FARMER BROTHERS CO
Form 10-K
September 13, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTIONS 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

þ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended June 30, 2007

OR

o 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: 0-1375

FARMER BROS. CO.

(Exact Name of Registrant as Specified in Its Charter)

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

20333 South Normandie Avenue, Torrance, California 90502

(Address of Principal Executive Offices; Zip Code)

Registrant s telephone number, including area code **310-787-5200**

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

Title of Each Class	**Name of Each Exchange on Which Registered**
Common stock, $1.00 par value	**NASDAQ**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES þ NO o

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 o 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 o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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. þ

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. Large Accelerated Filer o Accelerated Filer þ Non-Accelerated Filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES o 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, 2006 was approximately $205.9 million.

On September 1, 2007 the registrant had 16,075,080 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

The following documents are incorporated by reference into Part III of this Form 10-K: certain portions of the definitive proxy statement for the fiscal year ended June 30, 2007 that is expected to be filed with the U.S. Securities and Exchange Commission on or before October 28, 2007.

TABLE OF CONTENTS

PART I

Item 1. Business

General

Farmer Bros. Co., including its consolidated subsidiaries unless the context otherwise requires, (the Company, we, our or Farmer Bros.) is a manufacturer, wholesaler and distributor of coffee and spices to the institutional food service segment. The Company was incorporated in California in 1923, and reincorporated in Delaware in 2004. On April 27, 2007, we completed the acquisition of Coffee Bean Holding Co., Inc., a Delaware corporation (CBH), the parent company of Coffee Bean International, Inc., an Oregon corporation (CBI), a specialty coffee roaster and wholesaler headquartered in Portland, Oregon (the CBI Acquisition).

Our product line is specifically focused on the needs of our market segment: institutional food service establishments that prepare and market meals and food products, including restaurants, hotels and hospitals, as well as retailers such as convenience stores, coffee houses, general merchandisers and grocery stores. Our product line includes roasted coffee, coffee related products such as coffee filters, sugar and creamers, assorted teas, cocoa, spices, and soup and beverage bases. Our product line presently includes over 400 items. For the past three fiscal years sales of roasted coffee products represented approximately 50% of our total sales and no single product other than coffee accounted for more than 10% of our revenue. Coffee purchasing, roasting and packaging takes place at our Torrance, California and Portland, Oregon plants. Our Torrance plant also serves as the distribution hub for our branches.

Raw Materials and Supplies

Our primary raw material is green coffee, an agricultural commodity. Green coffee is mainly grown outside the United States and can be subject to volatile price fluctuations. Weather, real or perceived shortages, political unrest, labor actions and armed conflict in coffee producing nations, and government actions, including treaties and trade controls between the U.S. and coffee producing nations, can affect the price of green coffee.

Green coffee prices can also be affected by the actions of producer organizations. The most prominent of these are the Colombian Coffee Federation (CCF), the Association of Coffee Producing Countries (ACPC) and the International Coffee Organization (ICO). These organizations seek to increase green coffee prices largely by attempting to restrict supplies, thereby limiting the availability of green coffee to coffee consuming nations.

Other raw materials used in the manufacture of our non-coffee products (allied products) include a wide variety of spices, such as pepper, chilies, oregano and thyme, as well as cocoa, dehydrated milk products, salt and sugar. These raw materials are agricultural products and can be subject to wide cost fluctuations. Such fluctuations, however, historically have not had a material effect on our operating results.

Trademarks

We own 91 registered trademarks, which are integral to customer identification of our products. It is not possible to assess the impact of the loss of such identification.

Seasonality

We experience some seasonal influences. The winter months are generally the best 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 months from seasonal businesses located in vacation areas.

Distribution

Most sales are made off-truck to our institutional food service customers at their places of business by our sales representatives who are responsible for soliciting, selling and collecting from and otherwise maintaining our customer accounts. Our distribution trucks are replenished from warehouses located in a number of cities in the western United States. We operate our own long haul trucking fleet in an effort to more effectively control the supply of products to these warehouses. Inventory levels are maintained at each branch warehouse consisting of our complete product line and additional safety stocks to accommodate a modest interruption in supply. A portion of our products are distributed by third parties or are direct shipped via common carrier.

As one of the largest wholesale specialty coffee roasters in the nation, CBI markets their unique specialty coffee line primarily to coffee houses and private-label retailers and other national accounts utilizing a variety of distribution channels. In contrast, Farmer Bros. serves a variety of traditional coffee blends at different price points to restaurants, hotels, hospitals, etc. utilizing its own distribution network. We believe the combination of the two marketing approaches and the combined product line (adding over 100 SKU s) allows the two companies to better serve their current and prospective customers needs without regard to the means of distribution.

Customers

No single customer represents a significant concentration of sales. As a result, the loss of one or more of our larger customer accounts is not likely to have a material adverse effect on our results of operations. We serve a wide variety of customers, from small restaurants and donut shops to large institutional buyers like restaurant chains, hospitals, hotels, contract food services and convalescent hospitals. Customer contact, our distribution network and our service quality, are integral to our sales effort. As a result of the CBI Acquisition we added additional customer categories that include gourmet coffee houses, national foodservice, national mass market merchandisers and grocery stores.

Competition

We face competition from many sources, including the institutional food service divisions of multi-national manufacturers of retail products such as Procter & Gamble (Folgers Coffee), Kraft Foods (Maxwell House Coffee) and Sara Lee Foods (Superior Coffee), wholesale grocery distributors such as Sysco and U.S. Food Service, and regional institutional coffee roasters such as S & D Coffee Company and Boyd Coffee Company. Management believes we may have some competitive advantages due to our longevity and strong regional roots. Our focus on the quality of our products, our distribution network and our customer service are the major factors that differentiate us from our competitors.

Competition is robust, and is primarily based on products and price, with distribution often a major factor. 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 compete well when service and distribution are valued by our customers, and 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 we believe that working capital from internal sources will be adequate for the coming fiscal year.

