

FLOWERS FOODS INC
Form 10-Q
November 07, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended October 6, 2018

OR

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

For the transition period from _____ to _____

Commission file number 1-16247

FLOWERS FOODS, INC.

(Exact name of registrant as specified in its charter)

GEORGIA 58-2582379
(State or other jurisdiction of (I.R.S. Employer

incorporation or organization) Identification Number)
1919 FLOWERS CIRCLE, THOMASVILLE, GEORGIA

(Address of principal executive offices)

31757

(Zip Code)

(229)-226-9110

(Registrant's telephone number, including area code)

N/A

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

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

TITLE OF EACH CLASS	OUTSTANDING AT NOVEMBER 2, 2018
Common Stock, \$.01 par value	210,895,207

FLOWERS FOODS, INC.

INDEX

	PAGE NUMBER
<u>PART I. Financial Information</u>	
Item 1. <u>Financial Statements (unaudited)</u>	3
<u>Condensed Consolidated Balance Sheets as of October 6, 2018 and December 30, 2017</u>	3
<u>Condensed Consolidated Statements of Operations For the Twelve and Forty Weeks Ended October 6, 2018 and October 7, 2017</u>	4
<u>Condensed Consolidated Statements of Comprehensive Income For the Twelve and Forty Weeks Ended October 6, 2018 and October 7, 2017</u>	5
<u>Condensed Consolidated Statements of Changes in Stockholders' Equity For the Twelve and Forty Weeks Ended October 6, 2018</u>	6
<u>Condensed Consolidated Statements of Changes in Stockholders' Equity For the Twelve and Forty Weeks Ended October 7, 2017</u>	7
<u>Condensed Consolidated Statements of Cash Flows For the Forty Weeks Ended October 6, 2018 and October 7, 2017</u>	8
<u>Notes to Condensed Consolidated Financial Statements</u>	9
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	47
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	65
Item 4. <u>Controls and Procedures</u>	65
<u>PART II. Other Information</u>	66
Item 1. <u>Legal Proceedings</u>	66
Item 1A. <u>Risk Factors</u>	66
Item 2. <u>Unregistered Sales of Securities and Use of Proceeds</u>	66
Item 3. <u>Defaults Upon Senior Securities</u>	67
Item 4. <u>Mine Safety Disclosures</u>	67
Item 5. <u>Other Information</u>	67
Item 6. <u>Exhibits</u>	68
<u>Signatures</u>	69

Forward-Looking Statements

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

Forward-looking statements are based on current information and are subject to risks and uncertainties that could cause our actual results to differ materially from those projected. Certain factors that may cause actual results, performance, liquidity, and achievements to differ materially from those projected are discussed in this Quarterly Report on Form 10-Q (this “Form 10-Q”) and may include, but are not limited to:

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

- the loss or financial instability of any significant customer(s), including as a result of product recalls or safety concerns related to our products;

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

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

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

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

- our ability to execute our business strategies, including those strategies we have initiated under Project Centennial, which may involve, among other things, (i) the integration of acquisitions or the acquisition or disposition of assets at presently targeted values, (ii) the deployment of new systems and technology, and (iii) an enhanced organizational structure;

- consolidation within the baking industry and related industries;

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

- disruptions in our direct-store-delivery distribution model, including litigation or an adverse ruling by a court or regulatory or governmental body that could affect the independent contractor classifications of the independent distributors;

- increasing legal complexity and legal proceedings that we are or may become subject to;

- increases in employee and employee-related costs, including funding of pension plans;

- the credit, business, and legal risks associated with independent distributors and customers, which operate in the highly competitive retail food and foodservice industries;

- any business disruptions due to political instability, armed hostilities, incidents of terrorism, natural disasters, labor strikes or work stoppages, technological breakdowns, product contamination, product recalls or safety concerns related to our products, or the responses to or repercussions from any of these or similar events or conditions and our ability to insure against such events;

- the failure of our information technology systems to perform adequately, including any interruptions, intrusions or security breaches of such systems; and

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

The foregoing list of important factors does not include all such factors, nor necessarily present them in order of importance. In addition, you should consult other disclosures made by the company (such as in our other filings with the Securities and Exchange Commission (“SEC”) or in company press releases) for other factors that may cause actual results to differ materially from those projected by the company. Refer to Part I, Item 1A., Risk Factors, of our Annual Report on Form 10-K for the year ended December 30, 2017 (the “Form 10-K”) for additional information regarding factors that could affect the company’s results of operations, financial condition and liquidity.

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

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

PART 1. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

FLOWERS FOODS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Amounts in thousands, except share data)

(Unaudited)

	October 6, 2018	December 30, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	\$49,727	\$5,129
Accounts and notes receivable, net of allowances of \$5,833 and \$3,154, respectively	298,218	280,050
Inventories, net:		
Raw materials	43,922	41,710
Packaging materials	22,330	19,638
Finished goods	52,807	49,697
Inventories, net	119,059	111,045
Spare parts and supplies	64,103	61,330
Other	38,528	49,637
Total current assets	569,635	507,191
Property, plant and equipment, net:		
Property, plant and equipment, gross	1,969,293	1,906,979
Less: accumulated depreciation	(1,249,096)	(1,174,953)
Property, plant and equipment, net	720,197	732,026
Notes receivable from independent distributor partners	203,576	187,737
Assets held for sale	4,589	15,323
Other assets	7,839	10,228
Goodwill	464,777	464,777
Other intangible assets, net	722,524	742,442
Total assets	\$2,693,137	\$2,659,724
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current maturities of long-term debt and capital lease obligations	\$11,286	\$12,095
Accounts payable	246,185	181,388
Other accrued liabilities	143,940	200,468
Total current liabilities	401,411	393,951
Long-term debt:		
Total long-term debt and capital lease obligations	814,090	820,141
Other liabilities:		
Postretirement/post-employment obligations	41,075	60,107
Deferred taxes	103,298	82,976

Edgar Filing: FLOWERS FOODS INC - Form 10-Q

Other long-term liabilities	55,695	51,872
Total other long-term liabilities	200,068	194,955
Commitments and Contingencies		
Stockholders' equity:		
Preferred stock — \$100 stated par value, 200,000 authorized shares and none issued	—	—
Preferred stock — \$.01 stated par value, 800,000 authorized shares and none issued	—	—
Common stock — \$.01 stated par value and \$.001 current par value, 500,000,000 authorized shares and 228,729,585 shares and 228,729,585 shares issued, respectively	199	199
Treasury stock — 17,846,171 shares and 18,203,381 shares, respectively	(231,802)	(235,493)
Capital in excess of par value	652,375	650,872
Retained earnings	962,536	919,658
Accumulated other comprehensive loss	(105,740)	(84,559)
Total stockholders' equity	1,277,568	1,250,677
Total liabilities and stockholders' equity	\$2,693,137	\$2,659,724

(See Accompanying Notes to Condensed Consolidated Financial Statements)

FLOWERS FOODS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Amounts in thousands, except per share data)

(Unaudited)

	For the Twelve Weeks Ended		For the Forty Weeks Ended	
	October 6, 2018	October 7, 2017	October 6, 2018	October 7, 2017
Sales	\$923,449	\$932,822	\$3,071,185	\$3,047,110
Materials, supplies, labor and other production costs (exclusive of depreciation and amortization shown separately below)	485,680	476,264	1,599,673	1,552,578
Selling, distribution and administrative expenses	353,051	356,826	1,167,879	1,175,434
Depreciation and amortization	32,662	32,972	111,949	114,288
Loss (recovery) on inferior ingredients	(1,891)	—	1,993	—
Impairment of assets	—	—	2,483	—
Multi-employer pension plan withdrawal costs	—	18,268	2,322	18,268
Restructuring and related impairment charges	497	100,549	2,557	100,549
Gain on divestiture	—	—	—	(28,875)
Income (loss) from operations	53,450	(52,057)	182,329	114,868
Interest expense	8,180	8,194	27,390	28,255
Interest income	(6,615)	(5,464)	(21,176)	(17,199)
Pension plan settlement loss	930	3,030	6,633	3,030
Other components of net periodic pension and postretirement benefits credit	(171)	(1,321)	(1,204)	(4,687)
Income (loss) before income taxes	51,126	(56,496)	170,686	105,469
Income tax expense (benefit)	11,496	(22,925)	34,367	33,882
Net income (loss)	\$39,630	\$(33,571)	\$136,319	\$71,587
Net income (loss) per common share:				
Basic:				
Net income (loss) per common share	\$0.19	\$(0.16)	\$0.65	\$0.34
Weighted average shares outstanding	211,082	209,606	210,994	209,376
Diluted:				
Net income (loss) per common share	\$0.19	\$(0.16)	\$0.64	\$0.34
Weighted average shares outstanding	211,564	209,606	211,452	210,231
Cash dividends paid per common share	\$0.1800	\$0.1700	\$0.5300	\$0.5000

(See Accompanying Notes to Condensed Consolidated Financial Statements)

FLOWERS FOODS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Amounts in thousands)

(Unaudited)

	For the Twelve Weeks Ended		For the Forty Weeks Ended	
	October 6, 2018	October 7, 2017	October 6, 2018	October 7, 2017
Net income (loss)	\$39,630	\$(33,571)	\$136,319	\$71,587
Other comprehensive loss, net of tax:				
Pension and postretirement plans:				
Settlement loss	696	1,863	4,959	1,863
Net loss for the period	(32,639)	(2,707)	(19,883)	(2,707)
Amortization of prior service cost included in net income	35	21	96	79
Amortization of actuarial loss included in net income	768	769	2,709	2,712
Pension and postretirement plans, net of tax	(31,140)	(54)	(12,119)	1,947
Derivative instruments:				
Net change in fair value of derivatives	7,394	(9,652)	9,055	(5,932)
Loss reclassified to net income	266	372	689	1,166
Derivative instruments, net of tax	7,660	(9,280)	9,744	(4,766)
Other comprehensive loss, net of tax	(23,480)	(9,334)	(2,375)	(2,819)
Comprehensive income (loss)	\$16,150	\$(42,905)	\$133,944	\$68,768

(See Accompanying Notes to Condensed Consolidated Financial Statements)

FLOWERS FOODS, INC.

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(Amounts in thousands, except share data)

(Unaudited)

	For the Forty Weeks Ended October 6, 2018							
	Common Stock Number of Shares Issued	Par Value	Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock Number of Shares	Cost	Total
Balances at December 30, 2017	228,729,585	\$ 199	\$ 650,872	\$ 919,658	\$(84,559)	(18,203,381)	\$(235,493)	\$ 1,250,677
Net income				136,319				136,319
Derivative instruments, net of tax					9,744			9,744
Pension and postretirement plans, net of tax					(12,119)			(12,119)
Exercise of stock options			(151)			72,785	942	791
Amortization of share-based compensation awards			6,892					6,892
Issuance of deferred compensation			(122)			9,411	122	—
Performance-contingent restricted stock awards issued (Note 17)			(4,062)			313,906	4,062	—
Issuance of deferred stock awards			(1,054)			81,255	1,054	—
Stock repurchases						(120,147)	(2,489)	(2,489)
Dividends paid on vested share-based payment awards				(492)				(492)
Dividends paid — \$.5300 per				(111,755)				(111,755)

common share								
Reclassification of stranded income								
tax effects to retained earnings								
(Note 1)				18,806	(18,806)			—
Balances at October 6, 2018	228,729,585	\$ 199	\$ 652,375	\$ 962,536	\$(105,740)	(17,846,171)	\$(231,802)	\$ 1,277,568

	For the Twelve Weeks Ended October 6, 2018							
	Common Stock	Capital in		Retained	Accumulated	Treasury Stock		Total
	Number of	Excess	of Par		Other	Number of	Cost	
Shares	Par	Value	Value	Earnings	Comprehensive	Shares	Cost	Income (Loss)
	Issued	Value	Value	Earnings	(Loss)	Shares	Cost	
Balances at July 14, 2018	228,729,585	\$ 199	\$ 650,934	\$ 960,865	\$(82,260)	(17,846,284)	\$(231,803)	\$ 1,297,935
Net income				39,630				39,630
Derivative instruments, net of tax					7,660			7,660
Pension and postretirement plans, net of tax					(31,140)			(31,140)
Amortization of share-based compensation awards			1,442					1,442
Issuance of deferred compensation			(1)			113	1	—
Dividends paid — \$0.1800 per common share				(37,959)				(37,959)
Balances at October 6, 2018	228,729,585	\$ 199	\$ 652,375	\$ 962,536	\$(105,740)	(17,846,171)	\$(231,802)	\$ 1,277,568

(See Accompanying Notes to Condensed Consolidated Financial Statements)

FLOWERS FOODS, INC.

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(Amounts in thousands, except share data)

(Unaudited)

	For the Forty Weeks Ended October 7, 2017							
	Common Stock Number of Shares Issued	Par Value	Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock Number of Shares	Cost	Total
Balances at December 31, 2016	228,729,585	\$ 199	\$ 644,456	\$ 910,520	\$(83,283)	(20,306,784)	\$(261,812)	\$ 1,210,080
Net income				71,587				71,587
Derivative instruments, net of tax					(4,766)			(4,766)
Pension and postretirement plans, net of tax					1,947			1,947
Exercise of stock options			(1,702)			851,801	10,998	9,296
Amortization of share-based compensation awards			11,708					11,708
Issuance of deferred compensation			(37)			2,788	37	—
Performance-contingent restricted stock awards issued (Note 17)			(4,240)			328,947	4,240	—
Issuance of deferred stock awards			(1,789)			138,354	1,789	—
Stock repurchases						(140,135)	(2,671)	(2,671)
Dividends paid on vested share-based payment awards				(553)				(553)
Dividends paid — \$.5000 per				(104,654)				(104,654)

Edgar Filing: FLOWERS FOODS INC - Form 10-Q

common share

Balances at October 7, 2017	228,729,585	\$ 199	\$ 648,396	\$ 876,900	\$(86,102)	(19,125,029)	\$(247,419)	\$ 1,191,974
-----------------------------	-------------	--------	------------	------------	------------	--------------	-------------	--------------

For the Twelve Weeks Ended October 7, 2017

	Common Stock		Capital in		Accumulated Other Comprehensive Income (Loss)	Treasury Stock		Total
	Number of Shares Issued	Par Value	Excess of Par Value	Retained Earnings		Number of Shares	Cost	
Balances at July 15, 2017	228,729,585	\$ 199	\$ 645,927	\$ 946,077	\$(76,768)	(19,389,963)	\$(250,848)	\$ 1,264,587
Net income				(33,571)				(33,571)
Derivative instruments, net of tax					(9,280)			(9,280)
Pension and postretirement plans, net of tax					(54)			(54)
Exercise of stock options			(547)			264,821	3,427	2,880
Amortization of share-based compensation awards			3,018					3,018
Issuance of deferred compensation			(2)			113	2	—
Dividends paid — \$.1700 per common share				(35,606)				(35,606)
Balances at October 7, 2017	228,729,585	\$ 199	\$ 648,396	\$ 876,900	\$(86,102)	(19,125,029)	\$(247,419)	\$ 1,191,974

(See Accompanying Notes to Condensed Consolidated Financial Statements)

FLOWERS FOODS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in thousands)

(Unaudited)

	For the Forty Weeks Ended	
	October 6, 2018	October 7, 2017
CASH FLOWS PROVIDED BY (DISBURSED FOR) OPERATING ACTIVITIES:		
Net income	\$136,319	\$71,587
Adjustments to reconcile net income to net cash provided by operating activities:		
Restructuring and related impairment charges	174	69,651
Stock-based compensation	6,892	11,708
Impairment of assets	2,483	—
Gain on divestiture	—	(28,875)
Loss reclassified from accumulated other comprehensive income to net income	811	1,785
Depreciation and amortization	111,949	114,288
Deferred income taxes	21,139	(18,476)
Provision for inventory obsolescence	833	1,535
Allowances for accounts receivable	3,968	3,022
Pension and postretirement plans cost (income)	6,372	(879)
Other	(4,643)	(3,608)
Qualified pension plan contributions	(40,700)	(1,605)
Changes in operating assets and liabilities, net of acquisitions and disposals:		
Accounts receivable, net	(20,297)	(26,457)
Inventories, net	(8,847)	(7,241)
Hedging activities, net	7,939	(14,814)
Other assets	2,794	(14,395)
Accounts payable	60,810	13,780
Other accrued liabilities	(55,937)	53,020
NET CASH PROVIDED BY OPERATING ACTIVITIES	232,059	224,026
CASH FLOWS PROVIDED BY (DISBURSED FOR) INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	(74,992)	(51,213)
Proceeds from sale of property, plant and equipment	1,366	1,694
Repurchase of independent distributor territories	(2,306)	(5,866)
Cash paid at issuance of notes receivable	(19,007)	(19,102)
Principal payments from notes receivable	20,961	18,923
Proceeds from sale of mix plant	—	41,230
Other investing activities	566	1,530
NET CASH DISBURSED FOR INVESTING ACTIVITIES	(73,412)	(12,804)
CASH FLOWS PROVIDED BY (DISBURSED FOR) FINANCING ACTIVITIES:		
Dividends paid, including dividends on share-based payment awards	(112,247)	(105,207)
Exercise of stock options	791	9,296

Edgar Filing: FLOWERS FOODS INC - Form 10-Q

Stock repurchases	(2,489)	(2,671)
Change in bank overdrafts	3,746	(10,626)
Proceeds from debt borrowings	1,000	585,200
Debt and capital lease obligation payments	(4,750)	(686,450)
Other financing activities	(100)	(100)
NET CASH DISBURSED FOR FINANCING ACTIVITIES	(114,049)	(210,558)
Net increase in cash and cash equivalents	44,598	664
Cash and cash equivalents at beginning of period	5,129	6,410
Cash and cash equivalents at end of period	\$49,727	\$7,074

(See Accompanying Notes to Condensed Consolidated Financial Statements)

FLOWERS FOODS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. BASIS OF PRESENTATION

INTERIM FINANCIAL STATEMENTS — The accompanying unaudited Condensed Consolidated Financial Statements of Flowers Foods, Inc. (the “company”, “Flowers Foods”, “Flowers”, “us”, “we”, or “our”) have been prepared by the company’s management in accordance with generally accepted accounting principles in the United States of America (“GAAP”) for interim financial information and applicable rules and regulations of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Accordingly, they do not include all the information and footnotes required by GAAP for audited financial statements. In the opinion of management, the unaudited Condensed Consolidated Financial Statements included herein contain all adjustments (consisting of only normal recurring adjustments) necessary to state fairly the company’s financial position, results of operations and cash flows. The results of operations for the twelve and forty weeks ended October 6, 2018 and October 7, 2017 are not necessarily indicative of the results to be expected for a full fiscal year. The Condensed Consolidated Balance Sheet at December 30, 2017 has been derived from the audited financial statements at that date but does not include all the information and footnotes required by GAAP for complete financial statements. The Securities and Exchange Committee recently amended its rules to expand the disclosure requirements for reporting changes in stockholders’ equity. The new presentation requires that changes in stockholders’ equity will now be required for the current and comparative quarter and year-to-date interim periods. The company has presented its changes in stockholders’ equity for all periods presented in this Form 10-Q. These financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Form 10-K.

ESTIMATES — The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The company believes the following critical accounting estimates affect its more significant judgments and estimates used in the preparation of its consolidated financial statements: revenue recognition, derivative instruments, valuation of long-lived assets, goodwill and other intangible assets, self-insurance reserves, income tax expense and accruals, pension obligations, stock-based compensation, and commitments and contingencies. These estimates are summarized in the Form 10-K.

REPORTING PERIODS — The company operates on a 52-53 week fiscal year ending the Saturday nearest December 31. Fiscal 2018 consists of 52 weeks, with the company’s quarterly reporting periods as follows: first quarter ended April 21, 2018 (sixteen weeks), second quarter ended July 14, 2018 (twelve weeks), third quarter ended October 6, 2018 (twelve weeks) and fourth quarter ending December 29, 2018 (twelve weeks).

SEGMENTS — Flowers Foods currently operates two business segments: a direct-store-delivery (“DSD”) segment (“DSD Segment”) and a warehouse delivery segment (“Warehouse Segment”). The DSD Segment (84% of total year to date sales) currently operates 39 plants that produce a wide variety of fresh bakery foods, including fresh breads, buns, rolls, tortillas, and snack cakes. These products are sold through a DSD route delivery system to retail and foodservice customers in the East, South, Southwest, California, and select markets in the Midwest, Pacific Northwest, Nevada, and Colorado. The Warehouse Segment (16% of total year to date sales) currently operates eight plants that produce snack cakes, breads and rolls for national retail, foodservice, vending, and co-pack customers and deliver through

customers' warehouse channels.

On May 3, 2017, the company announced an enhanced organizational structure designed to provide greater focus on the company's strategic objectives, emphasize brand growth and innovation in line with a national branded food company, drive enhanced accountability, reduce costs, and strengthen long-term strategy. The new organizational structure establishes two business units ("BUs"), Fresh Packaged Bread and Snacking/Specialty, and realigns key leadership roles. The new structure also provides for centralized marketing, sales, supply chain, shared-services/administrative, and corporate strategy functions, each with clearly defined roles and responsibilities. The company intends to transition to the new structure over the next several months with full implementation expected to be completed at the beginning of fiscal 2019. Management will continue to review financial information for the DSD Segment and Warehouse Segment until the new organizational structure is fully implemented.

9

SIGNIFICANT CUSTOMER — Following is the effect that our largest customer, Walmart/Sam’s Club, had on the company’s sales for the twelve and forty weeks ended October 6, 2018 and October 7, 2017. Walmart/Sam’s Club is the only customer to account for greater than 10% of the company’s sales.

	For the Twelve Weeks Ended October 6, 2018		For the Forty Weeks Ended October 7, 2017	
	October 7, 2017		October 7, 2017	
	(% of Sales)		(% of Sales)	
DSD Segment	17.8	17.6	17.9	17.7
Warehouse Segment	2.4	2.6	2.4	2.5
Total	20.2	20.2	20.3	20.2

Walmart/Sam’s Club is our only customer with a balance greater than 10% of outstanding trade receivables. Its percentage of trade receivables was 17.5% and 17.5%, on a consolidated basis, as of October 6, 2018 and December 30, 2017, respectively. No other customer accounted for greater than 10% of the company’s outstanding trade receivables.

SIGNIFICANT ACCOUNTING POLICIES — Significant changes to our critical accounting policies from those disclosed in the Form 10-K are presented below. The policy changes for revenue, derivative financial instruments, and taxes are a result of adopting new guidance issued by the Financial Accounting Standards Board (the “FASB”) during the first quarter of our fiscal 2018. See Note 3, Recent Accounting Pronouncements, of Notes to Condensed Consolidated Financial Statements of this Form 10-Q for details on the new guidance.

Revenue. Revenue is recognized when obligations under the terms of a contract with our customers are satisfied. Revenue is measured as the amount of consideration we expect to receive in exchange for transferring goods or providing services. The company records both direct and estimated reductions to gross revenue for customer programs and incentive offerings at the time the incentive is offered or at the time of revenue recognition for the underlying transaction that results in progress by the customer towards earning the incentive. These allowances include price promotion discounts, coupons, customer rebates, cooperative advertising, and product returns. Consideration payable to a customer is recognized at the time control transfers and is a reduction to revenue. The recognition of costs for promotion programs involves the use of judgment related to performance and redemption estimates. Estimates are made based on historical experience and other factors. Price promotion discount expense is recorded as a reduction to gross sales when the discounted product is sold to the customer.

Shipping and handling costs associated with outbound freight after control over a product has transferred to a customer are accounted for as a fulfillment cost and are included in our selling, distribution, and administration expenses line item on the Condensed Consolidated Statements of Operations.

The company’s production facilities deliver products to independent distributor partners (“IDP” or “IDPs”), who sell and deliver those products to outlets of retail accounts that are within the IDPs’ defined geographic territory. The IDPs sell products using either scan-based trading (“SBT”) technology, authorized charge tickets, or cash sales.

SBT technology allows the retailer to take ownership of our products when the consumer purchases the products rather than at the time they are delivered to the retailer. Control of the inventory does not transfer upon delivery to the retailer because the company controls the risks and rights until the product is scanned at the reseller's register. Each of the company's products is considered distinct because the resellers expect each item to be a performance obligation. The company's performance obligations are satisfied at the point in time when the end consumer purchases the product because each product is considered a separate performance obligation. Consequently, revenue is recognized at a point in time for each scanned item. The company has concluded that we are the principal.

SBT is utilized primarily in certain national and regional retail accounts ("SBT Outlet"). Generally, revenue is not recognized by the company upon delivery of our products by the company to the IDP or upon delivery of our products by the IDP to a SBT Outlet, but when our products are purchased by the end consumer. Product inventory in the SBT Outlet is reflected as inventory on the Condensed Consolidated Balance Sheets.

The IDP performs a physical inventory of products at each SBT Outlet weekly and reports the results to the company. The inventory data submitted by the IDP for each SBT Outlet is compared with the product delivery data. Product delivered to a SBT Outlet that is not recorded in the product delivery data has been purchased by the consumer/customer of the SBT Outlet and is recorded as sales revenue by the company.

Non-SBT sales are classified as either authorized charged sales or cash sales. The company provides marketing support to the IDP for authorized charged sales, but does not provide marketing support to the IDP for cash sales. Marketing support includes providing a dedicated account representative, resolving complaints, and accepting responsibility for product quality which collectively define how to manage the relationship. Revenue is recognized at a point in time for non-SBT sales.

