included in "Property, plant and equipment" as the deemed owner of the New Facility.

(6) Excludes imputed interest.

(7) See Note 2, Acquisition, of the Notes to Consolidated Financial Statements included in Part II, Item 8 of this report.
(8) Includes $28.1 million New Facility lease obligation at June 30, 2016 recorded in “Other long-term liabilities.” See Note 19, Other Long-Term Liabilities, of the Notes to Consolidated Financial Statements included in Part II, Item 8 of this report.

## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of many factors. The results of operations for the fiscal years ended June 30, 2016, 2015 and 2014 are not necessarily indicative of the results that may be expected for any future period. The following discussion should be read in combination with the consolidated financial statements and the notes thereto included in Part II, Item 8 of this report and with the "Risk Factors" described in Part I, Item 1A of this report.

### Overview

We are a national coffee roaster, wholesaler and distributor of coffee, tea and culinary products manufactured under supply agreements, under our owned brands, as well as under private labels on behalf of certain customers. We were founded in 1912, incorporated in California in 1923, and reincorporated in Delaware in 2004. We operate in one business segment.

We serve a wide variety of customers, from small independent restaurants and foodservice operators to large institutional buyers like restaurants and convenience store chains, hotels, casinos, hospitals, and gourmet coffee houses, as well as grocery chains with private brand and consumer-branded coffee products. Through our sustainability, stewardship, environmental efforts, and leadership we are not only committed to serving the finest products available, considering the cost needs of the customer, but also insist on their sustainable cultivation, manufacture and distribution whenever possible. Our product categories consist of a robust line of roast and ground coffee, including organic, Direct Trade, DTVS and sustainably-produced offerings; frozen liquid coffee; flavored and unflavored iced and hot teas; culinary products including gelatins and puddings, soup bases, dressings, gravy and sauce mixes, pancake and biscuit mixes, jellies and preserves, and coffee-related products such as coffee filters, sugar and creamers; spices; and other beverages including cappuccino, cocoa, granitas, and ready-to-drink iced coffee. We offer a comprehensive approach to our customers by providing not only a breadth of high-quality products, but also value-added services such as market insight, beverage planning, and equipment placement and service.

We operate production facilities in Portland, Oregon and Houston, Texas. Distribution takes place out of our Portland facility as well as three separate distribution centers in Northlake, Illinois; Oklahoma City, Oklahoma; and Moonachie, New Jersey. As of June 30, 2016, the Torrance facility continued to house certain administrative functions, serve as a distribution facility and branch warehouse pending transition of the remaining Torrance operations to our other facilities. Upon completion, the New Facility will serve as a production facility and distribution center for our products.

Our products reach our customers primarily in two ways: through our nationwide DSD network of 450 delivery routes and 109 branch warehouses at June 30, 2016, or direct-shipped via common carriers or third-party distributors. We operate a large fleet of trucks and other vehicles to distribute and deliver our products, and we rely on 3PL service providers for our long-haul distribution. DSD sales are made "off-truck" to our customers at their places of business.

### Corporate Relocation

In an effort to make the Company more competitive and better positioned to capitalize on growth opportunities, in fiscal 2015 we began the process of relocating our corporate headquarters, product development lab, and manufacturing and distribution operations from Torrance, California to a new facility housing these operations currently under construction in Northlake, Texas (the "Corporate Relocation Plan"). Approximately 350 positions were impacted as a result of the Torrance facility closure.

The significant milestones associated with our Corporate Relocation Plan are as follows:

| Event | Date |
|---|---|
| Announced Corporate Relocation Plan | Q3 fiscal 2015 |
| Transitioned coffee processing and packaging from Torrance production facility and consolidated them with Houston and Portland production facilities | Q4 fiscal 2015 |
| Moved Houston distribution operations to Oklahoma City distribution center | Q4 fiscal 2015 |
| Entered into the lease agreement and development management agreement for New Facility | Q1 fiscal 2016 |
| Commenced construction of New Facility | Q1 fiscal 2016 |
| Transitioned primary administrative offices from Torrance to temporary leased offices in Fort Worth, Texas | Q1-Q2 fiscal 2016 |
| Sold Spice Assets to Harris | Q2 fiscal 2016 |
| Principal design work completed on New Facility | Q3 fiscal 2016 |
| Completed transition services to Harris and ceased spice processing and packaging at Torrance facility | Q4 fiscal 2016 |
| Entered into purchase and sale agreement to sell Torrance facility | Q4 fiscal 2016 |
| Exercised purchase option on New Facility | Q4 fiscal 2016 |
| Closed sale of Torrance facility | Q1 fiscal 2017 |
| Close on purchase option for New Facility | Estimated Q1 fiscal 2017 |
| Exit from Torrance facility | Estimated Q2 fiscal 2017 |
| Completion of construction and relocation to New Facility | Estimated Q3 fiscal 2017 |

See Liquidity, Capital Resources and Financial Condition below for further details of the impact of these activities on our financial condition and liquidity.

Recent Developments

On September 9, 2016, we entered into an asset purchase agreement to acquire substantially all of the assets of China Mist Brands, Inc., for an aggregate purchase price of $11.3 million, with $10.8 million to be paid in cash at closing and $0.5 million to be paid as earnout if certain sales levels are achieved in the calendar years of 2017 and 2018. The transaction is expected to close during the second quarter of fiscal 2017. We anticipate that the acquisition of China Mist will give us a greater presence in the high-growth premium tea industry. See Note 24, Subsequent Events, of the Notes to Consolidated Financial Statements included in Part II, Item 8 of this report.

Important Factors Affecting Our Results of Operations

We have identified factors that affect our industry and business which we expect to also play an important role in our future growth and profitability. Some of these factors include:

- Demographic and Channel Trends. Our success is dependent upon our ability to develop new products in response to demographic and other trends to better compete in areas such as premium coffee and tea, including expansion of our product portfolio by investing resources in what we believe to be key growth categories, including the launch of our Metropolitan™ single cup coffee, expanded seasonal coffee and specialty beverages, new shelf-stable coffee products, new hot teas, the introduction of Collaborative Coffee™ branded products into the retail grocery channel, and the packaging redesign and product portfolio optimization of our Un Momento® retail branded product line.
- Fluctuations in Green Coffee Prices. Our primary raw material is green coffee, an agricultural commodity traded on the Commodities and Futures Exchange that is subject to price fluctuations. Over the past five years, coffee “C” market price per pound ranged from approximately $1.02 to $2.90. The coffee “C” market price as of June 30, 2016 and 2015 was $1.46 and $1.32 per pound, respectively. The price and availability of green coffee directly impacts our results of operations. For additional details, see Risk Factors in Part I, Item 1A of this report.

- Hedging Strategy. We are exposed to market risk of losses due to changes in coffee commodity prices. Our business model strives to reduce the impact of green coffee price fluctuations on our financial results and to protect and stabilize our margins, principally through customer arrangements and derivative instruments, as further explained in Note 7, Derivative Instruments, of the Notes to Consolidated Financial Statements included in Part II, Item 8 of this report. In each of fiscal 2016 and fiscal 2015, a lower percentage of our roast and ground coffee volume was based on a price schedule and a higher percentage was sold to customers under commodity-based pricing arrangements as compared to fiscal 2014.
- Sustainability. With an increasing focus on sustainability across the coffee and foodservice industry, and particularly from the customers we serve, it is important for us to embrace sustainability across our operations, in the quality of our products, as well as, how we treat our coffee growers. We believe that our collective efforts in measuring our social and environmental impact, creating programs for waste, water and energy reduction, promoting partnerships in our supply chain that aim at supply chain stability and food security, and focusing on employee engagement place us in a unique position to help retailers and foodservice operators create differentiated coffee programs that can include sustainable supply chains, direct trade purchasing, training and technical assistance, recycling and composting networks, and packaging material reductions.
- Supply Chain Efficiencies and Competition. In order to compete effectively and capitalize on growth opportunities, we must continue to evaluate and undertake initiatives to reduce costs and streamline our supply chain. We undertook the Corporate Relocation Plan, in part, to pursue improved production efficiency to allow us to provide a more cost-competitive offering of high-quality products. We continue to look for ways to deploy our personnel, systems, assets and infrastructure to create or enhance stockholder value. Areas of focus have included corporate staffing and structure, methods of procurement, logistics, inventory management, supporting technology, and real estate assets.
- Market Opportunities. We have invested and in the future may invest in acquisitions that we believe will enhance long-term stockholder value and complement or enhance our product, equipment, service and/or distribution offerings to existing and new customer bases. For example, subsequent to the fiscal year end, on September 9, 2016, we entered into an asset purchase agreement to acquire substantially all of the assets of China Mist as described in Note 24, Subsequent Events, of the Notes to Consolidated Financial Statements included in Part II, Item 8 of this report. We anticipate that the acquisition of China Mist will give us a greater presence in the high-growth premium tea industry. Additionally, in the first quarter of fiscal 2015 we acquired substantially all of the assets of Rae' Launo Corporation ("RLC") as described in Note 2, Acquisition, of the Notes to Consolidated Financial Statements included in Part II, Item 8 of this report.
- Capacity Utilization. We calculate our utilization for all of our production facilities on an aggregate basis based on the number of product pounds manufactured during the actual number of production shifts worked during an average week, compared to the number of product pounds that could be manufactured based on the maximum number of production shifts that could be operated during the week (assuming three shifts per day, seven days per week), in each case, based on our current product mix. Utilization rates for our production facilities were approximately 90%, 66% and 65% during the fiscal years ended June 30, 2016, 2015 and 2014, respectively. The higher utilization rate in fiscal 2016 was due to the wind-down of production at our Torrance facility and the addition of those production volumes to our Portland and Houston production facilities. Since most of our customers do not commit to long-term firm production schedules, we are unable to forecast the level of customer orders with certainty to maximize utilization of manufacturing capacity. As a result, our production facility capacity utilization generally remains less than 100%.

Results of Operations

Fiscal Years Ended June 30, 2016 and 2015

Financial Highlights

- Gross profit increased 5.8% to $208.5 million in fiscal 2016 from $197.0 million in fiscal 2015.
- Gross margin increased to 38.3% in fiscal 2016 from 36.1% in fiscal 2015.
- Income from operations increased 149.1% to $8.2 million in fiscal 2016 from $3.3 million in fiscal 2015.
- Net income was $89.9 million, or $5.41 per diluted common share, in fiscal 2016, primarily due to non-cash income tax benefit of $80.3 million from the release of valuation allowance on deferred tax assets, compared to $0.7 million, or $0.04 per diluted common share, in fiscal 2015.

Fiscal 2016 Strategic Initiatives

In fiscal 2016, we undertook initiatives to reduce costs, streamline our supply chain, improve the breadth of products and services we provide to our customers, and better position the Company to attract new customers. These initiatives included the following:

- Corporate Relocation Plan. We continued to execute on the Corporate Relocation Plan that we initiated in the third quarter of fiscal 2015 by executing on the milestones described above under Corporate Relocation.
- Third-Party Logistics. During the second half of fiscal 2016, we replaced our long-haul fleet operations with 3PL. We expect that this transportation arrangement will reduce our fuel consumption and empty trailer miles, while improving our intermodal and trailer cube utilization.
- Vendor Managed Inventory. During the second half of fiscal 2016, we entered into a vendor managed inventory arrangement with a third party. We anticipate that the use of vendor managed inventory arrangements will result in a reduction in raw material, finished goods and logistics costs, while improving packaging innovation and fulfillment.
- DSD Reorganization. In fiscal 2016, we continued our efforts to improve efficiencies in our sales and product offerings. During the second half of fiscal 2016, we began to realign our DSD organization by undertaking initiatives intended to streamline communication and decision making, enhance branch organizational structure, and improve customer focus, including toward a comprehensive training program for all DSD team members to strengthen customer engagement. In fiscal 2016, we executed a regional test of our first advertising and lead generation campaign designed to improve our new customer acquisition rate within our DSD network.
- Branch Consolidation and Property Sales. In an effort to streamline our branch operations, in the fourth quarter of fiscal 2016 we sold two Northern California branch properties, with a third Northern California property under contract for sale, and we acquired a new branch facility in Hayward, California.
- Introduction of Collaborative Coffee™ and Redesign of Un Momento® Branded Retail Products. In an effort to address what we believe to be unmet consumer needs and improve margin within the retail grocery environment, in fiscal 2016, we launched Collaborative Coffee™, a new brand of ethically sourced, whole bean direct trade coffees into the retail grocery channel. In addition, we completed a packaging redesign and product portfolio optimization of our Un Momento® retail branded product line.

Net Sales

Net sales in fiscal 2016 decreased $1.5 million, or 0.3%, to $544.4 million from $545.9 million in fiscal 2015 primarily due to a decrease in net sales of coffee and tea products, partially offset by an increase in net sales of spice products and other beverages. Net sales in fiscal 2016 included $9.7 million in price decreases to customers utilizing commodity-based pricing arrangements, where the changes in the green coffee commodity costs are passed on to the customer, as compared to $9.7 million in price increases to customers utilizing such arrangements in fiscal 2015.

The change in net sales in fiscal 2016 compared to fiscal 2015 was due to the following:

| (In millions) | Year Ended June 30, 2016 vs. 2015 |
|---|---|
| Effect of change in unit sales | $14.4 |
| Effect of pricing and product mix changes | (15.9 ) |
| Total decrease in net sales | $(1.5 ) |

Unit sales increased 3.6% in fiscal 2016 as compared to fiscal 2015, but average unit price decreased by 3.8% resulting in a decrease in net sales of 0.3%. The increase in unit sales was primarily due to a 3.4% increase in unit sales of roast and ground coffee products, which accounted for approximately 61% of our total net sales, while the decrease in average unit price was primarily due to the lower average unit price of roast and ground coffee products primarily driven by the pass-through of lower green coffee commodity purchase costs to our customers. In fiscal 2016, we processed and sold approximately 90.7 million pounds of green coffee as compared to 87.7 million pounds of green coffee processed and sold in fiscal 2015. There were no new product category introductions in fiscal 2016 or 2015 which had a material impact on our net sales.

The following table presents net sales aggregated by product category for the respective periods indicated:

| | Year Ended June 30, | | | |
|---|---|---|---|---|
| | 2016 | | 2015 | |
| (In thousands) | $ | % of total | $ | % of total |
| Net Sales by Product Category: | | | | |
| Coffee (Roast & Ground) | $332,533 | 61 % | $336,129 | 60 % |
| Coffee (Frozen Liquid) | 35,933 | 7 % | 37,428 | 7 % |
| Tea (Iced & Hot) | 25,096 | 4 % | 27,172 | 5 % |
| Culinary | 54,036 | 10 % | 54,208 | 11 % |
| Spice(1) | 35,789 | 6 % | 32,336 | 6 % |
| Other beverages(2) | 57,690 | 11 % | 54,933 | 10 % |
| Net sales by product category | 541,077 | 99 % | 542,206 | 99 % |
| Fuel surcharge | 3,305 | 1 % | 3,676 | 1 % |
| Net sales | $544,382 | 100% | $545,882 | 100% |

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(1) Spice product net sales included $3.2 million in sale of inventory to Harris at cost in fiscal 2016 upon conclusion of the transition services provided by the Company in connection with the sale of Spice Assets.

(2) Includes all beverages other than coffee and tea.

Cost of Goods Sold

Cost of goods sold in fiscal 2016 decreased $12.9 million, or 3.7%, to $335.9 million, or 61.7% of net sales, from $348.8 million, or 63.9% of net sales, in fiscal 2015. The decrease in cost of goods sold as a percentage of net sales in fiscal 2016 was primarily due to lower coffee commodity costs compared to the same period in the prior fiscal year, supply chain efficiencies realized primarily through the consolidation of our former Torrance coffee production volumes into our Houston manufacturing facility, and other supply chain improvements. The average Arabica "C" market price of green coffee decreased 24.8% in fiscal 2016. Inventories decreased at the end of fiscal 2016 compared to fiscal 2015 primarily due to production consolidation and the sale of processed and unprocessed inventories to Harris at cost upon conclusion of the transition services provided by the Company in connection with the sale of Spice Assets. As a result, a beneficial effect of liquidation of LIFO inventory quantities in the amount of $4.2 million was recorded in cost of goods sold in fiscal 2016 reducing cost of goods sold by the same amount. In fiscal 2015

$4.9 million in beneficial effect of liquidation of LIFO inventory quantities was recorded.

Gross Profit

Gross profit in fiscal 2016 increased $11.4 million, or 5.8%, to $208.5 million from $197.0 million in the prior fiscal year and gross margin increased to 38.3% in fiscal 2016 from 36.1% in the prior fiscal year. The increase in gross profit was primarily due to lower coffee commodity costs compared to the same period in the prior fiscal year, supply chain efficiencies realized primarily through the consolidation of our former Torrance coffee production volumes into our Houston manufacturing facility and other supply chain improvements. Gross profit in fiscal 2016 and 2015 included the beneficial effect of the liquidation of LIFO inventory quantities in the amount of $4.2 million and $4.9 million, respectively.

Operating Expenses

In fiscal 2016, operating expenses increased $6.5 million, or 3.4%, to $200.3 million or 36.8% of net sales, from $193.8 million, or 35.5% of net sales, in fiscal 2015, primarily due to higher general and administrative expenses and restructuring and other transition expenses associated with the Corporate Relocation Plan as compared to the prior fiscal year. General and administrative expenses and restructuring and other transition expenses increased $10.8 million and $6.1 million, respectively, in fiscal 2016, as compared to the prior fiscal year, partially offset by a $1.6 million decrease in selling expenses. The increase in general and administrative expenses in fiscal 2016 as compared to fiscal 2015 was primarily due to higher accruals for incentive compensation to eligible employees as compared to a reduction in accrual for incentive compensation to eligible employees in the prior fiscal year, an increase in employee and retiree medical costs, workers' compensation expense and the write-off of a long-term loan receivable that was deemed uncollectible. The increase in general and administrative expenses was partially offset by $5.6 million in net gains from sale of Spice Assets and $2.8 million in net gains from sales of assets, primarily real estate, as compared to $(0.4) million in net losses from sales of assets, primarily vehicles, in fiscal 2015. The decrease in selling expenses in fiscal 2016 as compared to fiscal 2015 was primarily due to lower depreciation and amortization expense and lower vehicle, fuel and freight expenses, partially offset by higher accruals for incentive compensation for eligible employees as compared to a reduction in accrual for incentive compensation to eligible employees in the prior fiscal year.

Income from Operations

Income from operations in fiscal 2016 was $8.2 million as compared to $3.3 million in fiscal 2015 primarily due to higher gross profit, net gains from the sale of Spice Assets and certain real estate assets and lower selling expenses, partially offset by higher restructuring and other transition expenses associated with the Corporate Relocation Plan and general and administrative expenses.

Total Other Income (Expense)

Total other income in fiscal 2016 was $1.7 million compared to total other expense of $(2.2) million in fiscal 2015, primarily due to net gains on derivative instruments and investments of $0.3 million in fiscal 2016 compared to net losses on derivative instruments and investments of $(3.3) million in fiscal 2015. The net gains and net losses on derivative instruments and investments in fiscal 2016 and fiscal 2015, respectively, were primarily due to mark-to-market net gains and net losses on coffee-related derivative instruments not designated as accounting hedges. Net gains on such coffee-related derivative instruments in fiscal 2016 were $0.3 million compared to net losses of $(3.0) million in fiscal 2015. In fiscal 2016 and 2015, we recognized $(0.6) million and $(0.3) million in net losses on coffee-related derivative instruments designated as cash flow hedges due to ineffectiveness.

Income Taxes

In fiscal 2016, we released $80.3 million of the valuation allowance on deferred tax assets, resulting in unreserved deferred tax assets of $90.2 million at June 30, 2016 and a non-cash reduction in income tax expense, or a tax benefit of $80.0 million in fiscal 2016 as compared to income tax expense of $(0.4) million in fiscal 2015. In fiscal 2016, total deferred tax assets were largely unchanged. Deferred tax assets related to our defined benefit pension plans and retiree medical plan increased due to losses recorded in OCI, and net operating loss related to deferred tax assets declined as losses were used to offset current income. In fiscal 2015, deferred tax assets increased primarily due to losses recorded in Other comprehensive income (loss) ("OCI") related to coffee-related derivative instruments, our defined benefit pension plans and retiree medical plan.

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Since 2009, a full valuation allowance has been maintained to offset our deferred tax assets. In the fourth quarter of fiscal 2016, after analyzing the available positive and negative evidence, we concluded that it is more likely than not that we will utilize a portion of our tax loss carryforwards. In this analysis, we considered the following items of positive evidence: twelve quarters of our cumulative gain position and our forecasted future earnings; completion of parts of our restructuring plan which significantly reduced costs; and sale of our Torrance facility which is expected to result in a significant gain in the first quarter of fiscal 2017. We also considered the following items of negative evidence: large pension related OCI losses that we recorded in the prior twelve quarters and potential expiration of certain state unused net operating loss carryforwards and credits.

