CALLOWAYS NURSERY INC
Form 10-Q
May 10, 2002

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2002

Commission File No. 0-19305

CALLOWAY'S NURSERY, INC.
(Exact name of registrant as specified in its charter)

Texas	75-2092519
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification Number)

4200 Airport Freeway
Fort Worth, Texas 76117-6200
817.222.1122

(Address, including zip code, of principal executive offices and Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES [X] NO [ ]

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

Title	Shares Outstanding as of May 10, 2002
Common Stock, par value $.01 per share	6,400,614

CALLOWAY'S NURSERY, INC.

FORM 10-Q

MARCH 31, 2002

TABLE OF CONTENTS

FORWARD-LOOKING STATEMENTS OR INFORMATION

This Form 10-Q Report contains forward-looking statements. We are including this statement for the express purpose of providing Calloway's the protections of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 with respect to all forward-looking statements. Several important factors, in addition to the specific factors discussed in connection with such forward-looking statements individually, could affect future results and could cause those results to differ materially from those expressed in the forward-looking statements contained in this Report.

Our expected future results, products and service performance or other non-historical facts are forward-looking and reflect our current perspective of existing trends and information. These statements involve risks and uncertainties that cannot be predicted or quantified and, consequently, actual results may differ materially from those expressed or implied by such forward-looking statements. Such risks and uncertainties include, among others, the seasonality of our business, geographic concentration, the impact of weather and other growing conditions, the ability to manage growth, the impact of competition, the ability to obtain future financing, government regulations, market risks associated with variable-rate debt, and other risks and uncertainties defined from time to time in our Securities and Exchange Commission filings.

Therefore, each reader of this report is cautioned to consider carefully these factors as well as the specific factors discussed with each forward-looking statement in this Report and disclosed in our filings with the Securities and Exchange Commission as such factors, in some cases, have affected, and in the future (together with other factors) could affect, our ability to implement our business strategy and may cause actual results to differ materially from those contemplated by the statements expressed in this Report.

PART 1. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

CALLOWAY'S NURSERY, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)
(IN THOUSANDS)

ASSETS

	MARCH 31, 2002	SEPTEMBER 30, 2001	
Cash and cash equivalents	$ 597	$ 279	$
Accounts receivable	1,031	433	
Inventories	7,671	6,042	
Prepaids and other assets	108	230	
Deferred income taxes, current	758	55	
Income taxes receivable	--	1,180	
Current assets of discontinued operations	70	2,847	
Total current assets	10,235	11,066	
Property and equipment, net	13,572	13,888	
Goodwill, net	686	740	
Deferred income taxes	1,301	1,301	
Other assets	226	266	
Noncurrent assets of discontinued operations	--	--	
Total assets	$ 26,020	$ 27,261	$

LIABILITIES AND SHAREHOLDERS' EQUITY

Accounts payable	$ 4,722	$ 2,128	$
Accrued expenses	1,973	1,534	
Income taxes payable	--	--	
Notes payable, current	70	730	
Current portion of long-term debt	574	732	
Deferred income taxes, current	74	187	
Current liabilities of discontinued operations	36	2,304	
Total current liabilities	7,449	7,615	
Deferred rent payable	872	929	
Long-term debt, net of current portion	8,630	8,646	
Total liabilities	16,951	17,190	
Commitments and contingencies			
Non-voting preferred stock, with mandatory redemption provisions	2,346	2,180	
Shareholders' equity:			
Voting convertible preferred stock	--	--	
Preferred stock	--	--	
Common stock (6,385,970, 6,248,346 and 6,109,304 shares outstanding, respectively)	66	65	
Additional paid-in capital	9,749	9,610	
Retained earnings (accumulated deficit)	(1,696)	(388)	
	8,119	9,287	
Less: Treasury stock, at cost (250,000 common shares)	(1,396)	(1,396)	
Total shareholders' equity	6,723	7,891	
Total liabilities and shareholders' Equity	$ 26,020	$ 27,261	$

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

4

CALLOWAY'S NURSERY, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
(AMOUNTS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	SIX MONTHS ENDED MARCH 31,		
	2002	2001	