The company retains inventory risk, establishes negotiated special pricing, and fulfills the contractual obligations for authorized charged sales. The company is the principal, the IDP is the agent, and the reseller is the customer. Revenue is recognized for authorized charge sales when the product is delivered to the customer because the company has satisfied its performance obligations.

Cash sales occur when the IDP is the end customer. The IDP maintains accounts receivable, inventory and fulfillment risk for cash sales. The IDP also controls pricing for the resale of cash sale products. The company is the principal and the IDP is the customer, and an agent relationship does not exist. The discount paid to the IDP for cash sales is recorded as a reduction to revenue. Revenue is recognized for cash sales when the company's products are delivered to the IDP because the company has satisfied its performance obligations.

Sales in the Warehouse Segment are under contracts and include a formal ordering system. Orders are placed primarily using purchase orders ("PO") or electronic data interchange information. Each PO, together with the applicable master supply agreement, is determined to be a separate contract. Product is delivered via contract carriers engaged by either the company or the customer with shipping terms provided in the PO.

Each unit sold, for all product categories, is a separate performance obligation. Each unit is considered distinct because the customer can benefit from each unit by selling each one separately to the end consumer. Additionally, each unit is separately identifiable in the PO. Products are delivered either freight-on-board ("FOB") shipping or destination. The company's right to payment is at the time our products are obtained from our warehouse for FOB shipping deliveries. The right to payment for FOB destination deliveries occurs after the products are delivered to the customer. Revenue is recognized at a point in time when control transfers. The company pays commissions to brokers who obtain contracts with customers. Commissions are paid on the total value of the contract, which is determined at contract inception and is based on expected future activity. Broker commissions will not extend beyond a one-year term because each product is considered a separate order in the PO.

The company recognizes the incremental costs of obtaining contracts as an expense when incurred if the amortization period of the assets that the company otherwise would have recognized is one year or less. These costs are included in our selling, distribution, and administrative expenses line item on the Condensed Consolidated Statements of Operations.

The company disaggregates revenue by sales channel for each reportable segment. Our sales channels are branded retail, store branded retail, and non-retail and other. The non-retail and other channel includes foodservice, restaurants, and contract manufacturing. The company does not disaggregate revenue by geographic region, customer type, or contract type. All revenues are recognized at a point in time. The disclosures for segment revenues by sales channel are in Note 20, Segment Reporting, of Notes to Condensed Consolidated Financial Statements of this Form 10-Q.

Derivative Financial Instruments. New guidance updates the disclosure requirements for derivatives and hedging activities with the intent to provide investors with an enhanced understanding of: (a) how and why an entity uses derivative instruments and related hedged items, (b) how the entity accounts for derivative instruments and related hedged items, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. Further, qualitative disclosures are required that explain the company's

objectives and strategies for using derivative instruments and related hedged items, as well as quantitative disclosures about the fair value of and gains and losses on derivative instruments and related hedged items, and disclosures about credit-risk-related contingent features in derivative instruments and related hedged items.

As required, the company records all derivatives on the Condensed Consolidated Balance Sheets at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether the company has elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivatives designated and qualifying as a hedge of the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives designated and qualifying as a hedge of the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedged item with the recognition of the changes in the fair value of the hedged item that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transactions in a cash flow hedge. The company may enter into derivative contracts that are intended to economically hedge certain of its risks, even though hedge accounting does not apply or the company elects not to apply hedge accounting.

Income taxes. The company releases the income tax effect from accumulated other comprehensive income (loss) (“AOCI”) in the period when the underlying transaction impacts earnings. We adopted new accounting requirements that provide the option to reclassify stranded income tax effects resulting from the Tax Cuts and Jobs Act (the “Act”) from AOCI to retained earnings. We elected to reclassify the stranded income tax effects resulting from the Act of \$18.8 million from AOCI to retained earnings. This reclassification consists of deferred taxes originally recorded in AOCI that exceed the newly enacted federal corporate tax rate.

LOSS (RECOVERY) ON INFERIOR INGREDIENTS

In June 2018, the company received from a supplier several shipments of inferior yeast, which reduced product quality and disrupted production and distribution of foodservice and retail bread and buns at several of the company’s bakeries during the second quarter. While the supplier confirmed that the inferior yeast used in the baking process was safe for consumption, customers and consumers reported instances of unsatisfactory product attributes, primarily involving smell and taste.

In addition, the company incurred costs associated with inferior whey during the twelve weeks ended October 6, 2018. A voluntary recall was issued on July 18, 2018 due to the potential of tainted whey. Costs associated with these inferior ingredients were reclassified from material, supplies, labor and other production costs and selling, distribution and administrative expenses to the ‘Loss (recovery) on inferior ingredients’ line item in our Condensed Consolidated Statements of Operations.

Although we anticipate incurring additional losses associated with the disruptions, we are not currently able to estimate the amount of such losses. The company recovered \$4.2 million in cash from the supplier of inferior yeast that has offset the direct costs in the twelve weeks ended October 6, 2018. We intend to seek additional recovery of all losses through appropriate means. The table below presents the total costs and recoveries during the third quarter (amounts in thousands):

	DSD		
	Segment	Warehouse Segment	Total
For the twenty-eight weeks ended July 14, 2018	\$ 3,884	\$ —	\$ 3,884
Expense recognized during the twelve weeks ended October 6, 2018	1,170	1,095	2,265
Recovery recognized during the twelve weeks ended October 6, 2018	(4,156)	—	(4,156)
For the forty weeks ended October 6, 2018	\$ 898	\$ 1,095	\$ 1,993

The currently identifiable and measurable costs reclassified during the twelve and forty weeks ended October 6, 2018 in our Condensed Consolidated Statements of Operations by segment related to these production and distribution disruptions were as follows (amounts in thousands):

	For the	For the
	Twelve	Forty
	Weeks	Weeks
	Ended	Ended
	October	October
	6, 2018	6, 2018

Materials, supplies, labor and other production costs (exclusive of depreciation and amortization shown separately):		
DSD Segment		\$(2,986) \$ 194
Warehouse Segment		1,095 1,095
Total materials, supplies, labor and other production costs (exclusive of depreciation and amortization shown separately)		
		(1,891) 1,289
Selling, distribution and administrative expenses:		
DSD Segment		— 704
Warehouse Segment		— —
Total selling, distribution and administrative expenses		— 704
Loss (recovery) on inferior ingredients		\$(1,891) \$ 1,993

2. FINANCIAL STATEMENT REVISIONS

The company identified an error in reporting the cash flow impacts of certain repurchases and sales of territories. Cash receipts and payments for the repurchase and sale of territories and cash paid at the issuance of notes receivable were previously reported net when these transactions should have been disaggregated. The company has evaluated the impact of this error and determined it is not material to previously issued annual and interim financial statements. These corrections did not impact our previously reported Condensed Consolidated Balance Sheets, Condensed Consolidated Statements of Operations, Condensed Consolidated Statements of Comprehensive Income (Loss), and Condensed Consolidated Statements of Changes in Stockholders' Equity.

Certain amounts in the Condensed Consolidated Statements of Cash Flows for the forty weeks ended October 7, 2017 have been reclassified to conform to the current period presentation.

The table below presents the revisions to the applicable Condensed Consolidated Statements of Cash Flows line item to correct the errors for the forty weeks ended October 7, 2017 (amounts in thousands):

Impacted Condensed Consolidated Statements of Cash Flows Line Item	Condensed Consolidated Statements of Cash Flows For the Forty Weeks Ended October 7, 2017 As Previously		
	Reported	Revisions	As Revised
Other assets	\$(29,833)	\$ 15,438	\$ (14,395)
Other accrued liabilities	\$24,786	\$ 28,234	\$ 53,020
Net cash provided by operating activities	\$211,252	\$ 12,774	\$ 224,026
Repurchase of independent distributor territories	\$(11,187)	\$ 5,321	\$ (5,866)
Cash paid at issuance of notes receivable	\$—	\$ (19,102)	\$ (19,102)
Other investing activities	\$523	\$ 1,007	\$ 1,530
Net cash provided by investing activities	\$(30)	\$ (12,774)	\$ (12,804)

3. RECENT ACCOUNTING PRONOUNCEMENTS

Recently adopted accounting pronouncements

In May 2014, the FASB issued guidance for recognizing revenue in contracts with customers. This guidance requires entities to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. There are five steps outlined in the guidance to achieve this core principle. This guidance was adopted on December 31, 2017, the first day of our fiscal 2018. The company applied the guidance at adoption on the modified retrospective transition method. This guidance was applied to all contracts not completed at the adoption date. The adoption of this guidance did not impact our financial statements; however, updated disclosures are included in Note 1, Basis of Presentation, of Notes to Condensed Consolidated Financial Statements of this Form 10-Q. Changes were made to our internal control over financial reporting processes to ensure all contracts are reviewed for each of the five revenue recognition steps. Additionally, the company's revenue disclosures changed beginning in fiscal 2018. The new disclosures require more granularity into our sources of revenue, as well as the assumptions about recognition timing, and include our selection of certain practical expedients and policy elections.

In August 2016, the FASB issued guidance on the classification of certain cash receipts and payments in the statements of cash flows. This guidance was adopted on December 31, 2017, the first day of our fiscal 2018, and it did not impact the prior or current period presentation.

In January 2017, the FASB issued guidance to clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. This guidance was adopted on December 31, 2017, the first day of our fiscal 2018. This guidance will impact the company's assessment of future transactions beginning in our fiscal 2018.

In March 2017, the FASB issued guidance that requires all employers to separately present the service cost component from the other pension and postretirement benefit cost components in the income statements. Service cost will now be presented with other employee compensation costs in operating income or capitalized in assets, as appropriate. The other components reported in the income statements will be reported separate from the service cost and outside of income from operations. This guidance was adopted on December 31, 2017, the first day of our fiscal 2018. The guidance is required to be applied on a retrospective basis for the presentation of the service cost component and the other components of net benefit cost, and on a prospective basis for the capitalization of only the service cost component of net benefit cost. The company has elected to use the practical expedient option and presented the amounts disclosed in our prior pension and postretirement footnote for the comparative prior period for the retrospective presentation requirement. The company did not capitalize pension cost. The impact (including defined benefit and postretirement plans) for the twelve and forty weeks ended October 7, 2017 is presented in the table below (amounts in thousands):

	For the Twelve Weeks Ended Previously	
	Filed October 7, 2017	Post-adoption October 7, 2017
Materials, supplies, labor and other production costs (exclusive of depreciation and amortization shown separately)	\$476,170	\$ 476,264
Selling, distribution and administrative expenses	\$355,599	\$ 356,826
Loss from operations	\$(53,766)	\$(52,057)
Other components of net periodic pension and postretirement benefits credit	\$—	\$ (1,321)
	For the Forty Weeks Ended Previously	
	Filed October 7, 2017	Post-adoption October 7, 2017
Materials, supplies, labor and other production costs (exclusive of depreciation and amortization shown separately)	\$1,552,263	\$ 1,552,578
Selling, distribution and administrative expenses	\$1,171,062	\$ 1,175,434
Income from operations	\$116,525	\$ 114,868
Other components of net periodic pension and postretirement benefits credit	\$—	\$ (4,687)

In May 2017, the FASB issued guidance to provide clarity and reduce diversity in practice for changes to the terms and conditions of a share-based payment award. This guidance clarifies which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. This guidance was adopted on December 31, 2017, the first day of our fiscal 2018. This guidance will impact any modified share-based payment awards beginning in our fiscal 2018.

In August 2017, the FASB amended the guidance for hedge accounting. This guidance makes more financial and nonfinancial hedging strategies eligible for hedge accounting. It also amends the presentation and disclosure

requirements and changes the requirements for companies to separately measure ineffectiveness. It is intended to more closely align hedge accounting with companies' risk management strategies, simplify the application of hedge accounting, and increase transparency as to the scope and results of hedging activities. We elected to early adopt this guidance as of December 31, 2017, the first day of our fiscal 2018. All transition requirements and elections were applied to hedging relationships existing on the date of adoption. The amended presentation and disclosure requirements must be applied prospectively. The guidance requires a modified retrospective transition method in which companies recognize the cumulative effect of the change on the opening balance of each affected component of equity on the balance sheet as of the date of adoption. There was no cumulative effect change to the company at adoption of this amended guidance.

In February 2018, the FASB issued guidance to allow a reclassification from AOCI to retained earnings for stranded tax effects resulting from the Act. We elected to early adopt this guidance as of December 31, 2017, the first day of our fiscal 2018. The table below presents the impact of this reclassification on December 31, 2017 (amounts in thousands) (positive value denotes a debit balance):

	Impacted Line Item (Dr (Cr))	
	Retained Earnings	AOCI
Pension and postretirement plans	(17,097)	17,097
Hedged financial instruments	(1,709)	1,709
Total reclassification of stranded income tax effects to retained earnings from AOCI	\$(18,806)	\$18,806

Accounting pronouncements not yet adopted

In February 2016, the FASB issued guidance that requires an entity to recognize lease liabilities and a right-of-use asset for virtually all leases (other than those that meet the definition of a short-term lease) on the balance sheet and to disclose key information about the entity's leasing arrangements. This guidance is effective for annual reporting periods beginning after December 15, 2018, including interim periods within those periods, with earlier adoption permitted. This guidance must be adopted using a modified retrospective approach for all leases existing at, or entered after, the date of initial adoption, with an option to elect transition relief.

The company chooses to elect the modified retrospective approach provided by the guidance and will adopt the updated standard in the first quarter of fiscal 2019. At the adoption date, the company will recognize a cumulative-effect adjustment to the opening balance of retained earnings. As a result, the comparative periods presented in the financial statements in the period of adoption will be in accordance of current GAAP.

The company anticipates electing the package of transition practical expedients within the new guidance. As required by the new standard, these expedients will be elected as a package, and consistently applied across the company's lease portfolio. Given this election, the company will not reassess the following:

- whether any expired or existing contracts are or contain leases;
- the lease classification for any expired or existing leases; or
- the treatment of initial direct costs relating to any existing leases.

The company has a cross-functional project team focused on implementation of this new guidance. Our analysis includes a review of our current accounting policies and procedures and how these will be impacted upon adoption. We acquired a lease accounting software to facilitate implementation, and are currently installing, configuring and testing the software. The lease data abstraction is substantially complete.

Currently, we are unable to reasonably estimate the expected increase in assets and liabilities on our Condensed Consolidated Balance Sheets upon adoption. We expect a significant impact to our consolidated balance sheet, but not to our consolidated income statement. The most significant impact will be the recognition of right-of-use assets and lease liabilities for operating leases, while our accounting for finance leases will remain substantially unchanged. The company currently has significant operating leases with our fiscal 2017 lease expense totaling \$95.0 million.

In June 2016, the FASB issued guidance that effects loans, debt securities, trade receivables, net investments in leases, off-balance sheet credit exposures, reinsurance receivables, and any other financial assets not excluded from the scope that have the contractual right to receive cash. The company is determining what the impact, if any, will be on the trade and notes receivables recorded in our Consolidated Financial Statements. The guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019 (the company's fiscal 2020). Early adoption is permitted for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018 (the company's fiscal 2019). The company is evaluating when this guidance will be adopted and the impact on our Consolidated Financial Statements.

In January 2017, the FASB issued guidance to simplify the accounting for goodwill impairment. The guidance removed Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation. A goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. Companies will still have the option to perform a qualitative assessment to determine if a quantitative impairment test is necessary. This guidance will be applied prospectively. Companies are required to disclose the nature of and reason for the change in accounting principle upon transition. That disclosure shall be provided in the first annual reporting period and in the interim period within the first annual reporting period when the company adopts this guidance. This change to the guidance is effective for fiscal years beginning after December 15,

2019. Early adoption is permitted after January 1, 2017. The company is currently evaluating when this guidance will be adopted and the impact on our Consolidated Financial Statements.

In August 2018, the FASB issued guidance to modify the disclosure requirements on fair value measurements. The guidance removes, modifies, and adds certain disclosures related to Level 1, Level 2, and Level 3 assets. The guidance is effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. This is applicable in the company's fiscal 2020 Consolidated Financial Statements. The company is currently evaluating when this guidance will be adopted and the impact on our Consolidated Financial Statements.

In August 2018, the FASB issued guidance to modify the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. The guidance is effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020 (the company's fiscal 2021). Disclosures were removed for the amounts in AOCI expected to be recognized as components of net periodic benefit cost over the next fiscal year, the amount and timing of assets expected to be returned to the employer, certain related party disclosures, and the effects of a one-percentage-point change in the assumed health care cost trend rates. Additional disclosures include the weighted average interest crediting rate for plan with promised crediting interest rates and an explanation of the reasons for significant gains and losses related to the benefit obligation for the period. This guidance shall be applied on a retrospective basis. The company is currently evaluating when this guidance will be adopted and the impact on our Consolidated Financial Statements.

We have reviewed other recently issued accounting pronouncements and concluded that either they are not applicable to our business or no material effect is expected upon future adoption.

4. RESTRUCTURING ACTIVITIES

On August 10, 2016, we announced the launch of Project Centennial, a comprehensive business and operational review. We identified opportunities to enhance revenue growth, streamline operations, improve efficiencies, and make investments that strengthen our competitive position and improve margins over the long term. We began Project Centennial with an evaluation of our brands, product mix, and organizational structure. We then developed strategic priorities to help us capitalize on retail and consumer changes. The primary objective is to improve margins and profitably grow the revenue over time. These priorities are as follows:

Reduce costs to fuel growth. The company is focusing on reducing costs in our purchased goods and services initiative and our supply chain optimization plan. Purchased goods and services operations will be centralized to create standardization and continuously improve and to develop consistent policies and specifications. Supply chain optimization intends to reduce operational complexity and capitalize on scale. This initiative includes, and will continue to include, consulting and other third-party costs as we finalize the organizational structure. We incurred \$0.7 million and \$9.4 million for these non-restructuring consulting costs during the twelve and forty weeks ended October 6, 2018. We incurred \$7.1 million and \$31.8 million, respectively, for these non-restructuring consulting costs during the twelve and forty weeks ended October 7, 2017.

Develop leading capabilities. As of October 6, 2018, we report our financial results in either the DSD Segment or the Warehouse Segment. On May 3, 2017, the company announced an enhanced organizational structure designed to provide greater focus on the company's strategic objectives, emphasize brand growth and innovation in line with a national branded food company, drive enhanced accountability, reduce costs, and strengthen our long-term strategy. The new organizational structure established two BUs, Fresh Packaged Bread and Snacking/Specialty. The new structure also provided for centralized marketing, sales, supply chain, shared-services/administrative, and corporate strategy functions, each with more clearly defined roles and responsibilities. On July 2, 2018, the company announced the creation of the Chief Operating Officer (COO) position which continued refinements to the organizational structure. This role will be responsible for executing the company's strategies under Project Centennial, as well as overseeing the BUs, supply chain, sales, corporate strategy and ventures, and communications. The company intends to transition to the new structure over the next several months with full implementation expected to be completed at the beginning of fiscal 2019. We began relocating certain employees during the third quarter of fiscal 2017 as we transition to the new structure. Reorganization costs for relocating employees of \$2.6 million and \$0.5 million were incurred during the forty weeks ended October 6, 2018 and October 7, 2017, respectively, and are recognized in the restructuring charges line item on the Condensed Consolidated Statements of Operations. We anticipate incurring additional reorganization costs as we continue implementing the new structure. The current DSD and warehouse segmentation will remain until the new structure is in place.

On July 17, 2017, the company commenced a voluntary employee separation incentive plan (the “VSIP”). The VSIP was implemented as part of our effort to restructure and streamline operations, and better position the company for profitable growth. The VSIP election period closed on September 25, 2017 and resulted in approximately 325 employees accepting the offer. The separations began on September 7, 2017, and were substantially complete by the end of fiscal 2017. We recorded an aggregate charge of \$29.7 million in fiscal 2017 for the VSIP and a credit of \$0.6 million during the forty weeks ended October 6, 2018. These charges consist primarily of employee severance and benefits-related costs and are recorded in the restructuring charges line item on our Condensed Consolidated Statements of Operations.

Reinvigorate core business. This objective is to invest in our brands to align brands to consumers to maximize our return on investment. We expect to incur significant incremental marketing costs annually for brand development. These costs will not be restructuring and will be recognized as incurred. Project Centennial also included a brand rationalization study to identify high-potential and established brands to focus on innovation and cash flow, respectively. The study, which concluded in our third quarter of fiscal 2017, changed the outlook for several brands and resulted in the recognition of an impairment on certain of these finite-lived and indefinite-lived intangible trademark assets in our third quarter of fiscal 2017. The total intangible asset impairment charges, which were recorded in the Restructuring and related impairment charges line item in our Condensed Consolidated Statements of Operations, were \$66.2 million. Project Centennial is expected to be completed by our fiscal 2021.

On August 9, 2017, the company announced the closure of a Warehouse Segment snack cake plant in Winston-Salem, North Carolina. The bakery closed in November 2017. The closure costs were \$4.4 million and consisted of \$3.4 million for property, plant and equipment impairments and \$1.0 million for employee termination benefits. These amounts are recorded in the restructuring and related impairment charges line item on our Condensed Consolidated Statements of Operations. The company continues to explore additional opportunities to streamline our core operations, but as of October 6, 2018, we cannot estimate the additional costs to be incurred for this initiative.

Capitalize on product adjacencies. This initiative focuses on growing market share in underdeveloped markets. Adjacencies are geographic and/or product categories that are expected to leverage our competitive advantages. This can be achieved either organically with our high-potential brands or through strategic acquisitions. As of October 6, 2018, we cannot estimate the costs to be incurred for this initiative.

See Note 20, Segment Reporting, of Notes to Condensed Consolidated Financial Statements of this Form 10-Q for the allocation of restructuring charges to each of our segments. The tables below present the components of costs associated with Project Centennial for the twelve and forty week periods ended October 6, 2018 and October 7, 2017 (amounts in thousands):

	For the Twelve Weeks Ended October 6, 2018	For the Forty Weeks Ended October 6, 2018
Restructuring and related impairment charges:		
Reorganization costs	\$ 323	\$2,636
VSIP	—	(597)
Impairment of assets	174	174
Employee termination benefits	—	344
Restructuring and related impairment charges (1)	497	2,557
Project Centennial implementation costs (2)	729	9,376
Total Project Centennial restructuring and implementation costs	\$ 1,226	\$ 11,933

	For the Twelve Weeks Ended October 7, 2017	For the Forty Weeks Ended October 7, 2017
Restructuring and related impairment charges:		
Reorganization costs	\$516	\$516
VSIP	28,982	28,982
Impairment of assets	69,651	69,651
Employee termination benefits	1,400	1,400
Restructuring and related impairment charges (1)	100,549	100,549
Project Centennial implementation costs (2)	7,050	31,845
Total Project Centennial restructuring and implementation costs	\$ 107,599	\$ 132,394

(1) Presented on our Condensed Consolidated Statements of Operations.

(2) Costs are recorded in the selling, distribution and administrative expenses line item of our Condensed Consolidated Statements of Operations.

The tables below present the components of, and changes in, our restructuring accruals for the forty weeks ended October 6, 2018 and October 7, 2017 (amounts in thousands):

	Employee			
		Termination	Reorganization	
	VSIP	Benefits ⁽¹⁾	Costs ⁽²⁾	Total
Liability balance at December 30, 2017	\$25,022	\$ 468	\$ —	\$25,490
Charges	(597)	344	2,636	2,383
Cash payments	(24,234)	(769)	(2,636)	(27,639)
Liability balance (3) at October 6, 2018	\$191	\$ 43	\$ —	\$234

	Employee			
	VSIP	Benefits ⁽¹⁾	Costs ⁽²⁾	Total
Liability balance at December 31, 2016	\$—	\$ —	\$ —	\$—
Charges	28,982	1,400	516	30,898
Cash payments	(892)	(147)	(516)	(1,555)
Liability balance (3) at October 7, 2017	\$28,090	\$ 1,253	\$ —	\$29,343

(1) Employee termination benefits are not related to the VSIP.

(2) Reorganization costs include employee relocation expenses.

(3) Recorded in the other accrued current liabilities line item of our Condensed Consolidated Balance Sheets.

5. DIVESTITURE

On January 14, 2017, the company completed the sale of a non-core mix manufacturing business located in Cedar Rapids, Iowa for \$44.0 million, an amount reduced by a working capital adjustment of \$2.8 million, resulting in net proceeds of \$41.2 million. This resulted in a gain on sale of \$28.9 million, which was recognized in the first quarter of fiscal 2017. The gain on the sale is presented on the Condensed Consolidated Statements of Operations on the 'Gain on divestiture' line item. The mix manufacturing business was a small component of our Warehouse Segment and the disposal of this business does not represent a strategic shift in the segment's operations or financial results. The table below presents a computation of the gain on divestiture (amounts in thousands):

Cash consideration received	\$41,230
Recognized amounts of identifiable assets acquired and liabilities assumed:	
Property, plant, and equipment recorded as assets held for sale	3,824
Goodwill	801
Financial assets	7,730
Net derecognized amounts of identifiable assets sold	12,355
Gain on divestiture	\$28,875

6. ACCUMULATED OTHER COMPREHENSIVE INCOME (“AOCI”)

The company’s total comprehensive income (loss) presently consists of net income, adjustments for our derivative financial instruments accounted for as cash flow hedges, and various pension and other postretirement benefit related items.

