CALLOWAYS NURSERY INC
Form 10-Q
May 09, 2003

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, 2003

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 by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

YES [ ] NO [X]

6,740,095 shares of the Registrant's Common Stock, $.01 par value, were outstanding as of April 30, 2003.

CALLOWAY'S NURSERY, INC.

FORM 10-Q

MARCH 31, 2003

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, general economic 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, the costs and benefits of discontinuing certain operations, 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, 2003	SEPTE 2
Cash and cash equivalents	$ 787	$
Accounts receivable	971	
Inventories	7,418	
Prepaids and other assets	122	
Deferred income taxes, current	1,226	
Income taxes receivable	--	
Current assets of discontinued operations	--	
Total current assets	10,524	
Property and equipment, net	11,852	
Goodwill, net	631	
Deferred income taxes	1,568	
Other assets	197	
Noncurrent assets of discontinued operations	--	
Total assets	$ 24,772	$
LIABILITIES AND SHAREHOLDERS' EQUITY		
Accounts payable	$ 5,489	$
Accrued expenses	3,351	
Notes payable, current	--	
Current portion of long-term debt	390	
Deferred income taxes, current	--	
Current liabilities of discontinued operations	--	
Total current liabilities	9,230	
Deferred rent payable	720	
Long-term debt, net of current portion	7,191	
Total liabilities	17,141	
Commitments and contingencies		
Non-voting preferred stock, with mandatory redemption provisions	2,743	
Shareholders' equity:		
Voting convertible preferred stock	--	
Preferred stock	--	

Common stock	69	
Additional paid-in capital	10,043	
Accumulated deficit	(3,828)	
	6,284	
Less: Treasury stock, at cost	(1,396)	
Total shareholders' equity	4,888	
Total liabilities and shareholders' equity	$ 24,772	$

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,		THREE MONTH MARCH 3
	2003	2002	2003
Net sales	$ 20,115	$ 17,220	$ 9,252
Cost of goods sold	11,207	9,457	4,729
Gross profit	8,908	7,763	4,523
Operating expenses	8,306	6,377	4,137
Occupancy expenses	1,690	1,460	869
Advertising expenses	984	725	430
Depreciation and amortization	318	464	136
Interest expense	405	443	205
Interest income	(7)	(9)	(3)
Total expenses	11,696	9,460	5,774
Loss from continuing operations before income taxes	(2,788)	(1,697)	(1,251)
Income tax benefit	(1,064)	(596)	(460)
Loss from continuing operations	(1,724)	(1,101)	(791)
Discontinued operations:			
Loss from discontinued operations, net of income tax benefits of $330, $22, $80 and $2	(542)	(41)	(171)
Gain on disposal of discontinued operations, net of income tax expense of $257, $--, $257, and $--	420	--	420
Gain (loss) from discontinued operations	(122)	(41)	249

Net loss	(1,846)	(1,142)	(542)
Accretion of preferred stock	(205)	(166)	(102)
Net loss attributable to common shareholders	$ (2,051)	$ (1,308)	$ (644)
Weighted average number of common shares outstanding - basic and diluted	6,615	6,317	6,663
Net loss per common share - basic and diluted			
Loss from continuing operations	$ (.29)	$ (.20)	$ (.14)
Income (loss) from discontinued operations	(.02)	(.01)	.04
Net loss	$ (.31)	$ (.21)	$ (.10)

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

5

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

	SIX MONTHS ENDED MARCH 31, 2003	2002
Cash flows from operating activities:		
Net loss	$ (1,846)	$ (1,142)
Adjustments to reconcile net loss to net cash provided by (used for) operating activities:		
Loss from discontinued operations (net of tax)	122	41
Depreciation and amortization	318	464
Net change in operating assets and liabilities	78	1,705
Net cash provided by (used for) operating activities	(1,328)	1,068
Cash flows from investing activities - Additions to property and equipment	(77)	(143)
Cash flows from financing activities:		
Proceeds from issuance of common stock	159	140
Repayments of debt	(1,166)	(834)
Net cash used for financing activities	(1,007)	(694)

Net increase (decrease) in cash and cash equivalents from continuing operations	(2,412)	231
Net increase in cash and cash equivalents from discontinued operations	724	87
Net increase (decrease) in cash and cash equivalents	(1,688)	318
Cash and cash equivalents at beginning of period	2,475	279
Cash and cash equivalents at end of period	$ 787	$ 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 condensed 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 consolidated financial position at March 31, 2003, and the results of operations and cash flows for the six-month and three-month periods ended March 31, 2003 and 2002 have been made. Such adjustments are of a normal recurring nature.

Because of seasonal and other factors, the results of operations for the six-month and three-month periods ended March 31, 2003, and the cash flows for the six-month period ended March 31, 2003, are not necessarily indicative of expected results of operations and cash flows for the fiscal year ending September 30, 2003.

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, 2003 included in the Form 10-K covering such period.