Foreign Operations

We have no material revenues from foreign operations.

Other

On June 30, 2007 we employed 1,233 employees, 441 of whom are subject to collective bargaining agreements. Compliance with government regulations relating to the discharge of materials into the environment has not had a material effect on our financial condition or results of operations. The nature of our business does not provide for maintenance of or reliance upon a sales backlog. No portion of our business may be subject to renegotiation of profits or termination of contracts or subcontracts at the election of the government.

Available Information

Our Internet website address is http://www.farmerbroscousa.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, 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.

Item 1A. Risk Factors

Certain statements contained in this annual report on Form 10-K regarding the risks, circumstances and financial trends that may affect our future operating results, financial position and cash flows are not based on historical fact and are forward-looking statements within the meaning of federal securities laws and regulations. These statements are based on management s current expectations, assumptions, estimates and observations of future events and include any statements that do not directly relate to any historical or current fact. These forward-looking statements can be identified by the use of words like anticipates, feels, estimates, projects, expects, plans, believes, intends, will, other words of similar meaning. Owing to the uncertainties inherent in forward-looking statements, actual results could differ materially from those set forth in forward-looking statements. We intend these forward-looking statements to speak only at the time of this report and do not undertake to update or revise these statements as more information becomes available except as required under federal securities laws and the rules and regulations of the SEC. Factors that could cause actual results to differ materially from those in forward-looking statements include, but are not limited to, fluctuations in availability and cost of green coffee, competition, organizational changes, our ability to successfully integrate the CBI Acquisition, the impact of a weaker economy, business conditions in the coffee industry and food industry in general, the Company s continued success in attracting new customers, variances from budgeted sales mix and growth rates, and weather and special or unusual events, as well as other risks described in this report and other factors described from time to time in the Company s filings with the SEC.

The following items are representative of the risks, uncertainties and other conditions that may impact the Company s business, future performance and the forward-looking statements that it makes in this annual report on Form 10-K or that it may make in the future. Our actual results could differ materially from anticipated results as a result of some or all of these items or from other factors.

OUR EFFORTS TO SECURE AN ADEQUATE SUPPLY OF QUALITY COFFEES MAY BE UNSUCCESSFUL AND EXPOSE US TO COMMODITY PRICE RISK.

Maintaining a steady supply of green coffee is essential to keep inventory levels low and secure sufficient stock to meet customer needs. To help ensure future supplies, we may purchase our coffee on forward contracts for delivery as long as six months in the future. In the event of non-performance by the suppliers, the Company could be exposed to credit and supply risk. Entering into such future commitments also leaves the Company subject to purchase price risk. Various techniques are used to hedge these purchases against untoward price movement. Competitive factors make it difficult for the Company to pass through such price fluctuations to its customers. Therefore, unpredictable price changes can have an immediate effect on operating results that cannot be corrected in the short run. To reduce its exposure to the volatile fluctuation of green coffee costs, Farmer Bros. has, from time to time, entered into futures contracts to hedge coffee purchase commitments. Open contracts associated with these hedging activities are described in Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

INCREASES IN THE COST OF GREEN COFFEE COULD REDUCE OUR GROSS MARGIN AND PROFIT.

Our primary raw material is green coffee, an agricultural commodity. Green coffee is mainly grown outside the U.S. and can be subject to volatile price fluctuations. Weather, real or perceived shortages, labor actions, political unrest and armed conflict in coffee producing nations, and government actions, including treaties and trade controls between the U.S. and coffee producing nations, can affect the price of green coffee. Green specialty coffees sell at a premium to other green coffees due to the inability of producers to increase supply in the short run to meet rising demand. As a result, the price spread between specialty coffee and non-specialty coffee is likely to widen as demand continues to increase.

Green coffee prices can also be affected by the actions of producer organizations. The most prominent of these are the Colombian Coffee Federation (CCF), the International Coffee Organization (ICO) and the Association of Coffee Producing Countries (ACPC). These organizations seek to increase coffee prices largely be attempting to restrict supplies, thereby limiting the availability of green coffee to coffee consuming nations. As a result these organizations or others may succeed in raising green coffee prices.

In the past, we generally have been able to pass on increases in green coffee costs to our customers. However, there can be no assurance that we will be successful in passing such fluctuations on to our customers without losses in sales volume or gross margin in the future. Similarly, 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 INDUSTRY IS HIGHLY COMPETITIVE AND WE MAY NOT HAVE THE RESOURCES TO COMPETE EFFECTIVELY.

We primarily compete with other coffee companies, including multi-national firms with substantially greater financial, marketing and operating resources than the Company. We face competition from many sources including the food service divisions of multi-national manufacturers of retail products such as Proctor and Gamble (Folgers Coffee), Kraft Foods (Maxwell House Coffee) and Sara Lee Foods (Superior Coffee), wholesale grocery distributors such as Sysco and U.S. Food Service, and regional coffee roasters such as S & D Coffee Company and Boyd Coffee Company. If we do not succeed in differentiating ourselves from our competitors or our competitors adopt our strategies, then our competitive position may be weakened.

CHANGES IN CONSUMER PREFERENCES COULD ADVERSELY AFFECT OUR BUSINESS.

Our continued success depends, in part, upon the demand for coffee. We believe that competition from other beverages continues to dilute the demand for coffee. Consumers who choose soft drinks, juices, bottled water, teas and other beverages all reduce spending on coffee. Consumer trends away from coffee could negatively impact our business.

REDUCTIONS IN DISCRETIONARY SPENDING COULD ADVERSELY AFFECT OUR BUSINESS.

Our success depends to a significant extent on a number of factors that affect discretionary consumer spending, including economic conditions, disposable consumer income and consumer confidence. In a slow economy, businesses and individuals scale back their discretionary spending on travel and entertainment, including dining out, as well as the purchase of high-end consumables like specialty coffee. Economic conditions may also cause businesses to reduce travel and entertainment expenses, and even cause office coffee benefits to be eliminated. These factors could reduce demand for our products or impose practical limits on pricing, either of which could adversely affect our business, financial condition, operating results and cash flows.