During the twelve and forty weeks ended October 6, 2018 and October 7, 2017, reclassifications out of AOCI were as follows (amounts in thousands):

Details about AOCI Components (Note 2)	Amount Reclassified from AOCI For the Twelve Weeks Ended		Affected Line Item in the Statement Where Net Income is Presented
	October 6, 2018	October 7, 2017	
Gains and losses on cash flow hedges:			
Interest rate contracts	\$(33)	\$(33)	Interest expense
Commodity contracts	(233)	(571)	Cost of sales, Note 3
Total before tax	(356)	(604)	Total before tax
Tax benefit	90	232	Tax benefit
Total net of tax	(266)	(372)	Net of tax
Amortization of defined benefit pension items:			
Prior-service costs	(48)	(34)	Note 1
Settlement loss	(930)	(3,030)	Note 1
Actuarial losses	(1,027)	(1,251)	Note 1
Total before tax	(2,005)	(4,315)	Total before tax
Tax benefit	506	1,662	Tax benefit
Total net of tax	(1,499)	(2,653)	Net of tax
Total reclassifications	\$(1,765)	\$(3,025)	Net of tax
Details about AOCI Components (Note 2)	Amount Reclassified from AOCI For the Forty Weeks Ended		Affected Line Item in the Statement Where Net Income (Loss) is Presented
	October 6, 2018	October 7, 2017	
Gains and losses on cash flow hedges:			
Interest rate contracts	\$(110)	\$(110)	Interest expense
Commodity contracts	(811)	(1,785)	Cost of sales, Note 3
Total before tax	(921)	(1,895)	Total before tax
Tax benefit	232	729	Tax benefit
Total net of tax	(689)	(1,166)	Net of tax
Amortization of defined benefit pension items:			
Prior-service costs	(129)	(128)	Note 1
Settlement loss	(6,633)	(3,030)	Note 1

Edgar Filing: FLOWERS FOODS INC - Form 10-Q

Actuarial losses	(3,624)	(4,410)	Note 1
Total before tax	(10,386)	(7,568)	Total before tax
Tax benefit	2,622	2,914	Tax benefit
Total net of tax	(7,764)	(4,654)	Net of tax
Total reclassifications	\$(8,453)	\$(5,820)	Net of tax

Note 1: These items are included in the computation of net periodic pension cost and are reported in the other components of net periodic pension and postretirement benefits credit line item on the Condensed Consolidated Statements of Operations. See Note 18, Postretirement Plans, of Notes to Condensed Consolidated Financial Statements of this Form 10-Q for additional information.

Note 2: Amounts in parentheses indicate debits to determine net income (loss).

Note 3: Amounts are presented as an adjustment to reconcile net income (loss) to net cash provided by operating activities on the Condensed Consolidated Statements of Cash Flows.

Edgar Filing: FLOWERS FOODS INC - Form 10-Q

During the forty weeks ended October 6, 2018, changes to AOCI, net of income tax, by component were as follows (amounts in thousands and parentheses denote a debit balance):

	Gains/Losses		Defined	Total
	on Cash	Benefit Pension		
	Flow Hedges	Plan Items		
AOCI at December 30, 2017	\$ (6,483)	\$ (78,076)		\$(84,559)
Other comprehensive income (loss) before reclassifications	9,055	(19,883)		(10,828)
Reclassified to earnings from AOCI	689	7,764		8,453
Reclassified to retained earnings from AOCI	(1,709)	(17,097)		(18,806)
AOCI at October 6, 2018	\$ 1,552	\$ (107,292)		\$(105,740)

During the forty weeks ended October 7, 2017, changes to AOCI, net of income tax, by component were as follows (amounts in thousands and parentheses denote a debit balance):

	Gains/Losses		Defined	Total
	on Cash	Benefit Pension		
	Flow Hedges	Plan Items		
AOCI at December 31, 2016	\$ (1,061)	\$ (82,222)		\$(83,283)
Other comprehensive income before reclassifications	(5,932)	(2,707)		(8,639)
Reclassified to earnings from AOCI	1,166	4,654		5,820
AOCI at October 7, 2017	\$ (5,827)	\$ (80,275)		\$(86,102)

Amounts reclassified out of AOCI to net income that relate to commodity contracts are presented as an adjustment to reconcile net income to net cash provided by operating activities on the Condensed Consolidated Statements of Cash Flows. The following table presents the net of tax amount of the loss reclassified from AOCI for our commodity contracts (amounts in thousands and positive value indicates debits to determine net income):

	For the Forty Weeks Ended October	
	6, 2018	October 7, 2017
Gross loss reclassified from AOCI into income	\$811	\$1,785
Tax benefit	(205)	(687)
Net of tax	\$606	\$1,098

7. GOODWILL AND OTHER INTANGIBLE ASSETS

The table below summarizes our goodwill and other intangible assets at October 6, 2018 and December 30, 2017, respectively, each of which is explained in additional detail below (amounts in thousands):

	October 6, 2018	December 30, 2017
Goodwill	\$464,777	\$464,777
Amortizable intangible assets, net of amortization	515,924	535,842
Indefinite-lived intangible assets	206,600	206,600
Total goodwill and other intangible assets	\$1,187,301	\$1,207,219

There were no changes in the carrying amount of goodwill during the forty weeks ended October 6, 2018.

As of October 6, 2018 and December 30, 2017, respectively, the company had the following amounts related to amortizable intangible assets (amounts in thousands):

Asset	October 6, 2018			December 30, 2017		
	Cost	Accumulated Amortization	Net Value	Cost	Accumulated Amortization	Net Value
Trademarks	\$371,392	\$ 42,404	\$328,988	\$371,392	\$ 34,716	\$336,676
Customer relationships	281,621	96,299	185,322	281,621	84,280	197,341
Non-compete agreements	4,874	4,874	—	4,874	4,874	—
Distributor relationships	4,123	2,509	1,614	4,123	2,298	1,825
Total	\$662,010	\$ 146,086	\$515,924	\$662,010	\$ 126,168	\$535,842

Aggregate amortization expense for the twelve and forty weeks ended October 6, 2018 and October 7, 2017 was as follows (amounts in thousands):

	Amortization Expense
For the twelve weeks ended October 6, 2018	\$ 5,975
For the twelve weeks ended October 7, 2017	\$ 6,218
For the forty weeks ended October 6, 2018	\$ 19,918
For the forty weeks ended October 7, 2017	\$ 21,190

Estimated amortization of intangibles for each of the next five years is as follows (amounts in thousands):

	Amortization of Intangibles
Remainder of 2018	\$ 5,892
2019	\$ 25,288
2020	\$ 24,795
2021	\$ 24,234
2022	\$ 23,643

There were \$206.6 million of indefinite-lived intangible trademark assets separately identified from goodwill at October 6, 2018 and December 30, 2017. These trademarks are classified as indefinite-lived because we believe they are well established brands, many older than forty years old, with a long history and well defined markets. In addition, we are continuing to use these brands both in their original markets and throughout our expansion territories. We believe these factors support an indefinite-life. We perform an annual impairment analysis, or on an interim basis if the facts and circumstances change, to determine if the trademarks are realizing their expected economic benefits.

During the twelve and forty weeks ended October 7, 2017, the company recognized intangible asset impairments of \$66.2 million that are recorded in the restructuring and related impairment charges line item of our Condensed Consolidated Statements of Operations. The company is currently undergoing an enterprise-wide business and operational review as discussed in Note 4, Restructuring Activities, above. The review included a brand rationalization study that impacted certain trademarks' future use. The study was completed in the third quarter of fiscal 2017. The study concluded that brands should be classified as either national or regional and brands that did not fit into those categories were to be discontinued. National brands would have more marketing support than the de-emphasized remaining regional brands and in many cases, would shift sales from regional brands as certain regional brand bread products are discontinued. As a result of these actions, a triggering event occurred and we examined several trademarks for potential impairment. One of the trademarks was an indefinite-lived trademark asset and was tested by comparing the fair value of the brand to its carrying value. Three finite-lived trademark assets were

tested using an undiscounted cash flow test. As a result of this test, the projected cash flows for these brands did not exceed the carrying value. The second step of the test determined the fair value of the asset and the difference between the fair value and the carrying value was recorded as an impairment. The impairment charge also consisted of six brands that either are being discontinued or will have limited future benefits to the company. These brands were fully impaired. All of these impairments were attributed to regional brands. Following the impairments, we evaluated the classification of the impaired indefinite-lived asset and determined that it should be reassigned as finite-lived with an estimated useful life of 30 years. The table below presents the impairments, by reporting segment, that were recognized during the twelve weeks ended October 7, 2017 (amounts in thousands):

	DSD Segment	Warehouse Segment	Total
Indefinite-lived trademark asset impairments	\$ 18,500	\$ —	\$18,500
Finite-lived trademark asset impairments	36,612	11,135	47,747
Total	\$ 55,112	\$ 11,135	\$66,247

8. FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying value of cash and cash equivalents, accounts receivable, and short-term debt approximates fair value because of the short-term maturity of the instruments. Notes receivable are entered into in connection with the purchase of independent distributors' distribution rights by IDPs. These notes receivable are recorded in the Condensed Consolidated Balance Sheets at carrying value, which represents the closest approximation of fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. As a result, the appropriate interest rate that should be used to estimate the fair value of the distributor notes receivable is the prevailing market rate at which similar loans would be made to IDPs with similar credit ratings and for the same maturities. However, the company financed approximately 4,300 and 4,000 IDPs' distribution rights as of October 6, 2018 and December 30, 2017, respectively, all with varied financial histories and credit risks. Considering the diversity of credit risks among the IDPs, the company has no method to accurately determine a market interest rate to apply to the notes. The distribution rights are generally purchased by the IDP with a 5% down payment with the remainder financed for up to ten years. The distributor notes receivable are collateralized by the IDPs' distribution rights. The company maintains a wholly-owned subsidiary to assist in financing the distribution rights purchase activities if requested by new IDPs, using the distribution rights and certain associated assets as collateral. These notes receivable earn interest at a fixed rate.

Interest income was primarily related to the IDPs' notes receivable and was as follows (amounts in thousands):

	Interest Income
For the twelve weeks ended October 6, 2018	\$6,615
For the twelve weeks ended October 7, 2017	\$5,464
For the forty weeks ended October 6, 2018	\$21,176
For the forty weeks ended October 7, 2017	\$17,199

At October 6, 2018 and December 30, 2017, respectively, the carrying value of the distributor notes receivable was as follows (amounts in thousands):

	October 6, 2018	December 30, 2017
Distributor notes receivable	\$229,380	\$211,702
Current portion of distributor notes receivable recorded in		
accounts and notes receivable, net	25,804	23,965
Long-term portion of distributor notes receivable	\$203,576	\$187,737

At October 6, 2018 and December 30, 2017, respectively, the company has evaluated the collectability of the distributor notes receivable and determined that a reserve is not necessary. Payments on these distributor notes receivable are collected by the company weekly in conjunction with the distributor settlement process.

Edgar Filing: FLOWERS FOODS INC - Form 10-Q

The fair value of the company's variable rate debt at October 6, 2018 approximates the recorded value. The fair value of the company's 3.5% senior notes due 2026 ("2026 notes") and 4.375% senior notes due 2022 ("2022 notes"), as discussed in Note 13, Debt and Other Obligations, of Notes to Condensed Consolidated Financial Statements of this Form 10-Q are estimated using yields obtained from independent pricing sources for similar types of borrowing arrangements and are considered a Level 2 valuation. The fair value of the 2026 notes and 2022 notes are presented in the table below (amounts in thousands, except level classification):

	Carrying Value	Fair Value	Level
2026 notes	\$395,418	\$369,039	2
2022 notes	\$398,312	\$405,721	2

For fair value disclosure information about our derivative assets and liabilities see Note 9, Derivative Financial Instruments.

9. DERIVATIVE FINANCIAL INSTRUMENTS

The company measures the fair value of its derivative portfolio by using the price that would be received to sell an asset or paid to transfer a liability in the principal market for that asset or liability. These measurements are classified into a hierarchy by the inputs used to perform the fair value calculation as follows:

Level 1: Fair value based on unadjusted quoted prices for identical assets or liabilities at the measurement date
 Level 2: Modeled fair value with model inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly

Level 3: Modeled fair value with unobservable model inputs that are used to estimate the fair value of the asset or liability

Commodity Risk

The company enters into commodity derivatives designated as cash-flow hedges of existing or future exposure to changes in commodity prices. The company's primary raw materials are flour, sweeteners and shortening, along with pulp, paper and petroleum-based packaging products. Natural gas, which is used as oven fuel, and diesel fuel are also important commodity inputs.

As of October 6, 2018, the company's hedge portfolio contained commodity derivatives, which are recorded in the following accounts with fair values measured as indicated (amounts in thousands):

	Level 1	Level 2	Level 3	Total
Assets:				
Other current	\$3,872	\$ —	\$ —	\$3,872
Other long-term	617	—	—	617
Total	4,489	—	—	4,489
Liabilities:				
Other current	(1,180)	—	—	(1,180)
Other long-term	(616)	—	—	(616)
Total	(1,796)	—	—	(1,796)
Net Fair Value	\$2,693	\$ —	\$ —	\$2,693

As of December 30, 2017, the company's hedge portfolio contained commodity derivatives, which are recorded in the following accounts with fair values measured as indicated (amounts in thousands):

	Level 1	Level 2	Level 3	Total
Assets:				
Other current	\$259	\$ —	\$ —	\$259
Other long-term	32	—	—	32
Total	291	—	—	291

Liabilities:

Other current	(10,247)	—	—	(10,247)
Other long-term	(639)	—	—	(639)
Total	(10,886)	—	—	(10,886)
Net Fair Value	\$(10,595)	\$ —	\$ —	\$(10,595)

The positions held in the portfolio are used to hedge economic exposure to changes in various raw material prices and effectively fix, or limit increases in, prices for a period of time extending into fiscal 2021. These instruments are designated as cash-flow hedges. The change in the fair value for these derivatives is reported in AOCI. All the company-held commodity derivatives at October 6, 2018 and December 30, 2017, respectively, qualified for hedge accounting.

Interest Rate Risk

The company entered into treasury rate locks on August 5, 2016 and August 8, 2016 to fix the interest rate for the 2026 notes issued on September 28, 2016. The derivative positions were closed when the debt was priced on September 23, 2016 with a net cash receipt of \$1.0 million that offset changes in the benchmark treasury rate between execution of the treasury rate locks and the debt pricing date. These rate locks were designated as a cash flow hedge. During fiscal 2016, the company recognized \$0.1 million of ineffectiveness due to issuing the debt earlier than the settlement date of the treasury locks. The ineffectiveness amount was reported as a selling, distribution and administrative expense in our Condensed Consolidated Statements of Operations.

The company entered into a treasury rate lock on March 28, 2012 to fix the interest rate for the 2022 notes issued on April 3, 2012. The derivative position was closed when the debt was priced on March 29, 2012 with a cash settlement of \$3.1 million that offset changes in the benchmark treasury rate between the execution of the treasury rate lock and the debt pricing date. This treasury rate lock was designated as a cash flow hedge.

The following table outlines the company's derivatives, which were hedging the risk of changes in forecasted interest payments on forecasted issuance of long-term debt (amounts in thousands, before tax, and an asset is a positive value and a liability is a negative value):

Terminated	Description	Aggregate Notional Amount	Fair Value When Terminated	Fair Value Deferred in AOCI(1)	Ineffective Portion at Termination
April/2012	Treasury lock	\$ 500,000	\$ (3,137)	\$ 2,510	\$ 627
September/2016	Treasury lock	\$ 200,000	\$ 1,298	\$ (1,298)	\$ —
September/2016	Treasury lock	\$ 150,000	\$ (323)	\$ 215	\$ 108

(1)The amount reported in AOCI is reclassified to interest expense as interest payments are made on the related notes through the maturity date.

Derivative Assets and Liabilities

The company has the following derivative instruments located on the Condensed Consolidated Balance Sheets, which are utilized for the risk management purposes detailed above (amounts in thousands):

	Derivative Assets				Derivative Liabilities			
	October 6, 2018		December 30, 2017		October 6, 2018		December 30, 2017	
Derivatives Designated as	Balance	Fair Value	Balance	Fair Value	Balance	Fair Value	Balance	Fair Value
Hedging Instruments	Sheet		Sheet		Sheet		Sheet	

Edgar Filing: FLOWERS FOODS INC - Form 10-Q

	Location		Location		Location		Location	
Commodity contracts	Other		Other		Other		Other	
	current		current		accrued		accrued	
	assets	\$3,872	assets	\$ 259	liabilities	\$1,180	liabilities	\$10,247
Commodity contracts					Other		Other	
					long-term		long-term	
	Other assets	617	Other assets	32	liabilities	616	liabilities	639
Total		\$4,489		\$ 291		\$1,796		\$10,886

Derivative AOCI transactions

The company had the following derivative instruments for deferred gains and (losses) on closed contracts and the effective portion for changes in fair value recorded in AOCI (no amounts were excluded from the effectiveness test), all of which are utilized for the risk management purposes detailed above (amounts in thousands and net of tax):

Derivatives in Cash Flow	Amount of Gain or (Loss) Recognized in AOCI on Derivatives		Location of (Gain) or Loss	Amount of (Gain) or Loss	
	(Effective Portion)			Reclassified from AOCI into Income (Effective Portion)	
	For the Twelve Weeks Ended		Reclassified from AOCI	For the Twelve Weeks Ended	
	October 6, 2018	October 7, 2017	into Income (Effective Portion)(2)	October 6, 2018	October 7, 2017
Hedge Relationships(1)					
Interest rate contracts	\$—	\$—	Interest expense	\$25	\$21
Commodity contracts	7,394	(9,652)	Production costs(3)	241	351
Total	\$7,394	\$(9,652)		\$266	\$372

Derivatives in Cash Flow	Amount of Gain or (Loss) Recognized in AOCI on Derivatives		Location of (Gain) or Loss	Amount of (Gain) or Loss	
	(Effective Portion)			Reclassified from AOCI into Income (Effective Portion)	
	For the Forty Weeks Ended		Reclassified from AOCI	For the Forty Weeks Ended	
	October 6, 2018	October 7, 2017	into Income (Effective Portion)(2)	October 6, 2018	October 7, 2017
Hedge Relationships(1)					
Interest rate contracts	\$—	\$—	Interest expense	\$83	\$68
Commodity contracts	9,055	(5,932)	Production costs(3)	606	1,098
Total	\$9,055	\$(5,932)		\$689	\$1,166

1. Amounts in parentheses indicate debits to determine net income (loss).

2. Amounts in parentheses, if any, indicate credits to determine net income (loss).

3. Included in materials, supplies, labor and other production costs (exclusive of depreciation and amortization shown separately).

There was no hedging ineffectiveness, and no amounts were excluded from the ineffectiveness testing, during the twelve and forty weeks ended October 6, 2018 and October 7, 2017, respectively, related to the company's commodity risk hedges.

At October 6, 2018, the balance in AOCI related to commodity price risk and interest rate risk derivative transactions that closed or will expire over the following years are as follows (amounts in thousands and net of tax) (amounts in parenthesis indicate a debit balance):

	Commodity	Interest	
	Price Risk	Rate Risk	
	Derivatives	Derivatives	Totals
Closed contracts	\$ (453)	\$ (9)	\$(462)
Expiring in 2018	29	—	29
Expiring in 2019	2,073	—	2,073
Expiring in 2020	32	—	32
Expiring in 2021	(120)	—	(120)
Total	\$ 1,561	\$ (9)	\$1,552

Derivative Transactions Notional Amounts

As of October 6, 2018, the company had the following outstanding financial contracts that were entered to hedge commodity risk (amounts in thousands):

	Notional
	Amount
Wheat contracts	\$139,152
Soybean oil contracts	22,825
Natural gas contracts	14,146
Corn contracts	16,097
Total	\$192,220

The company's derivative instruments contain no credit-risk related contingent features at October 6, 2018. As of October 6, 2018 and December 30, 2017, the company had \$7.3 million and \$16.3 million, respectively, in other current assets representing collateral for hedged positions. There were no amounts representing collateral recorded in other accrued liabilities for hedged positions as of October 6, 2018 and December 30, 2017.

10. OTHER CURRENT AND NON-CURRENT ASSETS

Other current assets consist of (amounts in thousands):

	October 6, 2018	December 30, 2017
Prepaid assets	\$16,436	\$22,154
Fair value of derivative instruments	3,872	259
Collateral to counterparties for derivative positions	7,255	16,324
Income taxes receivable	9,557	10,133
Other	1,408	767
Total	\$38,528	\$49,637

Other non-current assets consist of (amounts in thousands):

	October 6, 2018	December 30, 2017
Unamortized financing fees	\$1,492	\$1,787
Investments	3,293	3,434
Notes receivable	—	2,464
Deposits	2,280	2,342
Other	774	201
Total	\$7,839	\$10,228

The company recognized an impairment of \$2.5 million for the notes receivable (not related to IDPs) because the counterparty defaulted on the note during the first quarter of fiscal 2018. This amount is recorded in the impairment of assets line item on the Condensed Consolidated Statements of Operations.

11. OTHER ACCRUED LIABILITIES

Other accrued liabilities consist of (amounts in thousands):

	October 6, 2018	December 30, 2017
Employee compensation	\$23,799	\$15,276
VSIP liabilities	191	25,022

Edgar Filing: FLOWERS FOODS INC - Form 10-Q

Employee vacation	23,699	22,638
Employee bonus	7,209	29,369
Fair value of derivative instruments	1,180	10,247
Insurance	31,140	30,052
Bank overdraft	9,445	5,699
Accrued interest	523	7,711
Accrued taxes	12,053	10,943
Accrued legal settlements	11,877	6,928
Accrued legal costs	5,930	7,877
Multi-employer pension plan withdrawal costs	—	15,223
Accrued short term deferred income	5,326	4,940
Other	11,568	8,543
Total	\$ 143,940	\$ 200,468

12. ASSETS HELD FOR SALE

The company repurchases distribution rights from IDPs in circumstances when the company decides to exit a territory or, in some cases, when the IDP elects to terminate its relationship with the company. In the majority of the distributor agreements, if the company decides to exit a territory or stop using the independent distribution model in a territory, the company is contractually required to purchase the distribution rights from the IDP. In the event an IDP terminates its relationship with the company, the company, although not legally obligated, may repurchase and operate those distribution rights as a company-owned territory. The IDPs may also sell their distribution rights to another person or entity. Distribution rights purchased from IDPs and operated as company-owned territories are recorded on the Condensed Consolidated Balance Sheets in the line item assets held for sale while the company actively seeks another IDP to purchase the distribution rights for the territory. Distributions rights held for sale and operated by the company are sold to IDPs at fair market value pursuant to the terms of a distributor agreement. There are multiple versions of the distributor agreement in place at any given time and the terms of such distributor agreements vary.

Additional assets recorded in assets held for sale are for property, plant and equipment. The carrying values of assets held for sale are not amortized and are evaluated for impairment as required at the end of the reporting period. The table below presents the assets held for sale as of October 6, 2018 and December 30, 2017, respectively (amounts in thousands):

	October 6, 2018	December 30, 2017
Distributor territories	\$ 3,391	\$ 13,584
Property, plant and equipment	1,198	1,739
Total assets held for sale	\$ 4,589	\$ 15,323

Distribution rights sold to IDPs decreased the distributor territories held for sale during the forty weeks ended October 6, 2018.

13. DEBT AND OTHER OBLIGATIONS

Long-term debt and capital leases (net of issuance costs and debt discounts excluding line-of-credit arrangements) consisted of the following at October 6, 2018 and December 30, 2017, respectively (amounts in thousands):

	October 6, 2018	December 30, 2017
Unsecured credit facility	\$—	\$—
2026 notes	395,418	394,978
2022 notes	398,312	397,941
Accounts receivable securitization facility	—	—
Capital lease obligations	23,063	27,150
Other notes payable	8,583	12,167
	825,376	832,236
Current maturities of long-term debt and capital lease obligations	11,286	12,095
Total long-term debt and capital lease obligations	\$ 814,090	\$ 820,141

Bank overdrafts occur when checks have been issued but have not been presented to the bank for payment. Certain of our banks allow us to delay funding of issued checks until the checks are presented for payment. The delay in funding results in a temporary source of financing from the bank. The activity related to bank overdrafts is shown as a financing activity in our Condensed Consolidated Statements of Cash Flows. Bank overdrafts are included in other accrued liabilities on our Condensed Consolidated Balance Sheets. As of October 6, 2018 and December 30, 2017, the bank overdraft balance was \$9.4 million and \$5.7 million, respectively.

The company also had standby letters of credit (“LOCs”) outstanding of \$8.3 million and \$8.7 million at October 6, 2018 and December 30, 2017, respectively, which reduce the availability of funds under the credit facility (as defined below). The outstanding LOCs are for the benefit of certain insurance companies and lessors. None of the outstanding LOCs are recorded as a liability on the Condensed Consolidated Balance Sheets.