We cannot conclude that certain state net operating loss carryforwards and tax credit carryovers will be utilized before expiration. Accordingly, we will maintain a valuation allowance of $1.6 million to offset these deferred tax assets. We will continue to monitor all available evidence, both positive and negative, in determining whether it is more likely than not that the Company will realize its remaining deferred tax assets.

The Internal Revenue Service is currently auditing our tax years ended June 30, 2013 and 2014.

Net Income

As a result of the foregoing factors, net income was $89.9 million, or $5.41 per diluted common share, in fiscal 2016 as compared to $0.7 million, or $0.04 per diluted common share, in fiscal 2015.

Fiscal Years Ended June 30, 2015 and 2014

Overview

In fiscal 2015, we continued our efforts to improve efficiencies in our sales and product offerings. These efforts included targeted selling efforts in untapped markets, sales and marketing training for all of our RSRs, and the discontinuation over 300 SKUs, excluding the SKUs added from the RLC Acquisition. We also continued to expand our product portfolio by investing resources in what we believe to be key growth categories, including the launch of our Metropolitan™ single cup coffee, expanded seasonal coffee and specialty beverages, new shelf-stable coffee products, and new hot teas.

Net Sales

Net sales in fiscal 2015 increased $17.5 million, or 3.3%, to $545.9 million from $528.4 million in fiscal 2014. The increase in net sales in fiscal 2015 included $9.7 million in price increases to customers utilizing commodity-based pricing arrangements, where the changes in the green coffee commodity costs are passed on to the customer.

The change in net sales in fiscal 2015 compared to fiscal 2014 was due to the following:

| (In millions) | Year Ended June 30, 2015 vs. 2014 |
|---|---|
| Effect of change in unit sales | $(2.0 ) |
| Effect of pricing and product mix changes | 19.5 |
| Total increase in net sales | $17.5 |

Unit sales decreased (0.2)% in fiscal 2015 as compared to fiscal 2014, fully offset by a 3.5% increase in average unit price resulting in an increase in net sales of 3.3%. The decrease in unit sales was primarily due to a (0.7)% decrease in unit sales of roast and ground coffee products, which accounted for approximately 61% of our total net sales, while the increase in average unit price was primarily due to the higher average unit price of roast and ground coffee products primarily driven by the pass-through of higher green coffee commodity purchase costs to our customers. In fiscal 2015, we processed and sold approximately 87.7 million pounds of green coffee as compared to approximately 88.3 million pounds of green coffee processed and sold in fiscal 2014. There were no new product category introductions in fiscal 2015 or 2014 which had a material impact on our net sales.

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The following table presents net sales aggregated by product category for the respective periods indicated:

| | Year Ended June 30, | | | |
|---|---|---|---|---|
| | 2015 | | 2014 | |
| (In thousands) | $ | % of total | $ | % of total |
| Net Sales by Product Category: | | | | |
| Coffee (Roast & Ground) | $336,129 | 61 % | $319,251 | 60 % |
| Coffee (Frozen Liquid) | 37,428 | 7 % | 37,840 | 7 % |
| Tea (Iced & Hot) | 27,172 | 5 % | 28,452 | 5 % |
| Culinary | 54,208 | 10 % | 56,567 | 11 % |
| Spice | 32,336 | 6 % | 31,876 | 6 % |
| Other beverages(1) | 54,933 | 10 % | 50,572 | 10 % |
| Net sales by product category | 542,206 | 99 % | 524,558 | 99 % |
| Fuel surcharge | 3,676 | 1 % | 3,822 | 1 % |
| Net sales | $545,882 | 100% | $528,380 | 100% |

(1) Includes all beverages other than coffee and tea.

Cost of Goods Sold

Cost of goods sold in fiscal 2015 increased $16.4 million, or 4.9%, to $348.8 million, or 63.9% of net sales, from $332.5 million, or 62.9% of net sales in fiscal 2014. The increase in cost of goods sold as a percentage of net sales in fiscal 2015 was primarily due to a 16.2% increase in the average Arabica "C" market price of green coffee. Inventories decreased at the end of fiscal 2015 compared to fiscal 2014 and, therefore, a beneficial effect of liquidation of LIFO inventory quantities in the amount of $4.9 million was recorded in cost of goods sold in fiscal 2015 reducing cost of goods sold by the same amount. No beneficial effect of liquidation of LIFO inventory quantities was recorded in fiscal 2014.

Gross Profit

Gross profit in fiscal 2015 increased $1.1 million, or 0.6%, to $197.0 million from $195.9 million in fiscal 2014, but gross margin decreased to 36.1% in fiscal 2015 from 37.1% in the prior fiscal year. The increase in gross profit was primarily due to the increase in net sales from higher prices of roast and ground coffee, frozen liquid coffee, tea products, spice and other beverages. The decrease in gross margin was primarily due to a 16.9% increase in the average "C" market price of green coffee as compared to the prior fiscal year. Gross profit in fiscal 2015 included the beneficial effect of the liquidation of LIFO inventory quantities in the amount of $4.9 million.

Operating Expenses

In fiscal 2015, operating expenses increased $6.8 million, or 3.6%, to $193.8 million, or 35.5% of net sales, from $187.0 million, or 35.4% of net sales, in fiscal 2014, primarily due to $10.4 million in restructuring and other transition expenses associated with the Corporate Relocation Plan. In fiscal 2015 selling expenses decreased $(3.3) million and general and administrative expenses decreased $(4.6) million as compared to fiscal 2014. The decrease in selling expenses in fiscal 2015 as compared to fiscal 2014 was primarily due to lower depreciation and amortization expense, bonus expense and salaries-related expense offset by an increase in workers' compensation expense. The decrease in general and administrative expenses in fiscal 2015 as compared to fiscal 2014 was primarily due to lower depreciation and amortization expense, bonus expense, consulting expense and the absence of expenses in connection with the restatement of certain prior period financial statements included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2013. This decrease in general and administrative expenses was partially offset by an increase in salaries-related expense, employee and retiree medical expense, ESOP compensation expense and workers' compensation expense. Operating expenses in fiscal 2015 also reflected $(0.4) million in net losses from sales of assets, primarily vehicles, as compared to $3.8 million in net gains from sales of assets, primarily real estate, in fiscal 2014.

Income from Operations

Income from operations in fiscal 2015 was $3.3 million compared to $8.9 million in fiscal 2014 primarily due to restructuring and other transition expenses associated with the Corporate Relocation Plan and lower gross profit partially offset by the decrease in selling expenses and general administrative expenses.

Total Other Income (Expense)

Total other expense in fiscal 2015 was $(2.2) million compared to total other income of $3.9 million in fiscal 2014, primarily due to net losses on derivative instruments and investments of $(3.3) million compared to net gains on derivative instruments and investments of $3.1 million in fiscal 2014. The net losses and net gains on derivative instruments and investments in fiscal 2015 and fiscal 2014, respectively, were primarily due to mark-to-market net losses and net gains, respectively, on coffee-related derivative instruments not designated as accounting hedges. Net losses on such coffee-related derivative instruments in fiscal 2015 were $(3.0) million compared to net gains on such coffee-related derivative instruments in fiscal 2014 of $2.7 million. In each of the fiscal years ended June 30, 2015 and 2014, we recognized $(0.3) million in losses on coffee-related derivative instruments designated as cash flow hedges due to ineffectiveness.

Income Taxes

In fiscal 2015, we recorded income tax expense of $0.4 million compared to $0.7 million in fiscal 2014. Income tax expense in fiscal 2015 was primarily attributable to cash taxes paid.

As of June 30, 2015, the Company has generated approximately $0.6 million of excess tax benefits related to stock compensation, the benefit of which will be recorded to additional paid in capital if and when realized.

Net Income

As a result of the foregoing factors, net income was $0.7 million, or $0.04 per diluted common share, in fiscal 2015 compared to $12.1 million, or $0.76 per diluted common share, in fiscal 2014.

Non-GAAP Financial Measures

In addition to net income determined in accordance with U.S. generally accepted accounting principles (“GAAP”), we use the following non-GAAP financial measures in assessing our operating performance:

“Non-GAAP net income” is defined as net income excluding the impact of:

- restructuring and other transition expenses;
- net gains and losses from sales of assets; and
- income tax benefit, including the release of valuation allowance on deferred tax assets.

“Non-GAAP net income per diluted common share” is defined as Non-GAAP net income divided by the weighted-average number of common shares outstanding, inclusive of the dilutive effect of common equivalent shares outstanding during the period.

"Adjusted EBITDA" is defined as net income excluding the impact of:

- income taxes;
- interest expense;
- depreciation and amortization expense;
- ESOP and share-based compensation expense;
- non-cash impairment losses;
- non-cash pension withdrawal expense;
- other similar non-cash expenses;
- restructuring and other transition expenses; and
- net gains and losses from sales of assets.

"Adjusted EBITDA Margin" is defined as Adjusted EBITDA expressed as a percentage of net sales.

Restructuring and other transition expenses are expenses that are directly attributable to the Corporate Relocation Plan, consisting primarily of employee retention and separation benefits, facility-related costs and other related costs such as travel, legal, consulting and other professional services.

We believe these non-GAAP financial measures provide a useful measure of the Company's operating results, a meaningful comparison with historical results and with the results of other companies, and insight into the Company's ongoing operating performance. Further, management utilizes these measures, in addition to GAAP measures, when evaluating and comparing the Company's operating performance against internal financial forecasts and budgets.

In the fourth quarter of fiscal 2016, we modified the calculation of Non-GAAP net income and Non-GAAP net income per diluted common share to exclude the non-cash income tax benefit from the release of valuation allowance on deferred tax assets. We believe this non-cash income tax benefit is not reflective of our ongoing operating results and that excluding the income tax benefit will help investors with comparability of our results. The historical presentation of the non-GAAP measures was not affected by this modification.

Non-GAAP net income, Non-GAAP net income per diluted common share, Adjusted EBITDA and Adjusted EBITDA Margin, as defined by us, may not be comparable to similarly titled measures reported by other companies. We do not intend for non-GAAP financial measures to be considered in isolation or as a substitute for other measures prepared in accordance with GAAP.

Set forth below is a reconciliation of reported net income to Non-GAAP net income and reported net income per common share-diluted to Non-GAAP net income per diluted common share:

| (In thousands) | Year Ended June 30, 2016 | 2015 | 2014 |
|---|---|---|---|
| Net income, as reported | $89,918 | $652 | $12,132 |
| Restructuring and other transition expenses | 16,533 | 10,432 | — |
| Net gains from sale of Spice Assets | (5,603 ) | — | — |
| Net (gains) losses from sales of assets | (2,802 ) | 394 | (3,814 ) |
| Non-cash income tax benefit, including release of valuation allowance on deferred tax assets | (80,439 ) | — | — |
| Non-GAAP net income | $17,607 | $11,478 | $8,318 |
| | | | |
| Net income per common share—diluted, as reported | $5.41 | $0.04 | $0.76 |
| Impact of restructuring and other transition expenses | $1.00 | $0.64 | $— |
| Impact of net gains from sale of Spice Assets | $(0.34 ) | $— | $— |
| Impact of net (gains) losses from sales of assets | $(0.17 ) | $0.03 | $(0.24 ) |
| Impact of release of valuation allowance on deferred tax assets | $(4.84 ) | $— | $— |
| Non-GAAP net income per diluted common share | $1.06 | $0.71 | $0.52 |

Set forth below is a reconciliation of reported net income to Adjusted EBITDA:

| (In thousands) | Year Ended June 30, 2016 | 2015 | 2014 |
|---|---|---|---|
| Net income, as reported | $89,918 | $652 | $12,132 |
| Income tax (benefit) expense | (79,997 ) | 402 | 705 |
| Interest expense | 425 | 769 | 1,258 |
| Depreciation and amortization expense | 20,774 | 24,179 | 27,334 |
| ESOP and share-based compensation expense | 4,342 | 5,691 | 4,692 |
| Restructuring and other transition expenses | 16,533 | 10,432 | — |
| Net gains from sale of Spice Assets | (5,603 ) | — | — |
| Net (gains) losses from sales of assets | (2,802 ) | 394 | (3,814 ) |
| Adjusted EBITDA | $43,590 | $42,519 | $42,307 |
| Adjusted EBITDA Margin | 8.0 % | 7.8 % | 8.0 % |

Liquidity, Capital Resources and Financial Condition

Credit Facility

We maintain a $75.0 million senior secured revolving credit facility (the “Revolving Facility”) with JPMorgan Chase Bank, N.A. and SunTrust Bank (collectively, the “Lenders”), with a sublimit on letters of credit and swingline loans of $30.0 million and $15.0 million respectively. The Revolving Facility includes an accordion feature whereby we may increase the Revolving Commitment by up to an additional $50.0 million, subject to certain conditions. Advances are based on our eligible accounts receivable, eligible inventory, and the value of certain real property and trademarks, less required reserves. The commitment fee ranges from 0.25% to 0.375% per annum based on average revolver usage. Outstanding obligations are collateralized by all of our assets, excluding certain real property not included in the borrowing base, machinery and equipment (other than inventory), and our preferred stock portfolio. Borrowings under the Revolving Facility bear interest based on average historical excess availability levels with a range of PRIME - 0.25% to PRIME + 0.50% or Adjusted LIBO Rate + 1.25% to Adjusted LIBO Rate + 2.00%. We are subject to a variety of affirmative and negative

covenants of types customary in an asset-based lending facility, including financial covenants relating to the maintenance of a fixed charge coverage ratio in certain circumstances, and the right of the Lenders to establish reserve requirements, which may reduce the amount of credit otherwise available to us. We are allowed to pay dividends, provided, among other things, certain excess availability requirements are met, and no event of default exists or has occurred and is continuing as of the date of any such payment and after giving effect thereto. The Revolving Facility expires on March 2, 2020.

At June 30, 2016, we were eligible to borrow up to a total of $58.6 million under the Revolving Facility and had outstanding borrowings of $0.1 million, utilized $11.9 million of the letters of credit sublimit, and had excess availability under the Revolving Facility of $46.6 million. At June 30, 2016, the weighted average interest rate on our outstanding borrowings under the Revolving Facility was 1.64%. At June 30, 2016, we were in compliance with all of the restrictive covenants under the Revolving Facility.

At August 31, 2016, we had estimated outstanding borrowings of $0.2 million, utilized $11.9 million of the letters of credit sublimit, and had excess availability under the Revolving Facility of $46.5 million. At August 31, 2016, the weighted average interest rate on our outstanding borrowings under the Revolving Facility was 1.65%.

Liquidity

We generally finance our operations through cash flows from operations and borrowings under our Revolving Facility described above. At June 30, 2016, we had $21.1 million in cash and cash equivalents and $25.6 million in short-term investments. We believe our Revolving Facility, to the extent available, in addition to our cash flows from operations and other liquid assets, the net proceeds from the sale of the Spice Assets and the proceeds from the sale of our Torrance facility, collectively, will be sufficient to fund our working capital and capital expenditure requirements for the next 12 to 18 months including the expected capital expenditures associated with the Corporate Relocation Plan, the purchase option under the Lease Agreement for the partially constructed New Facility, additional construction costs to complete the New Facility and anticipated capital expenditures for machinery and equipment, furniture and fixtures, and related expenditures.

Changes in Cash Flows

We generate cash from operating activities primarily from cash collections related to the sale of our products. Net cash provided by operating activities was $27.6 million in fiscal 2016 compared to $26.9 million in fiscal 2015 and $52.9 million in fiscal 2014. The higher level of net cash provided by operating activities in fiscal 2016 compared to the prior fiscal year was primarily due to higher net income and a higher level of cash inflows from operating activities. The increase in net income was primarily due to non-cash income tax benefit resulting from the release of valuation allowance on deferred tax assets. The higher level of cash inflows from operating activities was primarily due to higher proceeds from sales of short-term investments, accruals for incentive compensation payments to eligible employees and a decrease in inventory balances, partially offset by higher cash outflows from increases in derivative assets and accounts receivable balances, purchases of short-term investments and payments for restructuring and other transition expenses. Inventories decreased at the end of fiscal 2016 compared to fiscal 2015 primarily due to production consolidation, and the sale of processed and unprocessed inventories to Harris at cost upon conclusion of the transition services provided by the Company in connection with the sale of Spice Assets. At June 30, 2016, we had a net gain position in our margin accounts for coffee-related derivative instruments resulting in the release of restriction of the use of $1.0 million of cash in these accounts, which contributed to higher cash inflows in fiscal 2016.

In fiscal 2015, the lower level of net cash provided by operating activities as compared to the prior fiscal year was due to lower net income and a higher level of cash outflows from operating activities. Cash outflows were primarily from payments of accounts payable balances including the payment of expenses associated with the Corporate Relocation Plan, payroll expenses including accrued bonuses and restriction of cash held in margin accounts for coffee-related derivative instruments. Cash outflows were partially offset by cash inflows from a decrease in inventory balances. Inventory balances decreased in fiscal 2015 compared to the prior fiscal year primarily due to the consolidation of coffee production from the Torrance production facility with the Houston and Portland production facilities pursuant to our Corporate Relocation Plan. At June 30, 2015, we had a net loss position in our margin accounts for coffee-related derivative instruments resulting in restriction of the use of $1.0 million of cash in these accounts, which contributed to lower cash inflows in fiscal 2015.

Net cash used in investing activities was $39.5 million in fiscal 2016 as compared to $20.1 million in fiscal 2015 and $20.7 million in fiscal 2014. In fiscal 2016, net cash used in investing activities included $31.1 million for purchases of property, plant and equipment including $4.4 million in machinery and equipment for the New Facility and $19.4 million in

purchases of construction-in-progress assets in connection with the construction of the New Facility as the deemed owner under the lease arrangement, partially offset by $10.9 million in proceeds from sales of assets, primarily spice assets and real estate. In fiscal 2015, net cash used in investing activities included $1.2 million in payments in connection with the RLC Acquisition and $19.2 million for purchases of property, plant and equipment, partially offset by proceeds from sales of assets, primarily vehicles, of $0.3 million. The increase in cash outflows for property, plant and equipment compared to the prior fiscal year was primarily due to the capital expenditures for the New Facility as the deemed owner of the New Facility.

Net cash provided by financing activities in fiscal 2016 was $17.8 million as compared to net cash used in financing activities of $3.6 million and $22.8 million in fiscal 2015 and 2014, respectively. Net cash provided by financing activities in fiscal 2016 included $19.4 million in proceeds from lease financing in connection with the construction of the New Facility as the deemed owner under the lease arrangement and $1.7 million in proceeds from stock option exercises, partially offset by $3.1 million used to pay capital lease obligations, $0.2 million in tax withholding payments related to net share settlement of equity awards and net repayments on our credit facility of $31,000. Net cash used in financing activities in fiscal 2015 included $3.9 million used to pay capital lease obligations, $0.6 million in net repayments on our credit facility, $0.6 million in deferred financing costs for the Revolving Facility and $0.1 million in tax withholding payments related to net share settlement of equity awards, partially offset by $1.5 million in proceeds from stock option exercises. Net repayments on our credit facility in fiscal 2014 were $20.6 million.

Sale of Spice Assets

In order to focus on our core product offerings, in the second quarter of fiscal 2016, we completed the sale of certain assets associated with our manufacture, processing and distribution of raw, processed and blended spices and certain other culinary products to Harris. We received $6.0 million in cash at closing, and we are eligible to receive an earnout amount of up to $5.0 million over a three year period based upon a percentage of certain institutional spice sales by Harris following the closing. The sale of the Spice Assets does not represent a strategic shift for us and is not expected to have a material impact on our results of operations because we will continue to sell a complete portfolio of spice and other culinary products purchased from Harris under a supply agreement to our DSD customers. See Note 5, Sale of Spice Assets, of the Notes to Consolidated Financial Statements included in Part II, Item 8 of this report.

Sale of Torrance Facility

In the fourth quarter of fiscal 2016, we entered into a purchase and sale agreement to sell the Torrance facility. Subsequent to the fiscal year end, the sale of the Torrance facility closed on July 15, 2016 for an aggregate cash sale price of $43.0 million (which sale price was subject to customary adjustments for closing costs and documentary transfer taxes). We have agreed to lease back the Torrance facility on a triple net basis through October 31, 2016 at zero base rent, subject to two one-month extensions at our option at a base rent of $100,000 per month. As of June 30, 2016, the Torrance facility continued to house certain administrative functions and serve as a distribution facility and branch warehouse pending transition of the remaining Torrance operations to our other facilities. See Note 6, Assets Held for Sale, and Note 24, Subsequent Events, of the Notes to Consolidated Financial Statements included in Part II, Item 8 of this report.