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, the costs associated with managing, purchasing, maintaining and insuring a fleet of delivery vehicles, the costs of maintaining distribution warehouses throughout the country, and the costs of hiring, training and managing our route sales professionals. Many of these costs are beyond our control, and others are fixed rather than variable. Some competitors use alternate methods of distribution that eliminate some of the costs associated with our method of distribution.

WE ARE SELF-INSURED. 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 have recently increased substantially. 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 experience, future claims may exceed claims we have incurred in the past. Should a different amount of claims occur compared to what was estimated or the cost of the claims increase or decrease beyond what was anticipated, reserves recorded may not be sufficient and the accruals may need to be adjusted accordingly in future periods.

EMPLOYEE STRIKES AND OTHER LABOR-RELATED DISRUPTIONS MAY ADVERSELY AFFECT OUR OPERATIONS.

We have union contracts relating to the majority of our workforce located on the West Coast, including California, Oregon, Washington and Nevada. Although we believe union relations have been amicable in the past, there is no assurance that this will continue in the future. There are potential adverse effects of labor disputes with our own employees or by others who provide transportation (shipping lines, truck drivers) or cargo handling (longshoremen), both domestic and foreign, of our raw materials or other products. These actions could restrict our ability to obtain, process and/or distribute our products.

THE FAILURE TO INTEGRATE SUCCESSFULLY OTHER BUSINESSES THAT WE ACQUIRE COULD ADVERSELY AFFECT OUR BUSINESS.

In April 2007, we acquired CBI in a stock acquisition. While we have no current agreements or binding commitments regarding any potential acquisitions, as part of our growth strategy we may evaluate opportunities to acquire other businesses or enter into joint ventures that would complement our existing product line, expand our geographic reach or increase our customer base. Acquisitions entail numerous risks, including:

- the integration of new operations, products, services and personnel;
- the diversion of management and other resources from our existing businesses;

- the inability to generate revenues from new products sufficient to offset associated acquisition costs;
- the maintenance of uniform standards, controls, procedures and policies;
- accounting effects that may adversely affect our financial results, including the amortization of intangible assets;
- difficulties in retaining customers of the acquired companies;
- the impairment of employee and customer relations as a result of any integration of new management personnel or the loss of key employees of the acquired companies;
- dilution to existing stockholders from the issuance of equity securities; and
- liabilities or other problems associated with an acquired business.

Any problems we encounter in connection with our acquisitions could have a material adverse effect on our business.

OUR ROASTING AND BLENDING METHODS ARE NOT PROPRIETARY, SO COMPETITORS MAY BE ABLE TO DUPLICATE THEM, WHICH COULD HARM OUR COMPETITIVE POSITION.

We consider our roasting and blending methods essential to the flavor and richness of our coffee and, therefore, essential to our brand. Because the Company s 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 brands 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.

BECAUSE A SUBSTANTIAL PORTION OF OUR BUSINESS IS BASED IN CALIFORNIA, OREGON, TEXAS, COLORADO, ARIZONA AND WASHINGTON, AN INTERRUPTION IN OPERATIONS IN ANY OF THESE MARKETS WOULD ADVERSELY IMPACT OUR BUSINESS.

Over half of our business is conducted in California, Oregon, Texas, Colorado, Arizona and Washington. We expect that these operations will continue to generate a substantial portion of our revenue. A significant interruption in operations at our facilities in these markets, whether as a result of an earthquake, natural disaster, terrorism or other causes, could significantly impair our ability to operate our business. Our major manufacturing facility and distribution hub is in Los Angeles County. The majority of our green coffee comes through the Ports of Los Angeles, Long Beach, San Francisco and Portland. Any interruption to port operations, highway arteries, gas mains or electrical service in these areas could restrict our ability to supply our branches with product and would adversely impact our business.

OUR OPERATING RESULTS MAY HAVE SIGNIFICANT FLUCTUATIONS FROM QUARTER TO QUARTER WHICH COULD HAVE A NEGATIVE EFFECT ON OUR STOCK PRICE.

From time to time, our operating results likely will fall below investor expectations. These results are influenced by a number of factors, including fluctuations in the price of green coffee, competition from existing or new competitors in our industry and changes in consumer preferences.

Quarterly fluctuations in our operating results as the result of these factors or for any other reason, could cause our stock price to decline. Accordingly, we believe that period-to-period comparisons of our historical or future operating results are not necessarily meaningful, and such comparisons should not be relied upon as indicators of future performance.

OPERATING LOSSES MAY CONTINUE AND, AS A RESULT, THE PRICE OF OUR STOCK MAY BE NEGATIVELY AFFECTED.

We have incurred operating losses for each of the prior three fiscal years and a net loss in one of the prior three fiscal years. If our current strategies are unsuccessful or if we are unsuccessful in integrating the CBI Acquisition with our existing operations 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.

FUTURE FUNDING DEMANDS UNDER PENSION PLANS FOR CERTAIN UNION EMPLOYEES ARE UNKNOWN.

We participate in two multi-employer defined benefit plans for certain union employees. The management, funding status and future viability of these plans is not known at this time. The nature of the contracts with these plans allows for future funding demands that are outside our control or ability to estimate.

WE RELY ON A SINGLE THIRD PARTY SUPPLIER TO MANAGE OUR INTEGRATED ORACLE SYSTEM THAT IS INTEGRAL TO THE SUCCESS AND OPERATION OF OUR BUSINESS.

We rely on WTS, a company affiliated with Oracle, and its employees, in connection with the hosting of our integrated management information system. This system is essential to our operations and currently includes all accounting and production software applications. By the end of fiscal 2008, WTS is also expected to host our route sales application software. If WTS were to experience financial, operational, or quality assurance difficulties, or if there were any other disruption in our relationship with WTS, we might be unable to produce financial statements, fill replenishment orders for our branch warehouses, issue payroll checks, process payments to our vendors or bill customers. Any of these items could have a material adverse effect on the Company.