2026 Notes, Accounts Receivable Securitization Facility, 2022 Notes, and Credit Facility

2026 Notes. On September 28, 2016, the company issued \$400.0 million of senior notes. The company pays semiannual interest on the 2026 notes on each April 1 and October 1 and the 2026 notes will mature on October 1, 2026. The notes bear interest at 3.500% per annum. The 2026 notes are subject to interest rate adjustments if either Moody's or S&P downgrades (or downgrades and subsequently upgrades) the credit rating assigned to the 2026 notes. On any date prior to July 1, 2026, the company may redeem some or all of the notes at a price equal to the greater of (1) 100% of the principal amount of the notes redeemed and (2) a "make-whole" amount plus, in each case, accrued and unpaid interest. The make-whole amount is equal to the sum of the present values of the remaining scheduled payments of principal and interest on the 2026 notes to be redeemed that would be due if such notes matured July 1, 2026 (exclusive of interest accrued to, but not including, the date of redemption), discounted to the date of redemption on a semi-annual basis (assuming a 360-day year consisting of twelve 30-day months) at the treasury rate (as defined in the indenture governing the notes), plus 30 basis points, plus in each case accrued and unpaid interest. At any time on or after July 1, 2026, the company may redeem some or all of the 2026 notes at a price equal to 100% of the principal amount of the notes redeemed plus accrued and unpaid interest. If the company experiences a "change of control triggering event" (which involves a change of control of the company and the related rating of the notes below investment grade), it is required to offer to purchase the notes at a purchase price equal to 101% of the principal amount, plus accrued and unpaid interest thereon unless the company exercised its option to redeem the notes in whole. The 2026 notes are also subject to customary restrictive covenants for investment grade debt, including certain limitations on liens and sale and leaseback transactions.

The face value of the 2026 notes is \$400.0 million. There was a debt discount representing the difference between the net proceeds, after expenses, received upon issuance of debt and the amount repayable at its maturity. The company also paid issuance costs of \$3.6 million (including underwriting fees and legal fees) on the 2026 notes. Debt issuance costs and the debt discount are being amortized to interest expense over the term of the 2026 notes. As of October 6, 2018, and December 30, 2017, respectively, the company was in compliance with all restrictive covenants under the indenture governing the 2026 notes. The table below presents the debt discount, underwriting fees and the legal and other fees for issuing the 2026 notes (amounts in thousands):

	Amount at Issuance
Debt discount	\$ 2,108
Underwriting, legal, and other fees	3,634
Total fees	\$ 5,742

Accounts Receivable Securitization Facility. On July 17, 2013, the company entered into an accounts receivable securitization facility (the "facility"). The company has amended the facility six times since execution, most recently on September 27, 2018. These amendments include provisions which (i) increased the revolving commitments under the facility to \$200.0 million from \$150.0 million, (ii) added a leverage pricing grid, (iii) added an additional bank to the lending group, (iv) made certain other conforming changes, and (v) extended the term, most recently one additional year to September 27, 2020. The amendment that added the additional bank was accounted for as an extinguishment of the debt. The remaining amendments were accounted for as modifications.

Under the facility, a wholly-owned, bankruptcy-remote subsidiary purchases, on an ongoing basis, substantially all trade receivables. As borrowings are made under the facility, the subsidiary pledges the receivables as collateral. In the event of liquidation of the subsidiary, its creditors would be entitled to satisfy their claims from the subsidiary's pledged receivables prior to distributions of collections to the company. We include the subsidiary in our Consolidated

Financial Statements. The facility contains certain customary representations and warranties, affirmative and negative covenants, and events of default. There were no amounts outstanding under the facility on either October 6, 2018 or December 30, 2017. As of October 6, 2018 and December 30, 2017, respectively, the company was in compliance with all restrictive covenants under the facility. The company currently has \$194.2 million available under its facility for working capital and general corporate purposes. Amounts available for withdrawal under the facility are determined as the lesser of the total commitments and a formula derived amount based on qualifying trade receivables.

Optional principal repayments may be made at any time without premium or penalty. Interest is due two days after our reporting periods end in arrears on the outstanding borrowings and is computed as the cost of funds rate plus an applicable margin of 85 basis points. An unused fee of 30 basis points is applicable on the unused commitment at each reporting period. Financing costs paid at inception of the facility and at the time amendments are executed are being amortized over the life of the facility. The balance of unamortized financing costs was \$0.2 million on October 6, 2018 and December 30, 2017 and are recorded in other assets on the Condensed Consolidated Balance Sheets.

2022 Notes. On April 3, 2012, the company issued \$400.0 million of senior notes. The company pays semiannual interest on the 2022 notes on each April 1 and October 1 and the 2022 notes will mature on April 1, 2022. The 2022 notes bear interest at 4.375% per annum. On any date prior to January 1, 2022, the company may redeem some or all of the 2022 notes at a price equal to the greater of (1) 100% of the principal amount of the notes redeemed and (2) a “make-whole” amount plus, in each case, accrued and unpaid interest. The make-whole amount is equal to the sum of the present values of the remaining scheduled payments of principal thereof (not including any interest accrued thereon to, but not including, the date of redemption), discounted to the date of redemption on a semi-annual basis (assuming a 360-day year consisting of twelve 30-day months) at the treasury rate (as defined in the indenture governing the notes), plus 35 basis points, plus in each case, unpaid interest accrued thereon to, but not including, the date of redemption. At any time on or after January 1, 2022, the company may redeem some or all of the 2022 notes at a price equal to 100% of the principal amount of the 2022 notes redeemed plus accrued and unpaid interest. If the company experiences a “change of control triggering event” (which involves a change of control of the company and the related rating of the notes below investment grade), it is required to offer to purchase the 2022 notes at a purchase price equal to 101% of the principal amount, plus accrued and unpaid interest thereon unless the company exercised its option to redeem the 2022 notes in whole. The 2022 notes are also subject to customary restrictive covenants for investment grade debt, including certain limitations on liens and sale and leaseback transactions.

The face value of the 2022 notes is \$400.0 million and the debt discount on the 2022 notes at issuance was \$1.0 million. The company paid issuance costs (including underwriting fees and legal fees) on the 2022 notes of \$3.9 million. The issuance costs and the debt discount are being amortized to interest expense over the term of the 2022 notes. As of October 6, 2018 and December 30, 2017, the company was in compliance with all restrictive covenants under the indenture governing the 2022 notes.

Credit Facility. On November 29, 2017, the company entered into the sixth amendment to its amended and restated credit agreement, dated as of October 24, 2003, with the lenders party thereto and Deutsche Bank AG New York Branch, as administrative agent, the swingline lender and issuing lender. The amendment, among other things (i) extends the maturity date of the existing credit agreement to November 29, 2022; (ii) amends the applicable margin for revolving loans maintained as (1) base rate loans and swingline loans to a range of 0.00% to 0.575% (from a range of 0.00% to 0.75% in the existing credit agreement) and (2) Eurodollar loans to a range of 0.575% to 1.575% (from a range of 0.70% to 1.75% in the existing credit agreement), in each case, based on the leverage ratio of the company and its subsidiaries; (iii) amends the applicable facility fee to a range of 0.05% to 0.30% (from a range of 0.05% to 0.50% in the existing credit agreement), due quarterly on all commitments under the amended credit agreement, based on the leverage ratio of the company and its subsidiaries; and (iv) amends the maximum leverage ratio covenant to permit the company, at its option, in connection with certain acquisitions and investments and subject to the terms and conditions provided in the amended credit agreement, to increase the maximum ratio permitted thereunder on one or more occasions to 4.00 to 1.00 for a period of four consecutive fiscal quarters, including and/or immediately following the fiscal quarter in which such acquisitions or investments were completed (the “covenant holiday”), provided that each additional covenant holiday will not be available to the company until it has achieved and maintained a leverage ratio of at least 3.75 to 1.00 and has been complied with for at least two fiscal quarters.

This credit facility (the “credit facility”) is a five-year, \$500.0 million senior unsecured revolving loan facility. The credit facility contains a provision that permits the company to request up to \$200.0 million in additional revolving commitments, for a total of up to \$700.0 million, subject to the satisfaction of certain conditions. Proceeds from the credit facility may be used for working capital and general corporate purposes, including capital expenditures, acquisition financing, refinancing of indebtedness, dividends and share repurchases. The credit facility includes certain customary restrictions, which, among other things, require maintenance of financial covenants and limit encumbrance of assets and creation of indebtedness. Restrictive financial covenants include such ratios as a minimum interest coverage ratio and a maximum leverage ratio. The company believes that, given its current cash position, its cash flow from operating activities and its available credit capacity, it can comply with the current terms of the

amended credit facility and can meet its presently foreseeable financial requirements. As of October 6, 2018 and December 30, 2017, respectively, the company was in compliance with all restrictive covenants under the credit facility.

Financing costs paid at inception of the credit facility and at the time amendments are executed are being amortized over the life of the credit facility. The balance of unamortized financing costs was \$1.3 million and \$1.6 million on October 6, 2018 and December 30, 2017, respectively, and are recorded in other assets on the Condensed Consolidated Balance Sheets.

Amounts outstanding under the credit facility vary daily. Changes in the gross borrowings and repayments can be caused by cash flow activity from operations, capital expenditures, acquisitions, dividends, share repurchases, and tax payments, as well as derivative transactions, which are part of the company's overall risk management strategy as discussed in Note 9, Derivative Financial Instruments, of Notes to Condensed Consolidated Financial Statements of this Form 10-Q. The table below presents the borrowings and repayments under the credit facility during the forty weeks ended October 6, 2018.

	Amount
	(thousands)
Balance at December 30, 2017	\$ —
Borrowings	1,000
Payments	(1,000)
Balance at October 6, 2018	\$ —

The table below presents the net amount available under the credit facility as of October 6, 2018:

	Amount
	(thousands)
Gross amount available	\$ 500,000
Outstanding	—
Letters of credit	(8,300)
Available for withdrawal	\$ 491,700

The table below presents the highest and lowest outstanding balance under the credit facility during the forty weeks ended October 6, 2018:

	Amount
	(thousands)
High balance	\$ 1,000
Low balance	\$ —

Aggregate maturities of debt outstanding, including capital leases and the associated interest, as of October 6, 2018, are as follows (excluding unamortized debt discount and issuance costs) (amounts in thousands):

Remainder of 2018	\$ 2,372
-------------------	----------

Edgar Filing: FLOWERS FOODS INC - Form 10-Q

2019	10,827
2020	7,026
2021	3,598
2022	402,101
2023 and thereafter	405,889
Total	\$831,813

Debt discount and issuance costs are being amortized straight-line (which approximates the effective method) over the term of the underlying debt outstanding. The table below reconciles the debt issuance costs and debt discounts to the net carrying value of each of our debt obligations (excluding line-of-credit arrangements) at October 6, 2018 (amounts in thousands):

	Debt Issuance Costs		
	Face Value	and Debt Discount	Net Carrying Value
2026 notes	\$400,000	\$ 4,582	\$ 395,418
2022 notes	400,000	1,688	398,312
Other notes payable	8,750	167	8,583
Total	\$808,750	\$ 6,437	\$ 802,313

The table below reconciles the debt issuance costs and debt discounts to the net carrying value of each of our debt obligations (excluding line-of-credit arrangements) at December 30, 2017 (amounts in thousands):

	Debt Issuance Costs		
	Face Value	and Debt Discount	Net Carrying Value
2026 notes	\$400,000	\$ 5,022	\$ 394,978
2022 notes	400,000	2,059	397,941
Other notes payable	12,500	333	12,167
Total	\$812,500	\$ 7,414	\$ 805,086

The company also leases certain property and equipment under various operating and capital lease arrangements. During the first quarter of fiscal 2017, the company terminated certain operating lease contracts prior to the maturity date, which resulted in net termination costs. The net termination costs consisted of \$1.2 million of lease termination gain recognized in the selling, distribution and administrative expenses line item and \$1.8 million of lease termination costs recognized in the depreciation and amortization line item of our Condensed Consolidated Statements of Operations.

14. VARIABLE INTEREST ENTITIES

Transportation agreement variable interest entity (the “VIE”) analysis

The company maintains a transportation agreement with an entity that transports a significant portion of the company’s fresh bakery products from the company’s production facilities to outlying distribution centers. The company represents a significant portion of the entity’s revenue. This entity qualifies as a VIE, but the company has determined it is not the primary beneficiary of the VIE because the company does not (i) have the ability to direct the significant activities of the VIE and (ii) provide any implicit or explicit guarantees or other financial support to the VIE for specific return or performance benchmarks. In addition, we do not provide, nor do we intend to provide, financial or other support to the entity.

The company has concluded that certain of the trucks and trailers the VIE uses for distributing our products from the manufacturing facilities to the distribution centers qualify as right to use leases. As of October 6, 2018 and December 30, 2017, there was \$23.1 million and \$27.2 million, respectively, in net property, plant and equipment and capital lease obligations associated with the right to use leases.

Distribution rights agreement VIE analysis

The incorporated IDPs in the DSD Segment qualify as VIEs. The IDPs who are formed as sole proprietorships are excluded from the following VIE accounting analysis and discussion.

Incorporated IDPs acquire distribution rights and enter into a contract with the company to sell the company’s products in the IDPs’ defined geographic territory. The incorporated IDPs have the option to finance the acquisition of their distribution rights with the company. They can also pay cash or obtain external financing at the time they acquire the distribution rights. The combination of the company’s loans to the incorporated IDPs and the ongoing distributor arrangements with the incorporated IDPs provide a level of funding to the equity owners of the various incorporated IDPs that would not otherwise be available. As of October 6, 2018 and December 30, 2017, there was \$155.6 million

and \$137.9 million, respectively, in gross distribution rights notes receivable outstanding from incorporated IDPs.

The company is not considered to be the primary beneficiary of the VIEs because the company does not (i) have the ability to direct the significant activities of the VIEs that would affect their ability to operate their respective businesses and (ii) provide any implicit or explicit guarantees or other financial support to the VIEs, other than the financing described above, for specific return or performance benchmarks. The activities controlled by the incorporated IDPs that are deemed to most significantly impact the ultimate success of the incorporated IDP entities relate to those decisions inherent in operating the distribution business in the territory, including acquiring trucks and trailers, managing fuel costs, employee matters and other strategic decisions. In addition, we do not provide, nor do we intend to provide, financial or other support to the IDP. The IDPs are responsible for the operations of their respective territories.

The company's maximum contractual exposure to loss for the incorporated IDP relates to the distributor rights note receivable for the portion of the territory the incorporated IDPs financed at the time they acquired the distribution rights. The incorporated IDPs remit payment on their distributor rights note receivable each week during the settlement process of their weekly activity. The company will operate a territory on behalf of an incorporated IDP in situations where the IDP has abandoned its distribution rights. Any remaining balance outstanding on the distribution rights notes receivable is relieved once the distribution rights have been sold on the IDPs behalf. The company's collateral from the territory distribution rights mitigates the potential losses.

15. COMMITMENTS AND CONTINGENCIES

Self-insurance reserves and other commitments and contingencies

The company has recorded current liabilities of \$35.8 million and \$30.1 million related to self-insurance reserves, excluding the distributor litigation discussed below, at October 6, 2018 and December 30, 2017, respectively. The reserves include an estimate of expected settlements on pending claims, defense costs and a provision for claims incurred but not reported. These estimates are based on the company's assessment of potential liability using an analysis of available information with respect to pending claims, historical experience and current cost trends. The amount of the company's ultimate liability in respect of these matters may differ materially from these estimates.

In the event the company ceases to utilize the independent distributor model or exits a geographic market, the company is contractually required in some situations to purchase the distribution rights from the independent distributor. The company expects to continue operating under this model and has concluded that the possibility of a loss is remote.

The company's facilities are subject to various federal, state and local laws and regulations regarding the discharge of material into the environment and the protection of the environment in other ways. The company is not a party to any material proceedings arising under these laws and regulations. The company believes that compliance with existing environmental laws and regulations will not materially affect the consolidated financial condition, results of operations, cash flows or the competitive position of the company. The company believes it is currently in substantial compliance with all material environmental laws and regulations affecting the company and its properties. In August 2016, the U.S. Department of Labor (the "Department") notified the company that it was scheduled for a compliance review under the Fair Labor Standards Act. On November 5, 2018, the company was advised by the Department that the compliance review has been closed.

Litigation

The company and its subsidiaries from time to time are parties to, or targets of, lawsuits, claims, investigations and proceedings, including personal injury, commercial, contract, environmental, antitrust, product liability, health and safety and employment matters, which are being handled and defended in the ordinary course of business. While the company is unable to predict the outcome of these matters, it believes, based upon currently available facts, that it is remote that the ultimate resolution of any such pending matters will have a material adverse effect on its overall financial condition, results of operations or cash flows in the future. However, adverse developments could negatively impact earnings in a particular future fiscal period.

Edgar Filing: FLOWERS FOODS INC - Form 10-Q

At this time, the company is defending 27 complaints filed by distributors alleging that such distributors were misclassified as independent contractors. Twenty-three of these lawsuits seek class and/or collective action treatment. The remaining four cases either allege individual claims or do not seek class or collective action treatment or, in cases in which class treatment was sought, the court denied class certification. The respective courts have ruled on plaintiffs' motions for class certification in 13 of the pending cases, each of which is discussed below. Unless otherwise noted, a class was conditionally certified under the FLSA in each of the cases described below, although the company has the ability to petition the court to decertify that class at a later date:

Case Name	Case No.	Venue	Date Filed	Status
Rosinbaum et al. v. Flowers Foods, Inc. and Franklin Baking Co., LLC	7:16-cv-00233	U.S. District Court Eastern District of North Carolina	12/1/2015	
Neff et al. v. Flowers Foods, Inc., Lepage Bakeries Park Street, LLC, and CK Sales Co., LLC	5:15-cv-00254	U.S. District Court District of Vermont	12/2/2015	
Noll v. Flowers Foods, Inc., Lepage Bakeries Park Street, LLC, and CK Sales Co., LLC	1:15-cv-00493	U.S. District Court District of Maine	12/3/2015	
Richard et al. v. Flowers Foods, Inc., Flowers Baking Co. of Lafayette, LLC, Flowers Baking Co. of Baton Rouge, LLC, Flowers Baking Co. of Tyler, LLC and Flowers Baking Co. of New Orleans, LLC	6:15-cv-02557	U.S. District Court Western District of Louisiana	10/21/2015	
Carr et al. v. Flowers Foods, Inc. and Flowers Baking Co. of Oxford, Inc.	2:15-cv-06391	U.S. District Court Eastern District of Pennsylvania	12/1/2015	
Boulangue v. Flowers Foods, Inc. and Flowers Baking Co. of Oxford, Inc.	2:16-cv-02581	U.S. District Court Eastern District of Pennsylvania	3/25/2016	This matter has been consolidated with the Carr litigation described immediately above.
Medrano v. Flowers Foods, Inc. and Flowers Baking Co. of El Paso, LLC	1:16-cv-00350	U.S. District Court District of New Mexico	4/27/2016	
	3:17-cv-00724		4/20/2017	

Long v. Flowers
Foods, Inc., Flowers
Baking Co. of
Morristown, LLC,
and Flowers Baking
Co. of Knoxville,
LLC

U.S. District
Court Middle
District of
Tennessee

On September 7, 2018, the parties, as part of a global resolution, agreed in principle to settle this and 11 other collective action lawsuits pending against the company for a payment in the amount of \$9.0 million, comprised of \$5.4 million in settlement funds and \$3.6 million in attorneys' fees. The proposed settlement class consists of approximately 900 members. The settlement also contains certain non-economic terms that are included to strengthen and enhance the independent contractor model, which remains in place. The parties are working to obtain final court approval of the settlement. This settlement was recorded as a selling, distribution and administrative expense in our Condensed Consolidated Statements of Operations during the third quarter of fiscal 2018.

Martins v. Flowers Foods, Inc., Flowers Baking Co. of Bradenton, LLC and Flowers Baking Co. of Villa Rica, LLC	8:16-cv-03145	U.S. District Court Middle District of Florida	11/8/2016
-------------------------------------------------------------------------------------------------------------------------------	---------------	---------------------------------------------------------	-----------

Bryant v. Flowers Foods, Inc. and Flowers Baking Co. of Denton, LLC	4:17-cv-00725	U.S. District Court Eastern District of Texas	10/9/2017	On September 7, 2018, the parties agreed in principle to settle this matter as part of the settlement referenced in the Long litigation described above.
Green v. Flowers Foods, Inc. and Flowers Baking Co. of Birmingham, LLC	5:17-cv-00784	U.S. District Court Northern District of Alabama	5/11/2017	On September 7, 2018, the parties agreed in principle to settle this matter as part of the settlement referenced in the Long litigation described above.
Hall et al. v. Flowers Foods, Inc., Flowers Baking Co. of Gadsden, LLC, and Flowers Baking Co. of Birmingham, LLC	1:17-cv-00932	U.S. District Court Northern District of Alabama	6/5/2017	On September 7, 2018, the parties agreed in principle to settle this matter as part of the settlement referenced in the Long litigation described above.
Robbins v. Flowers Foods, Inc. and Flowers Baking Co. of Batesville, LLC	3:17-cv-00138	U.S. District Court Northern District of Mississippi	7/31/2017	On September 7, 2018, the parties agreed in principle to settle this matter as part of the settlement referenced in the Long litigation described above.

The company and/or its respective subsidiaries contests the allegations and are vigorously defending all of these lawsuits. Given the stage of the complaints and the claims and issues presented, except for lawsuits disclosed herein that have reached a settlement or agreement in principle, the company cannot reasonably estimate at this time the possible loss or range of loss that may arise from the unresolved lawsuits.

As of October 6, 2018, the company has settled, and the appropriate court has approved, the following collective and/or class action lawsuits filed by distributors alleging that such distributors were misclassified as independent contractors. In each of these settlements, in addition to the monetary terms noted below, the settlements also included certain non-economic terms intended to strengthen and enhance the independent contractor model:

Case Name	Case No.	Venue	Date Filed	Comments
Rehberg et al. v. Flowers Foods, Inc. and Flowers Baking Co. of Jamestown, LLC	3:12-cv-00596	U.S. District Court Western District of North Carolina	9/12/2012	On June 30, 2017, the Court dismissed this lawsuit and approved an agreement to settle this matter for \$9.0 million, comprised of \$5.2 million in settlement funds and \$3.8 million in attorneys' fees. The settlement class consisted of approximately 270 class members. This settlement was recorded as a selling, distribution and administrative expense in our Consolidated Statements of Income during the fourth quarter of fiscal 2016 and was paid in fiscal 2017.
Bokanoski et al. v. Lepage Bakeries Park Street, LLC and CK Sales Co., LLC	3:15-cv-00021	U.S. District Court District of Connecticut	1/6/2015	On March 13, 2017, the Court dismissed this lawsuit and approved an agreement to settle this matter, which includes 49 territories, for \$1.25 million, including attorneys' fees. This settlement was recorded as a selling, distribution and administrative expense in our Condensed Consolidated Statements of Operations during the third quarter of our fiscal 2016 and was paid during the first quarter of fiscal 2017.
Stewart et al. v. Flowers Foods, Inc. and Flowers Baking Co. of Batesville, LLC	1:15-cv-01162	U.S. District Court Western District of Tennessee	7/2/2015	On April 10, 2017, the Court dismissed this lawsuit and approved an agreement to settle this matter for \$250,000, including attorneys' fees, on behalf of sixteen distributors. This settlement was paid and recorded as a selling, distribution and administrative expense in our Condensed Consolidated Statements of Operations during the first quarter of fiscal 2017.
Coyle v. Flowers Foods, Inc. and Holsum Bakery, Inc.	2:15-cv-01372	U.S. District Court District of Arizona	7/20/2015	On March 23, 2018, the court dismissed this lawsuit and approved an agreement to settle this matter for \$4.3 million, comprised of \$1.2 million in settlement funds, \$2.9 million in attorneys' fees, and \$0.2 million as an incentive for class members who are active distributors not to opt out of certain portions of the new distributor agreement. The settlement consisted of approximately 190 class members. This settlement charge was recorded as a selling, distribution and administrative expense in our Consolidated Statements of Income during the third quarter of fiscal 2017 and was paid during the first quarter of fiscal 2018.

McCurley v. Flowers Foods, Inc. and Derst Baking Co., LLC	5:16-cv-00194	U.S. District Court District of South Carolina	1/20/2016	On September 10, 2018, the court approved the parties' agreement to settle this matter for a payment of \$1.5 million, comprised of \$0.8 million in settlement funds, \$0.6 million in attorneys' fees, and a collective \$0.1 million for a service award and as an incentive for class members who are active distributors not to opt out of certain portions of the new distributor agreement. The settlement class consisted of 106 class members. This settlement charge was recorded as a selling, distribution and administrative expense in our Condensed Consolidated Statements of Operations during the fourth quarter of fiscal 2017. This settlement was paid on November 1, 2018.
Zapata et al. v. Flowers Foods, Inc. and Flowers Baking Co. of Houston, LLC (the "Zapata litigation")	4:16-cv-00676	U.S. District Court Southern District of Texas	3/14/2016	On September 12, 2018, the court dismissed the Zapata litigation and the Rodriguez litigation (defined below) and approved an agreement to settle both matters for \$740,700, including attorneys' fees, on behalf of 43 distributors. This settlement was paid and recorded as a selling, distribution and administrative expense in our Condensed Consolidated Statements of Operations during the third quarter of fiscal 2018.
Rodriguez et al. v. Flowers Foods, Inc. and Flowers Baking Co. of Houston, LLC (the "Rodriguez litigation")	4:16-cv-00245	U.S. District Court Southern District of Texas	1/28/2016	See the Zapata litigation discussion immediately above.
Schucker et al. v. Flowers Foods, Inc., Lepage Bakeries Park St., LLC, and C.K. Sales Co., LLC	1:16-cv-03439	U.S. District Court Southern District of New York	5/9/2016	On September 5, 2018, the court dismissed this lawsuit and approved an agreement to settle this matter for approximately \$1.3 million, comprised of \$0.4 million in settlement funds, \$0.9 million in attorneys' fees, and a collective \$0.1 million for service awards and incentives for class members who are active distributors not to opt out of certain portions of the new distributor agreement. The settlement consisted of 27 class members. This settlement charge has been recorded as a selling, distribution and administrative expense in our Condensed Consolidated Statements of Operations during the first quarter of fiscal 2018.