Net sales	$ 17,220	$ 17,335	$
Cost of goods sold	9,457	9,037	
Gross profit	7,763	8,298	
Operating expenses	6,337	6,385	
Occupancy expenses	1,512	1,304	
Advertising expenses	726	724	
Depreciation and amortization	480	444	
Interest expense	444	621	
Interest income	(9)	(5)	
Total expenses	9,490	9,473	
Loss from continuing operations before income taxes	(1,727)	(1,175)	
Income tax benefit	(605)	(409)	
Loss from continuing operations	(1,122)	(766)	
Income (loss) from discontinued operations, net of income tax	(20)	(70)	
Net loss	(1,142)	(836)	
Accretion of preferred stock	(166)	(150)	
Net loss attributable to common shareholders	$ (1,308)	$ (986)	$
Weighted average number of common shares outstanding			
Basic and diluted	6,317	6,043	
Net income (loss) per common share - basic and diluted			
Loss from continuing operations	$ (.21)	$ (.15)	$
Income (loss) from discontinued operations	--	$ (.01)	
Net loss	$ (.21)	$ (.16)	$

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

CALLOWAY'S NURSERY, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(IN THOUSANDS)

	SIX MONTHS EN MARCH 31,
	2002

CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (1,142)	$
Adjustments to reconcile net loss to net cash provided by (used for) operating activities:		
Loss from discontinued operations (net of tax)	20	
Depreciation and amortization	480	
Net change in operating assets and liabilities	1,275	
Net cash provided by (used for) operating activities	633	
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions to property and equipment	(110)	
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock	140	
Borrowings on debt	--	
Repayments of debt	(834)	
Net cash provided by (used for) financing activities	(694)	
Net increase (decrease) in cash and cash equivalents from continuing operations	(171)	
Net increase (decrease) in cash and cash equivalents from discontinued operations	489	
Net increase (decrease) in cash and cash equivalents	318	
Cash and cash equivalents at beginning of period	279	
Cash and cash equivalents at end of period	$ 597	$

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

CALLOWAY'S NURSERY, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

These interim unaudited consolidated financial statements were prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). In management's opinion, all adjustments considered necessary for a fair presentation of the financial position at March 31, 2002, and the results of operations and cash flows for the six-month periods ended March 31, 2002 and

2001 have been made. Such adjustments are of a normal recurring nature.

Because of seasonal and other factors, the results of operations and cash flows for the six-month period ended March 31, 2002 are not necessarily indicative of expected results of operations and cash flows for the fiscal year ending September 30, 2002.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the SEC rules and regulations referred to above. Accordingly, these financial statements should be read in conjunction with the audited financial statements and related notes for the fiscal year ended September 30, 2001 included in the Form 10-K covering such period.

2. RECLASSIFICATIONS

Certain amounts for fiscal 2001 have been reclassified to conform to the fiscal 2002 presentation.

3. INVENTORIES

Inventories consist of the following (amounts in thousands):

	March 31, 2002	September 30, 2001	March 31, 2001
Finished goods (retail)	$ 4,313	$ 3,921	$ 6,130
Work in process (growing)	3,016	1,884	1,476
Supplies (growing)	342	237	106
	$ 7,671	$ 6,042	$ 7,712

4. NOTES PAYABLE AND LONG-TERM DEBT

On March 31, 2002 the Company amended its revolving line of credit agreement and one of its term loan agreements to amend certain defined terms relating to financial covenants.

7

5. SEGMENT INFORMATION

The Company has two reportable segments: (i) Retail, and (ii) Growing.

The following is a tabulation of business segment information as of and for the six-month periods ended March 31, 2002 and 2001. Intersegment elimination information is included to reconcile segment data to the condensed consolidated financial statements. Amounts are in thousands:

	Six Months Ended March 31, 2002	Six Months Ended March 31, 2001	Three Months Ended March 31, 2002
REVENUES			
From external customers			
Retail	$ 17,203	$ 17,266	$ 6,985
Growing	17	69	7
Totals	17,220	17,335	6,992
From other operating segments			
Retail	--	--	--
Growing	911	441	731
Totals	911	441	731
Elimination of intersegment sales	(911)	(441)	(731
Total consolidated net sales	$ 17,220	$ 17,335	$ 6,992
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES			
Retail	$ (1,640)	$ (1,191)	$ (1,138
Growing	(87)	16	(3
Total loss from continuing operations before income taxes	$ (1,727)	$ (1,175)	$ (1,141

TOTAL ASSETS	March 31, 2002	September 30 2001
Retail	$ 22,295	$ 21,973
Growing	3,655	2,441
Totals	$ 25,950	$ 24,414

8

6. DISCONTINUED OPERATIONS

On August 7, 2001 the Company adopted a formal plan to dispose of the wholesale operations, which had been a part of its wholesale and growing segment. The Company exited its wholesale operations by the end of March 2002. The wholesale operation included the wholesale growing operations of Turkey Creek Farms as well as the wholesale landscape distribution centers ("WLD") in Austin and Houston. At Turkey Creek Farms, the Company now exclusively grows plants for sale at its retail stores. The adopted disposal plan included: (i) the sale of the Turkey Creek Farms wholesale inventories to unaffiliated customers, and (ii) the sale of the WLD operations as an ongoing business to an unaffiliated third party.