WE ARE DEPENDENT ON ENTERPRISE RESOURCE PLANNING (ERP) SOFTWARE TO OPERATE OUR BUSINESS. SHOULD WE FAIL TO OPERATE EFFECTIVELY OR IF WE ENCOUNTER DIFFICULTIES INTEGRATING SYSTEMS OR SUFFER ILL-TIMED POWER OR COMMUNICATIONS FAILURES, THE RESULT COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR OPERATIONS.

We rely on complex software and hardware to invoice our customers, produce customer statements, account for our inventory and manufacturing costs, fill branch inventory replenishment orders, pay our bills, pay our employees and produce our financial statements. We have in the past encountered, and in the future may encounter, software and hardware errors, system design errors and errors in the operation of our systems. This has resulted and may in the future result in a number of adverse consequences, including: users being disconnected from systems and being unable to perform their job functions, and delays in producing financial statements and other key management system information.

Reliance on such software also leaves us exposed to harmful software programs such as viruses that could disrupt our business and damage our network. It is possible that a security breach or inappropriate use of our network could expose us to the possibility of system failure or other disruption. A security breach could jeopardize security of confidential information and thereby expose the Company to potential legal liability.

THE COMPANY DEPENDS ON THE EXPERTISE OF KEY PERSONNEL. THE UNEXPECTED LOSS OF ONE OR MORE OF THESE KEY EMPLOYEES COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR OPERATIONS OR COMPETITIVE POSITION.

Our continued 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. The unexpected loss of one or more of these key employees could have a material adverse effect on our operations and competitive position.

WE ARE SUBJECT TO RE-FUNDING OBLIGATIONS AND MAY ACQUIRE ADDITIONAL SHARES UNDER THE ESOP.

The Farmer Bros. Co. Employee Stock Ownership Plan was designed to help us attract and retain employees and to better align the efforts of our employees with the interests of our stockholders. To that end, the Company has purchased 3,000,500 shares of Company stock for the ESOP to allocate to employees over the next 12 years. It is possible that additional shares could be acquired that might deplete the Company s cash. We expect that the future re-funding liability of the existing shares in the ESOP will increase and require additional investment as the ESOP matures and individual holdings grow. When employees vested in the ESOP leave the Company, they have the right to put their shares to the Company for cash. This requires the Company to repurchase those shares at the current market value. Assuming all shares currently owned by the ESOP are fully distributed, the Company s re-funding liability is approximately $67,700,000 based on the June 30, 2007 closing share price.

CONCENTRATION OF OWNERSHIP AMONG OUR EXISTING PRINCIPAL STOCKHOLDERS 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 1, 2007, members of the Farmer family or entities controlled by the Farmer family (including trusts and a family partnership) as a group beneficially owned approximately 40% of our outstanding common stock. 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 and approval of significant corporate transactions. This level of concentrated ownership, along with the factors described in Risk Factors ANTI-TAKEOVER PROVISIONS COULD MAKE IT MORE DIFFICULT FOR A THIRD PARTY TO ACQUIRE US, 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 for our common stock if investors perceive disadvantages in owning stock in a company with such concentrated ownership.

ANTI-TAKEOVER PROVISIONS COULD MAKE IT MORE DIFFICULT FOR A THIRD PARTY TO ACQUIRE US.

We have adopted a stockholder rights plan (the Rights Plan) and declared a dividend distribution of one preferred share purchase right (a Right) for each outstanding share of our common stock to stockholders of record as of March 28, 2005. Each Right, when exercisable, will entitle the registered holder to purchase from the Company one one-hundredth of a share of Series A Junior Participating Preferred Stock, $1.00 par value per share, at a purchase price of $112.50, subject to adjustment. The Rights expire on March 28, 2015, unless they are earlier redeemed, exchanged or terminated as provided in the Rights Plan. Because the Rights may substantially dilute the stock ownership of a person or group attempting to take us over without the approval of our Board of Directors, our Rights Plan could make it more difficult for a third party to acquire us (or a significant percentage of our outstanding capital stock) without first negotiating with our Board of Directors regarding such acquisition.

In addition, our Board of Directors has the authority to issue up to 500,000 shares of Preferred Stock (of which 200,000 shares have been designated as Series A Junior Participating 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 the 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 of control of Farmer Bros. without further action by the 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 Farmer Bros., 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 of control or management.

FAILURE TO MAINTAIN EFFECTIVE INTERNAL CONTROLS IN ACCORDANCE WITH SECTION 404 OF THE SARBANES-OXLEY ACT OF 2002 COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR BUSINESS AND STOCK PRICE.

As directed by Section 404 of the Sarbanes-Oxley Act of 2002 (SOX), the SEC adopted rules requiring us, as a public company, to include a report of management on our internal controls over financial reporting in our annual report on Form 10-K and quarterly reports on Form 10-Q that contains an assessment by management of the effectiveness of our internal controls over financial reporting. In addition, our independent auditors must attest to and report on management s assessment of the effectiveness of our internal controls over financial reporting as of the end of the fiscal year. Compliance with SOX Section 404 has been a challenge for many companies. Our ability to continue to comply is uncertain as we expect that our internal controls will continue to evolve as our business activities change. If, during any year, our independent auditors are not satisfied with our internal controls over financial reporting or the level at which these controls are documented, designed, operated, tested or assessed, or if the independent auditors interpret the requirements, rules or regulations differently than we do, then they may decline to attest to management s assessment or may issue a report that is qualified. In addition, if we fail to maintain the adequacy of our internal controls, as such standards are modified, supplemented or amended from time to time, we may not be able to ensure that we can conclude on an ongoing basis that we have effective internal controls over financial reporting in accordance with SOX Section 404. Failure to maintain an effective internal control environment could have a material adverse effect on our stock price. In addition, there can be no assurance that we will be able to remediate material weaknesses, if any, that may be identified in future periods.