On August 12, 2016, a class action complaint was filed in the U.S. District Court for the Southern District of New York by Chris B. Hendley (the “Hendley complaint”) against the company and certain senior members of management (collectively, the “defendants”). On August 17, 2016, another class action complaint was filed in the U.S. District Court for the Southern District of New York by Scott Dovell, II (the “Dovell complaint” and together with the Hendley complaint, the “complaints”) against the defendants. Plaintiffs in the complaints are securities holders that acquired company securities between February 7, 2013 and August 10, 2016. The complaints generally allege that the defendants made materially false and/or misleading statements and/or failed to disclose that (1) the company’s labor practices were not in compliance with applicable federal laws and regulations; (2) such non-compliance exposed the company to legal liability and/or negative regulatory action; and (3) as a result, the defendants’ statements about the company’s business, operations, and prospects were false and misleading and/or lacked a reasonable basis. The counts of the complaints are asserted against the defendants pursuant to Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 under the Exchange Act. The complaints seek (1) class certification under the Federal Rules of Civil Procedure, (2) compensatory damages in favor of the plaintiffs and all other class members against the defendants, jointly and severally, for all damages sustained as a result of wrongdoing, in an amount to be proven at trial, including interest, and (3) awarding plaintiffs and the class their reasonable costs and expenses incurred in the actions, including counsel and expert fees. On October 21, 2016, the U.S. District Court for the Southern District of New York consolidated the complaints into one action captioned “In re Flowers Foods, Inc. Securities Litigation” (the “consolidated securities action”), appointed Walter Matthews as lead plaintiff (“lead plaintiff”), and appointed Glancy Prongay & Murray LLP and Johnson & Weaver, LLP as co-lead counsel for the putative class. On November 21, 2016, the court granted defendants’ and lead plaintiff’s joint motion to transfer the consolidated securities action to the U.S. District Court for the Middle District of Georgia. Lead plaintiff filed his Consolidated Class Action Complaint on January 12, 2017, raising the same counts and general allegations and seeking the same relief as the Dovell and Hendley complaints. On March 13, 2017, the defendants filed a motion to dismiss the lawsuit which was granted in part and denied in part on March 23, 2018. The court dismissed certain allegedly false or misleading statements as nonactionable under federal securities laws, and will allow others to proceed to fact discovery. On July 23, 2018, lead plaintiff filed his motion for class certification. The defendants filed their memorandum of law in opposition to class certification on October 5, 2018. The deadline for lead plaintiff to file his reply in support of class certification is November 13, 2018.

On June 8, 2018, a verified shareholder derivative complaint was filed in the U.S. District Court for the Middle District of Georgia by William D. Wrigley, derivatively on behalf of the company (the “Wrigley complaint”), against certain current and former directors and officers of the company. On June 14, 2018, a related shareholder derivative complaint was filed in the U.S. District Court for the Middle District of Georgia by Stephen Goldberger, derivatively on behalf of the company (the “Goldberger complaint” and together with the Wrigley complaint, the “federal derivative complaints”), against the same current and former directors and officers of the company. The federal derivative complaints allege, among other things, breaches of fiduciary duties and violations of federal securities laws relating to the company’s labor practices, and seek unspecified damages, disgorgement, and other relief. On June 27, 2018, these derivative actions were consolidated and stayed until the earlier of (1) an order from the court on any summary judgment motions that may be filed in the consolidated securities action, or (2) notification that there has been a settlement reached in the consolidated securities action, or until otherwise agreed to by the parties.

On June 21, 2018, two verified shareholder derivative complaints were filed in The Superior Court of Thomas County, State of Georgia, by Margaret Cicchini Family Trust and Frank Garnier, separately, derivatively on behalf of the company (together the “state derivative complaints”), against certain current and former directors and officers of the company. The state derivative complaints allege, among other things, breaches of fiduciary duties relating to the company’s labor practices, and seek unspecified damages, disgorgement, and other relief. On July 12, 2018, these derivative actions were consolidated and stayed until the earlier of (1) an order from the court on any summary judgment motions that may be filed in the consolidated securities action, or (2) notification that there has been a settlement reached in the consolidated securities action, or until otherwise agreed to by the parties.

The company and/or its respective subsidiaries are vigorously defending these lawsuits. Given the stage of the complaints and the claims and issues presented, the company cannot reasonably estimate at this time the possible loss or range of loss, if any, that may arise from the unresolved lawsuits.

See Note 13, Debt and Other Obligations, of Notes to Condensed Consolidated Financial Statements of this Form 10-Q for additional information on the company's commitments.

37

16. EARNINGS PER SHARE

The following is a reconciliation of net income and weighted average shares for calculating basic and diluted earnings per common share for the twelve and forty weeks ended October 6, 2018 and October 7, 2017, respectively (amounts and shares in thousands, except per share data):

	For the Twelve Weeks Ended		For the Forty Weeks Ended	
	October 6, 2018	October 7, 2017	October 6, 2018	October 7, 2017
Net income (loss)	\$39,630	\$(33,571)	\$136,319	\$71,587
Basic Earnings (Loss) Per Common Share:				
Basic weighted average shares outstanding for common stock	211,082	209,606	210,994	209,376
Basic earnings (loss) per common share	\$0.19	\$(0.16)	\$0.65	\$0.34
Diluted Earnings (Loss) Per Common Share:				
Basic weighted average shares outstanding for common stock	211,082	209,606	210,994	209,376
Add: Shares of common stock assumed issued upon exercise of				
stock options and vesting of restricted stock	482	—	458	855
Diluted weighted average shares outstanding for common stock	211,564	209,606	211,452	210,231
Diluted earnings (loss) per common share	\$0.19	\$(0.16)	\$0.64	\$0.34

There were no anti-dilutive shares during the twelve and forty weeks ended October 6, 2018. There were 1,682,086 and 792,136 of anti-dilutive shares during the twelve and forty weeks ended October 7, 2017, respectively.

17. STOCK-BASED COMPENSATION

On March 5, 2014, our Board of Directors approved and adopted the 2014 Omnibus Equity and Incentive Compensation Plan (“Omnibus Plan”). The Omnibus Plan was approved by our shareholders on May 21, 2014. The Omnibus Plan authorizes the compensation committee of the Board of Directors to provide equity-based compensation in the form of stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares, performance units, dividend equivalents and other awards to provide our officers, key employees, and non-employee directors’ incentives and rewards for performance. The Omnibus Plan replaced the Flowers Foods’ 2001 Equity and Performance Incentive Plan, as amended and restated as of April 1, 2009 (“EPIP”), the stock appreciation right plan, and the bonus plan. Equity awards granted after May 21, 2014 are governed by the Omnibus Plan. No additional awards were issued under the EPIP after May 21, 2014 and the last issued awards were fully exercised during the first quarter of fiscal 2018. Awards granted under the Omnibus Plan are limited to the authorized amount of 8,000,000 shares.

The following is a summary of stock options, restricted stock, and deferred stock outstanding under the plans described above. Information relating to the company’s stock appreciation rights, which were issued under a separate stock appreciation right plan, is also described below. The company typically grants awards at the beginning of its fiscal year. There were no grants in the first three quarters of fiscal 2018.

Stock Options

The company issued non-qualified stock options (“NQSOs”) during fiscal years 2011 and prior that were vested and fully exercised by our first quarter of fiscal 2018.

The company’s final 72,785 stock options, with an exercise price of \$10.87, outstanding on December 30, 2017 were exercised during the first quarter of fiscal 2018. There are no outstanding NQSOs as of October 6, 2018.

The cash received, the windfall tax benefit, and intrinsic value from stock option exercises for the forty weeks ended October 6, 2018 and October 7, 2017, respectively, were as follows (amounts in thousands):

	October 6, 2018	October 7, 2017
Cash received from option exercises	\$ 791	\$ 9,296
Tax benefit at exercise, net	\$ 111	\$ 2,004
Intrinsic value of stock options exercised	\$ 609	\$ 7,197

Performance-Contingent Restricted Stock Awards

Performance-Contingent Total Shareholder Return Shares (“TSR Shares”)

Certain key employees have been granted performance-contingent restricted stock under the Omnibus Plan in the form of TSR Shares. The awards vest approximately two years from the date of grant (after the filing of the company’s Annual Report on Form 10-K), and the shares become non-forfeitable if, and to the extent that, on that date the vesting conditions are satisfied. The total shareholder return (“TSR”) is the percent change in the company’s stock price over the measurement period plus the dividends paid to shareholders. The performance payout is calculated at the end of each of the last four quarters (averaged) in the measurement period. Once the TSR is determined for the company (“Company TSR”), it is compared to the TSR of our food company peers (“Peer Group TSR”). The Company TSR compared to the Peer Group TSR will determine the payout as set forth below:

	Payout as %
Percentile	of Target
90th	200 %
70th	150 %
50th	100 %
30th	50 %
Below 30th	0 %

For performance between the levels described above, the degree of vesting is interpolated on a linear basis. The 2015 award, which vested in fiscal 2017, did not meet the performance condition and no shares were issued. The 2016 award, which vested in fiscal 2018, vested at 12.5% of target.

The TSR shares vest immediately if the grantee dies or becomes disabled. However, if the grantee retires at age 65 (or age 55 with at least 10 years of service with the company) or later, on the normal vesting date the grantee will receive a pro-rated number of shares based upon the retirement date and measured at the actual performance for the entire performance period. In addition, if the company undergoes a change in control, the TSR shares will immediately vest at the target level, provided that if 12 months of the performance period have been completed, vesting will be determined based on Company TSR as of the date of the change in control without application of four-quarter averaging. During the vesting period, the grantee has none of the rights of a shareholder. Dividends declared during the vesting period will accrue and will be paid at vesting on the TSR shares that ultimately vest. The fair value estimate was determined using a Monte Carlo simulation model, which utilizes multiple input variables to estimate the probability of the company achieving the market condition discussed above. Inputs into the model included the following for the company and comparator companies: (i) TSR from the beginning of the performance cycle through the measurement date; (ii) volatility; (iii) risk-free interest rates; and (iv) the correlation of the comparator companies’ TSR. The inputs are based on historical capital market data.

The following performance-contingent TSR Shares have been granted under the Omnibus Plan and have service period remaining (amounts in thousands, except price data):

Grant Date	January 1, 2017
Shares granted	426
Vesting date	3/1/2019
Fair value per share	\$ 23.31

Performance-Contingent Return on Invested Capital Shares (“ROIC Shares”)

Certain key employees have been granted performance-contingent restricted stock under the Omnibus Plan in the form of ROIC Shares. The awards generally vest approximately two years from the date of grant (after the filing of the company’s Annual Report on Form 10-K), and the shares become non-forfeitable if, and to the extent that, on that date, the vesting conditions are satisfied. Return on Invested Capital (“ROIC”) is calculated by dividing our profit, as defined, by the invested capital. Generally, the performance condition requires the company’s average ROIC to exceed its average weighted cost of capital (“WACC”) by between 1.75 to 4.75 percentage points (the “ROI Target”) over the two fiscal year performance period. If the lowest ROI Target is not met, the awards are forfeited. The ROIC Shares can be earned based on a range from 0% to 125% of target as defined below:

- ROIC above WACC by less than 1.75 percentage points pays 0% of ROI Target;
- ROIC above WACC by 1.75 percentage points pays 50% of ROI Target; or
- ROIC above WACC by 3.75 percentage points pays 100% of ROI Target; or
- ROIC above WACC by 4.75 percentage points pays 125% of ROI Target.

39

For performance between the levels described above, the degree of vesting is interpolated on a linear basis. The 2015 award, which vested in fiscal 2017, actual attainment was 87% of ROI Target. The 2016 award, which vested in fiscal 2018, actual attainment was 70% of ROI Target.

The ROIC Shares vest immediately if the grantee dies or becomes disabled. However, if the grantee retires at age 65 (or age 55 with at least 10 years of service with the company) or later, on the normal vesting date the grantee will receive a pro-rated number of ROIC Shares based upon the retirement date and actual performance for the entire performance period. In addition, if the company undergoes a change in control, the ROIC Shares will immediately vest at the target level. During the vesting period, the grantee has none of the rights of a shareholder. Dividends declared during the vesting period will accrue and will be paid at vesting on the ROIC Shares that ultimately vest. The fair value of this type of award is equal to the stock price on the grant date. Since these awards have a performance condition feature the expense associated with these awards may change depending on the expected ROI Target attained at each reporting period. The 2017 award is being expensed at 90% of ROI Target. The following performance-contingent ROIC Shares have been granted under the Omnibus Plan and have service period remaining (amounts in thousands, except price data):

Grant Date	January 1, 2017
Shares granted	426
Vesting date	3/1/2019
Fair value per share	\$ 19.97

Performance-Contingent Restricted Stock Summary

The table below presents the TSR modifier share adjustment, ROIC modifier share adjustment, accumulated dividends on vested shares, and the tax benefit/(expense) at vesting of the performance-contingent restricted stock awards (amounts in thousands, except per share data). The shortfall at vesting of 2015 and 2016 awards was recorded as tax expense.

Award Granted	Fiscal Year	TSR Modifier Increase/(Decrease) Shares	ROIC Modifier Increase/(Decrease) Shares	Dividends at		Fair Value at
				Vesting	Tax	
2016	2018	(333,112)	(114,190)	\$ 405	\$ (2,130)	\$ 6,504
2015	2017	(378,219)	(49,272)	\$ 392	\$ (3,099)	\$ 6,316

Performance-Contingent Restricted Stock

The company's performance-contingent restricted stock activity for the forty weeks ended October 6, 2018 is presented below (amounts in thousands, except price data):

		Weighted
		Average
		Grant
		Date
		Fair
	Shares	Value
Nonvested shares at December 30, 2017	1,575	\$ 22.20
Grant reduction for not achieving the ROIC modifier	(114)	\$ 21.49
Grant reduction for not achieving the TSR modifier	(333)	\$ 24.17
Vested	(314)	\$ 21.89
Forfeited	(35)	\$ 22.83
Nonvested shares at October 6, 2018	779	\$ 21.63

As of October 6, 2018, there was \$2.8 million of total unrecognized compensation cost related to nonvested restricted stock granted under the Omnibus Plan. That cost is expected to be recognized over a weighted-average period of 0.40 years. The total intrinsic value of shares vested during the twelve and forty weeks ended October 6, 2018 was \$6.5 million.

Deferred and Restricted Stock

Non-employee directors may convert their annual board retainers into deferred stock equal in value to 100% of the cash payments directors would otherwise receive and the vesting period is a one-year period to match the period of time that cash would have been received if no conversion existed. Accumulated dividends are paid upon delivery of the shares. During fiscal 2018, non-employee directors elected to receive an aggregate of 12,950 common shares for board retainer deferrals pursuant to the Omnibus Plan. A total of 10,020 common shares were vested and issued for previous board retainer deferrals.

Non-employee directors also receive annual grants of deferred stock. This deferred stock vests one year from the grant date. The deferred stock will be distributed to the grantee at a time designated by the grantee at the date of grant. Compensation expense is recorded on this deferred stock over the one-year minimum vesting period. During fiscal 2018, non-employee directors received an aggregate of 65,000 shares for their annual grant pursuant to the Omnibus Plan. The deferred grant in fiscal 2017 fully vested in our second quarter of fiscal 2018 with 63,180 shares issued at vesting and 14,040 deferred at vesting.

On May 31, 2013, the company's Chief Executive Officer ("CEO") received a time-based restricted stock award of approximately \$1.3 million of restricted stock pursuant to the EPIP. This award vested at 100% on the fourth anniversary of the date of the grant. Dividends accrued on the award and were paid to the CEO on the vesting date. There were 58,500 shares issued for this award at a fair value of \$22.25 per share. This award vested at a price of \$18.48 and the shares were issued in our second quarter of fiscal 2017.

The deferred stock activity for the forty weeks ended October 6, 2018 is set forth below (amounts in thousands, except price data):

	Shares	Value	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Nonvested shares at December 30, 2017	87	\$ 18.70		
Vested	(87)	\$ 18.57		
Granted	78	\$ 19.89		
Nonvested shares at October 6, 2018	78	\$ 19.89	0.62	\$ 1,756

As of October 6, 2018, there was \$0.9 million of total unrecognized compensation cost related to deferred stock awards granted under the Omnibus Plan that will be recognized over a weighted-average period of 0.62 years. The total intrinsic value of shares vested during the twelve and forty weeks ended October 6, 2018 was \$1.8 million.

Stock-Based Payments Compensation Expense Summary

The following table summarizes the company's stock-based compensation expense for the twelve and forty weeks ended October 6, 2018 and October 7, 2017, respectively (amounts in thousands):

For the Twelve
Weeks Ended
October 6, 2018
October 7, 2017

Edgar Filing: FLOWERS FOODS INC - Form 10-Q

	2018	
Performance-contingent restricted stock awards	\$ 1,061	\$ 2,638
Deferred and restricted stock	381	380
Total stock-based compensation	\$ 1,442	\$ 3,018

	For the Forty Weeks Ended October	
	6, 2018	October 7, 2017
Performance-contingent restricted stock awards	\$ 5,634	\$ 10,321
Deferred and restricted stock	1,258	1,387
Total stock-based compensation	\$ 6,892	\$ 11,708

18. POSTRETIREMENT PLANS

The following summarizes the company's balance sheet related pension and other postretirement benefit plan accounts at October 6, 2018 compared to accounts at December 30, 2017 (amounts in thousands):

	October 6, 2018	December 30, 2017
Current liability	\$ 935	\$ 935
Noncurrent liability	\$ 41,075	\$ 60,107
Accumulated other comprehensive loss, net of tax	\$ 107,292	\$ 78,076

Defined Benefit Plans and Nonqualified Plan

On September 28, 2018, the Board of Directors approved a resolution to terminate the Flowers Foods, Inc. Retirement Plan No. 1 (“Plan No. 1”), effective December 31, 2018. The plan was closed to new participants on January 1, 1999 and benefit accruals were previously frozen on or before August 1, 2008. The Company has commenced the plan termination process and expects to distribute a portion of the pension plan assets as lump sum payments during late 2019 (or early 2020) with the remaining balance transferred to an insurance company in the form of an annuity. The total payments distributed will depend on the lump sum offer participation rate of eligible participants. Based on the estimated value of assets held in the plan, the Company currently estimates that a cash contribution of approximately \$5.0 million to \$35.0 million will be required to fully fund the plan’s liabilities at termination. In addition, based on current assumptions, the Company estimates a final non-cash settlement charge of approximately \$125.0 million.

The company amended our qualified defined benefit plans in October 2015 to allow pension plan participants not yet receiving benefit payments the option to elect to receive their benefit as a single lump sum payment. This amendment was effective as of January 1, 2016.

In addition, the company continues to recognize settlement accounting charges each year as a result of the ongoing lump sum payments from the plan. Settlement accounting, which accelerates recognition of a plan’s unrecognized net gain or loss, is triggered if the lump sums paid during a year exceeds the sum of the plan’s service and interest cost. The company determined it was probable a settlement would occur and paid lump sums that exceeded that threshold during our first quarter of fiscal 2018. The table below presents our recognized settlement loss by quarter for the forty weeks ended October 6, 2018 (amounts in thousands):

	Settlement charge
First quarter	\$ 4,668
Second quarter	1,035
Third quarter	930
For the forty weeks ended October 6, 2018	\$ 6,633

An additional settlement charge will be recognized in the fourth quarter of fiscal 2018. The amount will depend on the amounts settled and the plan’s unrecognized net gain or loss at the end of the quarter.

The company used a measurement date of December 31, 2017 for the defined benefit and postretirement benefit plans described below (excluding Plan No. 1, which has a measurement date of September 30, 2018 due to the settlement). The actuarial loss for Plan No. 1 from December 31, 2017 to September 30, 2018 is primarily due to revaluing the benefit obligations reflecting the plan termination cost to settle the obligations. This valuation assumption basis and method is different than what was used for prior measurement dates, and is a more precise measurement of the obligation now that the termination is imminent. Plan termination is subject to regulatory approval, prevailing market conditions, and other considerations, including interest rates and annuity pricing at the time assets are distributed. For Plan No. 1, a discount rate of 3.47% was used to derive the estimated plan termination obligations as of September 30, 2018. Interest Cost for the fourth quarter of 2018 for Plan No. 1 will not use the granular approach, given that the Plan No. 1’s assets are expected to be distributed within the next 18 months.

The long-term expected rate of return, net of expenses, for the defined benefit plans was 5.9% at the March 31, 2018 re-measurement. When Plan No. 1 was re-measured as of June 30, 2018 and September 30, 2018, the expected return

was changed from 5.9% to 5.2% due to re-balancing the plan asset allocation to more debt rather than equities as part of our pension de-risking strategy. The mortality assumptions were not changed from the re-measurement as of December 31, 2017.

The company voluntarily contributed \$10.0 million during our first quarter of fiscal 2018, \$30.0 million during our second quarter of fiscal 2018, and \$0.1 million during our third quarter of fiscal 2018 to Plan No. 1. A voluntary contribution of \$0.6 million was made to Plan No. 2 during the third quarter of fiscal 2018.

The net periodic pension cost (income) for the company's plans include the following components (amounts in thousands):

	For the Twelve Weeks Ended		For the Forty Weeks Ended	
	October 6, 2018	October 7, 2017	October 6, 2018	October 7, 2017
Service cost	\$216	\$174	\$720	\$581
Interest cost	3,166	2,779	9,413	9,792
Expected return on plan assets	(4,464)	(5,437)	(14,549)	(19,191)
Settlement loss	930	3,030	6,633	3,030
Amortization of prior service cost	97	83	291	291
Amortization of net loss	1,126	1,365	3,956	4,792
Total net periodic pension cost (income)	\$1,071	\$1,994	\$6,464	\$(705)

The components of net periodic benefit cost (income) other than the service cost are included in the other components of net periodic pension and postretirement benefits credit line item on our Condensed Consolidated Statements of Operations.

Postretirement Benefit Plan

The company provides certain medical and life insurance benefits for eligible retired employees covered under the active medical plans. The plan incorporates an up-front deductible, coinsurance payments and retiree contributions at various premium levels. Eligibility and maximum period of coverage is based on age and length of service.

The net periodic postretirement income for the company includes the following components (amounts in thousands):

	For the Twelve Weeks Ended		For the Forty Weeks Ended	
	October 6, 2018	October 7, 2017	October 6, 2018	October 7, 2017
Service cost	\$66	\$59	\$221	\$197
Interest cost	54	52	181	174
Amortization of prior service credit	(49)	(49)	(163)	(163)
Amortization of net gain	(99)	(114)	(331)	(383)
Total net periodic postretirement income	\$(28)	\$(52)	\$(92)	\$(175)

The components of net periodic postretirement benefits income other than the service cost are included in the other components of net periodic pension and postretirement benefits credit line item on our Condensed Consolidated Statements of Operations.

401(k) Retirement Savings Plan

The Flowers Foods, Inc. 401(k) Retirement Savings Plan (“401(k) plan”) covers substantially all the company’s employees who have completed certain service requirements. During the twelve weeks ended October 6, 2018 and October 7, 2017, the total cost and employer contributions were \$6.0 million and \$6.5 million, respectively. During the forty weeks ended October 6, 2018 and October 7, 2017 the total cost and employer contributions were \$19.6 million and \$22.0 million, respectively.

Multi-employer Pension Plan

On August 18, 2017, the union participants of the Bakery and Confectionary Union and Industry International Pension Fund (the “MEPP Fund”) at our Lakeland, Florida plant voted to withdraw from the MEPP Fund in the most recent collective bargaining agreement. The withdrawal was effective, and the union participants were eligible to participate in the 401(k) plan, on November 1, 2017. During the third quarter of fiscal 2017, the company recorded a liability of \$15.2 million related to the withdrawal from the MEPP Fund. During the first quarter of fiscal 2018, the company recorded an additional liability of \$2.3 million for the final settlement amount of the withdrawal liability. The withdrawal liability was computed as the net present value of 20 years of monthly payments derived from the company’s share of unfunded vested benefits. The company began making payments during the first quarter of fiscal 2018. While this is our best estimate of the ultimate cost of the withdrawal from the MEPP Fund, additional withdrawal liability may be incurred based on the final fund assessment or in the event of a mass withdrawal, as defined by statute following our complete withdrawal. Transition payments, including related tax payments, were made on November 3, 2017 to, and for the benefit of, union participants as part of the collective bargaining agreement. An additional \$3.1 million was recorded for these transition payments. The withdrawal liability charge and the transition payments were recorded in the multi-employer pension plan withdrawal costs line item on our Condensed Consolidated Statements of Operations and are in the DSD Segment. The liability on December 30, 2017 was recorded in other accrued current liabilities on the Condensed Consolidated Balance Sheets. We paid \$0.2 million during the first quarter of fiscal 2018 and the balance was paid early in the second quarter of fiscal 2018.

19. INCOME TAXES

The effective tax rate for the twelve weeks ended October 6, 2018 was 22.5% compared to 40.6% for the twelve weeks ended October 7, 2017. The decrease in the rate is primarily due to the reduction of the U.S. corporate tax rate from 35% to 21%, as a result of U.S. tax reform. In addition, tax benefits in the third quarter of the prior year increased the effective tax rate due to negative earnings before tax in the quarter. Tax benefits in the current quarter have a favorable impact on the effective tax rate. During the twelve weeks ended October 6, 2018, the primary differences in the effective rate and the statutory rate are state income taxes, offset with credits recognized for job creation and preservation of historical real property.