The sale of the WLD operations was completed in October 2001 and indebtedness related to the WLD real property was repaid. The Turkey Creek Farms wholesale inventory was completely sold or otherwise liquidated by the end of December 2001.

Following is a summary of the asset and liabilities of the discontinued wholesale operations as of the applicable periods (amounts in thousands):

	March 31, 2002	September 30, 2001	March 31, 2001
Cash	$ 24	$ 41	$ 21
Accounts receivable	44	717	1,039
Inventories	--	1,458	7,095
Prepaid expenses	2	--	2
Property and equipment	--	631	--
Current assets of discontinued operations	$ 70	$ 2,847	$ 8,157
Noncurrent assets of discontinued operations	$ --	$ --	$ 593
Accounts payable	$ 36	$ 693	$ 898
Accrued expenses	--	495	98
Current portion of long-term debt	--	1,116	6
Current liabilities of discontinued operations	$ 36	$ 2,304	$ 1,002

Following is a summary of the operating results of the discontinued wholesale operations for the applicable periods (amounts in thousands):

	Six Months Ended March 31, 2002	Six Months Ended March 31, 2001	Three Months Ended March 31, 2002
Sales	$ 1,389	$ 3,286	$ 37
Cost of goods sold	1,132	2,322	--
Gross profit	257	964	37
Expenses	290	1,079	13

Income (loss) from discontinued operations before income taxes	(33)	(115)	24
Income tax expense (benefit)	(13)	(45)	7
Income (loss) from discontinued operations	$ (20)	$ (70)	$ 17

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

RESULTS OF OPERATIONS

INTRODUCTION

In August 2001 the Company adopted a formal plan to dispose of the wholesale operations that had been a part of its wholesale and growing segment (see Note 6 to Condensed Consolidated Financial Statements). Accordingly, the following discussion of results of operations has been separated into (i) Continuing Operations and (ii) Discontinued Operations.

CONTINUING OPERATIONS

(Amounts in millions, except per share a

Second quarter highlights (unaudited)	Fiscal 2002	Fis
Consolidated net sales	$ 7.0	
Retail segment sales	7.0	
Growing segment sales	.7	
Less: internal sales	$ (.7)	
Sales decrease	(6)%	
Number of retail stores (end of quarter)	20	
Gross profit margin	49%	
Loss from continuing operations before income taxes	$ (1.1)	
Net loss per share (basic and diluted)	(.13)	
Cash flows used for operations	(1.9)	
Retail inventories	4.3	
Growing inventories	3.4	
Current ratio	1.4	
Property, plant and equipment (net)	13.6	
Long-term debt (including current portion)	$ 9.2	

QUARTER ENDED MARCH 31, 2002 COMPARED WITH QUARTER ENDED MARCH 31, 2001

Sales decreased 6%, primarily due to weaker early-season consumer demand for living plants and related gardening products for the second quarter of fiscal

2002 (the "March 2002 Quarter") as compared to the prior year (the "March 2001 Quarter").

The Company typically reports a loss during its second fiscal quarter. For the March 2002 Quarter the Loss from Continuing Operations before Income Taxes was somewhat larger than it was for the March 2001 Quarter, primarily due to the reduced Sales.

Gross Margin (Gross Profit divided by Sales) was essentially unchanged at 49% for both the March 2002 Quarter and the March 2001 Quarter.

Operating Expenses were essentially unchanged at approximately $3.0 million for both the March 2002 Quarter and the March 2001 Quarter.

Occupancy Expenses increased from $619,000 for the March 2001 Quarter to $825,000 for the March 2002 Quarter, primarily due to higher estimated property taxes for the March 2002 Quarter than had been estimated for the March 2001 Quarter.

Advertising Expenses decreased 9% from $278,000 for the March 2001 Quarter to $254,000 for the March 2002 Quarter, primarily due to reduced use of media other than newspapers and radio.