COMPLIANCE WITH CHANGING REGULATION OF CORPORATE GOVERNANCE AND PUBLIC DISCLOSURE MAY RESULT IN ADDITIONAL EXPENSES.

Changing laws, regulations and standards relating to corporate governance and public disclosure, including SOX, new SEC and Public Accounting Oversight Board regulations and NASDAQ National Market rules, are creating uncertainty for public companies. These new or changed laws, regulations and standards are subject to varying interpretations in many cases due to their lack of specificity, and as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies, which could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. We are committed to maintaining high standards of corporate governance and public disclosure. As a result, our efforts to comply with evolving laws, regulations and standards have resulted in, and are likely to continue to result in, increased general and administrative expenses and management time related to compliance activities. Substantial costs have been incurred in fiscal 2007, and will continue to be incurred to comply with various of these mandates, including the engagement of separate public accounting firms to perform work that is now prohibited to be performed by our regular independent accounting firm, internal costs associated with documenting the adequacy of our internal controls over financial reporting and similar compliance activities, and increased costs of audit by our independent accounting firm. If our efforts to comply with new or changed laws, regulations and standards differ from the activities intended by regulatory or governing bodies due to ambiguities related to practice, our reputation may be harmed and we might be subject to sanctions or investigation by regulatory authorities, such as the SEC. Any such action could adversely affect our financial results and the market price of our common stock. While Farmer Bros. believes that it has been at all times in material compliance with laws and regulations pertaining to the proper recording and reporting of our financial results, there can be no assurance that future regulations, implementing SOX and otherwise, will not have a material adverse impact on our reported results as compared with prior reporting periods.

Item 1.B. Unresolved Staff Comments

None.

Item 2. Properties

Our largest and most significant facility consists of our roasting plant, warehouses and administrative offices in Torrance, California. This facility is our primary manufacturing facility and the distribution hub for our long haul trucking fleet. We presently lease a manufacturing facility in Portland, Oregon that is the manufacturing and distribution point for our specialty coffee, grocery and mass market customers. We stage our products in 101 small branch warehouses throughout our service area. These warehouses, taken together, represent a vital part of our business, but no individual warehouse is material to the group as a whole. Our warehouses vary in size from approximately 2,500 to 20,000 square feet. Approximately 40% of our facilities are leased with a variety of expiration dates through 2011.

We believe our Torrance plant and branch warehouses will continue to provide adequate capacity for the foreseeable future. We are currently seeking to expand our Portland plant to accommodate anticipated growth.

A complete list of properties and facilities operated by Farmer Bros. is attached hereto, and incorporated herein by reference, as Exhibit 99.1.

Item 3. Legal Proceedings

We are both defendant and plaintiff in various legal proceedings incidental to our business which are ordinary and routine. It is our opinion that the resolution of these lawsuits will not have a material impact on our financial condition or results of operations.

Item 4. Submission of Matters to a Vote of Security Holders

During the fourth quarter of fiscal 2007 no matters were submitted to a vote of security holders, through the solicitation of proxies or otherwise.

PART II

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

We have one class of common stock which is traded on the NASDAQ National Market under the symbol FARM. The following table sets forth, for the periods indicated, the dividends paid and the high and low sales prices of the shares of common stock of the Company as quoted on the NASDAQ National Market.

	Fiscal year ended June 30, 2007			Fiscal year ended June 30, 2006		
	High	**Low**	**Dividend**	**High**	**Low**	**Dividend**
1st Quarter	$ 21.13	$ 20.70	$ 0.11	$ 24.98	$ 19.50	$ 0.105
2nd Quarter	$ 21.48	$ 20.97	$ 0.11	$ 22.87	$ 19.11	$ 0.105
3rd Quarter	$ 20.61	$ 20.23	$ 0.11	$ 22.61	$ 19.31	$ 0.105
4th Quarter	$ 22.73	$ 22.12	$ 0.11	$ 23.18	$ 19.72	$ 0.105

There were approximately 3,893 holders of record on September 1, 2007. Holders of record is based upon the number of record holders and individual participants in security position listings.

Performance Graph

The chart set forth below shows the value of an investment of $100 on June 30, 2002 in each of Farmer Bros. Co. common stock, the Russell 2000 Index and the Value Line Food Processing Index. All values assume reinvestment of the pre-tax value of dividends paid by companies included in these indices and are calculated as of June 30 of each year. 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.

Comparison of Five-Year Cumulative Total Return*
Farmer Bros. Co., Russell 2000 Index And Value Line Food Processing Index
(Performance Results Through 6/30/07)

	2002	**2003**	**2004**	**2005**	**2006**	**2007**
Farmer Bros. Co.	$ 100.00	$ 94.51	$ 75.56	$ 63.70	$ 63.24	$ 67.35
Russell 2000 Index	$ 100.00	$ 96.91	$ 127.85	$ 138.26	$ 156.63	$ 180.20
Food Processing	$ 100.00	$ 95.10	$ 119.42	$ 126.55	$ 130.05	$ 164.82

Assumes $100 invested at the close of trading 6/30/02 in Farmer Bros. Co. common stock, Russell 2000 Index, and Value Line Food Processing Index.

*Cumulative total return assumes reinvestment of dividends.

Source: Value Line, Inc.

Factual material is obtained from sources believed to be reliable, but the publisher is not responsible for any errors or omissions contained herein.

Item 6. Selected Financial Data

	For the fiscal years ended June 30, 2007	2006	2005	2004	2003
	(In thousands, except per share data)				
Net sales	$ 216,259	$ 207,453	$ 198,420	$ 193,589	$ 201,558
(Loss) income from operations	(4,076)	$ (2,965)	$ (6,583)	$ 3,763	$ 23,888
Net income (loss)	$ 6,815	$ 4,756	$ (5,427)	$ 12,687	$ 23,629
Net income (loss) per common share(a)	$ 0.48	$ 0.34	$ (0.40)	$ 0.81	$ 1.30
Total assets	$ 337,609	$ 317,237	$ 314,923	$ 317,871	$ 416,415
Dividends per common share(a)	$ 0.44	$ 0.42	$ 0.40	$ 0.38	$ 0.36

(a) All per share disclosures have been adjusted to reflect the stock split that became effective on May 10, 2004.