The effective tax rate for the forty weeks ended October 6, 2018 and October 7, 2017 was 20.1% and 32.1%, respectively. The decrease in the rate from the prior year is primarily due to the reduction of the U.S. corporate tax rate from 35% to 21%, and adjustments to provisional taxes recorded in the fourth quarter of 2017 to revalue our U.S. deferred tax liabilities to the lower rate. During the forty weeks ended October 6, 2018, the primary differences in the effective rate and the statutory rate are state income taxes and adjustments to prior year estimates that impact the effective tax rate in the current quarter.

In the fourth quarter ending December 30, 2017, a tax benefit of \$48.2 million was recorded as an estimate of the impact of the Act. This provisional amount was adjusted in the second quarter of fiscal 2018 due to additional analysis, changes in assumptions and actions taken related to pension contributions and bonus depreciation on certain assets placed in service during fiscal 2017. The adjustment resulted in a discrete tax benefit of \$5.6 million, a reduction to federal income tax payable of \$16.4 million and an increase to federal deferred tax liabilities of \$10.8 million. No adjustments to the provisional estimate were recorded in the current quarter, and any subsequent adjustments in the fourth quarter are not expected to be significant.

During the forty weeks ended October 6, 2018, the company's activity with respect to its uncertain tax positions and related interest expense accrual was not material to the Condensed Consolidated Financial Statements. As of October 6, 2018, we do not anticipate significant changes to the amount of gross unrecognized tax benefits over the next twelve months.

The company adopted guidance discussed in Note 3, Recent Accounting Pronouncements, of Notes to Condensed Consolidated Financial Statements of this Form 10-Q and retrospectively adjusted our Condensed Consolidated Statements of Cash Flows.

20. SEGMENT REPORTING

The company's segments are currently separated primarily by the different delivery methods each segment uses for its respective product deliveries. The DSD Segment's products are delivered fresh to customers through a network of IDPs who are incentivized to grow sales and to build equity in their distributorships. The Warehouse Segment ships fresh and frozen products to customers' warehouses nationwide. Our bakeries fall into either the DSD Segment or Warehouse Segment depending on the primary method of delivery used to sell that bakery's products. The bakeries within each segment produce products that are sold externally and internally. Internal sales are to bakeries within the producing bakery's segment or to the other segment. Sales between bakeries are transferred at standard cost.

Edgar Filing: FLOWERS FOODS INC - Form 10-Q

The company evaluates each segment's performance based on income or loss before interest and income taxes, excluding unallocated expenses and charges, which the company's management deems to be an overall corporate cost or a cost not reflective of the segment's core operating businesses.

Information regarding the operations in these reportable segments is as follows (amounts in thousands):

	For the Twelve Weeks Ended		For the Forty Weeks Ended	
	October 6, 2018	October 7, 2017	October 6, 2018	October 7, 2017
Sales:				
DSD Segment	\$799,271	\$803,153	\$2,659,639	\$2,628,365
Warehouse Segment	182,639	185,219	615,530	596,740
Eliminations:				
Sales from Warehouse Segment to DSD Segment	(39,443)	(39,652)	(136,708)	(129,637)
Sales from DSD Segment to Warehouse Segment	(19,018)	(15,898)	(67,276)	(48,358)
	\$923,449	\$932,822	\$3,071,185	\$3,047,110
Gain on divestiture:				
Warehouse Segment	\$—	\$—	\$—	\$28,875
	\$—	\$—	\$—	\$28,875
Multi-employer pension plan withdrawal costs:				
DSD Segment	\$—	\$18,268	\$2,322	\$18,268
	\$—	\$18,268	\$2,322	\$18,268
Loss (recovery) on inferior ingredients:				
DSD Segment	\$(2,986)	\$—	\$898	\$—
Warehouse Segment	1,095	—	1,095	—
	\$(1,891)	\$—	\$1,993	\$—
Restructuring charges:				
DSD Segment	\$289	\$76,625	\$2,187	\$76,625
Warehouse Segment	175	20,091	251	20,091
Unallocated corporate costs	33	3,833	119	3,833
	\$497	\$100,549	\$2,557	\$100,549
Impairment of assets:				
DSD Segment	\$—	\$—	\$2,483	\$—
	\$—	\$—	\$2,483	\$—
Depreciation and amortization:				
DSD Segment	\$27,676	\$28,286	\$95,273	\$98,703
Warehouse Segment	4,916	4,769	16,443	15,841
Unallocated corporate costs(1)	70	(83)	233	(256)
	\$32,662	\$32,972	\$111,949	\$114,288
Income from operations:				
DSD Segment	\$58,819	\$(20,338)	\$197,725	\$146,388
Warehouse Segment	5,866	(9,082)	31,563	47,202
Unallocated corporate costs(2)	(11,235)	(22,637)	(46,959)	(78,722)
	\$53,450	\$(52,057)	\$182,329	\$114,868
Interest expense	\$(8,180)	\$(8,194)	\$(27,390)	\$(28,255)
Interest income	\$6,615	\$5,464	\$21,176	\$17,199

Edgar Filing: FLOWERS FOODS INC - Form 10-Q

Pension plan settlement loss	\$ (930)	\$ (3,030)	\$ (6,633)	\$ (3,030)
Other components of net periodic pension and postretirement benefits credit	\$ 171	\$ 1,321	\$ 1,204	\$ 4,687
Income before income taxes	\$ 51,126	\$ (56,496)	\$ 170,686	\$ 105,469

45

The table below presents the assets by segment (amounts in thousands):

Assets:	October 6, 2018	December 30, 2017
DSD Segment	\$2,293,104	\$2,270,179
Warehouse Segment	301,249	296,157
Other (3)	98,784	93,388
Total assets	\$2,693,137	\$2,659,724

(1) Represents costs allocated to the company's corporate head office.

(2) Represents costs allocated to the company's corporate head office and pension plan settlement loss.

(3) Represents the company's corporate head office assets, including primarily cash and cash equivalents and deferred taxes. Certain assets were reclassified from the unallocated corporate head office to the DSD Segment during the first quarter of our fiscal 2018.

Sales by product category in each reportable segment are as follows for the twelve and forty weeks ended October 6, 2018 and October 7, 2017, respectively (amounts in thousands):

	For the Twelve Weeks Ended October 6, 2018			For the Twelve Weeks Ended October 7, 2017		
	Warehouse			Warehouse		
	DSD Segment	Segment	Total	DSD Segment	Segment	Total
Branded retail	\$514,405	\$ 32,945	\$547,350	\$514,346	\$ 36,963	\$551,309
Store branded retail	114,581	26,418	140,999	110,853	27,803	138,656
Non-retail and other	151,267	83,833	235,100	162,056	80,801	242,857
Total	\$780,253	\$ 143,196	\$923,449	\$787,255	\$ 145,567	\$932,822

	For the Forty Weeks Ended October 6, 2018			For the Forty Weeks Ended October 7, 2017		
	Warehouse			Warehouse		
	DSD Segment	Segment	Total	DSD Segment	Segment	Total
Branded retail	\$1,700,461	\$ 116,192	\$1,816,653	\$1,674,871	\$ 121,052	\$1,795,923
Store branded retail	372,802	90,369	463,171	368,371	86,960	455,331
Non-retail and other	519,100	272,261	791,361	536,765	259,091	795,856
Total	\$2,592,363	\$ 478,822	\$3,071,185	\$2,580,007	\$ 467,103	\$3,047,110

The tables above present certain sales by category that have been reclassified from amounts previously reported.

21. SUBSEQUENT EVENTS

The company has evaluated subsequent events since October 6, 2018, the date of these financial statements. We believe there were no material events or transactions discovered during this evaluation that require recognition or disclosure in the financial statements other than the items discussed below.

On November 6, 2018, the company announced the closure of a bakery in Brattleboro, Vermont. We expect to close the bakery by the end of fiscal 2018. The closure costs are estimated to be between \$5.0 million and \$6.0 million and are expected to be finalized and recorded in our fourth quarter of fiscal 2018.

On November 7, 2018, the company announced a definitive agreement to acquire Canyon Bakehouse LLC, a privately held, gluten-free baking company based in Johnstown, Colorado, for approximately \$205 million (including a performance-based contingent payment of \$5 million). The acquisition, which is subject to regulatory approval and customary closing conditions, is expected to be completed later in the fourth quarter of 2018. The acquisition aligns with our strategic initiatives by capitalizing on growing segments in the bakery category. The company plans to fund the acquisition using its existing facility and available cash.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of the financial condition and results of operations of the company as of and for the twelve and forty weeks ended October 6, 2018 should be read in conjunction with the Form 10-K and Part II., Item 1A., Risk Factors, of the Form 10-Q.

Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is segregated into four sections, including:

- Executive overview — provides a summary of our business, operating performance and cash flows, and strategic initiatives.
 - Critical accounting estimates — describes the accounting areas where management makes critical estimates to report our financial condition and results of operations. There have been no changes to this section from the Form 10-K.
 - Results of operations — an analysis of the company's consolidated results of operations for the two comparative periods presented in our Condensed Consolidated Financial Statements.
 - Liquidity and capital resources — an analysis of cash flow, contractual obligations, and certain other matters affecting the company's financial position.
- Matters Affecting Comparability

Detailed below are expense (gain) items affecting comparability that will provide additional context while reading this discussion:

	For the Twelve Weeks Ended		For the Forty Weeks Ended		Footnote Disclosure
	October 6, 2018	October 7, 2017	October 6, 2018	October 7, 2017	
	(Amounts in thousands)				
Project Centennial consulting costs	\$729	\$ 7,050	\$9,376	\$ 31,845	Note 4
Restructuring and related impairment charges	497	100,549	2,557	100,549	Note 4
Loss (recovery) on inferior ingredients	(1,891)	—	1,993	—	Note 1
Impairment of assets	—	—	2,483	—	Note 10
Legal settlements	11,921	4,253	21,616	4,503	Note 15
Pension plan settlement loss	930	3,030	6,633	3,030	Note 18
Gain on divestiture	—	—	—	(28,875)	Note 5
Lease termination costs	—	—	—	565	Note 13
Multi-employer pension plan withdrawal costs	—	18,268	2,322	18,268	Note 18
	\$12,186	\$ 133,150	\$46,980	\$ 129,885	

In the second quarter of fiscal 2018, we recognized an income tax benefit of \$5.6 million to adjust the estimated provisional benefit recorded in fiscal 2017 related to tax reform enacted in 2017, which partially offset the net expense amount of the pre-tax items for the forty weeks ended October 6, 2018 detailed above.

Project Centennial consulting costs — During the second quarter of fiscal 2016, we partnered with a globally recognized consulting firm and launched Project Centennial, an enterprise-wide business and operational review. Key milestones and initiatives of the project are outlined in the “Executive Overview” section below. Consulting costs associated with the project are presented in the table above and are reflected in the selling, distribution and administrative expenses line item of the Condensed Consolidated Statements of Operations. We anticipate incurring additional consulting costs of approximately \$0.5 million to \$1.0 million in the fourth quarter of fiscal 2018.

47

Restructuring charges associated with Project Centennial – The following tables detail restructuring charges recorded by segment during the twelve and forty weeks ended October 6, 2018 and October 7, 2017 (amounts in thousands):

	Warehouse				Unallocated		Total	
	DSD Segment		Segment		Corporate			
	Twelve Weeks Ended	Forty Weeks Ended	Twelve Weeks Ended	Forty Weeks Ended	Twelve Weeks Ended	Forty Weeks Ended	Twelve Weeks Ended	Forty Weeks Ended
	October 6, 2018	October 6, 2018	October 6, 2018	October 6, 2018	October 6, 2018	October 6, 2018	October 6, 2018	October 6, 2018
(Amounts in thousands)								
Employee termination benefits								
and other cash charges	\$289	\$2,187	\$1	\$77	\$33	\$119	\$323	\$2,383
Property, plant and equipment								
impairments	—	—	174	174	—	—	174	174
Total restructuring charges	\$289	\$2,187	\$175	\$251	\$33	\$119	\$497	\$2,557

	Warehouse				Unallocated		Total	
	DSD Segment		Segment		Corporate			
	Twelve Weeks Ended	Forty Weeks Ended	Twelve Weeks Ended	Forty Weeks Ended	Twelve Weeks Ended	Forty Weeks Ended	Twelve Weeks Ended	Forty Weeks Ended
	October 7, 2017	October 7, 2017	October 7, 2017	October 7, 2017	October 7, 2017	October 7, 2017	October 7, 2017	October 7, 2017
(Amounts in thousands)								
Employee termination benefits								
and other cash charges	\$21,513	\$21,513	\$5,552	\$5,552	\$3,833	\$3,833	\$30,898	\$30,898
Trademark impairments	55,112	55,112	11,135	11,135	—	—	66,247	66,247
Property, plant and equipment								
impairments	—	—	3,404	3,404	—	—	3,404	3,404
Total restructuring charges	\$76,625	\$76,625	\$20,091	\$20,091	\$3,833	\$3,833	\$100,549	\$100,549

In the current year, restructuring charges primarily consisted of relocation and severance costs as we continue to transition to the new organizational structure. We anticipate incurring additional relocation costs of approximately \$0.5 million to \$1.0 million in the fourth quarter of fiscal 2018. Prior year restructuring and related impairment charges consisted of trademark impairments related to brand rationalization, VSIP and other termination costs, employee relocation costs, and bakery closure costs.

Loss (recovery) on inferior ingredients – During the twelve and forty weeks ended October 6, 2018, we recognized \$2.3 million and \$6.1 million, respectively, of currently identifiable and measurable costs associated with receiving inferior yeast and whey shipments. We received a reimbursement of \$4.2 million for costs associated with receiving inferior yeast during the third quarter of fiscal 2018. The shipments of yeast were from one supplier and reduced product quality and disrupted production and distribution of foodservice and retail bread and buns at a number of the company's bakeries during the second quarter of fiscal 2018. Although we anticipate incurring additional losses, we are not currently able to estimate the amount of such loss. We continue to seek recovery of all losses through

appropriate means.

Impairment of assets – During the first quarter of fiscal 2018, we recognized an impairment of \$2.5 million on a non-IDP notes receivable of our DSD Segment in our results of operations.

Legal settlements – Through the third quarter of fiscal 2018 and 2017, we reached agreements to settle distributor-related litigation in the aggregate amount of \$18.8 million and \$4.5 million, respectively, including plaintiffs' attorney fees. These amounts were recorded in the DSD Segment in the selling, distribution and administrative expenses line item. Additionally, in the third quarter of fiscal 2018, we reached agreements to settle other non-IDP matters in the amount of \$2.8 million, of which \$1.7 million was recorded in the DSD Segment and \$1.1 million was recorded in the Warehouse Segment, in the selling, distribution and administrative expenses line item.

Pension risk mitigation plan – In accordance with our long-term pension risk mitigation plan, at the beginning of fiscal 2016, the company began offering pension plan participants not yet receiving their benefit payments the option to elect to receive their benefit as a single lump sum payment. Settlement charges of \$4.7 million, \$1.0 million, and \$0.9 million were triggered in the first, second, and third quarters of fiscal 2018, respectively, as a result of lump sums paid during those quarters. A \$3.0 million settlement charge was recorded in the third quarter of the prior year. An additional settlement charge will be recognized in the fourth quarter of fiscal 2018. On September 28, 2018, the Board of Directors approved a resolution to terminate the Flowers Foods, Inc. Retirement Plan No. 1, effective December 31, 2018. The plan was closed to new participants on January 1, 1999 and benefit accruals were previously frozen on or before August 1,

48

2008. The Company has commenced the plan termination process and expects to distribute a portion of the pension plan assets as lump sum payments during late 2019 (or early 2020) with the remaining balance transferred to an insurance company in the form of an annuity. The total payments distributed will depend on the lump sum offer participation rate of eligible participants. Based on the estimated value of assets held in the plan, the Company currently estimates that a cash contribution of approximately \$5.0 million to \$35.0 million will be required to fully fund the plan's liabilities at termination. In addition, based on current assumptions, the Company estimates a final non-cash settlement charge of approximately \$125.0 million.

◆ **Gain on divestiture of the non-core mix manufacturing business** – On January 14, 2017, we completed the sale of our non-core mix manufacturing business located in Cedar Rapids, Iowa and received proceeds, net of a working capital adjustment, of \$41.2 million and recognized a gain on divestiture of \$28.9 million in our prior year results of operations. The mix manufacturing business was included in the Warehouse Segment.

◆ **Lease termination costs** – During the first quarter of fiscal 2017, we terminated certain lease contracts of the DSD Segment prior to the maturity date of the leases, resulting in net lease termination costs of \$0.6 million.

◆ **Multi-employer pension plan withdrawal costs (“MEPP costs”)** – On August 18, 2017, the union participants of the MEPP Fund at our Lakeland, Florida plant voted to withdraw from the MEPP Fund in the most recent collective bargaining agreement. This resulted in the recognition of an \$18.3 million pension plan withdrawal liability (including transition payments) in the DSD Segment in the third quarter of fiscal 2017. During the first quarter of fiscal 2018, this amount was revised for the final settlement and we recorded an additional \$2.3 million of liability. The transition payments of \$3.1 million were made on November 3, 2017. Of the remaining balance, we paid \$0.2 million during the first quarter of fiscal 2018 and the balance was paid in the second quarter of fiscal 2018.

◆ **Reclassification of certain prior year amounts** – Due to the change in the presentation of pension cost (benefit) other than service cost as a result of new accounting guidance, as well as certain organizational changes we have implemented as of the beginning of fiscal 2018, we have reclassified prior year amounts for comparability. In addition, the Condensed Consolidated Statement of Cash Flows for the forty weeks ended October 7, 2017 has been revised to correct errors. Refer to Notes to Condensed Consolidated Financial Statements of this Form 10-Q for additional information. Due to the organizational changes, we have restructured our discussion of segment operations below.

Executive Overview

Business

Flowers is the second largest producer and marketer of packaged bakery foods in the U.S. We operate in the highly competitive fresh bakery market and our product offerings include fresh breads, buns, rolls, snack cakes and tortillas, as well as frozen breads and rolls. We are focused on opportunities for growth within the baked foods category and seek to have our products available wherever bakery foods are consumed or sold — whether in homes, restaurants, fast food outlets, institutions, supermarkets, convenience stores, or vending machines. Currently, our business is managed based on delivery method of our products and we have two operating segments as outlined below.

DSD Segment

◆ **Produces fresh breads, buns, rolls, tortillas and snack cakes** sold primarily by a network of independent distributors to retail and foodservice customers in the following areas of the U.S.: East, South, Southwest, West Coast, and select markets in the Midwest, Nevada and Colorado.

◆ **Has a 39-bakery network with a highly developed reciprocal baking system** (where bakeries can produce for its market and that of other bakeries), which results in long and efficient production runs.

◆ **The DSD Segment currently has access to more than 85% of the U.S. population for fresh bakery foods.**

◆ **Major DSD Segment brands include Nature's Own, Wonder, Tastykake, Dave's Killer Bread (“DKB”), and Cobblestone Bread Company.**

Warehouse Segment

• Produces fresh snack cakes and frozen breads and rolls.

• Delivers its products fresh or frozen to customers' warehouses nationwide via contract carriers.

49

◆ Operates eight production facilities.

◆ Major brands include Mrs. Freshley's, Alpine Valley Bread and European Bakers.

Summary of Operating Results, Cash Flows and Financial Condition

Sales decreased 1.0% for the twelve weeks ended October 6, 2018 compared to the same period in the prior year primarily due to volume declines, partially offset by positive price/mix. In the prior year quarter, hurricanes positively impacted sales volumes. Year to date, sales increased 0.8% primarily due to growth in branded organic and store branded sales and improved price/mix, partially offset by volume declines in other branded products.

Net income for the twelve weeks ended October 6, 2018 was \$39.6 million compared to a net loss of \$33.6 million in the prior year quarter. The significant change was due to decreased restructuring charges, the prior year MEPP costs, the impact of lower federal tax rates, and decreased employee compensation and Project Centennial consulting costs. These items were partially offset by softer sales, higher product costs, and increased legal settlements. Year to date, net income increased \$64.7 million to \$136.3 million due to significantly lower restructuring, MEPP, Project Centennial consulting, and employee compensation costs as compared to the prior year, combined with the benefit of lower income tax rates in the current year. Partially offsetting these items were the prior year gain on divestiture and increased production costs, legal settlements, and marketing and promotional spending in the current year.

During the forty weeks ended October 6, 2018, we generated net cash flows from operations of \$232.0 million and invested \$75.0 million in capital expenditures. Additionally, we paid \$112.2 million in dividends to our shareholders. During the forty weeks ended October 7, 2017, we generated net cash flows from operations of \$224.0 million, received net proceeds of \$41.2 million from the divestiture of our mix manufacturing business, and invested \$51.2 million in capital expenditures. We paid \$105.2 million in dividends to our shareholders and reduced our total indebtedness by \$101.3 million. The increase in net cash flows from operations, period over period, was primarily due to increased net income, changes in hedging margin activity, more favorable payment terms and decreased Project Centennial consulting costs, net of making \$40.7 million of voluntary pension plan contributions as well as VSIP payments, MEPP payments and increased bonus payouts.

Project Centennial - Strategic Initiatives and Update on Progress

In June of 2016, the company launched Project Centennial, an enterprise-wide business and operational review to evaluate opportunities to streamline our operations, drive efficiencies, and invest in strategic capabilities that we believe will strengthen our competitive position and drive profitable revenue growth. Based upon the results of this review, Flowers has begun executing on four primary strategic initiatives:

◆ reinvigorate the core business – invest in the growth and innovation of our core brands, streamline our brand and product portfolio, improve trade promotion management, and strengthen our partnership with distributors so they can grow their businesses;

- capitalize on product adjacencies – greater focus on growing segments of the bakery category, such as foodservice, in-store bakery, impulse items, and healthy snacking;

◆ reduce costs to fuel growth – reduce complexity and better leverage scale to lower costs; and

◆ develop leading capabilities – invest in capabilities to become a more centralized and analytics-focused company.

The company implemented a plan to transition to these primary strategies beginning in fiscal 2017, with the transition intended to be completed by fiscal 2021. By executing on Project Centennial, the company expects to deliver on its stated long-term goals of sales growth in the range of 2% to 4% and EBITDA margins in the range of 12% to 14%. The company defines EBITDA as earnings from continuing operations before interest, income taxes, depreciation and amortization.

Flowers' priorities for fiscal 2018 are to simplify and streamline our brand assortment, provide additional tools to IDPs to enable them to grow their businesses, reduce costs of purchased goods and services, and put in place a more efficient operating model for a national branded food company.

In fiscal 2019 and beyond, Flowers expects to fully realize the benefits of a lower-cost operating model, stronger brand architecture, and increased strategic investments. These benefits are expected to drive sales growth and EBITDA margins to the upper end of our stated long-term goals discussed above.

During fiscal 2016, we completed the diagnostic phase of Project Centennial, which identified the aforementioned four strategic initiatives and outlined the timeline and financial targets described above.

During fiscal 2017, the company began the implementation phase of Project Centennial, and made significant progress on several initiatives, including streamlining our brand assortment in key retail categories, reducing spend on purchased goods and services, closing a Warehouse Segment snack cake plant, hiring a chief marketing officer, completing the VSIP and other workforce reductions, and began transitioning to the company's new organization structure, which establishes two BUs, Fresh Packaged Bread and Snacking/Specialty, and realigns key leadership roles.

For fiscal 2018, we continue to execute on key strategic initiatives, including the following accomplishments year to date:

- appointed a Chief Operating Officer (COO) which continued refinements to the organizational structure to align operating functions, drive accountability, generate additional cost savings, and identify new avenues for growth;
- introduced Nature's Own Perfectly Crafted artisan-inspired, thick-sliced bakery style breads that contain no artificial preservatives, colors or flavors, no high fructose corn syrup, and are Non-GMO Project Verified;
- introduced Dave's Killer Bread Boomin' Berry bagels;
- increased marketing budget to support growth of newly launched products and core brands in growth markets;
- continued to transition to the new organizational structure by filling key roles with individuals new to Flowers that enhanced capabilities and skills;
- continuing to execute on projects under the supply chain optimization initiative to improve efficiencies and lower product costs;
- continued to address indirect costs throughout the company to generate fuel for growth, particularly by reducing costs in purchased goods and services; and
- continued to evaluate a robust pipeline of strategic acquisition opportunities to drive enhanced growth in underdeveloped product categories and geographic markets.

In the second quarter of fiscal 2017, the company announced an enhanced organizational structure designed to emphasize brand growth and innovation in line with a national branded food company, drive enhanced accountability, reduce costs, strengthen long-term strategy and provide greater focus on the strategic initiatives under Project Centennial. The company continues to transition to the new structure and anticipates full implementation to be completed at the beginning of fiscal 2019. Prior to that time, the company will continue to manage the business and report segment information based on our current segments, the DSD Segment and the Warehouse Segment.

The new organizational structure establishes two BUs, Fresh Packaged Bread and Snacking/Specialty, and realigns key leadership roles. The new structure also provides for centralized marketing, sales, supply chain, shared-services/administrative, and corporate strategy functions. On July 2, 2018, the company announced the creation of the COO position. This role is responsible for executing the company's strategies under Project Centennial, as well as, overseeing the BUs, supply chain, sales, corporate strategy and ventures, and communications. We continue to explore additional opportunities to streamline our core operations, but as of October 6, 2018, we cannot estimate the costs to be incurred related to these initiatives.