Depreciation and Amortization Expenses rose 10% from $221,000 for the March 2001 Quarter to $244,000 for the March 2002 Quarter as a result of capital additions completed and placed in service during fiscal 2001.

Interest Expense decreased 40%, from $359,000 for the March 2001 Quarter to $217,000 for the March 2002 Quarter, as the Company used proceeds from the sale of its wholesale operations to reduce debt.

Inventories were essentially unchanged at $7.7 million at both March 31, 2002 and 2001. Retail inventories declined $1.8 million from $6.1 million at March 31, 2001 to $4.3 million at March 31, 2002, while growing inventories rose from $1.6 million at March 31, 2001 to $3.4 million at March 31, 2002. The decrease in retail inventories was due to clearance of slower-moving merchandise items, including certain Christmas items. The increase in growing inventories reflects the increase in those inventories for use exclusively in the Company's retail segment. Inventories formerly held by the growing segment for sale at wholesale were part of the wholesale nursery operations discontinued in 2001 and are not included in the growing inventory of $1.6 million shown at March 31, 2001 (see Note 6 to Condensed Consolidated Financial Statements). For 2002 Turkey Creek Farms has joined Miller Plant Farms in producing plants exclusively for sale at the Company's retail stores.

SIX MONTH PERIOD ENDED MARCH 31, 2002 COMPARED WITH QUARTER ENDED MARCH 31, 2001

Sales were essentially flat, indicating similar consumer demand for living plants and related gardening products.

The Company typically reports a loss during its first and second fiscal quarters. For the first six months of fiscal 2002 (the "2002 Six Month Period"), the Loss from Continuing Operations before Income Taxes was somewhat larger than it was for the prior year (the "2001 Six Month Period"). The larger loss was primarily due to lower Gross Margin (Gross Profit divided by Sales), which declined from 48% for the 2001 Six Month Period to 45% for the 2002 Six Month Period.

The reduced Gross Margin was primarily attributable to larger markdowns in the December 2001 Quarter that were needed to sell the Christmas inventory.

Operating Expenses decreased 1% from approximately $6.4 million for the 2001 Six Month Period to approximately $6.3 million for the 2002 Six Month Period.

Occupancy Expenses increased from approximately $1.3 million for the 2001 Six Month Period to approximately $1.5 million for the 2002 Six Month Period, primarily due to higher estimated property taxes for the 2002 Six Month Period than had been estimated for the 2001 Six Month Period.

Advertising Expenses were essentially unchanged at approximately $0.7 million for both the 2002 Six Month Period and the 2001 Six Month Period.

Depreciation and Amortization Expenses rose 8% from $444,000 for the 2001 Six Month Period to $480,000 for the 2002 Six Month Period as a result of capital additions completed and placed in service during fiscal 2001.

Interest Expense decreased 29%, from $621,000 for the 2001 Six Month Period to $444,000 for the 2002 Six Month Period, as the Company used proceeds from the sale of its wholesale operations to reduce debt.

DISCONTINUED OPERATIONS

QUARTER ENDED MARCH 31, 2002 COMPARED WITH QUARTER ENDED MARCH 31, 2001

Sales decreased 98%. The WLD operations were sold near the end of October 2001, and substantially all of the Turkey Creek Farms wholesale operation was liquidated by the end of December 2001.

Gross Profit decreased 93%, for the same reasons as the decrease in Sales.

Expenses decreased 98%, for the same reasons as the decrease in Sales.

Income before Income Taxes was $24,000 for the March 2002 Quarter and there was a Loss before Income Taxes of $26,000 for the March 2001 Quarter.

SIX MONTH PERIOD ENDED MARCH 31, 2002 COMPARED WITH QUARTER ENDED MARCH 31, 2001

Sales decreased 58%. The WLD operations were sold near the end of October 2001, and substantially all of the Turkey Creek Farms wholesale operation was liquidated by the end of December 2001.

Gross Profit decreased 73%, for the same reasons as the decrease in Sales.

Expenses decreased 73%, for the same reasons as the decrease in Sales.

Loss before Income Taxes was $33,000 for the 2002 Six Month Period, and there was a Loss before Income Taxes of $115,000 for the 2001 Six Month Period.