Torrance Facility Exit Costs

Based on current assumptions and subject to continued implementation of the Corporate Relocation Plan, we estimate that we will incur approximately $31 million in cash costs in connection with the exit of the Torrance facility consisting of $18 million in employee retention and separation benefits, $5 million in facility-related costs and $8 million in other related costs. Since adoption of the Corporate Relocation Plan in fiscal 2015 through June 30, 2016, we have recognized a total of $25.7 million of the estimated $31 million in aggregate cash costs, including $16.2 million in employee retention and separation benefits, $3.1 million in facility-related costs related to the relocation of our Torrance operations and certain distribution operations and $6.4 million in other related costs recorded in “Restructuring and other transition expenses” in our consolidated statements of operations. The remainder is expected to be recognized in the first half of fiscal 2017. Additionally, we recognized from inception through fiscal 2016 $1.3 million in non-cash depreciation expense associated with the Torrance production facility. We may incur certain other non-cash asset impairment costs and pension-related costs in connection with the Corporate Relocation Plan. See Note 3, Corporate Relocation Plan, of the Notes to Consolidated Financial Statements included in Part II, Item 8 of this

report.

New Facility Construction Costs

In the first quarter of fiscal 2016, we entered into the Lease Agreement for the New Facility pursuant to which the New Facility is being constructed by the lessor, at its expense, in accordance with agreed upon specifications and plans. Based on the final budget, which reflects substantial completion of the principal design work for the New Facility, we estimate that the construction costs for the New Facility will be approximately $55 million to $60 million. In the fourth quarter of fiscal 2016 we exercised the purchase option under the Lease Agreement to acquire the partially constructed New Facility with a targeted closing date in the first quarter of fiscal 2017. The estimated purchase option exercise price for the New Facility is $58.8 million based on the budget for the completed facility. The actual option exercise price for the partially constructed New Facility will depend upon, among other things, the timing of the closing and the actual costs incurred for construction of the New Facility as of the purchase option closing date. See Note 4, New Facility Lease Obligation, and Note 22, Commitments and Contingencies, of the Notes to Consolidated Financial Statements included in Part II, Item 8 of this report.

We recorded an asset related to the New Facility lease obligation included in property, plant and equipment of $28.1 million at June 30, 2016, as the deemed owner of the New Facility, and an offsetting liability of $28.1 million for the lease obligation in "Other long-term liabilities" on our consolidated balance sheet at June 30, 2016. There were no such amounts recorded at June 30, 2015.

Capital Expenditures

For the fiscal years ended June 30, 2016, 2015 and 2014, our capital expenditures were as follows:

| | June 30, | | |
|---|---|---|---|
| (In thousands) | 2016 | 2015 | 2014 |
| Coffee brewing equipment | $8,375 | $10,709 | $13,550 |
| Vehicles, machinery and equipment | 10,254 | 6,079 | 9,270 |
| Building and facilities | 3,354 | 1,460 | 758 |
| Software, office furniture and equipment | 3,165 | 946 | 1,689 |
| Land | 1,458 | — | — |
| Capital expenditures, excluding New Facility | $26,606 | $19,194 | $25,267 |
| New Facility: | | | |
| Machinery and equipment | $4,443 | $22 | $— |
| Total capital expenditures | $31,049 | $19,216 | $25,267 |

We expect to incur approximately $35 million to $39 million in anticipated capital expenditures for machinery and equipment, furniture and fixtures, and related expenditures associated with the New Facility. As of June 30, 2016, we had spent $4.4 million towards the purchase of machinery and equipment for the New Facility. No such capital expenditures were incurred in fiscal 2015. The majority of the capital expenditures associated with machinery and equipment, furniture and fixtures and related expenditures for the New Facility are expected to be incurred in the first half of fiscal 2017.

Our expected capital expenditures for fiscal 2017 unrelated to the New Facility include expenditures to replace normal wear and tear of coffee brewing equipment, vehicles, machinery and equipment and mobile sales solution hardware, and are expected to be consistent with the average capital expenditures for the past three fiscal years.

Working Capital

At June 30, 2016 and 2015, our working capital was composed of the following:

| | June 30, | |
|---|---|---|
| (In thousands) | 2016 | 2015 |
| Current assets(1) | $153,365 | $135,685 |
| Current liabilities(2) | 56,837 | 64,874 |
| Working capital | $96,528 | $70,811 |

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(1) Includes $4.0 million in coffee-related short-term derivative assets and $7.2 million in assets held for sale at June 30, 2016 and $1.0 million in restricted cash at June 30, 2015.
(2) Includes $4.0 million in coffee-related short-term derivative liabilities and $1.4 million in deferred tax liabilities at June 30, 2015.

Contractual Obligations

The following table contains information regarding total contractual obligations as of June 30, 2016, including capital leases:

| | Payment due by period | | | | |
|---|---|---|---|---|---|
| (In thousands) | Total | Less Than One Year | 1-3 Years | 3-5 Years | More Than 5 Years |
| Contractual obligations: | | | | | |
| Operating lease obligations | $11,801 | $4,093 | $5,927 | $1,720 | $ 61 |
| New Facility purchase option exercise price(1) | 58,779 | 58,779 | — | — | — |
| Capital lease obligations(2) | 2,504 | 1,443 | 1,005 | 56 | — |
| Pension plan obligations | 89,950 | 8,075 | 16,858 | 17,918 | 47,099 |
| Postretirement benefits other than pension plans | 11,957 | 1,080 | 2,245 | 2,386 | 6,246 |
| Revolving credit facility | 109 | 109 | — | — | — |
| Purchase commitments(3) | 72,217 | 72,217 | — | — | — |
| Total contractual obligations | $247,317 | $145,796 | $26,035 | $22,080 | $ 53,406 |

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(1) In the fourth quarter of fiscal 2016, we exercised the purchase option under the Lease Agreement to acquire the partially constructed New Facility with a targeted closing date in the first quarter of fiscal 2017. The purchase option exercise price shown in the table above is an estimate based on the budget for the completed facility. The actual option exercise price for the partially constructed New Facility will depend upon, among other things, the timing of the closing and the actual costs incurred for construction of the New Facility as of the purchase option closing date. See Note 4, New Facility Lease Obligation, of the Notes to Consolidated Financial Statements included in Part II, Item 8 of this report.
(2) Includes imputed interest of $0.1 million.
(3) Purchase commitments include commitments under coffee purchase contracts for which all delivery terms have been finalized but the related coffee has not been received as of June 30, 2016. Amounts shown in the table above: (a) include all coffee purchase contracts that the Company considers to be from normal purchases; and (b) do not include amounts related to derivative instruments that are recorded at fair value on the Company's consolidated balance sheets.

As of June 30, 2016, we had committed to purchase green coffee inventory totaling $62.5 million under fixed-price contracts, $3.3 million in equipment for the New Facility and $6.3 million in other inventory under non-cancelable purchase orders.

Off-Balance Sheet Arrangements
We have no off-balance sheet arrangements.

Critical Accounting Policies and Estimates
Management's discussion and analysis of financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with GAAP. Our significant accounting policies are discussed in Note 1, Summary of Significant Accounting Policies, of the Notes to Consolidated Financial Statements, included in Part II, Item 8 of this report. The preparation of these financial statements requires us to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to inventory valuation, including LIFO reserves, valuation of intangible assets, deferred tax assets, liabilities relating to retirement benefits, liabilities resulting from self-insurance, tax liabilities and litigation. We base our estimates, judgments and assumptions on historical experience and other relevant factors that are believed to be reasonable based on information available to us at the time these estimates are made.
While we believe that the historical experience and other factors considered provide a meaningful basis for the accounting policies applied in the preparation of the consolidated financial statements, actual results may differ from these estimates, which could require us to make adjustments to these estimates in future periods.
We believe that the estimates, judgments and assumptions involved in the accounting policies described below require the most subjective judgment and have the greatest potential impact on our financial statements, so we consider these to be our critical accounting policies. Our senior management has reviewed the development and selection of these critical accounting policies and estimates, and their related disclosure in this report, with the Audit Committee of our Board of Directors.
Exposure to Commodity Price Fluctuations and Derivative Instruments
We are exposed to commodity price risk arising from changes in the market price of green coffee. In general, increases in the price of green coffee could cause our cost of goods sold to increase and, if not offset by product price increases, could negatively affect our financial condition and results of operations. As a result, our business model strives to reduce the impact of green coffee price fluctuations on our financial results and to protect and stabilize our margins, principally through customer arrangements and derivative instruments.
Customers generally pay for our products based either on an announced price schedule or under commodity-based pricing arrangements whereby the changes in green coffee commodity costs are passed through to the customer. The pricing schedule is generally subject to adjustment, either on contractual terms or in accordance with periodic product price adjustments, typically monthly, resulting in, at the least, a 30-day lag in our ability to correlate the changes in our prices with fluctuations in the cost of raw materials and other inputs.
In addition to our customer arrangements, we utilize derivative instruments to reduce further the impact of changing green coffee commodity prices. We purchase over-the-counter coffee derivative instruments to enable us to lock in the price of green coffee commodity purchases. These derivative instruments may be entered into at the direction of the customer under commodity-based pricing arrangements to effectively lock in the purchase price of green coffee under such customer arrangements, in certain cases up to 18 months or longer in the future. Notwithstanding this customer direction, pursuant to Accounting Standards Codification ("ASC") 815, "Derivatives and Hedging," we are considered the owner of these derivative instruments and, therefore, we are required to account for them as such. In the event the customer fails to purchase the products associated with the underlying derivative instruments for which the price has been locked-in on behalf of the customer, we expect that such derivative instruments will be assigned to, and assumed by, the customer in accordance with contractual terms or, in the absence of such terms, in accordance with standard industry custom and practice. In the event the customer fails to assume such derivative instruments, we will remain obligated on the derivative instruments at settlement. We generally settle derivative instruments to coincide with the receipt of the purchased green coffee or apply the derivative instruments to purchase orders effectively fixing the cost of in-bound green coffee purchases. As of June 30, 2016 and 2015, we had 34.0 million and 34.2 million pounds of green coffee covered under coffee-related derivative instruments,

respectively. We do not purchase any derivative instruments to hedge cost fluctuations of any commodities other than green coffee.

The fair value of derivative instruments is based upon broker quotes. We account for certain coffee-related derivative instruments as accounting hedges in order to minimize the volatility created in our quarterly results from utilizing these derivative contracts and to improve comparability between reporting periods. The effective portion of the change in fair value of the derivative is reported in accumulated other comprehensive income (loss) (“AOCI”) on our consolidated balance sheet and subsequently reclassified into cost of goods sold in the period or periods when the hedged transaction affects earnings. At June 30, 2016, approximately 96% of our outstanding coffee-related derivative instruments, representing 32.6 million pounds of forecasted green coffee purchases, were designated as cash flow hedges. At June 30, 2015, approximately 94% of our outstanding coffee-related derivative instruments, representing 32.3 million pounds of forecasted green coffee purchases, were designated as cash flow hedges. The portion of open hedging contracts that are not 100% effective as cash flow hedges and those that are not designated as accounting hedges are marked to period-end market price and unrealized gains or losses based on whether the period-end market price was higher or lower than the price we locked-in are recognized in our financial results.

Our risk management practices reduce but do not eliminate our exposure to changing green coffee prices. While we have limited our exposure to unfavorable green coffee price changes, we have also limited our ability to benefit from favorable price changes. Further, our counterparty may require that we post cash collateral if the fair value of our derivative liabilities exceed the amount of credit granted by such counterparty, thereby reducing our liquidity. At June 30, 2016, because we had a net gain position in our coffee-related derivative margin accounts, none of the cash in these accounts was restricted. At June 30, 2015, we had $1.0 million in restricted cash representing cash held on deposit in margin accounts for coffee-related derivative instruments due to a net loss position in such accounts. Changes in commodity prices and the number of coffee-related derivative instruments held could have a significant impact on cash deposit requirements under our broker and counterparty agreements.

Inventories

Inventories are valued at the lower of cost or market. We account for coffee, tea and culinary products on the last in, first out (“LIFO”) basis, and coffee brewing equipment parts on the first in, first out (“FIFO”) basis. We regularly evaluate these inventories to determine inventory reserves for obsolete and slow-moving inventory. Inventory reserves are based on inventory obsolescence trends, historical experience and application of specific identification. At the end of each quarter, we record the expected effect of the liquidation of LIFO inventory quantities, if any, and record the actual impact at fiscal year-end. An actual valuation of inventory under the LIFO method is made only at the end of each fiscal year based on the inventory levels and costs at that time. If inventory quantities decline at the end of the fiscal year compared to the beginning of the fiscal year, the reduction results in the liquidation of LIFO inventory quantities carried at the cost prevailing in prior years. This LIFO inventory liquidation may result in a decrease or increase in cost of goods sold depending on whether the cost prevailing in prior years was lower or higher, respectively, than the current year cost. As these estimates are subject to many forces beyond management's control, interim results are subject to the final fiscal year-end LIFO inventory valuation.

Impairment of Goodwill and Indefinite-lived Intangible Assets

We account for our goodwill and indefinite-lived intangible assets in accordance with ASC 350, “Intangibles-Goodwill and Other” (“ASC 350”). Goodwill and other indefinite-lived intangible assets are not amortized but instead are reviewed for impairment annually, or more frequently if an event occurs or circumstances change which indicate that an asset might be impaired. We perform a qualitative assessment of goodwill and indefinite-lived intangible assets on our consolidated balance sheets, to determine if there is a more likely than not indication that our goodwill and indefinite-lived intangible assets are impaired as of June 30. If the indicators of impairment are present, we perform a quantitative test to determine the impairment of these assets as of the measurement date.

Testing for impairment of goodwill is a two-step process. The first step requires us to compare the fair value of our reporting unit to the carrying value of the reporting unit, including goodwill. If the fair value of a reporting unit is less than its carrying value, goodwill of the reporting unit is potentially impaired and we then complete step two to measure the impairment loss, if any. The second step requires the calculation of the implied fair value of goodwill, which is the residual fair value remaining after deducting the fair value of all tangible and intangible net assets of the

reporting unit from the fair

value of the reporting unit. If the implied fair value of goodwill is less than the carrying amount of goodwill, an impairment loss is recognized equal to the difference.

Indefinite-lived intangible assets are tested for impairment by comparing their fair values to their carrying values. An impairment charge is recorded if the estimated fair value of such assets has decreased below their carrying value.

Other Intangible Assets

Other intangible assets consist of finite-lived intangible assets including acquired non-compete agreements and customer relationships. These are amortized over their estimated useful lives and are tested for impairment by grouping them with other assets at the lowest level for which identifiable cash flows are largely independent of the cash flows of other groups of assets and liabilities. The estimated future cash flows are based upon, among other things, assumptions about expected future operating performance and may differ from actual cash flows. If the sum of the projected undiscounted cash flows (excluding interest) is less than the carrying value of the assets, the assets will be written down to the estimated fair value in the period in which the determination is made. We review the recoverability of our long-lived assets whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable.

Self-Insurance

We use a combination of insurance and self-insurance mechanisms, including the use of captive insurance entities and participation in a reinsurance treaty, to provide for the potential liability of certain risks including workers' compensation, health care benefits, general liability, product liability, property insurance and director and officers' liability insurance. Liabilities associated with risks retained by us are not discounted and are estimated by considering historical claims experience, demographics, exposure and severity factors and other actuarial assumptions.

Our self-insurance for workers' compensation liability includes estimated outstanding losses of unpaid claims and allocated loss adjustment expenses ("ALAE"), case reserves, the development of known claims and incurred but not reported claims. ALAE are the direct expenses for settling specific claims. The amounts reflect per occurrence and annual aggregate limits maintained by the Company. The estimated liability analysis does not include estimating a provision for unallocated loss adjustment expenses. We believe that the amount recorded at June 30, 2016 is adequate to cover all known workers' compensation claims at June 30, 2016. If the actual costs of such claims and related expenses exceed the amount estimated, additional reserves may be required which could have a material negative effect on operating results.

The estimated liability related to our self-insured group medical insurance is recorded on an incurred but not reported basis, within deductible limits, based on actual claims and the average lag time between the date insurance claims are filed and the date those claims are paid. General liability, product liability and commercial auto liability are insured through a captive insurance program. We retain the risk within certain aggregate amounts. Cost of the insurance through the captive program is accrued based on estimates of the aggregate liability claims incurred using certain actuarial assumptions and historical claims experience.

Employee Benefit Plans

We provide benefit plans for most full-time employees, including 401(k), health and other welfare benefit plans and, in certain circumstances, pension benefits. Generally the plans provide benefits based on years of service and/or a combination of years of service and earnings. In addition, we contribute to two multiemployer defined benefit pension plans, one multiemployer defined contribution pension plan and ten multiemployer defined contribution plans other than pension plans that provide medical, vision, dental and disability benefits for active, union-represented employees subject to collective bargaining agreements. In addition, we sponsor a postretirement defined benefit plan that covers qualified non-union retirees and certain qualified union retirees and provides retiree medical coverage and, depending on the age of the retiree, dental and vision coverage. We also provide a postretirement death benefit to certain of our employees and retirees.

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

Single Employer Pension Plans

We have a defined benefit pension plan, the Farmer Bros. Co. Pension Plan for Salaried Employees (the “Farmer Bros. Plan”), for our employees hired prior to January 1, 2010 who are not covered under a collective bargaining agreement. We amended the Farmer Bros. Plan, freezing the benefit for all participants effective June 30, 2011. After the plan freeze, participants do not accrue any benefits under the Farmer Bros. Plan, and new hires are not eligible to participate in the Farmer Bros. Plan. As all plan participants became inactive following this pension curtailment, net (gain) loss is now amortized based on the remaining life expectancy of these participants instead of the remaining service period of these participants.

We also have two defined benefit pension plans for certain hourly employees covered under collective bargaining agreements (the “Brewmatic Plan” and the “Hourly Employees’ Plan”).

We obtain actuarial valuations for our single employer defined benefit pension plans. In fiscal 2016 we discounted the pension obligations using a 4.40% discount rate and 7.50% expected long-term rate of return on plan assets. The performance of the stock market and other investments as well as the overall health of the economy can have a material effect on pension investment returns and these assumptions. A change in these assumptions could affect our operating results.

At June 30, 2016, the projected benefit obligation under our single employer defined benefit pension plans was $161.2 million and the fair value of plan assets was $96.6 million. The difference between the projected benefit obligation and the fair value of plan assets is recognized as a decrease in OCI and an increase in pension liability and deferred tax assets. The difference between plan obligations and assets, or the funded status of the plans, significantly affects the net periodic benefit cost and ongoing funding requirements of those plans. Among other factors, changes in interest rates, mortality rates, early retirement rates, mix of plan asset investments, investment returns and the market value of plan assets can affect the level of plan funding, cause volatility in the net periodic benefit cost, increase our future funding requirements and require premium payments to the Pension Benefit Guaranty Corporation. For the fiscal year ended June 30, 2016, we made $1.6 million in contributions to our single employer defined benefit pension plans and recorded pension expense of $1.2 million. We expect to make approximately $2.3 million in contributions to our single employer defined benefit pension plans in fiscal 2017 and accrue pension expense of approximately $1.7 million per year beginning in fiscal 2017. These pension contributions are expected to continue at this level for several years; however a deterioration in the current economic environment would increase the risk that we may be required to make larger contributions in the future.

The following chart quantifies the effect on the projected benefit obligation and the net periodic benefit cost of a change in the discount rate assumption and the impact on the net periodic benefit cost of a change in the assumed rate of return on plan assets under our single employer defined benefit pension plans for fiscal 2017:

| ($ in thousands) | | | |
|---|---|---|---|
| Farmer Bros. Plan Discount Rate | 3.1% | Actual 3.55% | 4.1% |
| Net periodic benefit cost | $983 | $ 1,086 | $1,159 |
| Projected benefit obligation | $162,790 | $ 152,324 | $142,921 |
| | | | |
| Farmer Bros. Plan Rate of Return | 7.3% | Actual 7.75% | 8.3% |
| Net periodic benefit cost | $1,529 | $ 1,086 | $642 |
| | | | |
| Brewmatic Plan Discount Rate | 3.1% | Actual 3.55% | 4.1% |
| Net periodic benefit cost | $68 | $ 71 | $73 |
| Projected benefit obligation | $4,856 | $ 4,575 | $4,327 |
| | | | |
| Brewmatic Plan Rate of Return | 7.3% | Actual 7.75% | 8.3% |
| Net periodic benefit cost | $85 | $ 71 | $56 |
| | | | |
| Hourly Employees’ Plan Discount Rate | 3.1% | Actual 3.55% | 4.1% |
| Net periodic benefit cost | $606 | $ 530 | $462 |
| Projected benefit obligation | $4,725 | $ 4,329 | $3,980 |
| | | | |
| Hourly Employees' Plan Rate of Return | 7.3% | Actual 7.75% | 8.3% |
| Net periodic benefit cost | $543 | $ 530 | $517 |

Multiemployer Pension Plans

We participate in two multiemployer defined benefit pension plans that are union sponsored and collectively bargained for the benefit of certain employees subject to collective bargaining agreements. We make contributions to these plans generally based on the number of hours worked by the participants in accordance with the provisions of negotiated labor contracts.