As discussed above, during the third quarter of fiscal 2017, the company announced the VSIP as part of its effort to restructure, streamline operations, and better position the company for profitable growth. Costs associated with the VSIP were recorded in the company's results of operations during the third quarter of fiscal 2017 and the VSIP was substantially completed as of the end of fiscal 2017.

In the third quarter of fiscal 2017, the company provided targets for gross cost savings associated with the primary cost savings programs under Project Centennial: the above-mentioned initiative to reduce spending on purchased goods and services, a supply chain optimization plan, and the new organizational structure described above. By the end of fiscal 2018, the company is targeting cumulative gross cost savings under these three programs of \$70 million to \$80 million, of which approximately \$32 million was realized in fiscal 2017.

Valuation of Intangible Assets

The company evaluates the recoverability of our indefinite-lived intangible assets that are not subject to amortization by comparing the fair value to the carrying value on an annual basis or at a time when events occur that indicate the carrying value may be impaired. In addition, the assets are evaluated to determine whether events and circumstances continue to support an indefinite life. The fair value is compared to the carrying value of the intangible asset, and if less than the carrying value, the intangible asset is written down to fair value. We are continually monitoring our indefinite-lived trademarks.

For trademarks and other intangible assets that we are amortizing, we evaluate these assets whenever events or changes in circumstances indicate the carrying amount of the asset may not be recoverable. We compare the undiscounted future cash flows of each intangible asset to the carrying amount, and if less than the carrying value, the intangible asset is written down to fair value.

For both amortizing and non-amortizing trademarks, there are certain inherent risks included in our expectations about their performance. If we are unable to implement our growth strategies for these acquired intangible assets as expected, it could adversely impact the carrying value of the brands. The implied fair value of the trademarks could be less than our carrying value if any of our four material assumptions in our fair value analysis do not meet our expectations: (a) weighted average cost of capital; (b) long-term sales growth rates; (c) forecasted operating margins; and (d) market multiples.

CRITICAL ACCOUNTING POLICIES:

Our financial statements are prepared in accordance with GAAP. These principles are numerous and complex. Our significant accounting policies are summarized in the Form 10-K. In many instances, the application of GAAP requires management to make estimates or to apply subjective principles to particular facts and circumstances. A variance in the estimates used or a variance in the application or interpretation of GAAP could yield a materially different accounting result. Please see the Form 10-K for a discussion of the areas where we believe that the estimates, judgments or interpretations that we have made, if different, could yield the most significant differences in our financial statements. There have been no significant changes to our critical accounting policies from those disclosed in the Form 10-K except as disclosed in Note 3, Recent Accounting Pronouncements, of Notes to Condensed Consolidated Financial Statements of this Form 10-Q, which details recently adopted accounting pronouncements and accounting pronouncements not yet adopted.

RESULTS OF OPERATIONS:

Results of operations, expressed as a percentage of sales and the dollar and percentage change from period to period, for the twelve weeks ended October 6, 2018 and October 7, 2017, respectively, are set forth below (dollars in thousands):

	For the Twelve Weeks Ended				Increase (Decrease)	
	October 6, 2018	October 7, 2017	Percentage of Sales		Dollars	%
	October 6, 2018	October 7, 2017	October 6, 2018	October 7, 2017		
Sales						
DSD Segment	\$780,253	\$ 787,255	84.5	84.4	\$(7,002)	(0.9)
Warehouse Segment	143,196	145,567	15.5	15.6	(2,371)	(1.6)
Total	\$923,449	\$ 932,822	100.0	100.0	\$(9,373)	(1.0)
Materials, supplies, labor and other production costs						
(exclusive of depreciation and amortization shown separately below)						
DSD Segment (1)	\$379,592	\$ 371,556	48.6	47.2	\$8,036	2.2
Warehouse Segment (1)	106,088	104,708	74.1	71.9	1,380	1.3
Total	\$485,680	\$ 476,264	52.6	51.1	\$9,416	2.0
Selling, distribution and administrative expenses						
DSD Segment (1)	\$316,863	\$ 312,858	40.6	39.7	\$4,005	1.3
Warehouse Segment (1)	25,056	25,081	17.5	17.2	(25)	(0.1)
Corporate (2)	11,132	18,887	—	—	(7,755)	(41.1)
Total	\$353,051	\$ 356,826	38.2	38.3	\$(3,775)	(1.1)
Multi-employer pension plan withdrawal costs						
DSD Segment (1)	\$—	\$ 18,268	—	2.3	\$(18,268)	NM
Total	\$—	\$ 18,268	—	2.0	\$(18,268)	NM
Restructuring and related impairment charges						
DSD Segment (1)	\$289	\$ 76,625	0.0	9.7	\$(76,336)	NM
Warehouse Segment (1)	175	20,091	0.1	13.8	(19,916)	NM
Corporate (2)	33	3,833	—	—	(3,800)	NM
Total	\$497	\$ 100,549	0.1	10.8	\$(100,052)	NM
Loss (recovery) on inferior ingredients						
DSD Segment (1)	\$(2,986)	\$ —	(0.4)	—	\$(2,986)	NM
Warehouse Segment (1)	1,095	—	0.8	—	1,095	NM
Total	\$(1,891)	\$ —	(0.2)	—	\$(1,891)	NM
Depreciation and amortization						
DSD Segment (1)	27,676	28,286	3.5	3.6	(610)	(2.2)
Warehouse Segment (1)	4,916	4,769	3.4	3.3	147	3.1

Edgar Filing: FLOWERS FOODS INC - Form 10-Q

Corporate (2)	70	(83	)	—	—	153	NM
Total	\$32,662	\$ 32,972		3.5	3.5	\$(310	) (0.9)
Income (loss) from operations							
DSD Segment (1)	\$58,819	\$ (20,338	)	7.5	(2.6	) \$79,157	389.2
Warehouse Segment (1)	5,866	(9,082	)	4.1	(6.2	) 14,948	164.6
Corporate (2)	(11,235	) (22,637	)	—	—	11,402	50.4
Total	\$53,450	\$ (52,057	)	5.8	(5.6	) \$105,507	202.7
Other components of net periodic pension and							
postretirement benefits credit	\$(171	) \$ (1,321	)	(0.0	) (0.1	) \$1,150	(87.1)
Pension plan settlement loss	930	3,030		0.1	0.3	(2,100	) NM
Interest expense, net	1,565	2,730		0.2	0.3	(1,165	) (42.7)
Income tax expense (benefit)	11,496	(22,925	)	1.2	(2.5	) 34,421	150.1
Net income (loss)	\$39,630	\$ (33,571	)	4.3	(3.6	) \$73,201	218.0
Comprehensive income (loss)	\$16,150	\$ (42,905	)	1.7	(4.6	) \$59,055	137.6

(1) As a percentage of revenue within the reporting segment.

(2) The corporate segment has no revenues.

NM Not meaningful.

Percentages may not add due to rounding.

Edgar Filing: FLOWERS FOODS INC - Form 10-Q

Results of operations, expressed as a percentage of sales and the dollar and percentage change from period to period, for the forty weeks ended October 6, 2018 and October 7, 2017, respectively, are set forth below (dollars in thousands):

	For the Forty Weeks Ended				Increase	
	October 6, 2018	October 7, 2017	Percentage of Sales		(Decrease)	
			October 6, 2018	October 7, 2017	Dollars	%
Sales						
DSD Segment	\$2,592,363	\$ 2,580,007	84.4	84.7	\$12,356	0.5
Warehouse Segment	478,822	467,103	15.6	15.3	11,719	2.5
Total	\$3,071,185	\$ 3,047,110	100.0	100.0	\$24,075	0.8
Materials, supplies, labor and other production costs (exclusive of depreciation and amortization shown separately below)						
DSD Segment (1)	\$1,252,830	\$ 1,220,622	48.3	47.3	\$32,208	2.6
Warehouse Segment (1)	346,843	331,956	72.4	71.1	14,887	4.5
Total	\$1,599,673	\$ 1,552,578	52.1	51.0	\$47,095	3.0
Selling, distribution and administrative expenses						
DSD Segment (1)	\$1,038,645	\$ 1,019,401	40.1	39.5	\$19,244	1.9
Warehouse Segment (1)	82,627	80,888	17.3	17.3	1,739	2.1
Corporate (2)	46,607	75,145	—	—	(28,538)	(38.0)
Total	\$1,167,879	\$ 1,175,434	38.0	38.6	\$(7,555)	(0.6)
Gain on divestiture						
Warehouse Segment (1)	\$—	\$ (28,875)	—	(6.2)	\$28,875	NM
Total	\$—	\$ (28,875)	—	(0.9)	\$28,875	NM
Multi-employer pension plan withdrawal costs						
DSD Segment (1)	\$2,322	\$ 18,268	0.1	0.7	\$(15,946)	NM
Total	\$2,322	\$ 18,268	0.1	0.6	\$(15,946)	NM
Restructuring and related impairment charges						
DSD Segment (1)	\$2,187	\$ 76,625	0.1	3.0	\$(74,438)	NM
Warehouse Segment (1)	251	20,091	0.1	4.3	(19,840)	NM
Corporate (2)	119	3,833	—	—	(3,714)	NM
Total	\$2,557	\$ 100,549	0.1	3.3	\$(97,992)	NM
Impairment of assets						
DSD Segment (1)	\$2,483	\$ —	0.1	—	\$2,483	NM
Total	\$2,483	\$ —	0.1	—	\$2,483	NM
Loss (recovery) on inferior ingredients						
DSD Segment (1)	\$898	\$ —	0.0	—	\$898	NM
Warehouse Segment (1)	1,095	—	0.2	—	1,095	NM
Total	\$1,993	\$ —	0.1	—	\$1,993	NM

Edgar Filing: FLOWERS FOODS INC - Form 10-Q

Depreciation and amortization							
DSD Segment (1)	\$95,273	\$ 98,703	3.7	3.8	\$(3,430)	(3.5)	
Warehouse Segment (1)	16,443	15,841	3.4	3.4	602	3.8	
Corporate (2)	233	(256)	—	—	489	NM	
Total	\$111,949	\$ 114,288	3.6	3.8	\$(2,339)	(2.0)	
Income from operations							
DSD Segment (1)	\$197,725	\$ 146,388	7.6	5.7	\$51,337	35.1	
Warehouse Segment (1)	31,563	47,202	6.6	10.1	(15,639)	(33.1)	
Corporate (2)	(46,959)	(78,722)	—	—	31,763	40.3	
Total	\$182,329	\$ 114,868	5.9	3.8	\$67,461	58.7	
Other components of net periodic pension and							
postretirement benefits credit	\$(1,204)	\$ (4,687)	(0.0)	(0.2)	\$3,483	(74.3)	
Pension plan settlement loss	\$6,633	\$ 3,030	0.2	0.1	\$3,603	NM	
Interest expense, net	\$6,214	\$ 11,056	0.2	0.4	\$(4,842)	(43.8)	
Income taxes	\$34,367	\$ 33,882	1.1	1.1	\$485	1.4	
Net income	\$136,319	\$ 71,587	4.4	2.3	\$64,732	90.4	
Comprehensive income	\$133,944	\$ 68,768	4.4	2.3	\$65,176	94.8	

(1) As a percentage of revenue within the reporting segment.

(2) The corporate segment has no revenues.

NM Not meaningful.

Percentages may not add due to rounding.

TWELVE WEEKS ENDED OCTOBER 6, 2018 COMPARED TO TWELVE WEEKS ENDED OCTOBER 7, 2017

Sales (dollars in thousands)

	DSD Segment For the Twelve Weeks Ended			Warehouse Segment For the Twelve Weeks Ended			Consolidated For the Twelve Weeks Ended		
			%			%			%
	October 6, 2018	October 7, 2017	Change	October 6, 2018	October 7, 2017	Change	October 6, 2018	October 7, 2017	Change
Branded retail	\$514,405	\$ 514,346	0.0	\$32,945	\$ 36,963	(10.9)	\$547,350	\$ 551,309	(0.7)
Store branded retail	114,581	110,853	3.4	26,418	27,803	(5.0)	140,999	138,656	1.7
Non-retail and other	151,267	162,056	(6.7)	83,833	80,801	3.8	235,100	242,857	(3.2)
Total	\$780,253	\$ 787,255	(0.9)	\$143,196	\$ 145,567	(1.6)	\$923,449	\$ 932,822	(1.0)

(The table above presents certain sales by category that have been reclassified from amounts previously reported.)

The change in sales was generally attributable to the following:

Percentage Point Change in Sales Attributed to:	Warehouse Segment		
	DSD Segment	Warehouse Segment	Consolidated
Pricing/mix	2.1	3.3	2.5
Volume	(3.0)	(4.9)	(3.5)
Total percentage change in sales	(0.9)	(1.6)	(1.0)

DSD Segment. Branded retail sales were consistent with prior year as positive price/mix was offset by volume declines. In the prior year quarter, hurricanes positively impacted volume. Sales of DKB branded products and sales in our expansion markets continued to increase along with sales of Nature's Own Perfectly Crafted breads introduced in the second quarter of fiscal 2018. These gains were more than offset by volume declines for other branded products. Store branded retail sales increased quarter over quarter due to positive price/mix and volume growth. Significant volume declines in foodservice primarily resulted in the decrease in non-retail and other sales. Foodservice sales were impacted by inferior yeast and the shift of certain foodservice business from the DSD Segment to the Warehouse Segment.

Warehouse Segment. Branded retail sales decreased mostly due to volume declines in branded cake and to a lesser extent in warehouse-delivered branded organic bread. Sales of store branded retail items decreased primarily due to volume decreases in store branded cake. Non-retail and other sales, which include contract manufacturing, vending and foodservice, increased primarily from significant volume growth in foodservice sales and to a lesser extent the shift of certain foodservice business from the DSD Segment to the Warehouse Segment in the current year and increased contract manufacturing, partially offset by declines in vending sales.

Consolidated. Volume declines drove the decrease in branded retail sales as we cycled hurricanes in the prior year quarter. Partially offsetting the decline, was continued sales growth from branded organic products, growth in our expansion markets, the contribution from Nature's Own Perfectly Crafted breads, and more favorable price/mix. Store branded retail sales increased due primarily to positive price/mix. Significant volume declines for foodservice and vending items resulted in the decrease in non-retail and other sales, partially offset by positive price/mix.

Materials, Supplies, Labor and Other Production Costs (exclusive of depreciation and amortization shown separately; as a percent of sales)

Line Item Component	For the Twelve Weeks		
	Ended		Increase
	October 6, 2018		October 7, 2017 (Decrease) as a
	% of	% of	% of
	Sales	Sales	Sales
Ingredients	25.7	24.9	0.8
Workforce-related costs	14.8	14.8	—
Packaging	4.4	4.4	—
Utilities	1.5	1.5	—
Other	6.2	5.5	0.7
Total	52.6	51.1	1.5

On a consolidated basis, costs were higher as a percent of sales due to increased commodity prices, softer production volumes, increased outside purchases of product, and decreased manufacturing efficiencies. Sales and production costs continued to be negatively impacted by the effects from inferior ingredients although we cannot currently quantify these amounts. Higher prices for non-organic flour and to a lesser extent higher yeast prices resulted in the ingredient increase as a percent of sales, partially offset by increased outside purchases of product (sales with no ingredient costs) and lower prices for organic ingredients. Outside purchases of product increased primarily for DKB branded breakfast items, pita breads and pastries and are included in the other line item in the table above. We continue to expect ingredient costs to be higher for the remainder of fiscal 2018 and into fiscal 2019.

Selling, Distribution and Administrative Expenses (as a percent of sales)

Line Item Component	For the Twelve Weeks		
	Ended	Increase	
	October 6, 2018	October 7, 2017	(Decrease) as a
	% of		
	Sales	% of Sales	% of Sales
Workforce-related costs	14.7	16.8	(2.1)
Distributor distribution fees	15.0	13.6	1.4
Other	8.5	7.9	0.6
Total	38.2	38.3	(0.1)

A larger portion of our sales were made through IDPs in the current quarter, resulting in increased distributor distribution fees as a percent of sales and decreased workforce-related costs as a percent of sales. Additionally, workforce reductions from the VSIP and other restructuring initiatives, as well as significantly lower employee incentive costs resulted in a decline in workforce-related costs. As discussed in the “Matters Affecting Comparability” section above, legal settlements of \$11.9 million were recorded in the current quarter compared to \$4.3 million in the prior year quarter, an increase of approximately 80 basis points, and are reflected in the other line item in the table above. Consulting costs associated with Project Centennial declined \$6.3 million quarter over quarter resulting in a decrease of approximately 70 basis points, and these costs are also reflected in the other line item in the table above. We anticipate incurring additional consulting costs related to Project Centennial of approximately \$0.5 million to \$1.0 million in the fourth quarter of fiscal 2018. Increased marketing investments and higher distribution costs, including transportation costs, on lower sales partially offset the overall decrease.

Loss (Recovery) on Inferior Ingredients, MEPP Costs, Pension Plan Settlement Loss and Restructuring and Related Impairment Charges

Refer to the discussion in the “Matters Affecting Comparability” section above regarding these items.

Depreciation and Amortization Expense

As a percent of sales, depreciation and amortization expense was relatively unchanged as compared to the prior year quarter.

Income (Loss) from Operations

The table below summarizes the percentage change in income (loss) from operations by segment and the change as a percent of sales for the twelve weeks ended October 6, 2018 compared to the twelve weeks ended October 7, 2017:

		Increase
		(Decrease)
		as
	% Favorable	a % of
Income (Loss) from Operations	(Unfavorable)	Sales
DSD Segment	389.2	10.1
Warehouse Segment	164.6	10.3
Unallocated corporate	50.4	NA
Consolidated	202.7	11.4

NA Not applicable as the corporate segment has no revenues.

DSD Segment. The significant favorable change in the DSD Segment operating income as a percent of sales primarily resulted from \$76.6 million of restructuring and related impairment charges and \$18.3 million of MEPP costs incurred in the prior year quarter, as well as the benefit of the VSIP and other restructuring, lower employee compensation costs and the recovery of a portion of the loss on inferior ingredients in the current quarter. Increased product costs on lower sales, increased distributor distribution fees, higher legal settlements of \$6.5 million, and increased marketing investments partially offset the overall improvement.

Warehouse Segment. The significant favorable change in the Warehouse Segment operating income as a percent of sales was primarily due to prior year restructuring costs of \$20.1 million and lower workforce-related costs in the current year quarter, partially offset by sales declines, higher product and distribution costs, the \$1.1 million legal settlement and \$1.1 million of loss on inferior ingredients in the current year quarter.

Unallocated Corporate. The favorable change in unallocated corporate expenses was primarily due to the \$6.3 million decrease in consulting costs associated with Project Centennial, prior year restructuring charges of \$3.8 million and to a lesser extent, reduced workforce-related expenses.

Other Components of Net Periodic Pension and Postretirement Benefits Credit

Other components of net periodic pension and postretirement benefits credit changed primarily due to a decrease in pension income resulting from the company changing its pension plan asset allocation to include a larger percentage of fixed-income assets as measured on September 30, 2018 compared to the end of fiscal 2017 as discussed in the “Matter Affecting Comparability” section above.

Net Interest Expense

Net interest expense was lower due to a significant increase in interest income resulting from increased distributor notes receivable outstanding quarter over quarter.

Income Tax Expense (Benefit)

The effective tax rate for the twelve weeks ended October 6, 2018 was 22.5% compared to 40.6% in the prior year quarter. The significant decrease in the rate was primarily due to the reduction of the U.S. corporate tax rate from 35% to 21% as a result of U.S. tax reform. In addition, tax benefits in the third quarter of the prior year increased the effective tax rate due to negative earnings before tax in the quarter. Tax benefits in the current quarter had a favorable impact on the effective tax rate. The primary differences in the effective rate and the statutory rate were state income taxes, offset with credits recognized for job creation and preservation of historical real property.

Comprehensive Income (Loss)

The change in comprehensive income (loss) quarter over quarter resulted primarily from net income of \$39.6 million compared to a net loss of \$33.6 million in the prior year quarter and changes in the fair value of derivatives, net of the actuarial loss recognized as a result of the pension plan remeasurement.

FORTY WEEKS ENDED OCTOBER 6, 2018 COMPARED TO FORTY WEEKS ENDED OCTOBER 7, 2017

Sales (dollars in thousands)

	DSD Segment			Warehouse Segment			Consolidated		
	For the Forty Weeks Ended		%	For the Forty Weeks Ended		%	For the Forty Weeks Ended		%
	October 6, 2018	October 7, 2017	Change	October 6, 2018	October 7, 2017	Change	October 6, 2018	October 7, 2017	Change
Branded retail	\$ 1,700,461	\$ 1,674,871	1.5	\$ 116,192	\$ 121,052	(4.0)	\$ 1,816,653	\$ 1,795,923	1.2

Edgar Filing: FLOWERS FOODS INC - Form 10-Q

Store branded retail	372,802	368,371	1.2	90,369	86,960	3.9	463,171	455,331	1.7
Non-retail and other	519,100	536,765	(3.3)	272,261	259,091	5.1	791,361	795,856	(0.6)
Total	\$2,592,363	\$2,580,007	0.5	\$478,822	\$467,103	2.5	\$3,071,185	\$3,047,110	0.8

(The table above presents certain sales by category that have been reclassified from amounts previously reported.)

The change in sales was generally attributable to the following:

Percentage Point Change in Sales Attributed to:	Warehouse		
	DSD Segment	DSD Segment	Consolidated
	Favorable (Unfavorable)		
Pricing/mix	2.5	(0.5)	1.6
Volume	(2.0)	3.2	(0.8)
Divestiture	—	(0.2)	—
Total percentage change in sales	0.5	2.5	0.8

DSD Segment. Branded retail sales increased due to significant sales growth for branded organic products, growth in our expansion markets, the launch of Nature's Own Perfectly Crafted breads in the current year, and improved price/mix, somewhat offset by declines in other branded items. Sales of DKB branded products continue to increase, driven by volume gains and the addition of DKB branded breakfast products during the second quarter of fiscal 2017. Store branded retail sales increased mainly due to positive price/mix and increased sales of pita bread, partially offset by declines in store branded white bread. Volume declines in foodservice, partly due to inferior yeast, decreased sales of products in our bakery outlet stores, and, less significantly, the shift of certain foodservice business from the DSD Segment to the Warehouse Segment primarily resulted in decreased non-retail and other sales.

Warehouse Segment. Branded retail sales decreased mostly due to volume declines in warehouse-delivered branded organic bread and branded cake. Sales of store branded retail items increased primarily due to the addition of a new customer in the second half of fiscal 2017 and growth in store branded cake, partially offset by price/mix declines. Non-retail and other sales, which include contract manufacturing, vending and foodservice, increased primarily from volume growth in foodservice and vending sales, and to a lesser extent the shift of certain foodservice business from the DSD Segment to the Warehouse Segment in the current year, partially offset by the impact of the mix manufacturing business divestiture in January 2017.

Consolidated. Continued sales growth from branded organic products and in our expansion markets, the launch of Nature's Own Perfectly Crafted breads in the current year, and more favorable price/mix drove the increase in branded retail sales, partially offset by softer volume for other branded items. Sales of DKB branded products continue to increase, partly due to the introduction of breakfast products during the second quarter of fiscal 2017. Store branded retail sales increased mainly due to positive price/mix and increased sales of pita breads. Declines in price/mix and decreased sales in our bakery outlet stores resulted in the decrease in non-retail and other sales, partially offset by increased foodservice volume.

Materials, Supplies, Labor and Other Production Costs (exclusive of depreciation and amortization shown separately; as a percent of sales)

Line item component	For the Forty Weeks		
	Ended October 6, 2018	Increase October 7, 2017 (Decrease) as a	
	% of sales	% of sales	% of sales
Ingredients	25.3	24.8	0.5
Workforce-related costs	14.8	14.8	—
Packaging	4.3	4.3	—

Edgar Filing: FLOWERS FOODS INC - Form 10-Q

Utilities	1.4	1.4	—
Other	6.3	5.7	0.6
Total	52.1	51.0	1.1

Ingredient costs were impacted by higher prices for non-organic flour and to a lesser extent sweetener prices, partially offset by increased outside purchases of product (sales with no ingredient costs) and decreased prices for organic ingredients. We continue to expect ingredient costs to be higher in the fourth quarter of fiscal 2018 and into fiscal 2019. Outside purchases of product increased primarily for the DKB branded breakfast products and pita breads and are reflected in the other line item in the table above. Additionally, production costs were negatively impacted by reduced manufacturing efficiency and production disruptions related to the shipments of inferior yeast.

Selling, Distribution and Administrative Expenses (as a percent of sales)

Line item component	For the Forty Weeks Ended		Increase (Decrease) as a
	October 6, 2018	October 7, 2017	
	% of sales	% of sales	% of sales
Workforce-related costs	15.2	17.2	(2.0)
Distributor distribution fees	14.9	13.4	1.5
Other	7.9	8.0	(0.1)
Total	38.0	38.6	(0.6)

Distributor distribution fees increased as a percent of sales due to a larger portion of our sales being made through IDPs resulting in decreased workforce-related costs. In addition, workforce reductions from the VSIP and other restructuring initiatives, and lower stock-based compensation (no stock awards have been granted to employees in the current year) and employee fringes resulted in decreased workforce-related costs. As discussed in the “Matters Affecting Comparability” section above, during the forty weeks ended October 6, 2018, the company incurred \$9.4 million of consulting costs associated with Project Centennial compared to \$31.8 million in the prior year, a decrease of approximately 80 basis points, and these costs are reflected in the other line item in the table above. Legal settlements recorded in the current year were \$17.4 million higher than the settlements recorded in the prior year, an increase of approximately 60 basis points, and were partially offset by lower legal expense, both of which are reflected in the other line item in the table above. Increased investments in marketing and higher distribution costs, including transportation costs, partially offset the overall decrease in costs.