In April 2007, Farmer Bros. acquired all of the outstanding shares of CBH for a purchase price of $23.6 million in cash, including transaction costs of approximately $1.4 million, net of the amount of all outstanding indebtedness of CBH and its subsidiaries. The results of operations of CBH have been included in our consolidated financial statements since April 27, 2007. The Notes to Consolidated Financial Statements and Management s Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this annual report should be read in conjunction with the selected financial data in order to understand factors such as business combinations and unusual items which may affect the comparability of the information shown above.

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

Management s discussion and analysis discusses the results of operations as reflected in the Company s consolidated financial statements. In April 2007, Farmer Bros. acquired all of the outstanding shares of CBH for a purchase price of $23.6 million in cash, including transaction costs of approximately $1.4 million, net of the amount of all outstanding indebtedness of CBH and its subsidiaries. The results of operations of CBH have been included in our consolidated financial statements since April 27, 2007. An amount of $3.3 million, representing the excess of the purchase price over the fair value of the identifiable net assets acquired, has been recorded as goodwill. We have completed our purchase price allocation at the acquisition date.

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, 2007, 2006 and 2005 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 Item 8 of this report and with the Risk Factors described in Item 1A of this report.

Critical Accounting Policies

Overview

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 U.S. generally accepted accounting principles. The preparation of these financial statements requires us to make estimates and judgments 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, the allowance for doubtful accounts, deferred tax assets, liabilities relating to retirement benefits, liabilities resulting from self-insurance of our workers compensation liabilities, tax liabilities and litigation. We base our estimates on historical experience and other relevant factors that are believed to be reasonable under the circumstances.

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 the Company to make adjustments to these estimates in future periods.

Investments

Our investments consist of investment grade marketable debt instruments issued by the U.S. Government and major U.S. and foreign corporations, equity securities, primarily preferred stock, and various derivative instruments, primarily exchange traded treasury futures and options, green coffee forward contracts and commodity purchase agreements. All derivatives not designated as accounting hedges are marked to market and changes are recognized in current earnings. The fair value of derivative instruments is based upon broker quotes where possible.

Inventories

Inventories are valued at the lower of cost or market and the costs of coffee and allied products for the Company are determined on the last in, first out (LIFO) basis. Costs of coffee and allied products for CBI are determined on an average cost basis. Costs of coffee brewing equipment manufactured are accounted for on the first in, first out (FIFO) basis. We regularly evaluate these inventories to determine whether market conditions are correctly reflected in the recorded carrying value.

Self-Insurance Retention

We are self-insured for California workers compensation insurance and use historical analysis to determine and record the estimates of expected future expenses resulting from workers compensation claims. Additionally, we accrue for estimated losses not covered by insurance for liability, auto, medical and fire up to the deductible amounts.

Retirement Plans

We have two defined benefit plans that provide retirement benefits for the majority of our non-union employees. Other employees are covered by multiemployer union defined benefit plans. We obtain actuarial valuations for both plans and at present we discount the pension obligations using a 6.25% discount rate and we estimate an 8% 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. Our retiree medical plan is not funded and shares the same discount rate as the defined benefit plans. We project an initial medical trend rate of 9% ultimately reducing to 5.5% in 6 years.

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 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 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 reevaluate our tax provision and reconsider our estimates and our assumptions related to specific tax assets and liabilities, making adjustments as circumstances change.

Liquidity and Capital Resources

We have been able to maintain a strong working capital position, and believe that our short and long term cash requirements will be provided by internal sources. We do not expect to rely on banks or other third parties for our working capital needs.

The Company expects to make additional investment in CBI to increase the capacity of its Portland plant to accommodate anticipated growth. We estimate the costs associated with this expansion will be approximately $8-15 million. The Company expects to fund this additional investment from internal sources.

Our working capital is composed of the following:

	June 30, 2007 (In thousands)	2006	2005
Current assets	$ 239,362	$ 246,808	$ 245,219
Current liabilities	27,096	16,578	20,693
Working capital	$ 212,266	$ 230,230	$ 224,526
Capital expenditures	$ 35,652	$ 12,840	$ 8,832

At June 30, 2007 we had no major commitments for new capital expenditures.

Results of Operations

Fiscal Years Ended June 30, 2007 and 2006

Overview

During fiscal 2007 our primary focus was to continue our initiatives to strengthen sales. We continue to provide resources and support to our national sales organization. We believe securing national accounts requires an extended effort over time and while we are hopeful that we will be successful in securing additional business as a result of these efforts in the future, there can be no assurance that such accounts will be obtained. We believe that the additional resources resulting from the CBI Acquisition will assist this effort.

We completed the roll-out of our new product packaging in fiscal 2007, which we believe has been well received by our customers.

In fiscal 2007 we completed a significant upgrade to our ERP system, converted our Custom Coffee Plan Division to our ERP system in May 2007, and we began testing the sales system. We expect branch operations will begin live testing of our route sales system in the second quarter of fiscal 2008. We also expect to convert CBI to our ERP system during the third quarter of fiscal 2008.

New branches in Shreveport, Louisiana and Nashville, Tennessee were opened in August 2007. Additionally, as a result of the CBI Acquistition, we acquired a coffee plant in Portland, Oregon.

In addition to our efforts to improve sales through organic growth of our customer base and product line, we are seeking to improve operating results through better sourcing, managing distribution and other costs, and making strategic acquisitions to complement our existing core business.

Comparative Information

Net sales in fiscal 2007 increased $8,806,000 or 4% to $216,259,000 from $207,453,000 in fiscal 2006, primarily because of increased sales of allied products and an additional $5,500,000 in sales associated with CBI from the date of its acquisition.