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

Postretirement Benefits

We sponsor a postretirement defined benefit plan that covers qualified non-union retirees and certain qualified union retirees. The plan provides medical, dental and vision coverage for retirees under age 65 and medical coverage only for retirees age 65 and above. Under this postretirement plan, our contributions toward premiums for retiree medical, dental and vision coverage for participants and dependents are scaled based on length of service, with greater Company contributions for retirees with greater length of service, subject to a maximum monthly Company contribution. Our retiree medical, dental and vision plan is unfunded, and its liability was calculated using an assumed discount rate of 3.7% at June 30, 2016. We project an initial medical trend rate of 9.0% in fiscal 2016, ultimately reducing to 4.5% in 10 years.

We also provide a postretirement death benefit to certain of our employees and retirees, subject, in the case of current employees, to continued employment with the Company until retirement, and certain other conditions related to the manner of employment termination and manner of death. We record the actuarially determined liability for the present value of the postretirement death benefit using a discount rate of 3.8%. We have purchased life insurance policies to fund the

postretirement death benefit wherein we own the policy but the postretirement death benefit is paid to the employee's or retiree's beneficiary. We record an asset for the fair value of the life insurance policies which equates to the cash surrender value of the policies.

Share-based Compensation

We measure all share-based compensation cost at the grant date, based on the fair values of the awards that are ultimately expected to vest, and recognize that cost on a straight line basis in our consolidated statements of operations over the requisite service period. Fair value of restricted stock is the closing price of the Company's common stock on the date of grant. We estimate the fair value of stock option awards on the date of grant using the Black-Scholes valuation model which requires that we make certain assumptions regarding: (i) the expected volatility in the market price of our common stock; (ii) dividend yield; (iii) risk-free interest rate; and (iv) the period of time employees are expected to hold the award prior to exercise (referred to as the expected term).

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. Because our stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimates, in management’s opinion, the existing models may not necessarily provide a reliable single measure of the fair value of our stock options. Although the fair value of stock options is determined using an option valuation model, that value may not be indicative of the fair value observed in a willing buyer/willing seller market transaction.

In addition, we estimate the expected impact of forfeited awards and recognize share-based compensation cost only for those awards ultimately expected to vest. If actual forfeiture rates differ materially from our estimates, share-based compensation expense could differ significantly from the amounts we have recorded in the current period. We will periodically review actual forfeiture experience and revise our estimates, as necessary. We will recognize as compensation cost the cumulative effect of the change in estimated forfeiture rates on current and prior periods in earnings of the period of revision. As a result, if we revise our assumptions and estimates, our share-based compensation expense could change materially in the future. In each of fiscal 2016 and 2015, we used an estimated annual forfeiture rate of 4.8% to calculate share-based compensation expense based on actual forfeiture experience.

We have outstanding share-based awards that have performance-based vesting conditions in addition to time-based vesting. Awards with performance-based vesting conditions require the achievement of certain financial and other performance criteria as a condition to the vesting. We recognize the estimated fair value of performance-based awards, net of estimated forfeitures, as share-based compensation expense over the performance period based upon our determination of whether it is probable that the performance targets will be achieved. At each reporting period, we reassess the probability of achieving the performance criteria and the performance period required to meet those targets. Determining whether the performance criteria will be achieved involves judgment, and the estimate of share-based compensation expense may be revised periodically based on changes in the probability of achieving the performance criteria. Revisions are reflected in the period in which the estimate is changed. If performance goals are not met, no share-based compensation expense is recognized, and, to the extent share-based compensation expense was previously recognized, such share-based compensation expense is reversed.

Income Taxes

Deferred income taxes are determined based on the temporary differences between the financial reporting and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Estimating our tax liabilities involves judgments related to uncertainties in the application of complex tax regulations. We make certain estimates and judgments to determine tax expense for financial statement purposes as we evaluate the effect of tax credits, tax benefits and deductions, some of which result from differences in the timing of recognition of revenue or expense for tax and financial statement purposes. Changes to these estimates may result in significant changes to our tax provision in future periods. Each fiscal quarter we re-evaluate our tax provision and reconsider our estimates and assumptions related to specific tax assets and liabilities, making adjustments as circumstances change.

Deferred Tax Asset Valuation Allowance

We evaluate our deferred tax assets quarterly to determine if a valuation allowance is required. We consider whether a valuation allowance should be recorded against deferred tax assets based on the likelihood that the benefits of the deferred tax assets will or will not ultimately be realized in future periods. In making this assessment, significant weight is given to evidence that can be objectively verified, such as recent operating results, and less consideration is given to less objective indicators, such as future income projections. After consideration of positive and negative evidence, including the recent history of income, we concluded that it is more likely than not that we will generate future income sufficient to realize our the majority of our deferred tax assets as of June 30, 2016. Accordingly, we recorded a reduction in our valuation allowance in fiscal 2016 in the amount of $83.2 million.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk

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

The following table demonstrates the impact of varying interest rate changes based on our preferred securities holdings and market yield and price relationships at June 30, 2016. This table is predicated on an “instantaneous” change in the general level of interest rates and assumes predictable relationships between the prices of our preferred securities holdings and the yields on U.S. Treasury securities. At June 30, 2016, we had no futures contracts or put options with respect to our preferred securities portfolio designated as interest rate risk hedges.

| ($ in thousands) | Market Value of Preferred Securities at June 30, 2016 | Change in Market Value |
|---|---|---|
| Interest Rate Changes | | |
| –150 basis points | $26,495 | $ 904 |
| –100 basis points | $26,310 | $ 719 |
| Unchanged | $25,591 | $ — |
| +100 basis points | $24,644 | $ (947) |
| +150 basis points | $24,184 | $ (1,407) |

Borrowings under our Revolving Facility bear interest based on average historical excess availability levels with a range of PRIME - 0.25% to PRIME + 0.50% or Adjusted LIBO Rate + 1.25% to Adjusted LIBO Rate + 2.00%.

At June 30, 2016, we had outstanding borrowings of $0.1 million, utilized $11.9 million of the letters of credit sublimit, and had excess availability under the Revolving Facility of $46.6 million. The weighted average interest rate on our outstanding borrowings under the Revolving Facility at June 30, 2016 was 1.64%.

Commodity Price Risk

We are exposed to commodity price risk arising from changes in the market price of green coffee. We value green coffee inventory on the LIFO basis. In the normal course of business we hold a large green coffee inventory and enter into forward commodity purchase agreements with suppliers. We are subject to price risk resulting from the volatility of green

coffee prices. Due to competition and market conditions, volatile price increases cannot always be passed on to our customers.
We purchase over-the-counter coffee derivative instruments to enable us to lock in the price of green coffee commodity purchases. These derivative instruments also may be entered into at the direction of the customer under commodity-based pricing arrangements to effectively lock in the purchase price of green coffee under such customer arrangements, in certain cases up to 18 months or longer in the future. We account for certain coffee-related derivative instruments as accounting hedges in order to minimize the volatility created in our quarterly results from utilizing these derivative contracts and to improve comparability between reporting periods.
When we designate coffee-related derivative instruments as cash flow hedges, we formally document the hedging instruments and hedged items, and measure at each balance sheet date the effectiveness of our hedges. The effective portion of the change in fair value of the derivative is reported in AOCI and subsequently reclassified into cost of goods sold in the period or periods when the hedged transaction affects earnings. For the fiscal year ended June 30, 2016 we reclassified $(13.2) million in net losses into cost of goods sold from AOCI. For the fiscal years ended June 30, 2015 and 2014 we reclassified $4.2 million and $1.2 million, respectively, in net gains into cost of goods sold from AOCI. Any ineffective portion of the derivative's change in fair value is recognized currently in “Other, net.”
Gains or losses deferred in AOCI associated with terminated derivative instruments, derivative instruments that cease to be highly effective hedges, derivative instruments for which the forecasted transaction is reasonably possible but no longer probable of occurring, and cash flow hedges that have been otherwise discontinued remain in AOCI until the hedged item affects earnings. If it becomes probable that the forecasted transaction designated as the hedged item in a cash flow hedge will not occur, we recognize any gain or loss deferred in AOCI in “Other, net” at that time. For the fiscal years ended June 30, 2016, 2015 and 2014, we recognized in “Other, net” $(0.6) million, $(0.3) million and $(0.3) million, respectively, in net losses on coffee-related derivative instruments designated as cash flow hedges due to ineffectiveness.
For derivative instruments that are not designated in a hedging relationship, and for which the normal purchases and normal sales exception has not been elected, the changes in fair value are reported in “Other, net.”
For the fiscal years ended June 30, 2016, 2015 and 2014, we recorded in “Other, net” net (losses) gains on coffee-related derivative instruments not designated as accounting hedges in the amounts of $(0.3) million, $(3.0) million and $2.7 million, respectively.
The following table summarizes the potential impact as of June 30, 2016 to net income and AOCI from a hypothetical 10% change in coffee commodity prices. The information provided below relates only to the coffee-related derivative instruments and does not include, when applicable, the corresponding changes in the underlying hedged items:

| | Increase (Decrease) to Net Income | | Increase (Decrease) to AOCI | |
|---|---|---|---|---|
| (In thousands) | 10% Increase in Underlying Rate | 10% Decrease in Underlying Rate | 10% Increase in Underlying Rate | 10% Decrease in Underlying Rate |
| Coffee-related derivative instruments(1) | $118 | $ (118 ) | $4,941 | $ (4,941 ) |

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(1) The Company's purchase contracts that qualify as normal purchases include green coffee purchase commitments for which the price has been locked in as of June 30, 2016. These contracts are not included in the sensitivity analysis above as the underlying price has been fixed.

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Item 8. Financial Statements and Supplementary Data
Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of
Farmer Bros. Co.
Fort Worth, Texas

We have audited the accompanying consolidated balance sheets of Farmer Bros. Co. and subsidiaries (the "Company") as of June 30, 2016 and 2015 and the related consolidated statements of operations, comprehensive income (loss), stockholders' equity, and cash flows for each of the three years in the period ended June 30, 2016. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the consolidated financial statements based on our audits.
We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.
In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Farmer Bros. Co. and subsidiaries as of June 30, 2016 and 2015, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2016, in conformity with accounting principles generally accepted in the United States of America.
We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of June 30, 2016, based on the criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated September 13, 2016 expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ DELOITTE & TOUCHE LLP
Dallas, Texas
September 13, 2016

FARMER BROS. CO.
CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)

| | June 30, 2016 | June 30, 2015 |
|---|---|---|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $21,095 | $15,160 |
| Restricted cash | — | 1,002 |
| Short-term investments | 25,591 | 23,665 |
| Accounts and notes receivable, net of allowance for doubtful accounts of $714 and $643, respectively | 44,364 | 40,161 |
| Inventories | 46,378 | 50,522 |
| Income tax receivable | 247 | 535 |
| Short-term derivative assets | 3,954 | — |
| Prepaid expenses | 4,557 | 4,640 |
| Assets held for sale | 7,179 | — |
| Total current assets | 153,365 | 135,685 |
| Property, plant and equipment, net | 118,416 | 90,201 |
| Goodwill and intangible assets, net | 6,491 | 6,691 |
| Other assets | 9,933 | 7,615 |
| Deferred income taxes | 80,786 | 751 |
| Total assets | $368,991 | $240,943 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | 23,919 | 27,023 |
| Accrued payroll expenses | 24,540 | 23,005 |
| Short-term borrowings under revolving credit facility | 109 | 78 |
| Short-term obligations under capital leases | 1,323 | 3,249 |
| Short-term derivative liabilities | — | 3,977 |
| Deferred income taxes | — | 1,390 |
| Other current liabilities | 6,946 | 6,152 |
| Total current liabilities | 56,837 | 64,874 |
| Accrued pension liabilities | 68,047 | 47,871 |
| Accrued postretirement benefits | 20,808 | 23,471 |
| Accrued workers' compensation liabilities | 11,459 | 10,964 |
| Other long-term liabilities-capital leases | 1,036 | 2,599 |
| Other long-term liabilities | 28,210 | 225 |
| Deferred income taxes | — | 928 |
| Total liabilities | $186,397 | $150,932 |
| Commitments and contingencies (Note 22) | | |
| Stockholders' equity: | | |
| Preferred stock, $1.00 par value, 500,000 shares authorized and none issued | — | — |
| Common stock, $1.00 par value, 25,000,000 shares authorized; 16,781,561 and 16,658,148 shares issued and outstanding at June 30, 2016 and 2015, respectively | 16,782 | 16,658 |
| Additional paid-in capital | 39,096 | 38,143 |
| Retained earnings | 196,782 | 106,864 |
| Unearned ESOP shares | (6,434) | (11,234) |
| Accumulated other comprehensive loss | (63,632) | (60,420) |

| | | |
|---|---|---|
| Total stockholders’ equity | $182,594 | $90,011 |
| Total liabilities and stockholders’ equity | $368,991 | $240,943 |

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

FARMER BROS. CO.
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except share and per share data)

| | Year Ended June 30, | | |
|---|---|---|---|
| | 2016 | 2015 | 2014 |
| Net sales | $544,382 | $545,882 | $528,380 |
| Cost of goods sold | 335,907 | 348,846 | 332,466 |
| Gross profit | 208,475 | 197,036 | 195,914 |
| Selling expenses | 150,198 | 151,753 | 155,088 |
| General and administrative expenses | 41,970 | 31,173 | 35,724 |
| Restructuring and other transition expenses | 16,533 | 10,432 | — |
| Net gains from sale of Spice Assets | (5,603) | — | — |
| Net (gains) losses from sales of assets | (2,802) | 394 | (3,814) |
| Operating expenses | 200,296 | 193,752 | 186,998 |
| Income from operations | 8,179 | 3,284 | 8,916 |
| Other income (expense): | | | |
| Dividend income | 1,115 | 1,172 | 1,073 |
| Interest income | 496 | 381 | 429 |
| Interest expense | (425) | (769) | (1,258) |
| Other, net | 556 | (3,014) | 3,677 |
| Total other income (expense) | 1,742 | (2,230) | 3,921 |
| Income before taxes | 9,921 | 1,054 | 12,837 |
| Income tax (benefit) expense | (79,997) | 402 | 705 |
| Net income | $89,918 | $652 | $12,132 |
| Net income per common share—basic | $5.45 | $0.04 | $0.76 |
| Net income per common share—diluted | $5.41 | $0.04 | $0.76 |
| Weighted average common shares outstanding—basic | 16,502,523 | 16,127,610 | 15,909,631 |
| Weighted average common shares outstanding—diluted | 16,627,402 | 16,267,134 | 16,014,587 |

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

FARMER BROS. CO.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(In thousands)

| | Year Ended June 30, | | |
|---|---|---|---|
| | 2016 | 2015 | 2014 |
| Net income | $89,918 | $652 | $12,132 |
| Other comprehensive income (loss), net of tax: | | | |
| Unrealized gains (losses) on derivative instruments designated as cash flow hedges, net of taxes | 185 | (14,295) | 18,685 |
| Losses (Gains) on derivative instruments designated as cash flow hedges reclassified to cost of goods sold, net of taxes | 8,064 | (4,211) | (1,161) |
| Change in the funded status of retiree benefit obligations, net of taxes | (11,461) | (14,122) | (2,802) |
| Total comprehensive income (loss), net of tax | $86,706 | $(31,976) | $26,854 |

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

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

| | Year Ended June 30, | | |
|---|---|---|---|
| | 2016 | 2015 | 2014 |
| Cash flows from operating activities: | | | |
| Net income | $89,918 | $652 | $12,132 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation and amortization | 20,774 | 24,179 | 27,334 |
| Provision for (recovery of) doubtful accounts | 71 | (8) | 80 |
| Restructuring and other transition expenses, net of payments | (2,697) | 6,608 | — |
| Deferred income taxes | (80,314) | 123 | 137 |
| Net (gains) losses from sales of assets | (8,405) | 394 | (3,814) |
| ESOP and share-based compensation expense | 4,342 | 5,691 | 4,692 |
| Net losses (gains) on derivative instruments and investments | 12,910 | (950) | (4,276) |
| Change in operating assets and liabilities: | | | |
| Restricted cash | 1,002 | (1,002) | 8,084 |
| Purchases of trading securities held for investment | (7,255) | (3,661) | (5,915) |
| Proceeds from sales of trading securities held for investment | 5,901 | 2,358 | 4,290 |
| Accounts and notes receivable | (3,476) | 2,078 | 2,248 |
| Inventories | 3,608 | 20,470 | (14,439) |
| Income tax receivable | 288 | (307) | 181 |
| Derivative (liabilities) assets, net | (10,583) | (7,269) | 3,932 |
| Prepaid expenses and other assets | (111) | (1,332) | (661) |
| Accounts payable | (3,343) | (16,841) | 17,526 |
| Accrued payroll expenses and other current liabilities | 5,829 | (4,606) | 2,574 |
| Accrued postretirement benefits | (358) | (1,507) | (1,905) |
| Other long-term liabilities | (473) | 1,860 | 695 |
| Net cash provided by operating activities | $27,628 | $26,930 | $52,895 |
| Cash flows from investing activities: | | | |
| Acquisition of business, net of cash acquired | $— | $(1,200) | $— |
| Purchases of property, plant and equipment | (31,050) | (19,216) | (25,267) |
| Purchases of construction-in-progress assets under New Facility lease | (19,426) | — | — |
| Proceeds from sales of property, plant and equipment | 10,946 | 273 | 4,536 |
| Net cash used in investing activities | $(39,530) | $(20,143) | $(20,731) |
| Cash flows from financing activities: | | | |
| Proceeds from revolving credit facility | $405 | $63,376 | $44,806 |
| Repayments on revolving credit facility | (374) | (63,947) | (65,454) |
| Proceeds from New Facility lease financing | 19,426 | — | — |
| Payments of capital lease obligations | (3,147) | (3,910) | (3,681) |
| Payment of financing costs | (8) | (571) | — |
| Proceeds from stock option exercises | 1,694 | 1,548 | 1,480 |
| Tax withholding payment - net share settlement of equity awards | (159) | (116) | — |
| Net cash provided by (used in) financing activities | $17,837 | $(3,620) | $(22,849) |

(continued on next page)

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

| | Year Ended June 30, | | |
|---|---|---|---|
| | 2016 | 2015 | 2014 |
| Net increase in cash and cash equivalents | $5,935 | $3,167 | $9,315 |
| Cash and cash equivalents at beginning of year | 15,160 | 11,993 | 2,678 |
| Cash and cash equivalents at end of year | $21,095 | $15,160 | $11,993 |

| | | | |
|---|---|---|---|
| Supplemental disclosure of cash flow information: | | | |
| Cash paid for interest | $425 | $769 | $1,258 |
| Cash paid for income taxes | 324 | $858 | $361 |
| Supplemental disclosure of non-cash investing activities: | | | |
| Equipment acquired under capital leases | $— | $55 | $1,217 |
| Net change in derivative assets and liabilities included in other comprehensive income (loss), net of tax | $8,249 | $(18,506) | $17,524 |
| Construction-in-progress assets under New Facility lease | $8,684 | $— | $— |
| New Facility lease obligation | $8,684 | $— | $— |
| Non-cash additions to equipment | $441 | $51 | $142 |
| Asset held for sale | $7,179 | $— | $— |
| Non-cash portion of earnout recognized | $496 | $— | $— |

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

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FARMER BROS. CO.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(In thousands, except share and per share data)

| | Common Shares | Stock Amount | Additional Paid-in Capital | Retained Earnings | Unearned ESOP Shares | Accumulated Other Comprehensive Income (Loss) | Total |
|---|---|---|---|---|---|---|---|
| Balance at June 30, 2013 | 16,454,422 | $16,454 | $34,654 | $94,080 | $(20,836) | $ (42,514) | $81,838 |
| Net income | — | — | — | 12,132 | — | — | 12,132 |
| Unrealized gains on derivative instruments designated as cash flow hedges, net of reclassifications to cost of goods sold | — | — | — | — | — | 17,524 | 17,524 |
| Change in the funded status of retiree benefit obligations, net of tax of zero | — | — | — | — | — | (2,802) | (2,802) |
| ESOP compensation expense, including reclassifications | — | — | (1,475) | — | 4,801 | — | 3,326 |
| Share-based compensation | (4,936) | (5) | 1,371 | — | — | — | 1,366 |
| Stock option exercises | 112,964 | 113 | 1,367 | — | — | — | 1,480 |
| Balance at June 30, 2014 | 16,562,450 | $16,562 | $35,917 | $106,212 | $(16,035) | $ (27,792) | $114,864 |
| Net income | — | — | — | 652 | — | — | 652 |
| Unrealized losses on derivative instruments designated as cash flow hedges, net of reclassifications to cost of goods sold | — | — | — | — | — | (18,506) | (18,506) |
| Change in the funded status of retiree benefit obligations, net of tax of zero | — | — | — | — | — | (14,122) | (14,122) |
| ESOP compensation expense, including reclassifications | — | — | (377) | — | 4,801 | — | 4,424 |
| Share-based compensation | 4,272 | 4 | 1,263 | — | — | — | 1,267 |
| Stock option exercises | 95,723 | 96 | 1,452 | — | — | — | 1,548 |
| Shares withheld to cover taxes | (4,297) | (4) | (112) | — | — | — | (116) |
| Balance at June 30, 2015 | 16,658,148 | $16,658 | $38,143 | $106,864 | $(11,234) | $ (60,420) | $90,011 |
| Net income | — | — | — | 89,918 | — | — | 89,918 |
| Unrealized gains on derivative instruments designated as cash flow hedges, net of reclassifications to cost of goods sold, net of tax of $5,238 | — | — | — | — | — | 8,249 | 8,249 |
| Change in the funded status of retiree benefit obligations, net of tax benefit of $7,277 | — | — | — | — | — | (11,461) | (11,461) |
| ESOP compensation expense, including reclassifications | — | — | (1,413) | — | 4,800 | — | 3,387 |
| Share-based compensation | 1,551 | 2 | 954 | — | — | — | 956 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Stock option exercises | 127,039 | 127 | 1,566 | — | — | — | 1,693 |
| Shares withheld to cover taxes | (5,177) | (5) | (154) | — | — | — | (159) |
| Balance at June 30, 2016 | 16,781,561 | $16,782 | $39,096 | $196,782 | $(6,434) | $ (63,632) | $182,594 |

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

FARMER BROS. CO.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 1. Summary of Significant Accounting Policies

### Overview

Farmer Bros. Co., a Delaware corporation (including its consolidated subsidiaries unless the context otherwise requires, the "Company," or "Farmer Bros."), is a national coffee roaster, wholesaler and distributor of coffee, tea and culinary products. The Company serves a wide variety of customers, from small independent restaurants and foodservice operators to large institutional buyers like restaurant and convenience store chains, hotels, casinos, hospitals, and gourmet coffee houses, as well as grocery chains with private brand and consumer-branded coffee products. The Company's product categories consist of roast and ground coffee, frozen liquid coffee; flavored and unflavored iced and hot teas; culinary products; spices; and other beverages including cappuccino, cocoa, granitas, and ready-to-drink iced coffee. The Company was founded in 1912, incorporated in California in 1923, and reincorporated in Delaware in 2004. The Company operates in one business segment.