Loss (Recovery) on Inferior Ingredients, Impairment of Assets, Pension Plan Settlement Loss, MEPP Costs, and Restructuring Charges

Refer to the discussion in the “Matters Affecting Comparability” section above regarding these items.

Depreciation and Amortization Expense

As a percent of sales, depreciation and amortization expense was relatively unchanged year over year.

Income from Operations

The table below summarizes the percentage change in income from operations by segment and the change as a percent of sales for the forty weeks ended October 6, 2018 compared to the forty weeks ended October 7, 2017:

	Increase	
	% Favorable	(Decrease) as a
	(Unfavorable)	% of Sales
Operating income (loss)		
DSD Segment	35.1	1.9
Warehouse Segment	(33.1)	(3.5)
Unallocated corporate	40.3	NA
Consolidated	58.7	2.1

NA Not applicable as the corporate segment has no revenues.

DSD Segment. The increase in the DSD Segment operating income as a percent of sales was primarily due to significantly lower restructuring and related impairment charges and MEPP costs, increased sales, the benefit of the VSIP and other restructuring initiatives, and lower employee compensation costs. Partially offsetting these items were higher production costs, increased legal settlements, the loss on inferior ingredients and the asset impairment charge incurred during the current year.

Warehouse Segment. The significant decrease in the Warehouse Segment operating income as a percent of sales was primarily due to the \$28.9 million gain on divestiture in the prior year, as well as a negative shift in product mix, higher product costs, and increased distribution costs. These items were partially offset by the \$19.8 million decrease in restructuring and related impairment charges and lower workforce-related costs.

Unallocated Corporate. The favorable change in unallocated corporate expenses was primarily due to the \$22.5 million decrease in consulting costs associated with Project Centennial, decreased restructuring charges of \$3.7 million and to a lesser extent, reduced workforce-related and legal costs.

Other Components of Net Periodic Pension and Postretirement Benefits Credit

Other components of net periodic pension and postretirement benefits credit changed primarily due to a decrease in pension income resulting from the company changing its pension plan asset allocation to include a larger percentage of fixed-income assets as measured on September 30, 2018 compared to the end of fiscal 2017 as discussed in the “Matter Affecting Comparability” section above.

Net Interest Expense

Net interest expense decreased primarily due to a significant increase in interest income resulting from increases in distributor notes receivable outstanding, and to a lesser extent lower average amounts outstanding under the company’s debt arrangements compared to the same period in the prior year.

Income Tax Expense

The effective tax rate for the forty weeks ended October 6, 2018 was 20.1% compared to 32.1% in the prior year. The significant decrease in the rate was primarily due to the reduction of the U.S. corporate tax rate from 35% to 21% as a result of U.S. tax reform, adjustments to provisional taxes recorded in the fourth quarter of 2017 to revalue our U.S. deferred tax liabilities at the new tax rate, and tax credits recognized for research and development, job training and preservation of historical real property. The primary differences in the effective rate and the statutory rate were as follows (amounts are percentages):

	For the Forty Weeks Ended October 6, 2018	
Expected tax at U.S. federal and state income tax rates	25.3	%
Tax reform impact	(3.3))
Net share-based payments shortfall	1.2)
Discrete tax credits	(1.2))
Other	(1.9))
Effective federal and state income tax rate	20.1	%

In the fourth quarter of fiscal 2017, a tax benefit of \$48.2 million was recorded as an estimate of the impact of the Act. This provisional amount was adjusted in the second quarter of fiscal 2018 due to additional analysis, changes in assumptions and actions taken related to pension contributions and bonus depreciation on certain assets placed in service in fiscal 2017. The adjustment resulted in a discrete tax benefit of \$5.6 million, a reduction to federal income tax payable of \$16.4 million and an increase to federal deferred tax liabilities of \$10.8 million. No adjustments to the provisional estimate were recorded in the current quarter, and any subsequent adjustments in the fourth quarter are not expected to be significant.

Comprehensive Income

The change in comprehensive income year over year resulted primarily from increased net income and changes in the fair value of derivatives, partially offset by changes in the pension plan as a result of the remeasurement.

LIQUIDITY AND CAPITAL RESOURCES:

Strategy

We believe our ability to consistently generate cash flows from operating activities to meet our liquidity needs is one of our key financial strengths and we do not anticipate significant risks to these cash flows in the foreseeable future. Additionally, we strive to maintain a conservative financial position. We believe having a conservative financial position allows us flexibility to make investments and acquisitions and is a strategic competitive advantage. Currently, our liquidity needs arise primarily from working capital requirements, capital expenditures, pension contributions and obligated debt repayments. We believe we currently have access to available funds and financing sources to meet our short and long-term capital requirements. The company's strategy for use of its excess cash flows includes:

- implementing our strategies under Project Centennial;
- paying dividends to our shareholders;
- maintaining a conservative financial position;
- making strategic acquisitions;

60

- repurchasing shares of our common stock; and
- making discretionary contributions to our qualified pension plans.

Liquidity Discussion for the Forty Weeks Ended October 6, 2018 and October 7, 2017

The Condensed Consolidated Statement of Cash Flows for the forty weeks ended October 7, 2017 has been revised to correct errors. See Note 2, Financial Statement Revisions, of Notes to Condensed Consolidated Financial Statements of the Form 10-Q for details on these revisions.

Cash and cash equivalents were \$49.7 million at October 6, 2018 compared to \$5.1 million at December 30, 2017. The cash and cash equivalents were derived from the activities presented in the tables below (amounts in thousands):

Cash Flow Component	For the Forty Weeks Ended		
	October 6, 2018	October 7, 2017	Change
Cash provided by operating activities	\$232,059	\$ 224,026	\$8,033
Cash disbursed for investing activities	(73,412)	(12,804)	(60,608)
Cash disbursed for financing activities	(114,049)	(210,558)	96,509
Total change in cash	\$44,598	\$ 664	\$43,934

Cash Flows Provided by Operating Activities. The increase in net cash flows from operations, period over period, was primarily due to increased net income, changes in hedging margin activity, more favorable payment terms and decreased Project Centennial consulting costs, net of making \$40.7 million of voluntary pension plan contributions as well as VSIP payments, MEPP payments and increased bonus payouts. Net cash provided by operating activities consisted of the following items for non-cash adjustments to net income (amounts in thousands):

	For the Forty Weeks Ended		
	October 6, 2018	October 7, 2017	Change
Depreciation and amortization	\$111,949	\$ 114,288	\$(2,339)
Gain on divestiture	—	(28,875)	28,875
Impairment of assets	2,483	—	2,483
Restructuring and related impairment charges	174	69,651	(69,477)
Stock-based compensation	6,892	11,708	(4,816)
Deferred income taxes	21,139	(18,476)	39,615
Pension and postretirement plans cost (income)	6,372	(879)	7,251
Other non-cash items	969	2,734	(1,765)
Net non-cash adjustment to net income	\$149,978	\$ 150,151	\$(173)

The change in depreciation and amortization was primarily due to accelerated depreciation of certain leasehold improvements in the prior year, and reduced amortization expense as a result of impairing certain trademarks in the second half of fiscal 2017.

Refer to the Restructuring charges associated with Project Centennial and the Gain on divestiture of the non-core mix manufacturing business discussion in the “Matters Affecting Comparability” section above for additional information.

Other non-cash items include non-cash interest expense for the amortization of debt discounts and deferred financing costs and gains or losses on the sale of assets.

Net changes in working capital and pension plan contributions consisted of the following items (amounts in thousands):

	For the Forty Weeks Ended		
	October 6, 2018	October 7, 2017	Change
Changes in accounts receivable, net	\$(20,297)	\$ (26,457)	\$6,160
Changes in inventories, net	(8,847)	(7,241)	(1,606)
Changes in hedging activities, net	7,939	(14,814)	22,753
Changes in other assets, net	2,794	(14,395)	17,189
Changes in accounts payable, net	60,810	13,780	47,030
Changes in other accrued liabilities, net	(55,937)	53,020	(108,957)
Qualified pension plan contributions	(40,700)	(1,605)	(39,095)
Net changes in working capital and pension plan contributions	\$(54,238)	\$ 2,288	\$(56,526)

• Hedging activities change from market movements that affect the fair value and the associated required collateral of positions and the timing and recognition of deferred gains or losses. These changes will occur as part of our hedging program.

• Changes in income tax receivables and in deferred gains recorded in conjunction with the sale of distribution rights to IDPs primarily resulted in the change in other assets.

• The significant change in accounts payable resulted from extending our payment terms with certain of our suppliers in the second half of fiscal 2017 and during the current year as well as increases in ingredient costs.

• Changes in employee compensation accruals, including employee termination benefits, accrued MEPP costs, and legal accruals resulted in the change in other accrued liabilities. During the first quarter of fiscal 2018 and fiscal 2017, we paid \$28.1 million and \$17.3 million, respectively, including our share of employment taxes, in performance-based cash awards under our bonus plan. An additional \$0.4 million was paid during the first quarter of fiscal 2018 and fiscal 2017, respectively, for our share of employment taxes on the vesting of the performance-contingent restricted stock awards in each respective year. We paid \$27.6 million of VSIP and other restructuring related charges and \$17.5 million of MEPP costs through the third quarter of fiscal 2018. During the forty weeks ended October 6, 2018, we recognized \$21.6 million of legal settlements and paid \$16.4 million of legal settlements, of which \$5.2 million had been accrued for as of December 30, 2017.

• During the forty weeks ended October 6, 2018, we made voluntary contributions to our defined benefit pension plans of \$40.7 million. Currently, we do not anticipate making any additional contributions to these plans in fiscal 2018. The company believes its cash flow and balance sheet will allow it to fund future pension needs without adversely affecting the business strategy of the company.

Cash Flows Disbursed for Investing Activities. The table below presents net cash (disbursed for) provided by investing activities for the forty weeks ended October 6, 2018 and October 7, 2017, respectively (amounts in thousands):

	For the Forty Weeks Ended		
	October 6, 2018	October 7, 2017	Change
Purchases of property, plant, and equipment	\$(74,992)	\$ (51,213)	\$(23,779)
Principal payments from notes receivable, net of repurchases of			
independent distributor territories	214	(4,515)	4,729
Proceeds from divestiture	—	41,230	(41,230)
Proceeds from sale of property, plant and equipment	1,366	1,694	(328)

Edgar Filing: FLOWERS FOODS INC - Form 10-Q

Net cash disbursed for investing activities	\$(73,412)	\$ (12,804)	\$(60,608)
---------------------------------------------	------------	------------	---	------------

Capital expenditures for the DSD Segment and Warehouse Segment were \$60.2 million and \$12.3 million, respectively. We currently anticipate total capital expenditures of \$95 million to \$105 million for fiscal 2018. We received proceeds of \$41.2 million, net of a working capital adjustment, from the divestiture of our Cedar Rapids, Iowa mix manufacturing business in the first quarter of fiscal 2017.

62

Cash Flows Disbursed for Financing Activities. The table below presents net cash disbursed for financing activities for the forty weeks ended October 6, 2018 and October 7, 2017, respectively (amounts in thousands):

	For the Forty Weeks Ended		
	October 6, 2018	October 7, 2017	Change
Dividends paid	\$(112,247)	\$ (105,207)	\$(7,040)
Exercise of stock options	791	9,296	(8,505)
Payment of financing fees	(100)	(100)	—
Stock repurchases	(2,489)	(2,671)	182
Change in bank overdrafts	3,746	(10,626)	14,372
Net debt and capital lease obligations changes	(3,750)	(101,250)	97,500
Net cash disbursed for financing activities	\$(114,049)	\$ (210,558)	\$96,509

Our dividends paid increased due to an increased dividend payout rate compared to the prior year. While there are no requirements to increase the dividend payout, we have shown a historical trend to do so. If this trend continues in the future, we will have additional cash needs to meet these expected dividend payouts. Our Board of Directors declared the following quarterly dividends during the forty weeks ended October 6, 2018 (amounts in thousands, except per share data):

Date Declared	Record Date	Payment Date	Dividend per Common Share	Dividends Paid
August 17, 2018	August 31, 2018	September 14, 2018	\$0.1800	\$ 37,959
May 24, 2018	June 7, 2018	June 21, 2018	\$0.1800	\$ 37,959
February 16, 2018	March 2, 2018	March 16, 2018	\$0.1700	\$ 35,837

Additionally, we paid dividends of \$0.5 million at the time of vesting of our performance-contingent restricted stock awards and at issuance of deferred compensation shares.

Stock option exercises decreased due to fewer exercises in the current year compared to the prior year. There are currently no nonqualified stock options outstanding.

Stock repurchase decisions are made based on our stock price, our belief of relative value, and our cash projections at any given time. During the forty weeks ended October 6, 2018, we repurchased 0.1 million shares for \$2.5 million under a share repurchase plan approved by our Board of Directors. All shares repurchased by the company during the forty weeks ended October 6, 2018 were acquired to satisfy employees' tax withholding and payment obligations in connection with the vesting of restricted stock awards.

Capital Structure

Long-term debt and capital lease obligations and stockholders' equity were as follows at October 6, 2018 and December 30, 2017, respectively. For additional information regarding our debt and capital lease obligations, see Note 13, Debt and Other Obligations, of Notes to Condensed Consolidated Financial Statements of this Form 10-Q.

	Balance at October 6, 2018	December 30, 2017	Fixed or Variable Rate	Final Maturity
Long-term debt and capital lease obligations	(Amounts in thousands)			
2026 notes	\$395,418	\$394,978	Fixed Rate	2026
2022 notes	398,312	397,941	Fixed Rate	2022
The credit facility	—	—	Variable Rate	2022
The facility	—	—	Variable Rate	2020
Capital lease obligations	23,063	27,150		2025
Other notes payable	8,583	12,167		2020
	825,376	832,236		

Current maturities of long-term debt and

capital lease obligations	11,286	12,095
Long-term debt and capital lease obligations	\$814,090	\$820,141

Total stockholders' equity		
Total stockholders' equity	\$1,277,568	\$1,250,677

The facility and credit facility are generally used for short term liquidity needs. The company has historically entered into amendments and extensions approximately one year prior to the maturity of the facility and the credit facility. There is no current portion payable over the next year for these obligations. Amounts available for withdrawal under the facility are determined as the lesser of the total commitments and a formula derived amount based on qualifying trade receivables.

The following table details the amounts available under the facility and credit facility and the highest and lowest balances outstanding under these arrangements during the forty weeks ended October 6, 2018:

Facility	Amount Available for Withdrawal at October 6, (Amounts in thousands)	For the Forty Weeks Ended for Highest Balance	Lowest Balance
The facility	\$194,200	\$—	\$—
The credit facility (1)	491,700	1,000	—
	\$685,900		

(1) Amount excludes a provision in the credit facility agreement which allows the company to request an additional \$200.0 million in additional revolving commitments.

Amounts outstanding under the credit facility can vary daily. Changes in the gross borrowings and repayments can be caused by cash flow activity from operations, capital expenditures, acquisitions, dividends, share repurchases, and tax payments, as well as derivative transactions which are part of the company's overall risk management strategy as discussed in Note 9, Derivative Financial Instruments, of Notes to Condensed Consolidated Financial Statements of this Form 10-Q. During the forty weeks ended October 6, 2018, the company borrowed \$1.0 million in revolving borrowings under the credit facility and repaid \$1.0 million in revolving borrowings. The amount available under the credit facility is reduced by \$8.3 million for letters of credit.

The facility and the credit facility are variable rate debt. In periods of rising interest rates, the cost of using the facility and the credit facility will become more expensive and increase our interest expense. Therefore, borrowings under these facilities provide us the greatest direct exposure to rising rates. In addition, if interest rates do increase, it will make the cost of funds more expensive.

Restrictive financial covenants for our borrowings can include such ratios as a minimum interest coverage ratio and a maximum leverage ratio. Our debt may also contain certain customary representations and warranties, affirmative and negative covenants, and events of default. The company believes that, given its current cash position, its cash flow from operating activities and its available credit capacity, it can comply with the current terms of the debt agreements and can meet presently foreseeable financial requirements. As of October 6, 2018, the company was in compliance with all restrictive covenants under our debt agreements.

At October 6, 2018, the company did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which are established to facilitate off-balance sheet arrangements or other contractually narrow or limited purposes.

Under our share repurchase plan, the company may repurchase its common stock in open market or privately negotiated transactions at such times and at such prices as determined to be in the company's best interest. These repurchases may be commenced or suspended without prior notice depending on then-existing business or market conditions and other factors. During the forty weeks ended October 6, 2018, 0.1 million shares, at a cost of \$2.5 million, of the company's common stock were repurchased under the share repurchase plan. From the inception of the share repurchase plan through October 6, 2018, 68.0 million shares, at a cost of \$635.6 million, have been repurchased.

Accounting Pronouncements Recently Adopted and Not Yet Adopted

See Note 3, Recent Accounting Pronouncements, of Notes to Condensed Consolidated Financial Statements of this Form 10-Q for information regarding recently adopted accounting pronouncements and accounting pronouncements not yet adopted.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The company uses derivative financial instruments as part of an overall strategy to manage market risk. The company uses forward, futures, swap and option contracts to hedge existing or future exposure to changes in interest rates and commodity prices. The company does not enter into these derivative financial instruments for trading or speculative purposes. If actual market conditions are less favorable than those anticipated, raw material prices could increase significantly, adversely affecting the margins from the sale of our products.

Commodity Price Risk

The company enters into commodity forward, futures and option contracts and swap agreements for wheat and, to a lesser extent, other commodities in an effort to provide a predictable and consistent commodity price and thereby reduce the impact of market volatility in its raw material and packaging prices. As of October 6, 2018, the company's hedge portfolio contained commodity derivatives with a fair value of \$2.7 million, based on quoted market prices, and will primarily be utilized in fiscal 2019 with an immaterial amount to be utilized through fiscal 2021.

A sensitivity analysis has been prepared to quantify the company's potential exposure to commodity price risk with respect to the derivative portfolio. Based on the company's derivative portfolio as of October 6, 2018, a hypothetical ten percent increase (decrease) in commodity prices would increase (decrease) the fair value of the derivative portfolio by \$19.5 million. The analysis disregards changes in the exposures inherent in the underlying hedged items; however, the company expects that any increase (decrease) in fair value of the portfolio would be substantially offset by increases (decreases) in raw material and packaging prices.

ITEM 4. CONTROLS AND PROCEDURES

Management's Evaluation of Disclosure Controls and Procedures

We have established and maintain a system of disclosure controls and procedures that are designed to ensure that material information relating to the company, which is required to be timely disclosed by us in reports that we file or submit under the Exchange Act, is accumulated and communicated to management in a timely fashion and is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms.

Under the supervision and with the participation of our management, including our CEO, Chief Financial Officer ("CFO") and Chief Accounting Officer ("CAO"), we conducted an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this report. Based upon that evaluation and as of the end of the period covered by this report, the CEO, CFO and CAO concluded that the company's disclosure controls and procedures were effective to allow timely decisions regarding disclosure in its reports that the company files or submits to the SEC under the Exchange Act.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the fiscal quarter ended October 6, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

For a description of all material pending legal proceedings, see Note 15, Commitments and Contingencies, of Notes to Condensed Consolidated Financial Statements of this Form 10-Q.

ITEM 1A. RISK FACTORS

The information presented below supplements the risk factors set forth in the Form 10-K. In addition to these risk factors set forth below, refer to Part I, Item 1A., Risk Factors, in the Form 10-K for information regarding other factors that could affect the company's results of operations, financial condition and liquidity. Additional risks and uncertainties not presently known to us or that we currently deem to be immaterial also may affect us. The occurrence of any of these known or unknown risks could have a material adverse impact on our business, financial condition, or results of operations.

Disruption in our supply chain or distribution capabilities from political instability, armed hostilities, incidents of terrorism, natural disasters, weather, inferior product or ingredient supply, or labor strikes could have an adverse effect on our business, financial condition and results of operations.

Our ability to make, move and sell products is critical to our success. Damage or disruption to our manufacturing or distribution capabilities, or the manufacturing or distribution capabilities of our suppliers, due to weather, natural disaster, fire or explosion, terrorism, pandemics, inferior product or ingredient supply, labor strikes or work stoppages, or adverse outcomes in litigation involving our independent distributor model, could impair our ability to make, move or sell our products. Moreover, terrorist activity, armed conflict, political instability or natural disasters that may occur within or outside the U.S. may disrupt manufacturing, labor, and other business operations. Failure to take adequate steps to mitigate the likelihood or potential impact of such events and disruption to our manufacturing or distribution capabilities, or to effectively manage such events if they occur, could adversely affect our business, financial conditions and results of operations.

Product removals, damaged product or safety concerns could adversely impact our results of operations.

During fiscal 2018, we have been required, and may be required in future periods, to remove certain of our products from the market should they be mislabeled, contaminated, spoiled, tampered with or damaged, including as a result of inferior ingredients provided by any of our suppliers. We may become involved in lawsuits and legal proceedings alleging that the consumption of any of our products causes or caused injury, illness or death. Any such product removal, damaged product or an adverse result in any litigation related to such a product removal or damaged product could have a material adverse effect on our operating and financial results in future periods, depending on the costs of the product removal from the market, the destruction of product inventory, diversion of management time and attention, contractual and other claims made by customers that we supply, loss of key customers, competitive reaction and consumer attitudes. Even if a product liability, consumer fraud or other claim is unsuccessful or without merit, the negative publicity surrounding such assertions regarding our products could adversely affect our reputation and brand image. We also could be adversely affected if our customers or consumers in our principal markets terminate or alter their relationship with us or otherwise lose confidence in the safety and quality of our products.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Our Board of Directors has approved a plan that authorizes share repurchases of up to 74.6 million shares. Under the share repurchase plan, the company may repurchase its common stock in open market or privately negotiated transactions or under an accelerated share repurchase program at such times and at such prices as determined to be in the company's best interest. These repurchases may be commenced or suspended without prior notice depending on then-existing business or market conditions and other factors.

There were no common stock repurchases under the plan during the twelve weeks ended October 6, 2018. During the forty weeks ended October 6, 2018, 0.1 million shares, at a cost of \$2.5 million, of the company's common stock were repurchased under the share repurchase plan. From the inception of the share repurchase plan through October 6, 2018, 68.0 million shares, at a cost of \$635.6 million, have been repurchased. The company currently has 6.6 million shares remaining available for repurchase under the share repurchase plan.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

67

ITEM 6. EXHIBITS

The following documents are filed as exhibits hereto:

Exhibit

No	Name of Exhibit
3.1	<u>Restated Articles of Incorporation of Flowers Foods, Inc., as amended through June 5, 2015</u> —(Incorporated by reference to Exhibit 3.1 to Flowers Foods’ Current Report on Form 8-K, dated June 10, 2015, File No. 1-16247).
3.2	<u>Amended and Restated Bylaws of Flowers Foods, Inc., as amended through June 5, 2015 (Incorporated by reference to Exhibit 3.2 to Flowers Foods’ Current Report on Form 8-K, dated June 10, 2015, File No. 1-16247).</u>
10.1	* <u>Sixth Amendment to Receivables Loan, Security and Servicing Agreement, dated as of September 27, 2018, among Flowers Finance II, LLC, Flowers Foods, Inc., Nieuw Amsterdam Receivables Corporation B.U., Coöperatieve Rabobank U.A. (f/k/a Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A.), as facility agent and committed lender, PNC Bank National Association, as facility agent and committed lender, and Coöperatieve Rabobank U.A., New York Branch (f/k/a Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A. New York Branch), as administrative agent.</u>
31.1	* <u>Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>
31.2	* <u>Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>
31.3	* <u>Certification of Chief Accounting Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>
32	* <u>Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, by Allen L. Shiver, President and Chief Executive Officer, R. Steve Kinsey, Chief Financial Officer and Chief Administrative Officer, and Karyl H. Lauder, Senior Vice President and Chief Accounting Officer for the Quarter Ended October 6, 2018.</u>
101.INS	* <u>XBRL Instance Document.</u>
101.SCH	* <u>XBRL Taxonomy Extension Schema Linkbase.</u>
101.CAL	* <u>XBRL Taxonomy Extension Calculation Linkbase.</u>
101.DEF	* <u>XBRL Taxonomy Extension Definition Linkbase.</u>
101.LAB	* <u>XBRL Taxonomy Extension Label Linkbase.</u>
101.PRE	* <u>XBRL Taxonomy Extension Presentation Linkbase.</u>

* Filed herewith

SIGNATURES

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

FLOWERS FOODS, INC.

By: /s/ ALLEN L. SHIVER
Name: Allen L. Shiver
Title: President and Chief Executive Officer

By: /s/ R. STEVE KINSEY
Name: R. Steve Kinsey
Title: Chief Financial Officer and

Chief Administrative Officer

By: /s/ KARYL H. LAUDER
Name: Karyl H. Lauder
Title: Senior Vice President and Chief Accounting Officer

Date: November 7, 2018