Cost of goods sold in fiscal 2007 increased to $89,492,000, or 42% of sales, as compared to $84,910,000, or 41% of sales, in fiscal 2006. Although margins have been stable in fiscal 2007 and 2006, the volatility of green coffee prices, higher prices on a variety of raw materials and product packaging, strong competition and the integration of CBI with our existing operations will continue to impact future results. As a result of these factors, gross profit increased 3%, or $4,224,000, to $126,767,000 in fiscal 2007 as compared to $122,543,000 in fiscal 2006.

Selling expenses in fiscal 2007 increased 2% to $102,622,000 from $100,354,000 in fiscal 2006. This increase was primarily the result of higher coffee brewing equipment costs associated with our sales programs. General and administrative expenses in fiscal 2007 increased 12%, or $3,067,000, to $28,221,000 from $25,154,000 in fiscal 2006. This was primarily the result of higher consulting costs associated with software upgrade and development of the new sales system.

Total other income (expense) in fiscal 2007 was $10,924,000 as compared to $6,970,000 in fiscal 2006. This increase is primarily the result of higher interest rates during fiscal 2007.

As a result of the forgoing factors, net income for fiscal 2007 was $6,815,000 as compared to $4,756,000 in fiscal 2006. Net income per common share was $0.48 in fiscal 2007 as compared to a $0.34 in fiscal 2006.

Fiscal Years Ended June 30, 2006 and 2005

Overview

In fiscal 2005, management developed a number of short and long term initiatives to strengthen the Company s sales and distribution network and improve sales. Our efforts were focused primarily on enhancing our brand identification, expanding our product line and customer base and improving our sales and distribution efficiency. Our initiatives included:

- Promotion of our brand with new packaging throughout the product line, design and distribution of new point of sale marketing materials for our customers, and expanding our trade show schedule throughout our marketing area.
- Introduction of new products which included fruit smoothies, an expanded line of teas, liquid coffee and some seasonal products.
- Expansion of our customer base through a national accounts organization to solicit large customers and national accounts.

Comparative Information

Net sales in fiscal 2006 increased $9,033,000 or 5% to $207,453,000 from $198,420,000 in fiscal 2005, primarily because of higher sales prices. Programs to enhance sales began during fiscal 2005 and continue to be deployed in fiscal 2006.

Cost of goods sold in fiscal 2006 increased to $84,910,000, or 41% of sales, as compared to $82,964,000, or 42% of sales, in fiscal 2005. Although we stabilized our margins in fiscal 2006 compared to fiscal 2005, the volatility of green coffee prices, higher prices on a variety of raw materials and product packaging and strong competition have restricted our ability to return to previous gross profit margins. We continue to seek alternative and competitive sources of raw materials, packaging supplies and other key cost components in an effort to improve our profit margins. There can be no assurance that such efforts will be successful.

Selling, General and Administrative Expenses in fiscal 2006 increased $3,469,000 or 3% to $125,508,000 from $122,039,000 in fiscal 2005. This increase is primarily attributed to higher coffee brewing equipment costs largely associated with new products, higher gasoline and diesel costs and increased California workers compensation expense, offset by declines in self-insured employee medical costs, IT project consulting costs and SOX compliance consulting and auditing costs. Continuing development costs of our multi-year information systems project are currently capitalized. The new sales system implementation has been delayed and development costs associated with that project will begin depreciating in fiscal 2007.

Total other income (expense) in fiscal 2006 was $6,970,000 as compared to ($4,746,000) in fiscal 2005. This increase is primarily the result of higher interest rates during fiscal 2006 and the reduction of losses associated with higher green coffee prices during the second quarter of fiscal 2005 which resulted in a decrease in the value of green coffee futures and options used by the Company to hedge against a decline in commodity prices. Other, net (expense) during fiscal 2005 consisted of net realized and unrealized coffee trading losses of ($12,992,000), offset by net gains on other investments.

As a result of the forgoing factors, net income for fiscal 2006 was $4,756,000 as compared to a net loss of ($5,427,000) in fiscal 2005. Net income per common share was $0.34 in fiscal 2006 as compared to a net loss per common share of ($0.40) in fiscal 2005.

Contractual Obligations

The following table contains supplemental information regarding total contractual obligations as of June 30, 2007 (in thousands).

	Payment due by period:				
	Total	**Less Than One Year**	**1-3 Years**	**3-5 Years**	**More Than 5 years**
Operating lease obligations	$ 2,067	$ 1,105	$ 853	$ 109	

Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements.

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 investment grade money market instruments can include at any given time discount commercial paper, medium term notes, federal agency issues and treasury securities. As of June 30, 2007, over 90% of these funds were invested in U.S. Treasury securities with an average maturity of 99 days. A 100 basis point move in the general level of interest rates would result in a change in the market value of the portfolio of approximately $918,000.

Our portfolio of preferred securities includes investments in derivatives that provide a natural economic hedge of interest rate risk. We review the interest rate sensitivity of these securities and (a) enter into short positions in futures contracts on U.S. Treasury securities or (b) hold put options on such futures contracts in order to reduce the impact of certain interest rate changes on such preferred stocks. 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 following table demonstrates the impact of varying interest rate changes based on the preferred stock holdings, futures and options positions, and market yield and price relationships at June 30, 2007. This table is predicated on an instantaneous change in the general level of interest rates and assumes predictable relationships between the prices of preferred securities holdings, the yields on U.S. Treasury securities and related futures and options.

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 Treasury yield curve, the expected volatility of U.S. Treasury yields, and the costs of using futures and/or options.

Interest Rate Changes	Market Value at June 30, 2007 Preferred Securities (In thousands)	Futures and Options	Total Portfolio	Change in Market Value of Total Portfolio
-150 basis points	$ 71,100	$ 0	$ 71,100	$ 4,890
-100 basis points	$ 69,486	$ 1	$ 69,487	$ 3,277
Unchanged	$ 65,165	$ 1,045	$ 66,210	$ 0
+100 basis points	$ 60,230	$ 5,892	$ 66,122	$ (88)
+150 basis points	$ 57,736	$ 8,940	$ 66,676	$ 466

Commodity Price Risk

We are exposed to commodity price risk arising from changes in the market price of green coffee. The Company prices green coffee inventory on the LIFO basis and CBI prices green coffee on an average cost 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. Volatile price increases cannot, because of competition and market conditions, always be passed on to our customers. From time to time the Company will hold a mix of futures contracts and options to help hedge against volatile green coffee price decreases. Gains and losses on these derivative instruments are realized immediately in Other, net income (expense).