The Company operates production facilities in Portland, Oregon and Houston, Texas. Distribution takes place out of the Portland facility as well as separate distribution centers in Northlake, Illinois; Oklahoma City, Oklahoma; and Moonachie, New Jersey. As of June 30, 2016, the Company's Torrance facility continued to house certain administrative functions and serve as a distribution facility and branch warehouse pending transition of the Company's remaining Torrance operations to its other facilities.

The Company's products reach its customers primarily in two ways: through the Company's nationwide direct-store-delivery, or DSD, network of 450 delivery routes and 109 branch warehouses as of June 30, 2016, or direct-shipped via common carriers or third-party distributors. The Company operates a large fleet of trucks and other vehicles to distribute and deliver its products, and relies on third-party logistic ("3PL") service providers for its long-haul distribution. DSD sales are made "off-truck" by the Company to its customers at their places of business.

### Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its direct and indirect wholly owned subsidiaries FBC Finance Company, a California corporation, Coffee Bean Holding Co., Inc., a Delaware corporation, the parent company of Coffee Bean International, Inc., an Oregon corporation ("CBI"), and CBI. All inter-company balances and transactions have been eliminated.

### Use of Estimates

The preparation of financial statements in accordance with U.S. generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. The Company reviews its estimates on an ongoing basis using currently available information. Changes in facts and circumstances may result in revised estimates and actual results may differ from those estimates.

### Cash Equivalents

The Company considers all highly liquid investments with original maturity dates of 90 days or less to be cash equivalents. Fair values of cash equivalents approximate cost due to the short period of time to maturity.

### Investments

The Company's investments consist of money market instruments, marketable debt, equity and hybrid securities. Investments are held for trading purposes and stated at fair value. The cost of investments sold is determined on the specific identification method. Dividend and interest income are accrued as earned. See Note 8.

Fair Value Measurements

The Company groups its assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

- Level 1—Valuation is based upon quoted prices for identical instruments traded in active markets.
- Level 2—Valuation is based upon inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly (i.e. interest rate and yield curves observable at commonly quoted intervals, default rates, etc.). Observable inputs include quoted prices for similar instruments in active and non- active markets. Level 2 includes those financial instruments that are valued with industry standard valuation models that incorporate inputs that are observable in the marketplace throughout the full term of the instrument, or can otherwise be derived from or supported by observable market data in the marketplace. Level 2 inputs may also include insignificant adjustments to market observable inputs.
- Level 3—Valuation is based upon one or more unobservable inputs that are significant in establishing a fair value estimate. These unobservable inputs are used to the extent relevant observable inputs are not available and are developed based on the best information available. These inputs may be used with internally developed methodologies that result in management's best estimate of fair value.

Securities with quotes that are based on actual trades or actionable bids and offers with a sufficient level of activity on or near the measurement date are classified as Level 1. Securities that are priced using quotes derived from implied values, indicative bids and offers, or a limited number of actual trades, or the same information for securities that are similar in many respects to those being valued, are classified as Level 2. If market information is not available for securities being valued, or materially-comparable securities, then those securities are classified as Level 3. In considering market information, management evaluates changes in liquidity, willingness of a broker to execute at the quoted price, the depth and consistency of prices from pricing services, and the existence of observable trades in the market (see Note 9).

Derivative Instruments

The Company purchases various derivative instruments to create economic hedges of its commodity price risk. These derivative instruments consist primarily of forward and option contracts. The Company reports the fair value of derivative instruments on its consolidated balance sheets in "Short-term derivative assets," "Other assets," "Short-term derivative liabilities," or "Other long-term derivative liabilities." The Company determines the current and noncurrent classification based on the timing of expected future cash flows of individual trades and reports these amounts on a gross basis. Additionally, the Company reports cash held on deposit in margin accounts for coffee-related derivative instruments on a gross basis on its consolidated balance sheet in "Restricted cash" if restricted from withdrawal due to a net loss position in such margin accounts.

The accounting for the changes in fair value of the Company's derivative instruments can be summarized as follows:

| Derivative Treatment | Accounting Method |
| --- | --- |
| Normal purchases and normal sales exception | Accrual accounting |
| Designated in a qualifying hedging relationship | Hedge accounting |
| All other derivative instruments | Mark-to-market accounting |

The Company enters into green coffee purchase commitments at a fixed price or at a price to be fixed ("PTF"). PTF contracts are purchase commitments whereby the quality, quantity, delivery period, price differential to the coffee "C" market price and other negotiated terms are agreed upon, but the date, and therefore the price at which the base "C" market price will be fixed has not yet been established. The coffee "C" market price is fixed at some point after the purchase contract date and before the futures market closes for the delivery month and may be fixed either at the direction of the Company to the vendor, or by the application of a derivative that was separately purchased as a hedge. For both fixed-price and PTF contracts, the Company expects to take delivery of and to utilize the coffee in a reasonable period of time and in the conduct of normal business. Accordingly, these purchase commitments qualify as normal purchases and are not recorded at fair value on the Company's consolidated balance sheets.

The Company follows the guidelines of Accounting Standards Codification (“ASC”) 815, “Derivatives and Hedging” (“ASC 815”), to account for certain coffee-related derivative instruments as accounting hedges in order to minimize the volatility created in the Company's quarterly results from utilizing these derivative contracts and to improve comparability between reporting periods. For a derivative to qualify for designation in a hedging relationship, it must meet specific criteria

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and the Company must maintain appropriate documentation. The Company establishes hedging relationships pursuant to its risk management policies. The hedging relationships are evaluated at inception and on an ongoing basis to determine whether the hedging relationship is, and is expected to remain, highly effective in achieving offsetting changes in fair value or cash flows attributable to the underlying risk being hedged. The Company also regularly assesses whether the hedged forecasted transaction is probable of occurring. If a derivative ceases to be or is no longer expected to be highly effective, or if the Company believes the likelihood of occurrence of the hedged forecasted transaction is no longer probable, hedge accounting is discontinued for that derivative, and future changes in the fair value of that derivative are recognized in “Other, net.”

For coffee-related derivative instruments designated as cash flow hedges, the effective portion of the change in fair value of the derivative is reported as accumulated other comprehensive income (loss) (“AOCI”) and subsequently reclassified into cost of goods sold in the period or periods when the hedged transaction affects earnings. Any ineffective portion of the derivative instrument's change in fair value is recognized currently in “Other, net.” Gains or losses deferred in AOCI associated with terminated derivative instruments, derivative instruments that cease to be highly effective hedges, derivative instruments for which the forecasted transaction is reasonably possible but no longer probable of occurring, and cash flow hedges that have been otherwise discontinued remain in AOCI until the hedged item affects earnings. If it becomes probable that the forecasted transaction designated as the hedged item in a cash flow hedge will not occur, any gain or loss deferred in AOCI is recognized in “Other, net” at that time. For derivative instruments that are not designated in a hedging relationship, and for which the normal purchases and normal sales exception has not been elected, the changes in fair value are reported in “Other, net.”

The following gains and losses on derivative instruments are netted together and reported in “Other, net” in the Company's consolidated statements of operations:

- Gains and losses on all derivative instruments that are not designated as cash flow hedges and for which the normal purchases and normal sales exception has not been elected; and
- The ineffective portion of unrealized gains and losses on derivative instruments that are designated as cash flow hedges.

The fair value of derivative instruments is based upon broker quotes. At June 30, 2016 and 2015 approximately 96% and 94%, respectively, of the Company's outstanding coffee-related derivative instruments were designated as cash flow hedges (see Note 7).

Concentration of Credit Risk

At June 30, 2016, the financial instruments which potentially expose the Company to concentration of credit risk consist of cash in financial institutions (in excess of federally insured limits), short-term investments, investments in the preferred stocks of other companies, derivative instruments and trade receivables. Cash equivalents and short-term investments are not concentrated by issuer, industry or geographic area. Maturities are generally shorter than 180 days. Investments in the preferred stocks of other companies are limited to high quality issuers and are not concentrated by geographic area or issuer.

The Company does not have any credit-risk related contingent features that would require it to post additional collateral in support of its net derivative liability positions. At June 30, 2016, because the Company had a net gain position in its coffee-related derivative margin accounts, none of the cash in these accounts was restricted. At June 30, 2015, the Company had $1.0 million in restricted cash representing cash held on deposit in margin accounts for coffee-related derivative instruments due to a net loss position in such accounts. Changes in commodity prices and the number of coffee-related derivative instruments held could have a significant impact on cash deposit requirements under the Company's broker and counterparty agreements.

Concentration of credit risk with respect to trade receivables for the Company is limited due to the large number of customers comprising the Company’s customer base and their dispersion across many different geographic areas. The trade receivables are generally short-term and all probable bad debt losses have been appropriately considered in establishing the allowance for doubtful accounts. In fiscal 2016 and 2014, the Company increased the allowance for

doubtful accounts by $71,000 and $80,000, respectively. In fiscal 2015, the Company decreased the allowance for doubtful accounts by $8,000.

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Inventories

Inventories are valued at the lower of cost or market. The Company accounts for coffee, tea and culinary products on a last in, first out ("LIFO") basis, and coffee brewing equipment parts on a first in, first out ("FIFO") basis. The Company regularly evaluates these inventories to determine inventory reserves for obsolete and slow-moving inventory. Inventory reserves are based on inventory obsolescence trends, historical experience and application of specific identification.

At the end of each quarter, the Company records the expected effect of the liquidation of LIFO inventory quantities, if any, and records the actual impact at fiscal year-end. An actual valuation of inventory under the LIFO method is made only at the end of each fiscal year based on the inventory levels and costs at that time. If inventory quantities decline at the end of the fiscal year compared to the beginning of the fiscal year, the reduction results in the liquidation of LIFO inventory quantities carried at the cost prevailing in prior years. This LIFO inventory liquidation may result in a decrease or increase in cost of goods sold depending on whether the cost prevailing in prior years was lower or higher, respectively, than the current year cost. See Note 11.

Property, Plant and Equipment

Property, plant and equipment is carried at cost, less accumulated depreciation. Depreciation is computed using the straight-line method. The following useful lives are used:

| | |
|---|---|
| Buildings and facilities | 10 to 30 years |
| Machinery and equipment | 3 to 5 years |
| Equipment under capital leases | Term of lease |
| Office furniture and equipment | 5 years |
| Capitalized software | 3 years |

Leasehold improvements are depreciated on a straight-line basis over the lesser of the estimated useful life of the asset or the remaining lease term. When assets are sold or retired, the asset and related accumulated depreciation are removed from the respective account balances and any gain or loss on disposal is included in operations. Maintenance and repairs are charged to expense, and betterments are capitalized. See Note 12.

Assets to be disposed of by sale are recorded as held for sale at the lower of carrying value or estimated net realizable value. The Company considers properties to be assets held for sale when (1) management commits to a plan to sell the property; (2) it is unlikely that the disposal plan will be significantly modified or discontinued; (3) the property is available for immediate sale in its present condition; (4) actions required to complete the sale of the property have been initiated; (5) sale of the property is probable and the Company expects the completed sale will occur within one year; and (6) the property is actively being marketed for sale at a price that is reasonable given the Company's estimate of current market value. Upon designation of a property as an asset held for sale, the Company records the property's value at the lower of its carrying value or its estimated fair value less estimated costs to sell and ceases depreciation. See Note 6.

The Company may incur certain other non-cash asset impairment costs in connection with the Corporate Relocation Plan.

Coffee Brewing Equipment and Service

The Company classifies certain expenses related to coffee brewing equipment provided to customers as cost of goods sold. These costs include the cost of the equipment as well as the cost of servicing that equipment (including service employees' salaries, cost of transportation and the cost of supplies and parts) and are considered directly attributable to the generation of revenues from its customers. The Company capitalizes coffee brewing equipment and depreciates it over an estimated three or five year period, depending on the assessment of the useful life and reports the depreciation expense in cost of goods sold. Accordingly, such costs included in cost of goods sold in the accompanying consolidated financial statements for the years ended June 30, 2016, 2015 and 2014 are $27.0 million, $26.6 million and $25.9 million, respectively. In addition, depreciation expense related to capitalized coffee brewing equipment

reported in cost of goods sold in the fiscal years ended June 30, 2016, 2015 and 2014 was $9.8 million, $10.4 million and $10.9 million, respectively. The Company capitalized coffee brewing equipment (included in machinery and equipment) in the amounts of $8.4 million and $10.7 million in fiscal 2016 and 2015, respectively.

Leases

Leases are categorized as either operating or capital leases at inception. Operating lease costs are recognized on a straight-line basis over the term of the lease. An asset and a corresponding liability for the capital lease obligation are established for the cost of capital leases. The capital lease obligation is amortized over the life of the lease. For leases such as the New Facility lease, the Company establishes an asset and liability for the estimated construction costs incurred to the extent that it is involved in the construction of structural improvements or takes construction risk prior to the commencement of the lease. A portion of the lease arrangement is allocated to the land for which the Company accrues rent expense during the construction period. The amount of rent expense to be accrued is determined using the fair value of the leased land at construction commencement and the Company’s incremental borrowing rate, and recognized on a straight-line basis. See Note 4.

Income Taxes

Deferred income taxes are determined based on the temporary differences between the financial reporting and tax bases of assets and liabilities using enacted tax rates in effect for the year in which differences are expected to reverse. Estimating the Company’s tax liabilities involves judgments related to uncertainties in the application of complex tax regulations. The Company makes certain estimates and judgments to determine tax expense for financial statement purposes as it evaluates the effect of tax credits, tax benefits and deductions, some of which result from differences in the timing of recognition of revenue or expense for tax and financial statement purposes. Changes to these estimates may result in significant changes to the Company’s tax provision in future periods. Each fiscal quarter the Company re-evaluates its tax provision and reconsiders its estimates and assumptions related to specific tax assets and liabilities, making adjustments as circumstances change.
See Note 20.

Deferred Tax Asset Valuation Allowance

The Company evaluates its deferred tax assets quarterly to determine if a valuation allowance is required and considers whether a valuation allowance should be recorded against deferred tax assets based on the likelihood that the benefits of the deferred tax assets will or will not ultimately be realized in future periods. In making this assessment, significant weight is given to evidence that can be objectively verified, such as recent operating results, and less consideration is given to less objective indicators, such as future income projections. After consideration of positive and negative evidence, including the recent history of income, if the Company determines that it is more likely than not that it will generate future income sufficient to realize its deferred tax assets, the Company will record a reduction in the valuation allowance. See Note 20.

Revenue Recognition

The Company recognizes sales revenue when all of the following have occurred: (1) delivery; (2) persuasive evidence of an agreement exists; (3) pricing is fixed or determinable; and (4) collection is reasonably assured. When product sales are made “off-truck” to the Company’s customers at their places of business or products are shipped by third-party delivery "FOB Destination," title passes and revenue is recognized upon delivery. When customers pick up products at the Company's distribution centers, title passes and revenue is recognized upon product pick up.

Net Income Per Common Share

Net income per share (“EPS”) represents net income attributable to common stockholders divided by the weighted-average number of common shares outstanding for the period, excluding unallocated shares held by the Company's Employee Stock Ownership Plan (“ESOP”) (see Note 16). Diluted EPS represents net income attributable to common stockholders divided by the weighted-average number of common shares outstanding, inclusive of the dilutive impact of common equivalent shares outstanding during the period. However, nonvested restricted stock awards (referred to as participating securities) are excluded from the dilutive impact of common equivalent shares outstanding in accordance with authoritative guidance under the two-class method. The nonvested restricted stockholders are entitled to participate in dividends declared on common stock as if the shares were fully vested and hence are deemed to be participating securities. Under the two-class method, net income attributable to nonvested

restricted stockholders is excluded from net income attributable to common stockholders for purposes of calculating basic and diluted EPS. Computation of EPS for the years ended June 30, 2016, 2015 and 2014 includes the dilutive effect of 124,879, 139,524 and 104,956 shares, respectively, issuable under stock options with exercise prices below the closing price of the Company's common stock on the last trading day of the applicable period, but excludes the dilutive effect of 30,931, 10,455 and 22,441 shares, respectively, issuable under stock options with exercise prices above the closing price of the Company's common stock on the last trading day of the applicable period because their inclusion would be anti-dilutive. See Note 21.

Dividends

The Company's Board of Directors has omitted the payment of a quarterly dividend since the third quarter of fiscal 2011. The amount, if any, of dividends to be paid in the future will depend upon the Company's then available cash, anticipated cash needs, overall financial condition, credit agreement restrictions, future prospects for earnings and cash flows, as well as other relevant factors.

Employee Stock Ownership Plan

Compensation cost for the ESOP is based on the fair market value of shares released or deemed to be released to employees in the period in which they are committed. Dividends on allocated shares retain the character of true dividends, but dividends on unallocated shares are considered compensation cost. As a leveraged ESOP with the Company as lender, a contra equity account is established to offset the Company's note receivable. The contra account will change as compensation expense is recognized (see Note 16). The cost of shares purchased by the ESOP which have not been committed to be released or allocated to participants are shown as a contra-equity account "Unearned ESOP Shares" and are excluded from earnings per share calculations.

Share-based Compensation

On December 5, 2013, the Company's stockholders approved the Farmer Bros. Co. Amended and Restated 2007 Long-Term Incentive Plan (the "Amended Equity Plan"). The principal change to the Amended Equity Plan was to limit awards under the plan to performance-based stock options and to restricted stock under limited circumstances.

The Company measures all share-based compensation cost at the grant date, based on the fair values of the awards that are ultimately expected to vest, and recognizes that cost as an expense on a straight line-basis in its consolidated statements of operations over the requisite service period. Fair value of restricted stock is the closing price of the Company's common stock on the date of grant. The Company estimates the fair value of option awards using the Black-Scholes option valuation model, which requires management to make certain assumptions for estimating the fair value of stock options at the date of grant. The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. Because the Company's stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimates, in management's opinion, the existing models may not necessarily provide a reliable single measure of the fair value of the Company's stock options. Although the fair value of stock options is determined using an option valuation model, that value may not be indicative of the fair value observed in a willing buyer/willing seller market transaction. See Note 17.