FINANCIAL CONDITION - CAPITAL RESOURCES AND LIQUIDITY

Cash Flows Provided By Operating Activities were approximately $0.6 million for the 2002 Six Month Period, compared to Cash Flows Used For Operating Activities of approximately $2.1 million for the 2001 Six Month Period. The primary cause of the improvement was a refund of federal income taxes of approximately $1.1 million received during the 2002 Six Month Period period, as compared to federal income taxes paid of approximately $1.4 million during the 2001 Six Month Period period.

Cash flows Used For Investing Activities were approximately $110,000 for the 2002 Six Month Period, compared to $393,000 for the 2001 Six Month Period. The Company is limiting the amount of capital expenditures for fiscal 2002 to a greater extent than it did for fiscal 2001.

Cash Flows Used For Financing Activities were approximately $0.7 million for the 2002 Six Month Period, compared to Cash Flows Provided By Financing Activities of approximately $3.5 million for the 2001 Six Month Period. During 2002 the Company sold or otherwise disposed of substantially all of its wholesale operations, using the proceeds to retire certain long-term debt and repay $702,000 of seasonal borrowings under its line of credit arrangement. By comparison, during 2001 the Company refinanced certain long-term debt, increasing the total amount of indebtedness, and borrowed approximately $3.2 million under its revolving line of credit arrangement.

The Company has improved its liquidity position at March 31, 2002 by (i) reducing Notes Payable and Long Term Debt by approximately $4.5 million, and (ii) increasing Cash by $464,000.

The Company's business is seasonal, and it relies on its revolving line of credit arrangement to provide working capital during seasons of lower sales volumes. Typically, the Company borrows from the revolving line of credit during the quarter ending March 31, and repays those borrowings quickly during the spring selling season included in the quarter ending June 30. Continued availability of funds from the revolving line of credit depends upon the Company's continued compliance with its loan covenants. At March 31, 2002 the Company was in compliance with all of its loan covenants. The Company does not anticipate any problem in meeting its capital requirements or staying within the requirements of its loan covenants.

CONTRACTUAL OBLIGATIONS AND COMMITMENTS

As of September 30, 2001 the Company had the following contractual obligations (amounts in thousands):

	FISCAL YEAR ENDING SEPTEMB				
	2002	2003	2004	2005	2006

Long-term debt (including current portion)	$ 732	$ 696	$ 1,405	$ 1,965	$ 704
Future minimum lease payments under noncancellable operating leases	2,000	1,645	1,630	1,187	1,001
Preferred stock with mandatory redemption provisions (1)	--	--	3,420	--	--
Totals	$ 2,732	$ 2,341	$ 6,455	$ 3,152	$ 1,705

During the March 2002 Quarter there were no material changes to the September 30, 2001 amounts other than scheduled principal payments on long-term debt and scheduled rental payments on operating leases.

(1) Carrying amount of $2,180 as of September 30, 2001.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

Some assets and liabilities by their nature are subject to estimates and assumptions. For the Company, those assets and liabilities include:

- Inventories;
- Deferred income taxes;
- Property and equipment;
- Goodwill;
- Accrued expenses;
- Current and noncurrent assets and liabilities of discontinued operations.

Inventories - The Company values its inventories using the lower of cost or market on a first-in, first-out basis. The Company conducts physical inventories three times each year: December, June and September.

The Company's retail inventories turn-over several times each year; therefore, the cost of each inventory item is approximately the same as its current replacement cost. Merchandise that is considered to have declined in quality is marked-down to estimated net realizable value on a regular basis. The physical inventories are taken at retail prices and adjusted to cost using sampling techniques that determine a markup percentage for each merchandise category in each market area.

The Company's growing inventories turn over more slowly than the retail inventories, and items continue to grow and absorb costs until they are sold. At each physical inventory, the accumulated cost of growing inventories is compared to published wholesale prices from competing growers on a gallon-equivalent basis, with allowance for the estimated costs of disposal of such inventories. The growing inventories are then recorded at the lower of cost or market. In addition, merchandise that is considered to have declined in quality is marked-down to estimated net realizable value on a regular basis.

Deferred income taxes - As of March 31, 2002 and 2001, and September 30, 2001 the Company has recorded a valuation allowance of $0 for its deferred tax assets on the weight of available evidence at those balance sheet dates. The primary factor in not providing for a valuation allowance is the expectation that future taxable income and the reversal of temporary differences will be sufficient for the Company to realize the deferred tax assets. Such estimate could change in the future based on the occurrence of one or more future events.