On June 30, 2007 we had no open hedge derivative contracts, and our entire exposure to commodity risk was in the potential change of our inventory value resulting from changes in the market price of green coffee.

Item 8. Financial Statements and Supplementary Data

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of
Farmer Bros. Co. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Farmer Bros. Co. and Subsidiaries as of June 30, 2007 and 2006, and the related consolidated statements of operations, stockholders equity and cash flows for each of the three years in the period ended June 30, 2007. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these 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, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Farmer Bros. Co. and Subsidiaries at June 30, 2007 and 2006, and the consolidated results of their operations and their cash flows for each of the three years in the period ended June 30, 2007, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 5 to the consolidated financial statements, on June 30, 2007, the Company changed its method of accounting for defined benefit pension and postretirement plans in accordance with Statement of Financial Accounting Standards No. 158.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Farmer Bros. Co. and Subsidiaries internal control over financial reporting as of June 30, 2007, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated September 10, 2007 expressed an unqualified opinion thereon.

Los Angeles, California
September 10, 2007

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

	June 30, 2007	June 30, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 12,586	$ 5,333
Short term investments	158,050	176,336
Accounts and notes receivable, net	17,651	13,250
Inventories	44,996	45,008
Deferred income taxes	2,462	3,300
Prepaid expenses	3,617	3,581
Total current assets	$ 239,362	$ 246,808
Property, plant and equipment, net	52,667	46,385
Goodwill and other intangible assets	16,959	
Pension and other non-current assets	13,024	17,427
Deferred income taxes	15,597	6,617
Total assets	$ 337,609	$ 317,237
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 8,702	$ 4,197
Accrued payroll expenses	7,480	6,235
Other	10,914	6,146
Total current liabilities	27,096	16,578
Accrued postretirement benefits	44,297	31,436
Total liabilities	71,393	48,014
Commitments and contingencies		
Stockholders equity:		
Common stock, $1.00 par value, authorized 25,000,000 shares; 16,075,080 issued and outstanding	$ 16,075	$ 16,075
Additional paid-in capital	30,823	31,518
Retained earnings	272,406	271,733
Unearned ESOP shares	(44,240)	(50,103)
Less accumulated comprehensive loss	(8,848)	
Total stockholders equity	$ 266,216	$ 269,223
Total liabilities and stockholders equity	$ 337,609	$ 317,237

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

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

	Years ended June 30, 2007	2006	2005
Net sales	$ 216,259	$ 207,453	$ 198,420
Cost of goods sold	89,492	84,910	82,964
Gross profit	$ 126,767	$ 122,543	$ 115,456
Selling expense	102,622	100,354	92,112
General and administrative expenses	28,221	25,154	29,927
Operating expenses	$ 130,843	$ 125,508	$ 122,039
(Loss) from operations	$ (4,076)	$ (2,965)	$ (6,583)
Other income (expense):			
Dividend income	3,923	3,597	3,420
Interest income	5,768	4,445	2,721
Other, net income (expense)	1,233	(1,072)	(10,887)
Total other income (expense)	$ 10,924	$ 6,970	$ (4,746)
Income (loss) before taxes	6,848	4,005	(11,329)
Income tax expense (benefit)	33	(751)	(5,902)
Net income (loss)	$ 6,815	$ 4,756	$ (5,427)
Net income (loss) per common share	$ 0.48	$ 0.34	$ (0.40)
Weighted average shares outstanding	14,106,011	13,890,609	13,653,420

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

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

	Years ended June 30, 2007	2006	2005
Cash flows from operating activities:			
Net income (loss)	$ 6,815	$ 4,756	$ (5,427)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation	9,324	8,963	8,396
Deferred income taxes	(8,141)	(5,001)	(3,510)
Gain on sales of assets	(244)	(396)	(100)
ESOP compensation expense	5,168	4,538	6,171
Net (gain) loss on investments	(819)	2,301	11,571
Change in operating assets and liabilities:			
Short term investments	19,104	(7,582)	(5,723)
Accounts and notes receivable	(675)	2,235	(777)
Inventories	4,200	(3,922)	(5,507)
Income tax receivable	0	4,064	(3,656)
Prepaid expenses and other assets	5,026	5,056	(637)
Accounts payable	(614)	(3,655)	(1,737)
Accrued payroll, expenses and other liabilities	5,634	(139)	920
Accrued postretirement benefits	4,013	2,396	2,126
Total adjustments	$ 41,976	$ 8,858	$ 7,537
Net cash provided by operating activities	$ 48,791	$ 13,614	$ 2,110
Cash flows from investing activities:			
Investment in subsidiary (acquisition of CBI net of cash acquired)	(23,167)		
Purchases of property, plant and equipment	(12,485)	(12,840)	(8,832)
Proceeds from sales of property, plant and equipment	256	559	165
Net cash used in investing activities	$ (35,396)	$ (12,281)	$ (8,667)
Cash flows from financing activities:			
Dividends paid	(6,142)	(5,814)	(5,436)
Net cash used in financing activities	$ (6,142)	$ (5,814)	$ (5,436)
Net increase (decrease) in cash and cash equivalents	$ 7,253	$ (4,481)	$ (11,993)
Cash and cash equivalents at beginning of year	5,333	9,814	21,807
Cash and cash equivalents at end of year	$ 12,586	$ 5,333	$ 9,814

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

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	Other Comprehensive Income (Loss)	Total
Balance at June 30, 2004	16,075,080	$ 16,075	$ 32,248	$ 283,654	$ (61,542)		