Impairment of Goodwill and Indefinite-lived Intangible Assets

The Company accounts for its goodwill and indefinite-lived intangible assets in accordance with ASC 350, "Intangibles-Goodwill and Other" ("ASC 350"). Goodwill and other indefinite-lived intangible assets are not amortized but instead are reviewed for impairment annually, or more frequently if an event occurs or circumstances change which indicate that an asset might be impaired. Pursuant to ASC 350, the Company performs a qualitative assessment of goodwill and indefinite-lived intangible assets on its consolidated balance sheets, to determine if there is a more likely than not indication that its goodwill and indefinite-lived intangible assets are impaired as of June 30. If the indicators of impairment are present, the Company performs a quantitative assessment to determine the impairment of these assets as of the measurement date.

Testing for impairment of goodwill is a two-step process. The first step requires the Company to compare the fair value of its reporting unit to the carrying value of the reporting unit, including goodwill. If the fair value of the reporting unit is less than its carrying value, goodwill of the reporting unit is potentially impaired and the Company then completes step two to measure the impairment loss, if any. The second step requires the calculation of the implied fair value of goodwill, which is the residual fair value remaining after deducting the fair value of all tangible and intangible net assets of the reporting unit from the fair value of the reporting unit. If the implied fair value of goodwill is less than the carrying amount of goodwill, an impairment loss is recognized equal to the difference.

Indefinite-lived intangible assets are tested for impairment by comparing their fair values to their carrying values. An impairment charge is recorded if the estimated fair value of such assets has decreased below their carrying values. Long-lived assets evaluated for impairment are grouped with other assets to the lowest level for which identifiable cash flows are largely independent of the cash flows of other groups of assets and liabilities. The estimated future cash flows are based upon, among other things, assumptions about expected future operating performance and may differ from actual cash flows. If the sum of the

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projected undiscounted cash flows (excluding interest) is less than the carrying value of the assets, the assets will be written down to the estimated fair value in the period in which the determination is made.
There were no intangible asset or goodwill impairment charges recorded in the fiscal year ended June 30, 2016 or 2015.

Other Intangible Assets

Other intangible assets consist of finite-lived intangible assets including acquired non-compete agreements and customer relationships. These are amortized over their estimated useful lives and are tested for impairment by grouping them with other assets at the lowest level for which identifiable cash flows are largely independent of the cash flows of other groups of assets and liabilities. The estimated future cash flows are based upon, among other things, assumptions about expected future operating performance, and may differ from actual cash flows. If the sum of the projected undiscounted cash flows (excluding interest) is less than the carrying value of the assets, the assets will be written down to the estimated fair value in the period in which the determination is made. The Company reviews the recoverability of its long-lived assets whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. There were no other intangible asset impairment charges recorded in the fiscal year ended June 30, 2016 and 2015.

Shipping and Handling Costs

Shipping and handling costs incurred through outside carriers are recorded as a component of the Company's selling expenses and were $13.3 million, $8.3 million and $8.4 million, respectively, in the fiscal years ended June 30, 2016, 2015 and 2014. Shipping and handling costs in fiscal 2016 include costs related to the Company's move to 3PL for its long-haul operations.

Collective Bargaining Agreements

Certain Company employees are subject to collective bargaining agreements. The duration of these agreements extend to 2020. At June 30, 2016, approximately 31% of the Company's workforce was covered by such agreements.

Self-Insurance

The Company uses a combination of insurance and self-insurance mechanisms, including the use of captive insurance entities and participation in a reinsurance treaty, to provide for the potential liability of certain risks including workers' compensation, health care benefits, general liability, product liability, property insurance and director and officers' liability insurance. Liabilities associated with risks retained by the Company are not discounted and are estimated by considering historical claims experience, demographics, exposure and severity factors and other actuarial assumptions.
The Company's self-insurance for workers' compensation liability includes estimated outstanding losses of unpaid claims. and allocated loss adjustment expenses (“ALAE”), case reserves, the development of known claims and incurred but not reported claims. ALAE are the direct expenses for settling specific claims. The amounts reflect per occurrence and annual aggregate limits maintained by the Company. The estimated liability analysis does not include estimating a provision for unallocated loss adjustment expenses.
The estimated gross undiscounted workers' compensation liability relating to such claims was $14.7 million and $13.4 million respectively, and the estimated recovery from reinsurance was $2.4 million and $2.5 million, respectively, as of June 30, 2016 and 2015. The short-term and long-term accrued liabilities for workers' compensation claims are presented on the Company's consolidated balance sheets in “Other current liabilities” and in “Accrued workers' compensation liabilities,” respectively. The estimated insurance receivable is included in “Other assets” on the Company's consolidated balance sheets.
At June 30, 2016 and 2015, the Company posted a $7.4 million and $7.0 million letter of credit, respectively, as a security deposit with the State of California Department of Industrial Relations Self-Insurance Plans for participation in the alternative security program for California self-insurers for workers' compensation liability. At June 30, 2016 and 2015, the Company had posted a $4.3 million letter of credit as a security deposit for self-insuring workers' compensation, general liability and auto insurance coverages outside of California.

The estimated liability related to the Company's self-insured group medical insurance at June 30, 2016 and 2015 was $1.3 million and $1.0 million, respectively, recorded on an incurred but not reported basis, within deductible limits, based on actual claims and the average lag time between the date insurance claims are filed and the date those claims are paid.

General liability, product liability and commercial auto liability are insured through a captive insurance program. The Company's liability reserve for such claims was $0.9 million and $0.8 million at June 30, 2016 and 2015, respectively. The estimated liability related to the Company's self-insured group medical insurance, general liability, product liability and commercial auto liability is included on the Company's consolidated balance sheets in “Other current liabilities.”

Pension Plans

The Company’s pension plans are not admitting new participants, therefore, changes to pension liabilities are primarily due to market fluctuations of investments for existing participants and changes in interest rates. All plans are accounted for using the guidance of ASC 710, "Compensation - General" and ASC 715 "Compensation-Retirement Benefits" and are measured as of the end of the fiscal year.

The Company recognizes the overfunded or underfunded status of a defined benefit pension or postretirement plan as an asset or liability in the accompanying consolidated balance sheets. Changes in the funded status are recognized through AOCI, in the year in which the changes occur. See Note 14.

Business Combinations

The Company accounts for business combinations under the acquisition method of accounting. The purchase price of each business acquired is allocated to the tangible and intangible assets acquired and the liabilities assumed based on information regarding their respective fair values on the date of acquisition. Any excess of the purchase price over the fair value of the separately identifiable assets acquired and the liabilities assumed is allocated to goodwill. Management determines the fair values used in purchase price allocations for intangible assets based on historical data, estimated discounted future cash flows, and expected royalty rates for trademarks and trade names, as well as certain other information. The valuation of assets acquired and liabilities assumed requires a number of judgments and is subject to revision as additional information about the fair value of assets and liabilities becomes available. Additional information, which existed as of the acquisition date but unknown to the Company at that time, may become known during the remainder of the measurement period, a period not to exceed twelve months from the acquisition date. Adjustments in the purchase price allocation may require a recasting of the amounts allocated to goodwill and intangible assets. Acquisition costs are expensed as incurred. The results of operations of businesses acquired are included in the consolidated financial statements from their dates of acquisition. See Note 2.

Sale of Spice Assets

On December 8, 2015, the Company completed the sale of certain assets associated with the Company’s manufacture, processing and distribution of raw, processed and blended spices and certain other culinary products (collectively, the “Spice Assets”) to Harris Spice Company, Inc. (“Harris”). The Company has followed the guidance in ASC 205-20, "Presentation of Financial Statements-Discontinued Operations," as updated by Accounting Standards Update ("ASU") No. 2014-08, "Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity" and has not presented the sale of the Spice Assets as discontinued operations. Gain from the earnout on the sale is recognized when earned and when realization is assured beyond a reasonable doubt. See Note 5.

Recently Adopted Accounting Standards

In March 2016, the Financial Accounting Standards Board (the "FASB") issued ASU No. 2016-05, "Derivatives and Hedging (Topic 815): Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships (a consensus of the FASB Emerging Issues Task Force" ("ASU 2016-05"). ASU 2016-05 clarifies that "a change in the counterparty to a derivative instrument that has been designated as the hedging instrument in an existing hedging relationship would not, in and of itself, be considered a termination of the derivative instrument" or "a change in a critical term of the hedging relationship." As long as all other hedge accounting criteria in ASC 815 are met, a hedging relationship in which the hedging derivative instrument is novated would not be discontinued or require redesignation. This clarification applies to both cash flow and fair value hedging relationships. For public business entities, ASU 2016-05 is effective for financial statements issued for annual periods beginning after December 15, 2016, and interim

periods within those annual periods. Early application is permitted including adoption in an interim period. The Company early adopted ASU 2016-05 beginning in April 1, 2016. Adoption of ASU 2016-05 did not have a material effect on the results of operations, financial position or cash flows of the Company.

In November 2015, the FASB issued ASU No. 2015-17, "Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes" ("ASU 2015-17"), which requires entities to present deferred tax assets ("DTAs") and deferred tax liabilities ("DTLs") as noncurrent in a classified balance sheet. ASU 2015-17 simplifies the current guidance, which requires entities to separately present DTAs and DTLs as current and noncurrent in a classified balance sheet. For public business entities, the amendments in ASU 2015-17 are effective for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early application is permitted as of the beginning of an interim or annual reporting period. The Company early adopted ASU 2015-17 beginning in April 1, 2016. Adoption of ASU 2015-17 did not have a material effect on the results of operations, financial position or cash flows of the Company.

In August 2015, the FASB issued ASU No. 2015-15, “Interest-Imputation of Interest (Subtopic 835-30): Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements” (“ASU 2015-15”). ASU 2015-15 incorporates into the ASC an SEC staff announcement that the SEC staff will not object to an entity presenting the cost of securing a revolving line of credit as an asset, regardless of whether a balance is outstanding. The standard, as issued, did not address revolving lines of credit, which may not have outstanding balances. An entity that repeatedly draws on a revolving credit facility and then repays the balance could present the cost as a deferred asset and reclassify all or a portion of it as a direct deduction from the liability whenever a balance is outstanding. However, the SEC staff’s announcement provides a less-cumbersome alternative. Either way, the cost should be amortized over the term of the arrangement. The Company adopted ASU 2015-15 beginning July 1, 2015. Adoption of ASU 2015-15 did not have a material effect on the results of operations, financial position or cash flows of the Company.

New Accounting Pronouncements

In May 2016, the FASB issued ASU No. 2016-12, "Revenue from Contracts with Customers (Topic 606); Identifying Performance Obligations and Licensing" ("ASU 2016-12"), which clarifies guidance related to identifying performance obligations and licensing implementation guidance contained in the new revenue recognition standard. The amendments in ASU 2016-12 affect the guidance in ASU 2014-09, "Revenue From Contracts With Customers (Topic 606) ("ASU 2014-09") which is not yet effective. The effective date and transition requirements for the amendments in ASU 2016-12 are the same as the effective date and transition requirements in ASC 606 (and any other Topic amended by ASU 2014-09). ASU 2015-14, "Revenue From Contracts With Customers (Topic 606): Deferral of the Effective Date," ("ASU 2015-14"). defers the effective date of ASU 2014-09 by one year and, therefore, the deferral results in ASU 2014-09 and its amendment ASU 2016-12 being effective January 1, 2018.

In April 2016, the FASB issued ASU No. 2016-10 "Revenue from Contracts with Customers (Topic 606); Identifying Performance Obligations and Licensing" ("ASU 2016-10"), which clarifies guidance related to identifying performance obligations and licensing implementation guidance contained in the new revenue recognition standard. ASU 2016-10 seeks to pro-actively address areas in which diversity in practice potentially could arise, as well as to reduce the cost and complexity of applying certain aspects of the guidance both at implementation and on an ongoing basis. The effective date and transition requirements for the amendments in ASU 2016-10 are the same as the effective date and transition requirements in ASU 2014-09, which is effective January 1, 2018.

In March 2016, the FASB issued ASU No. 2016-09, "Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting" ("ASU 2016-09"). ASU 2016-09 is being issued as part of the FASB's Simplification Initiative. The areas for simplification in ASU 2016-09 involve several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. Some of the areas for simplification apply only to nonpublic entities. For public business entities, the amendments in ASU 2016-09 are effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted for any entity in any interim or annual period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity

that elects early adoption must adopt all of the amendments in the same period. ASU 2016-09 is effective for the Company beginning July 1, 2017. Adoption of ASU 2016-09 is not expected to have a material effect on the results of operations, financial position or cash flows of the Company.

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)" ("ASU 2016-02"), which introduces a new lessee model that brings substantially all leases onto the balance sheet. In addition, while the new guidance retains most of the principles of the existing lessor model in GAAP, it aligns many of those principles with ASC 606, "Revenue From Contracts With Customers." For public business entities, ASU 2016-02 is effective for financial statements issued for annual periods beginning after December 15, 2018, and interim periods within those annual periods. Early application is permitted. ASU

2016-02 is effective for the Company beginning July 1, 2019. Adoption of ASU 2016-02 is not expected to have a material effect on the results of operations, financial position or cash flows of the Company.

In September 2015, the FASB issued ASU No. 2015-16, “Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments” (“ASU 2015-16”). ASU 2015-16 eliminates the requirement that an acquirer in a business combination account for measurement-period adjustments retrospectively. Instead, an acquirer will recognize a measurement-period adjustment during the period in which it determines the amount of the adjustment, including the effect on earnings of any amounts it would have recorded in previous periods if the accounting had been completed at the acquisition date. The guidance is effective for public business entities for fiscal years, including interim periods within those fiscal years, beginning after December 15, 2015, with early adoption permitted. ASU 2015-16 is effective for the Company beginning July 1, 2016. Adoption of ASU 2015-16 is not expected to have a material effect on the results of operations, financial position or cash flows of the Company.

In July 2015, the FASB issued ASU No. 2015-12, “Plan Accounting: Defined Benefit Pension Plans (Topic 960), Defined Contribution Pension Plans (Topic 962), Health and Welfare Benefit Plans (Topic 965), (Part I) Fully Benefit-Responsive Investment Contracts, (Part II) Plan Investment Disclosures, (Part III) Measurement Date Practical Expedient” ("ASU 2015-12”). ASU 2015-12 eliminates requirements that employee benefit plans measure the fair value of fully benefit-responsive investment contracts ("FBRICs") and provide the related fair value disclosures. As a result, FBRICs are measured, presented and disclosed only at contract value. Also, plans will be required to disaggregate their investments measured using fair value by general type, either on the face of the financial statements or in the notes, and self-directed brokerage accounts are one general type. Plans no longer have to disclose the net appreciation/depreciation in fair value of investments by general type or individual investments equal to or greater than 5% of net assets available for benefits. In addition, a plan with a fiscal year end that does not coincide with the end of a calendar month is allowed to measure its investments and investment-related accounts using the month end closest to its fiscal year end. The new guidance for FBRICs and plan investment disclosures should be applied retrospectively. The measurement date practical expedient should be applied prospectively. The guidance is effective for fiscal years beginning after December 15, 2015, with early adoption permitted. ASU 2015-12 is effective for the Company beginning July 1, 2016. Adoption of ASU 2015-12 is not expected to have a material effect on the results of operations, financial position or cash flows of the Company.

In July 2015, the FASB issued ASU No. 2015-11, “Inventory (Topic 330): Simplifying the Measurement of Inventory” (“ASU 2015-11”). ASU 2015-11 simplifies the subsequent measurement of inventory by requiring inventory to be measured at the lower of cost and net realizable value. Entities will continue to apply their existing impairment models to inventories that are accounted for using last-in first-out or LIFO and the retail inventory method or RIM. Under current guidance, net realizable value is one of several calculations an entity needs to make to measure inventory at the lower of cost or market. ASU 2015-11 is effective for public business entities for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted, and the guidance must be applied prospectively after the date of adoption. ASU 2015-11 is effective for the Company beginning July 1, 2017. Adoption of ASU 2015-11 is not expected to have a material effect on the results of operations, financial position or cash flows of the Company.

In May 2015, the FASB issued ASU No. 2015-07, “Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)” (“ASU 2015-07”). ASU 2015-07 removes the requirement to categorize investments for which the fair values are measured using the net asset value per share practical expedient within the fair value hierarchy. It also limits certain disclosures to investments for which the entity has elected to measure the fair value using the practical expedient. ASU 2015-07 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2015, with early adoption permitted.

ASU 2015-07 is effective for the Company beginning July 1, 2016. The Company is in the process of assessing the impact of the adoption of ASU 2015-07 on its consolidated financial statements.

In May 2014, the FASB issued accounting guidance which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers under ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606)” (“ASU 2014-09”). ASU 2014-09 will replace most existing revenue recognition guidance in GAAP when it becomes effective. On July 9, 2015, the FASB issued ASU No. 2015-14, "Revenue From Contracts with Customers (Topic 606): Deferral of the Effective Date," which defers the effective date of ASU 2014-09 by one year allowing early adoption as of the original effective date of January 1, 2017. The deferral results in the new accounting standard being effective January 1, 2018. The Company is currently evaluating the impact of ASU 2014-09 on its results of operations, financial position and cash flows.

Note 2. Acquisition

On January 12, 2015, the Company acquired substantially all of the assets of Rae' Launo Corporation ("RLC") relating to its DSD and in-room distribution business in the Southeastern United States (the "RLC Acquisition"). The purchase price was $1.5 million, consisting of $1.2 million in cash paid at closing and earnout payments of up to $0.1 million that the Company expects to pay each year over a three-year period based on achievement of certain milestones.

The following table summarizes the estimated fair values of the assets acquired at the date of acquisition, based on the final purchase price allocation:

| Fair Values of Assets Acquired | | Estimated Useful Life (years) |
|---|---|---|
| (In thousands) | | |
| Property, plant and equipment | $338 | |
| Intangible assets: | | |
| Non-compete agreement | 20 | 3.0 |
| Customer relationships | 870 | 4.5 |
| Goodwill | 272 | |
| Total assets acquired | $1,500 | |

Definite-lived intangible assets consist of a non-compete agreement and customer relationships. Total net carrying value of definite-lived intangible assets as of June 30, 2016 and 2015 was $0.6 million and $0.8 million, respectively, and accumulated amortization as of June 30, 2016 and 2015 was $0.3 million and $0.1 million, respectively. Estimated aggregate amortization of definite-lived intangible assets, calculated on a straight-line basis and based on estimated fair values is $0.2 million in each of the next three fiscal years commencing with fiscal 2017.

Note 3. Corporate Relocation Plan

On February 5, 2015, the Company announced a plan (the "Corporate Relocation Plan") to close its Torrance, California facility and relocate its corporate headquarters, product development lab, and manufacturing and distribution operations from Torrance, California to a new facility housing these operations currently under construction in Northlake, Texas (the "New Facility"). Approximately 350 positions were impacted as a result of the Torrance facility closure. The Company's decision resulted from a comprehensive review of alternatives designed to make the Company more competitive and better positioned to capitalize on growth opportunities.

Based on current assumptions and subject to continued implementation of the Corporate Relocation Plan, the Company estimates that it will incur approximately $31 million in cash costs in connection with the exit of the Torrance facility consisting of $18 million in employee retention and separation benefits, $5 million in facility-related costs and $8 million in other related costs. Expenses related to the Corporate Relocation Plan in fiscal 2016 consisted of $9.7 million in employee retention and separation benefits, $3.7 million in facility-related costs including lease of temporary office space, costs associated with the move of the Company's headquarters and the relocation of certain distribution operations and $3.1 million in other related costs including travel, legal, consulting and other professional services. Facility-related costs also included $1.0 million in non-cash depreciation expense associated with the Torrance production facility resulting from the consolidation of coffee production operations with the Houston and Portland production facilities.

Since adoption of the Corporate Relocation Plan through June 30, 2016, the Company has recognized a total of $25.7 million of the estimated $31 million in aggregate cash costs including $16.2 million in employee retention and separation benefits, $3.1 million in facility-related costs related to the relocation of the Company's Torrance operations and certain distribution operations and $6.4 million in other related costs. The remainder is expected to be recognized in the first half of fiscal 2017. The Company also recognized from inception through fiscal 2016 $1.3 million in non-cash depreciation expense associated with the Torrance production facility. The Company may incur certain other non-cash asset impairment costs and pension-related costs in connection with the Corporate Relocation Plan.