Property and Equipment - The Company reevaluates the propriety of the carrying amounts of its properties as well as the amortization periods when events and circumstances indicate that impairment may have occurred. Recoverability of assets to be held and used is measured by the comparison of the carrying amount of an asset to future cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. As of March 31, 2002 and 2001, and September 30, 2001 management believes that no impairment has occurred and that no reduction of the estimated useful lives is warranted. As described below, during the fiscal year ended September 30, 2001 the Company adopted a formal plan to discontinue certain operations, and included in a loss on disposal of discontinued operations an adjustment of the carrying amount of certain property and equipment to its estimated net realizable value. The Company will adopt Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" as of October 1, 2002.

Goodwill - The Company assesses the recoverability of its goodwill by determining whether the amortization of the goodwill balance over its remaining life can be recovered through undiscounted future operating cash flows. The amount of goodwill impairment, if any, is measured based on the projected discounted future operating cash flows using a discount rate reflecting the Company's average cost of funds. The assessment of the recoverability of goodwill will be impacted if estimated future operating cash flows are not achieved. Management believes that no impairment has occurred. The Company will adopt Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" as of October 1, 2002. As of October 1, 2002, the Company expects to have unamortized goodwill in the amount of $632,000 that will be subject to the transition provisions. Amortization expense related to goodwill was $54,000 and $108,000 for the six months ended March 31, 2002 and the year ended September 30, 2001, respectively.

Accrued expenses - The Company routinely accrues for various costs and expenses for which it has received goods or services, but for which it has not been invoiced. Typically, accrued expenses include such items as salaries and related taxes, bonuses, and sales and use taxes for which amounts are readily determinable and significant estimates are not necessary. Property taxes are estimated and accrued based on the amounts paid for such taxes for the previous year, until a new tax bill is received. Various other expenses are accrued from time to time before an invoice is rendered based on the estimated costs of those goods or services.

Current and Noncurrent Assets and Liabilities of Discontinued Operations -- As noted above, in August 2001 the Company adopted a formal plan to discontinue certain operations. Management used estimates to determine the amounts to be recorded as a loss on disposal of discontinued operations. Those estimates included:

- Net realizable value of wholesale inventories;
- Net realizable value of accounts receivable;
- Net realizable value of property and equipment;
- Expenses associated with selling and/or terminating discontinued operations.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Calloway's is exposed to certain market risks, including fluctuations in interest rates. We do not enter into transactions designed to mitigate such market risk, nor do we enter into any transactions in derivative securities for trading or speculative purposes. As of March 31, 2002, we had no foreign exchange contracts or options outstanding.

We manage our interest rate risk by balancing (a) the amount of variable-rate long-term debt with (b) the amounts due under long-term leases, which typically have fixed rental payments that do not fluctuate with interest rate changes. For our variable-rate debt, interest rate changes generally do not affect the fair market value of such debt, but do impact future earnings and cash flows, assuming other factors are held constant.

At March 31, 2002 Calloway's had variable rate debt of $3.3 million, out of total long-term debt of $9.2 million. Holding other variables, such as debt levels, constant, a one percentage point increase in interest rates would be expected to have an estimated impact on pre-tax earnings and cash flows for next year of approximately $33,000 for the variable-rate debt.

PART 2. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

None.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS.

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

The Annual Meeting of Shareholders of the Company was held on February 20, 2002. The voting results at that meeting were as follows:

ELECTION OF DIRECTORS

Nominee	For
Dr. Stanley Block	5,306,420
James C. Estill	5,305,920
C. Sterling Cornelius	5,308,200
John T. Cosby	5,301,420
Daniel R. Feehan	5,306,420
Timothy J. McKibben	5,306,520
John S. Peters	5,301,920

APPROVAL OF CALLOWAY'S NURSERY, INC. 2001 STOCK OPTION PLAN

For	Against	Abstain	Broker Non-Votes
4,914,523	422,610	4,047	-0-

APPOINTMENT OF KPMG LLP AS AUDITORS FOR FISCAL YEAR 2002

For	Against	Abstain	Broker Non-Votes
5,219,467	118,210	3,503	-0-

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) Exhibits:

None.

(b) Reports on Form 8-K:

None.

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.

Dated: May 10, 2002

CALLOWAY'S NURSERY, INC.

By /s/ James C. Estill

James C. Estill, President and
Chief Executive Officer

By /s/ Daniel G. Reynolds

Daniel G. Reynolds, Vice President
and Chief Financial Officer