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

The following table sets forth the activity in liabilities associated with the Corporate Relocation Plan for the fiscal year ended June 30, 2016:

| (In thousands) | Balances, June 30, 2015 | Additions | Payments | Non-Cash Settled | Adjustments | Balances, June 30, 2016 |
|---|---|---|---|---|---|---|
| Employee-related costs(1) | $ 6,156 | $ 9,730 | $ 13,544 | $ — | $ — | $ 2,342 |
| Facility-related costs(2) | — | 3,716 | 2,712 | 1,004 | — | — |
| Other(3) | 200 | 3,087 | 3,087 | — | — | 200 |
| Total(2) | $ 6,356 | $ 16,533 | $ 19,343 | $ 1,004 | $ — | $ 2,542 |
| | | | | | | |
| Current portion | $ 6,356 | | | | | $ 2,542 |
| Non-current portion | $ — | | | | | $ — |
| Total | $ 6,356 | | | | | $ 2,542 |

(1) Included in “Accrued payroll expenses” on the Company's consolidated balance sheets.
(2) Non-cash settled facility-related costs represent depreciation expense associated with the Torrance production facility resulting from the consolidation of coffee production operations with the Houston and Portland production facilities and included in "Property, plant and equipment, net" on the Company's consolidated balance sheets.
(3) Included in “Accounts payable” on the Company's consolidated balance sheets.

Note 4. New Facility Lease Obligation

On July 17, 2015, the Company entered into a lease agreement, (as amended the “Lease Agreement”), pursuant to which the New Facility is being constructed by the lessor ("Lessor") at its expense, in accordance with agreed upon specifications and plans determined as set forth in the Lease Agreement. Based on the final budget, which reflects substantial completion of the principal design work for the New Facility, the Company estimates that the construction costs for the New Facility will be approximately $55 million to $60 million. The Company recorded an asset related to the New Facility lease obligation included in property, plant and equipment of $28.1 million at June 30, 2016 and an offsetting liability of $28.1 million for the lease obligation in "Other long-term liabilities" on its consolidated balance sheet at June 30, 2016 (see Note 19). Rent expense associated with the portion of the lease allocated to the land in the fiscal year ended June 30, 2016 and 2015 was $0.3 million and $0, respectively. Construction of and relocation to the New Facility is expected to be completed in the third quarter of fiscal 2017.

In conjunction with the Lease Agreement, the Company also entered into a Development Management Agreement (the “DMA”) pursuant to which an affiliate of Stream Realty Partners (“Developer”) has agreed to manage, coordinate, represent, assist and advise the Company on matters concerning the pre-development, development, design, entitlement, infrastructure, site preparation and construction of the New Facility. Pursuant to the DMA, the Company will pay Developer:

- a development fee of 3.25% of all development costs;
- an oversight fee of 2% of any amounts paid to the Company-contracted parties for any oversight by Developer of Company-contracted work;
- an incentive fee, the amount of which will be determined by the parties, if final completion occurs prior to the scheduled completion date; and
- an amount equal to $2.6 million as additional fee in respect of development services.

On June 15, 2016, the Company exercised the purchase option under the Lease Agreement to acquire the partially constructed New Facility. The estimated purchase option exercise price for the New Facility is $58.8 million based on the budget for the completed facility. The actual option exercise price for the partially constructed New Facility will

depend

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upon, among other things, the timing of the closing and the actual costs incurred for construction of the New Facility as of the purchase option closing date.

In addition to the costs to complete the construction of the New Facility, the Company estimates that it will incur $35 million to $39 million for machinery and equipment, furniture and fixtures and related expenditures. As of June 30, 2016, the Company had spent $4.4 million toward the purchase of machinery and equipment for the New Facility. No such capital expenditures were incurred in fiscal 2015. The majority of the capital expenditures associated with machinery and equipment, furniture, fixtures and related expenditures for the New Facility are expected to be incurred in the first half of fiscal 2017.

## Note 5. Sale of Spice Assets

In order to focus on its core products, on December 8, 2015, the Company completed the sale of the Spice Assets to Harris. Harris acquired substantially all of the Company’s personal property used exclusively in connection with the Spice Assets, including certain equipment; trademarks, tradenames and other intellectual property assets; contract rights under sales and purchase orders and certain other agreements; and a list of certain customers, other than the Company’s DSD customers, and assumed certain liabilities relating to the Spice Assets. The Company received $6.0 million in cash at closing, and is eligible to receive an earnout amount of up to $5.0 million over a three year period based upon a percentage of certain institutional spice sales by Harris following the closing. The Company recognized $0.5 million in earnout during the fiscal year ended June 30, 2016, a portion of which is included in net gains from the sale of Spice Assets.

In connection with the sale of the Spice Assets, the Company and Harris entered into certain other agreements, including (1) a transitional co-packaging supply agreement pursuant to which the Company, as the contractor, provided Harris with certain transition services for a six-month transitional period following the closing of the asset sale, and (2) an exclusive supply agreement pursuant to which Harris will supply to the Company, after the closing of the asset sale, spice and culinary products that were previously manufactured by the Company on negotiated pricing terms. While title to the Spice Assets transferred at closing, certain of the assets purchased by Harris were transferred to Harris' own manufacturing facilities, in phases, during the transitional period. As of June 30, 2016, the Company completed all the agreed upon transitional services to Harris. The sale of the Spice Assets does not represent a strategic shift for the Company and is not expected to have a material impact on the Company's results of operations because the Company will continue to sell a complete portfolio of spice and other culinary products purchased from Harris under the supply agreement to its DSD customers.

## Note 6. Assets Held for Sale

At June 30, 2016, the Company had listed for sale its Torrance facility and one of its branch properties in Northern California. The Company actively marketed these properties, entered into purchase and sale agreements with prospective buyers and expected these properties to be sold within one year. Accordingly, the Company designated these properties as assets held for sale and recorded the carrying values of these properties in the aggregate amount of $7.2 million as "Assets held for sale" on the Company's consolidated balance sheet at June 30, 2016. Subsequent to the year end the sale transaction for the Torrance facility was completed (see Note 24).

## Note 7. Derivative Instruments

### Derivative Instruments Held

#### Coffee-Related Derivative Instruments

The Company is exposed to commodity price risk associated with its PTF green coffee purchase contracts, which are described further in Note 1. The Company utilizes forward and option contracts to manage exposure to the variability in expected future cash flows from forecasted purchases of green coffee attributable to commodity price risk. Certain of these coffee-related derivative instruments utilized for risk management purposes have been designated as cash flow hedges, while other coffee-related derivative instruments have not been designated as cash flow hedges or do not qualify for hedge accounting despite hedging the Company's future cash flows on an economic basis.

The following table summarizes the notional volumes for the coffee-related derivative instruments held by the Company at June 30, 2016 and 2015:

| | June 30, | |
|---|---|---|
| (In thousands) | 2016 | 2015 |
| Derivative instruments designated as cash flow hedges: | | |
| Long coffee pounds | 32,550 | 32,288 |
| Derivative instruments not designated as cash flow hedges: | | |
| Long coffee pounds | 1,618 | 1,954 |
| Less: Short coffee pounds | (188 ) | — |
| Total | 33,980 | 34,242 |

Coffee-related derivative instruments designated as cash flow hedges outstanding as of June 30, 2016 will expire within 18 months.

Effect of Derivative Instruments on the Financial Statements

Balance Sheets

Fair values of derivative instruments on the consolidated balance sheets:

| | Derivative Instruments Designated as Cash Flow Hedges June 30, | | Derivative Instruments Not Designated as Accounting Hedges June 30, | |
|---|---|---|---|---|
| (In thousands) | 2016(1) | 2015(2) | 2016(1) | 2015(2) |
| Financial Statement Location: | | | | |
| Short-term derivative assets: | | | | |
| Coffee-related derivative instruments | $3,771 | $128 | $183 | $25 |
| Long-term derivative assets: | | | | |
| Coffee-related derivative instruments | $2,575 | $136 | $57 | $2 |
| Short-term derivative liabilities: | | | | |
| Coffee-related derivative instruments | $— | $4,128 | $— | $2 |
| Long-term derivative liabilities: | | | | |
| Coffee-related derivative instruments | $— | $163 | $— | $— |

(1) Included in "Short-term derivative assets" and "Other assets" on the Company's consolidated balance sheet at June 30, 2016.
(2) Included in "Short-term derivative liabilities" and "Other long-term liabilities" on the Company's consolidated balance sheet at June 30, 2015.

Statements of Operations

The following table presents pretax net gains and losses for the Company's coffee-related derivative instruments designated as cash flow hedges, as recognized in “AOCI,” “Cost of goods sold” and “Other, net”:

| | Year Ended June 30, | | | Financial Statement |
|---|---|---|---|---|
| (In thousands) | 2016 | 2015 | 2014 | Classification |
| Net gains (losses) recognized in accumulated other comprehensive income (loss) (effective portion) | $303 | $(14,295) | $17,524 | AOCI |
| Net (losses) gains recognized in earnings (effective portion) | $(13,184) | $4,211 | $1,161 | Costs of goods sold |
| Net losses recognized in earnings (ineffective portion) | $(575) | $(325) | $(259) | Other, net |

For the years ended June 30, 2016, 2015 and 2014, there were no gains or losses recognized in earnings as a result of excluding amounts from the assessment of hedge effectiveness or as a result of reclassifications to earnings following the discontinuance of any cash flow hedges.

Gains and losses on derivative instruments not designated as accounting hedges are included in “Other, net” in the Company's consolidated statements of operations and in “Net losses (gains) on derivative instruments and investments” in the Company's consolidated statements of cash flows.

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

| | Year Ended June 30, | | |
|---|---|---|---|
| (In thousands) | 2016 | 2015 | 2014 |
| Net (losses) gains on coffee-related derivative instruments | $(298) | $(2,992) | $2,655 |
| Net gains (losses) on investments | 611 | (270) | 464 |
| Net losses on interest rate swap | — | — | (5) |
| Net gains (losses) on derivative instruments and investments(1) | 313 | (3,262) | 3,114 |
| Other gains, net | 243 | 248 | 563 |
| Other, net | $556 | $(3,014) | $3,677 |

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(1) Excludes net (losses) gains on coffee-related derivative instruments designated as cash flow hedges recorded in cost of goods sold in the fiscal years ended June 30, 2016, 2015 and 2014.

Offsetting of Derivative Assets and Liabilities

The Company has agreements in place that allow for the financial right of offset for derivative assets and liabilities at settlement or in the event of default under the agreements. Additionally, the Company maintains accounts with its brokers to facilitate financial derivative transactions in support of its risk management activities. Based on the value of the Company’s positions in these accounts and the associated margin requirements, the Company may be required to deposit cash into these broker accounts.

The following table presents the Company’s net exposure from its offsetting derivative asset and liability positions, as well as cash collateral on deposit with its counterparty as of the reporting dates indicated:

| (In thousands) | | Gross Amount Reported on Balance Sheet | Netting Adjustments | Cash Collateral Posted | Net Exposure |
|---|---|---|---|---|---|
| June 30, 2016 | Derivative Assets | $ 6,586 | $ — | $ — | $ 6,586 |
| June 30, 2015 | Derivative Assets | $ 291 | $ (291) | $ — | $ — |
| | Derivative Liabilities | $ 4,292 | $ (291) | $ 1,001 | $ 3,000 |

Cash Flow Hedges

Changes in the fair value of the Company's coffee-related derivative instruments designated as cash flow hedges, to the extent effective, are deferred in AOCI and reclassified into cost of goods sold in the same period or periods in which the hedged forecasted purchases affect earnings, or when it is probable that the hedged forecasted transaction will not occur by the end of the originally specified time period. Based on recorded values at June 30, 2016, $2.0 million of net gains on coffee-related derivative instruments designated as cash flow hedges are expected to be reclassified into cost of goods sold within the next twelve months. These recorded values are based on market prices of the commodities as of June 30, 2016. Due to the volatile nature of commodity prices, actual gains or losses realized within the next twelve months will likely differ from these values.

Note 8. Investments

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

| | Year Ended June 30, | | |
|---|---|---|---|
| (In thousands) | 2016 | 2015 | 2014 |
| Total gains (losses) recognized from trading securities held for investment | $611 | $(270) | $464 |
| Less: Realized gains from sales of trading securities held for investment | 29 | 89 | 116 |
| Unrealized gains (losses) from trading securities held for investment | $582 | $(359) | $348 |

Note 9. Fair Value Measurements

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

| (In thousands) | Total | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| June 30, 2016 | | | | |
| Preferred stock(1) | $25,591 | $21,976 | $3,615 | $ — |
| Derivative instruments designated as cash flow hedges: | | | | |
| Coffee-related derivative assets(2) | $6,346 | $— | $6,346 | $ — |
| Coffee-related derivative liabilities(2) | $— | $— | $— | $ — |
| Derivative instruments not designated as accounting hedges: | | | | |
| Coffee-related derivative assets(2) | $240 | $— | $240 | $ — |
| Coffee-related derivative liabilities(2) | $— | $— | $— | $ — |

| | Total | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| June 30, 2015 | | | | |
| Preferred stock(1) | $23,665 | $19,132 | $4,533 | $ — |
| Derivative instruments designated as cash flow hedges: | | | | |
| Coffee-related derivative assets(2) | $264 | $— | $264 | $ — |
| Coffee-related derivative liabilities(2) | $4,290 | $— | $4,290 | $ — |
| Derivative instruments not designated as accounting hedges: | | | | |
| Coffee-related derivative assets(2) | $27 | $— | $27 | $ — |
| Coffee-related derivative liabilities(2) | $2 | $— | $2 | $ — |

(1) Included in “Short-term investments” on the Company's consolidated balance sheets.
(2) The Company's coffee derivative instruments are traded over-the-counter and, therefore, classified as Level 2.

During the fiscal year ended June 30, 2016, there was one transfer of preferred stock from Level 1 to Level 2, resulting from a decrease in the quantity and quality of information related to trading activity and broker quotes for

that security. The

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Company's coffee derivative instruments that were previously classified as Level 1 were appropriately reclassified as Level 2 because they are traded over-the-counter.

Note 10. Accounts and Notes Receivable, Net

| | June 30, | |
|---|---|---|
| (In thousands) | 2016 | 2015 |
| Trade receivables | $43,113 | $38,783 |
| Other receivables(1) | 1,965 | 2,021 |
| Allowance for doubtful accounts | (714) | (643) |
| Accounts and notes receivable, net | $44,364 | $40,161 |

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(1) At June 30, 2016 and 2015, respectively, the Company had recorded $0.5 million and $0 in "Other receivables" included in "Accounts and notes receivable, net" on its consolidated balance sheets representing earnout receivable from Harris.

Allowance for doubtful accounts:

| (In thousands) | |
|---|---|
| Balance at June 30, 2013 | $(1,115) |
| Provision | (80) |
| Reclassification to long-term | 544 |
| Balance at June 30, 2014 | $(651) |
| Recovery | 8 |
| Balance at June 30, 2015 | $(643) |
| Provision | (71) |
| Write-off | $— |
| Balance at June 30, 2016 | $(714) |

Note 11. Inventories

| | June 30, | |
|---|---|---|
| (In thousands) | 2016 | 2015 |
| Coffee | | |
| Processed | $12,362 | $13,837 |
| Unprocessed | 13,534 | 11,968 |
| Total | $25,896 | $25,805 |
| Tea and culinary products | | |
| Processed | $15,384 | $17,022 |
| Unprocessed | 377 | 2,764 |
| Total | $15,761 | $19,786 |
| Coffee brewing equipment parts | $4,721 | $4,931 |
| Total inventories | $46,378 | $50,522 |

In addition to product cost, inventory costs include expenditures such as direct labor and certain supply and overhead expenses incurred in bringing the inventory to its existing condition and location. The “Unprocessed” inventory values as stated in the above table represent the value of raw materials and the “Processed” inventory values represent all other products consisting primarily of finished goods.

Inventories decreased at the end of fiscal 2016 compared to fiscal 2015, primarily due to production consolidation and the sale of processed and unprocessed inventories to Harris at cost upon conclusion of the transition services provided

by the

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Company in connection with the sale of the Spice Assets. Inventories decreased at the end of fiscal 2015 compared to fiscal 2014, primarily due to the consolidation of the Company's Torrance coffee production with its coffee production in Houston and Portland as part of the Corporate Relocation Plan. As a result, the Company recorded in cost of goods sold $4.2 million and $4.9 million in beneficial effect of liquidation of LIFO inventory quantities in the fiscal year ended June 30, 2016 and 2015, respectively, which increased net income for the fiscal years ended June 30, 2016 and 2015 by $4.2 million and $4.9 million, respectively. Inventories increased at the end of fiscal 2014 compared to fiscal 2013 and, therefore, there was no similar benefit to cost of goods sold in fiscal 2014.

Current cost of coffee, tea and culinary product inventories exceeds the LIFO cost by:

| | June 30, | |
|---|---|---|
| (In thousands) | 2016 | 2015 |
| Coffee | $14,462 | $25,541 |
| Tea and culinary products | 7,139 | 8,200 |
| Total | $21,601 | $33,741 |

Note 12. Property, Plant and Equipment

| | June 30, | |
|---|---|---|
| (In thousands) | 2016 | 2015 |
| Buildings and facilities | $54,768 | $79,040 |
| Machinery and equipment | 182,227 | 172,432 |
| Buildings and facilities—New Facility(1) | 28,110 | — |
| Equipment under capital leases | 11,982 | 18,562 |
| Capitalized software | 21,545 | 19,703 |
| Office furniture and equipment | 16,077 | 15,005 |
| | $314,709 | $304,742 |
| Accumulated depreciation | (206,162 ) | (223,660 ) |
| Land | 9,869 | 9,119 |
| Property, plant and equipment, net(2) | $118,416 | $90,201 |

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(1) Asset recorded to offset New Facility lease obligation recorded in "Other long-term liabilities" (see Note 19).
(2) Includes in the years ended June 30, 2016 and 2015, expenditures for items that have not been placed in service in the amounts of $39.3 million and $2.5 million, respectively.

Capital leases consisted mainly of vehicle leases at June 30, 2016 and 2015. Depreciation and amortization expense includes amortization expense for assets recorded under capitalized leases.

The Company capitalized coffee brewing equipment (included in machinery and equipment) in the amounts of $8.4 million and $10.7 million in fiscal 2016 and 2015, respectively. Depreciation expense related to the capitalized coffee brewing equipment reported as cost of goods sold was $9.8 million, $10.4 million and $10.9 million in fiscal 2016, 2015 and 2014, respectively.

The Company may incur certain other non-cash asset impairment costs in connection with the Corporate Relocation Plan.

Maintenance and repairs to property, plant and equipment charged to expense for the years ended June 30, 2016, 2015, and 2014 were $7.7 million, $8.2 million and $8.7 million, respectively.

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

Note 13. Goodwill and Intangible Assets

The following is a summary of changes in the carrying value of goodwill:

| (In thousands) | |
|---|---|
| Balance at June 30, 2014 | $— |
| Additions—RLC acquisition | 272 |
| Balance at June 30, 2015 | $272 |
| Additions | — |
| Balance at June 30, 2016 | $272 |

The following is a summary of the Company's amortized and unamortized intangible assets other than goodwill, along with amortization expense on these intangible assets for the past two fiscal years.

| | June 30, 2016 | | June 30, 2015 | |
|---|---|---|---|---|
| (In thousands) | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization |
| Amortized intangible assets: | | | | |
| Customer relationships | $10,953 | $ (10,373 ) | $10,953 | $ (10,179 ) |
| Covenant not to compete | 20 | (10 ) | 20 | (3 ) |
| Total amortized intangible assets | $10,973 | $ (10,383 ) | $10,973 | $ (10,182 ) |
| Unamortized intangible assets: | | | | |
| Tradenames with indefinite lives | $3,640 | $ — | $3,640 | $ — |
| Trademarks with indefinite lives | 1,988 | — | 1,988 | — |
| Total unamortized intangible assets | $5,628 | $ — | $5,628 | $ — |
| Total intangible assets | $16,601 | $ (10,383 ) | $16,601 | $ (10,182 ) |

Aggregate amortization expense for the past three fiscal years:

| (In thousands): | |
|---|---|
| For the fiscal year ended June 30, 2016 | $ 200 |
| For the fiscal year ended June 30, 2015 | $ 99 |
| For the | $ 649 |

fiscal year ended June 30, 2014

Estimated amortization expense for the next three fiscal years:

| (In thousands): | |
|---|---|
| For the fiscal year ending June 30, 2017 | $1,200 |
| For the fiscal year ending June 30, 2018 | $1,198 |
| For the fiscal year ending June 30, 2019 | $1,193 |

Remaining weighted average amortization periods for intangible assets with finite lives are as follows:

| | |
|---|---|
| Customer relationships (years) | 3.0 |
| Covenant not to compete (years) | 1.5 |

Note 14. Employee Benefit Plans

The Company provides benefit plans for most full-time employees, including 401(k), health and other welfare benefit plans and, in certain circumstances, pension benefits. Generally the plans provide benefits based on years of service and/or a

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combination of years of service and earnings. In addition, the Company contributes to two multiemployer defined benefit pension plans, one multiemployer defined contribution pension plan and ten multiemployer defined contribution plans other than pension plans that provide medical, vision, dental and disability benefits for active, union-represented employees subject to collective bargaining agreements. In addition, the Company sponsors a postretirement defined benefit plan that covers qualified non-union retirees and certain qualified union retirees and provides retiree medical coverage and, depending on the age of the retiree, dental and vision coverage. The Company also provides a postretirement death benefit to certain of its employees and retirees.

The Company is required to recognize the funded status of a benefit plan in its consolidated balance sheets. The Company is also required to recognize in other comprehensive income (loss) ("OCI") certain gains and losses that arise during the period but are deferred under pension accounting rules.

Single Employer Pension Plans

The Company has a defined benefit pension plan, the Farmer Bros. Co. Pension Plan for Salaried Employees (the "Farmer Bros. Plan"), for Company employees hired prior to January 1, 2010, who are not covered under a collective bargaining agreement. The Company amended the Farmer Bros. Plan, freezing the benefit for all participants effective June 30, 2011. After the plan freeze, participants do not accrue any benefits under the Farmer Bros. Plan, and new hires are not eligible to participate in the Farmer Bros. Plan. As all plan participants became inactive following this pension curtailment, net (gain) loss is now amortized based on the remaining life expectancy of these participants instead of the remaining service period of these participants.

The Company also has two defined benefit pension plans for certain hourly employees covered under collective bargaining agreements (the "Brewmatic Plan" and the "Hourly Employees' Plan"). In fiscal 2015, the Company actuarially determined that no adjustments were required to be made to fiscal 2015 net periodic benefit cost for the defined benefit pension plans as a result of the Company's Corporate Relocation Plan.

Obligations and Funded Status

| | Farmer Bros. Plan June 30, | | Brewmatic Plan June 30, | | Hourly Employees' Plan June 30, | |
|---|---|---|---|---|---|---|
| ($ in thousands) | 2016 | 2015 | 2016 | 2015 | 2016 | 2015 |
| Change in projected benefit obligation | | | | | | |
| Benefit obligation at the beginning of the year | $136,962 | $133,136 | $4,064 | $3,991 | $3,145 | $2,619 |
| Service cost | — | — | — | — | 389 | 386 |
| Interest cost | 5,875 | 5,393 | 172 | 160 | 137 | 108 |
| Actuarial loss | 15,999 | 4,596 | 682 | 188 | 687 | 56 |
| Benefits paid | (6,511) | (6,163) | (344) | (275) | (29) | (24) |
| Projected benefit obligation at the end of the year | $152,325 | $136,962 | $4,574 | $4,064 | $4,329 | $3,145 |
| Change in plan assets | | | | | | |
| Fair value of plan assets at the beginning of the year | 94,815 | $98,426 | $3,291 | $3,435 | $2,104 | $1,629 |
| Actual return on plan assets | 1,556 | 1,731 | 42 | 66 | 85 | 10 |
| Employer contributions | 1,341 | 821 | — | 65 | 287 | 489 |
| Benefits paid | (6,511) | (6,163) | (344) | (275) | (29) | (24) |
| Fair value of plan assets at the end of the year | $91,201 | $94,815 | $2,989 | $3,291 | $2,447 | $2,104 |
| Funded status at end of year (underfunded) overfunded | (61,124) | $(42,147) | (1,585) | $(773) | $(1,882) | $(1,041) |
| Amounts recognized in consolidated balance sheets | | | | | | |
| Non-current liabilities | (61,124) | (42,147) | (1,585) | (773) | (1,882) | (1,041) |
| Total | $(61,124) | $(42,147) | $(1,585) | $(773) | $(1,882) | $(1,041) |
| Amounts recognized in consolidated statements of operations | | | | | | |
| Net loss | 70,246 | $50,743 | 2,756 | $1,965 | 988 | $237 |
| Total accumulated OCI (not adjusted for applicable tax) | $70,246 | $50,743 | $2,756 | $1,965 | $988 | $237 |
| Weighted average assumptions used to determine benefit obligations | | | | | | |
| Discount rate | 3.55 % | 4.40 % | 3.55 % | 4.40 % | 3.55 % | 4.40 % |
| Rate of compensation increase | N/A | N/A | N/A | N/A | N/A | N/A |

Components of Net Periodic Benefit Cost and
Other Changes Recognized in Other Comprehensive Income (Loss) (OCI)

| | Farmer Bros. Plan June 30, | | Brewmatic Plan June 30, | | Hourly Employees' Plan June 30, | |
|---|---|---|---|---|---|---|
| ($ in thousands) | 2016 | 2015 | 2016 | 2015 | 2016 | 2015 |
| Components of net periodic benefit cost | | | | | | |
| Service cost | $— | $— | $— | $— | $389 | $386 |
| Interest cost | 5,875 | 5,393 | 172 | 160 | 137 | 108 |
| Expected return on plan assets | (6,470 ) | (6,938 ) | (219 ) | (234 ) | (149 ) | (119 ) |
| Amortization of net loss | 1,411 | 1,153 | 68 | 57 | — | — |
| Net periodic benefit cost (credit) | $816 | $(392 ) | $21 | $(17 ) | $377 | $375 |
| Other changes recognized in OCI | | | | | | |
| Net loss | $20,913 | $9,803 | $859 | $356 | $750 | $165 |
| Amortization of net loss | (1,411 ) | (1,153 ) | (68 ) | (57 ) | — | — |
| Total recognized in OCI | $19,502 | $8,650 | $791 | $299 | $750 | $165 |
| Total recognized in net periodic benefit cost and OCI | $20,318 | $8,258 | $812 | $282 | $1,127 | $540 |
| Weighted-average assumptions used to determine net periodic benefit cost | | | | | | |
| Discount rate | 4.40 % | 4.15 % | 4.40 % | 4.15 % | 4.40 % | 4.15 % |
| Expected long-term return on plan assets | 7.50 % | 7.50 % | 7.50 % | 7.50 % | 7.50 % | 7.50 % |
| Rate of compensation increase | N/A | N/A | N/A | N/A | N/A | N/A |

Basis Used to Determine Expected Long-term Return on Plan Assets

The expected long-term return on plan assets assumption was developed as a weighted average rate based on the target asset allocation of the plan and the Long-Term Capital Market Assumptions (CMA) 2014. The capital market assumptions were developed with a primary focus on forward-looking valuation models and market indicators. The key fundamental economic inputs for these models are future inflation, economic growth, and interest rate environment. Due to the long-term nature of the pension obligations, the investment horizon for the CMA 2014 is 20 to 30 years. In addition to forward-looking models, historical analysis of market data and trends was reflected, as well as the outlook of recognized economists, organizations and consensus CMA from other credible studies.

Description of Investment Policy

The Company's investment strategy is to build an efficient, well-diversified portfolio based on a long-term, strategic outlook of the investment markets. The investment markets outlook utilizes both the historical-based and forward-looking return forecasts to establish future return expectations for various asset classes. These return expectations are used to develop a core asset allocation based on the specific needs of each plan. The core asset allocation utilizes investment portfolios of various asset classes and multiple investment managers in order to maximize the plan's return while providing multiple layers of diversification to help minimize risk.

Additional Disclosures

| ($ in thousands) | Farmer Bros. Plan June 30, 2016 | Farmer Bros. Plan June 30, 2015 | Brewmatic Plan June 30, 2016 | Brewmatic Plan June 30, 2015 | Hourly Employees' Plan June 30, 2016 | Hourly Employees' Plan June 30, 2015 |
|---|---|---|---|---|---|---|
| Comparison of obligations to plan assets | | | | | | |
| Projected benefit obligation | $152,325 | $136,962 | $4,574 | $4,064 | $4,329 | $3,145 |
| Accumulated benefit obligation | $152,325 | $136,962 | $4,574 | $4,064 | $4,329 | $3,145 |
| Fair value of plan assets at measurement date | $91,201 | $94,815 | $2,989 | $3,291 | $2,447 | $2,104 |
| Plan assets by category | | | | | | |
| Equity securities | $58,094 | $47,340 | $1,909 | $1,638 | $1,542 | $1,050 |
| Debt securities | 27,586 | 37,789 | 899 | 1,322 | 758 | 839 |
| Real estate | 5,521 | 9,686 | 181 | 331 | 147 | 215 |
| Total | $91,201 | $94,815 | $2,989 | $3,291 | $2,447 | $2,104 |
| Plan assets by category | | | | | | |
| Equity securities | 64 % | 50 % | 64 % | 50 % | 63 % | 50 % |
| Debt securities | 30 % | 40 % | 30 % | 40 % | 31 % | 40 % |
| Real estate | 6 % | 10 % | 6 % | 10 % | 6 % | 10 % |
| Total | 100.0 % | 100 % | 100 % | 100 % | 100 % | 100 % |

Fair values of plan assets were as follows:

| (In thousands) | June 30, 2016 Total | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Farmer Bros. Plan | $91,201 | $ — | $91,201 | $ — |
| Brewmatic Plan | $2,989 | $ — | $2,989 | $ — |
| Hourly Employees' Plan | $2,447 | $ — | $2,447 | $ — |

| (In thousands) | June 30, 2015 Total | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Farmer Bros. Plan | $94,815 | $ — | $94,815 | $ — |
| Brewmatic Plan | $3,291 | $ — | $3,291 | $ — |
| Hourly Employees' Plan | $2,104 | $ — | $2,104 | $ — |

As of June 30, 2016, approximately 6% of the assets of each of the Farmer Bros. Plan, the Brewmatic Plan and the Hourly Employees' Plan were invested in pooled separate accounts which invested mainly in commercial real estate and included mortgage loans which were backed by the associated properties. These underlying real estate investments are able to be redeemed at net asset value per share and therefore, are considered Level 2 assets.

The following is the target asset allocation for the Company's single employer pension plans—Farmer Bros. Plan, Brewmatic Plan and Hourly Employees' Plan—for fiscal 2017:

| | Fiscal 2017 |
|---|---|
| U.S. large cap equity securities | 42.8 % |
| U.S. small cap equity securities | 5.2 % |
| International equity securities | 16.0 % |
| Debt securities | 30.0 % |
| Real estate | 6.0 % |

| Total | 100.0% |
| --- | --- |

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Estimated Amounts in OCI Expected To Be Recognized
In fiscal 2017, the Company expects to recognize as a component of net periodic benefit cost $1.1 million for the Farmer Bros. Plan, $71,000 for the Brewmatic Plan, and $0.5 million for the Hourly Employees' Plan.
Estimated Future Contributions and Refunds
In fiscal 2017, the Company expects to contribute $2.0 million to the Farmer Bros. Plan, $0.1 million to the Brewmatic Plan, and $0.3 million to the Hourly Employees' Plan. The Company is not aware of any refunds expected from single employer pension plans.
Estimated Future Benefit Payments
The following benefit payments are expected to be paid over the next 10 fiscal years:

| (In thousands) | Farmer Bros. Plan | Brewmatic Plan | Hourly Employees' Plan |
|---|---|---|---|
| Year Ending: | | | |
| June 30, 2017 | $7,310 | $ 320 | $ 81 |
| June 30, 2018 | $7,520 | $ 310 | $ 110 |
| June 30, 2019 | $7,760 | $ 310 | $ 120 |
| June 30, 2020 | $8,040 | $ 300 | $ 140 |
| June 30, 2021 | $8,250 | $ 290 | $ 170 |
| June 30, 2022 to June 30, 2026 | $42,770 | $ 1,340 | $ 1,170 |

These amounts are based on current data and assumptions and reflect expected future service, as appropriate.

Multiemployer Pension Plans
The Company participates in two multiemployer defined benefit pension plans that are union sponsored and collectively bargained for the benefit of certain employees subject to collective bargaining agreements, of which the Western Conference of Teamsters Pension Plan ("WCTPP") is individually significant. The Company makes contributions to these plans generally based on the number of hours worked by the participants in accordance with the provisions of negotiated labor contracts.
The risks of participating in multiemployer pension plans are different from single-employer plans in that: (i) assets contributed to a multiemployer plan by one employer may be used to provide benefits to employees of other participating employers; (ii) if a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers; and (iii) if the Company stops participating in the multiemployer plan, the Company may be required to pay the plan an amount based on the underfunded status of the plan, referred to as a withdrawal liability.
The Company's participation in WCTPP is outlined in the table below. The Pension Protection Act ("PPA") Zone Status available in the Company's fiscal year 2016 and fiscal year 2015 is for the plan's year ended December 31, 2015 and December 31, 2014, respectively. The zone status is based on information obtained from WCTPP and is certified by WCTPP's actuary. Among other factors, plans in the green zone are generally more than 80% funded. Based on WCTPP's annual report on Form 5500, WCTPP was 91.7% and 91.9% funded for its plan year beginning January 1, 2015 and 2014, respectively. The "FIP/RP Status Pending/Implemented" column indicates if a funding improvement plan ("FIP") or a rehabilitation plan ("RP") is either pending or has been implemented.

| Pension Plan | Employer Identification Number | Pension Plan Number | PPA Zone Status | | FIP/RP Status Pending/ Implemented | Surcharge Imposed | Expiration Date of Collective Bargaining Agreements |
|---|---|---|---|---|---|---|---|
| | | | July 1, 2015 | July 1, 2014 | | | |
| Western Conference of Teamsters Pension Plan | 91-6145047 | 001 | Green | Green | No | No | January 31, 2020 |

Based upon the most recent information available from the trustees managing WCTPP, the Company's share of the unfunded vested benefit liability for the plan was estimated to be approximately $9.1 million if the withdrawal had occurred in calendar year 2015. These estimates were calculated by the trustees managing WCTPP. Although the Company believes the most recent plan data available from WCTPP was used in computing this 2015 estimate, the actual withdrawal liability amount is subject to change based on, among other things, the plan's investment returns and benefit levels, interest rates, financial difficulty of other participating employers in the plan such as bankruptcy, and continued participation by the Company and other employers in the plan, each of which could impact the ultimate withdrawal liability.

If withdrawal liability were to be triggered, the withdrawal liability assessment can be paid in a lump sum or on a monthly basis. The amount of the monthly payment is determined as follows: Average number of hours reported to the pension plan trust during the three consecutive years with highest number of hours in the 10-year period prior to the withdrawal is multiplied by the highest hourly contribution rate during the 10-year period ending with the plan year in which the withdrawal occurred to determine the amount of withdrawal liability that has to be paid annually. The annual amount is divided by 12 to arrive at the monthly payment due. If monthly payments are elected, interest is assessed on the unpaid balance after 12 months at the rate of 7% per annum.

In fiscal 2012, the Company withdrew from the Local 807 Labor-Management Pension Fund (“Pension Fund”) and recorded a charge of $4.3 million associated with withdrawal from this plan, representing the present value of the estimated withdrawal liability expected to be paid in quarterly installments of $0.1 million over 80 quarters. On November 18, 2014, the Pension Fund sent the Company a notice of assessment of withdrawal liability in the amount of $4.4 million, which the Pension Fund adjusted to $4.9 million on January 5, 2015. The Company is in the process of negotiating a reduced liability amount. The Company has commenced quarterly installment payments to the Pension Fund of $91,000 pending the final settlement of the liability. The total estimated withdrawal liability of $3.8 million and $4.3 million, respectively, is reflected in the Company's consolidated balance sheets at June 30, 2016 and June 30, 2015, with the short-term and long-term portions reflected in current and long-term liabilities, respectively.

The Company may incur certain pension-related costs in connection with the Corporate Relocation Plan. Future collective bargaining negotiations may result in the Company withdrawing from the remaining multiemployer pension plans in which it participates and, if successful, the Company may incur a withdrawal liability, the amount of which could be material to the Company's results of operations and cash flows.

Company contributions to the multiemployer pension plans:

| (In thousands) | WCTPP(1)(2)(3) | All Other Plans(4) |
|---|---|---|
| Year Ended: | | |
| June 30, 2016 | $ 2,587 | $ 39 |
| June 30, 2015 | $ 3,593 | $ 41 |
| June 30, 2014 | $ 3,153 | $ 34 |

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(1) Individually significant plan.

(2) Less than 5% of total contribution to WCTPP based on WCTPP's most recent annual report on Form 5500 for the calendar year ended December 31, 2015.

(3) The Company guarantees that one hundred seventy-three (173) hours will be contributed upon for all employees who are compensated for all available straight time hours for each calendar month. An additional 6.5% of the basic contribution must be paid for PEER or the Program for Enhanced Early Retirement.

(4) Includes one plan that is not individually significant.

The Company's contribution to multiemployer plans decreased in fiscal 2016 as compared to fiscal 2015 and 2014, as a result of reduction in employees due to the Corporate Relocation Plan. The Company expects to contribute an aggregate of $3.3 million towards multiemployer pension plans in fiscal 2017.

Multiemployer Plans Other Than Pension Plans

The Company participates in ten multiemployer defined contribution plans other than pension plans that provide medical, vision, dental and disability benefits for active, union-represented employees subject to collective bargaining agreements. The plans are subject to the provisions of the Employee Retirement Income Security Act of 1974, and provide that participating employers make monthly contributions to the plans in an amount as specified in the collective bargaining agreements. Also, the plans provide that participants make self-payments to the plans, the amounts of which are negotiated through the collective bargaining process. The Company's participation in these plans is governed by collective bargaining agreements which expire on or before January 31, 2020. The Company's aggregate contributions to multiemployer plans other than pension plans in the fiscal years ended June 30, 2016, 2015 and 2014 were $6.3 million, $6.9 million and $6.6 million, respectively. The Company expects to contribute an aggregate of $6.5 million towards multiemployer plans other than pension plans in fiscal 2017.

401(k) Plan

The Company's 401(k) Plan is available to all eligible employees who have worked more than 1,000 hours during a calendar year and were employed at the end of the calendar year. Participants in the 401(k) Plan may choose to contribute a percentage of their annual pay subject to the maximum contribution allowed by the Internal Revenue Service. The Company's matching contribution is discretionary, based on approval by the Company's Board of Directors. For the calendar years 2016, 2015 and 2014, the Company's Board of Directors approved a Company matching contribution of 50% of an employee's annual contribution to the 401(k) Plan, up to 6% of the employee's eligible income. The matching contributions (and any earnings thereon) vest at the rate of 20% for each of the participant's first 5 years of vesting service, so that a participant is fully vested in his or her matching contribution account after 5 years of vesting service, subject to accelerated vesting under certain circumstances in connection with the Corporate Relocation Plan due to the closure of the Company’s Torrance facility or a reduction-in-force at another Company facility designated by the Administrative Committee of the Farmer Bros. Co. Qualified Employee Retirement Plans. A participant is automatically vested in the event of death, disability or attainment of age 65 while employed by the Company. Employees are 100% vested in their contributions. For employees subject to a collective bargaining agreement, the match is only available if so provided in the labor agreement.

The Company recorded matching contributions of $1.6 million, $1.4 million and $1.3 million in operating expenses for the fiscal years ended June 30, 2016, 2015 and 2014, respectively.

Postretirement Benefits

The Company sponsors a postretirement defined benefit plan that covers qualified non-union retirees and certain qualified union retirees (“Retiree Medical Plan”). The plan provides medical, dental and vision coverage for retirees under age 65 and medical coverage only for retirees age 65 and above. Under this postretirement plan, the Company’s contributions toward premiums for retiree medical, dental and vision coverage for participants and dependents are scaled based on length of service, with greater Company contributions for retirees with greater length of service, subject to a maximum monthly Company contribution. The Company's retiree medical, dental and vision plan is unfunded, and its liability was calculated using an assumed discount rate of 3.7% at June 30, 2016. The Company projects an initial medical trend rate of 9.0% in fiscal 2017, ultimately reducing to 4.5% in 10 years.

The Company also provides a postretirement death benefit (“Death Benefit”) to certain of its employees and retirees, subject, in the case of current employees, to continued employment with the Company until retirement and certain other conditions related to the manner of employment termination and manner of death. The Company records the actuarially determined liability for the present value of the postretirement death benefit. The Company has purchased life insurance policies to fund the postretirement death benefit wherein the Company owns the policy but the postretirement death benefit is paid to the employee's or retiree's beneficiary. The Company records an asset for the fair value of the life insurance policies which equates to the cash surrender value of the policies. In fiscal 2016, the Company actuarially determined that no postretirement benefit costs related to the Corporate Relocation Plan were required to be recognized.

Retiree Medical Plan and Death Benefit

The following table shows the components of net periodic postretirement benefit cost for the Retiree Medical Plan and Death Benefit for the fiscal years ended June 30, 2016, 2015 and 2014. Net periodic postretirement benefit cost for fiscal 2016 was based on employee census information as of July 1, 2015 and asset information as of June 30, 2016.

| | Year Ended June 30, | | |
|---|---|---|---|
| (In thousands) | 2016 | 2015 | 2014 |
| Components of Net Periodic Postretirement Benefit Cost (credit): | | | |
| Service cost | $1,388 | $1,195 | $936 |
| Interest cost | 1,194 | 943 | |