2. RECLASSIFICATIONS

Certain amounts for fiscal 2002 have been reclassified to conform to the fiscal 2003 presentation. (See Note 5 - "Exit from Turkey Creek Farms")

3. INVENTORIES

Inventories consist of the following (amounts in thousands):

	March 31, 2003	September 30, 2003	March 31, 2002
Finished goods	$ 5,920	$ 4,006	$ 4,313
Work in process	1,317	929	1,522
Supplies	181	82	221
	$ 7,418	$ 5,017	$ 6,056

7

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

4. 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 three-month periods ended March 31, 2003 and 2002. Intersegment elimination information is included to reconcile segment data to the condensed consolidated financial statements. Amounts are in thousands:

	Six month period ended March 31, 2003	Six month period ended March 31, 2003	Three month period ended March 31, 2003	Three month period ended March 31, 2002
REVENUES				
From external customers				
Retail	$ 20,085	$ 17,203	$ 9,237	$ 6,985
Growing	30	17	15	7
Totals	20,115	17,220	9,252	6,992
From other operating segments				
Retail	--	--	--	--
Growing	476	517	345	337
Totals	476	517	345	337
Elimination of intersegment sales	(476)	(517)	(345)	(337
Total consolidated net sales	$ 20,115	$ 17,220	$ 9,252	$ 6,992
LOSS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES				
Retail	$ (2,733)	$ (1,640)	$ (1,215)	$ (1,252
Growing	(55)	(57)	(36)	141
Total loss from continuing operations before income taxes	$ (2,788)	$ (1,697)	$ (1,251)	$ (1,111

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	March 31, 2003	September 30, 2003	March 31, 2002
TOTAL ASSETS			
Retail	$ 23,218	$ 21,715	$ 21,306
Growing	1,554	1,077	1,820
Totals	$ 24,772	$ 22,792	$ 23,216

The following table provides the revenues from external customers by groups of similar products (amounts in thousands):

	Six month period ended March 31, 2003	Six month period ended March 31, 2003	Three month period ended March 31, 2003	Three month period ended March 31, 2002
REVENUES FROM EXTERNAL CUSTOMERS				
Living plants	$ 10,266	$ 8,255	$ 6,157	$ 4,590
Gardening related products	5,735	5,107	3,047	2,352
Christmas and other	4,114	3,858	48	50
Totals	$ 20,115	$ 17,220	$ 9,252	$ 6,992

8

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

5. DISCONTINUED OPERATIONS

Disposal of Wholesale Operations

In August 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 as of December 31, 2001. Specifically, the Company ceased in an orderly fashion production and marketing of plants and related products grown or purchased for sale to wholesale customers, including other nursery retailers and landscape contractors. The disposal of the wholesale operations was completed by December 31, 2001.

Exit from Turkey Creek Farms

In September 2002 the Company decided to sell its Turkey Creek Farms growing operation and discontinue the merchandise that it produced. The Company incurred operating losses and negative cash flows on Turkey Creek Farms in fiscal 2002 and concluded that market conditions then and for the foreseeable future were such that Turkey Creek Farms was likely to remain uncompetitive.

The Turkey Creek Farms growing operation was sold in March 2003. A gain of $420,000, net of income taxes, was recorded.

The Company recorded an inventory write-down of approximately $1.2 million in fiscal 2002. The assets, liabilities and results of operations for Turkey Creek Farms have been reclassified as discontinued operations in the accompanying condensed consolidated financial statements in accordance with Statement 144. (See Note 2 - "Reclassifications")

Following is a summary of the assets and liabilities of the discontinued operations as of the applicable years (amounts in thousands):

	March 31, 2003	September 30, 2003	March 31, 2002
Cash	$ --	$ 15	$ 24
Accounts receivable	--	1	46
Inventories	--	141	1,615
Property and equipment held for sale	--	1,176	--
Current assets of discontinued operations	$ --	$ 1,333	$ 1,685
Noncurrent assets of discontinued operations - property and equipment	$ --	$ --	$ 1,209
Accounts payable	$ --	$ 476	$ 380
Accrued expenses	--	11	20
Current liabilities of discontinued operations	$ --	$ 487	$ 400

The property and equipment of the discontinued Turkey Creek Farms operation was classified as a current asset at September 30, 2003 since it was sold in fiscal 2003.

9

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

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

	Six Month	Six Month	Three Month	Th Mo

	Period Ended March 31, 2003	Period Ended March 31, 2002	Period Ended March 31, 2003	Pe En Mar 2
Sales	$ 210	$ 1,784	$ 39	$
Cost of goods sold	210	1,527	39	
Gross profit	--	257	--	
Expenses	872	320	251	
Loss from discontinued operations before income taxes	(872)	(63)	(251)	
Income tax benefit	(330)	(22)	(80)	
Loss from discontinued operations	$ (542)	$ (41)	$ (171)	$

In April 2003 the Company decided to sell its Miller Plant Farms growing operation ("Miller") and discontinue the merchandise that it produced. (See Note 9 - "Subsequent Event")

6. NEW ACCOUNTING PRONOUNCEMENTS

Statement 142

The Company adopted Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets ("Statement 142") as of October 1, 2002 and no longer amortizes goodwill. As of the adoption date the Company had unamortized goodwill in the amount of $631,000 which was subject to the transition provisions of Statement 142.

In connection with the transitional goodwill impairment evaluation, Statement 142 required the Company to perform an assessment of whether there was an indication that goodwill is impaired as of the date of adoption. To accomplish this, the Company identified its reporting units and determined the carrying value of each reporting unit by assigning the assets and liabilities, including the existing goodwill and intangible assets, to those reporting units as of the date of adoption. The Company then determined the fair value of each reporting unit and compared it to the reporting unit's carrying amount.

Based on those tests, there was no indication that any reporting unit's goodwill was impaired. Accordingly, no transitional impairment losses were required to be recognized as the cumulative effect of a change in accounting principle.

There was no amortization expense for the three-month and six-month periods ended March 31, 2003. The Company's reported net loss for the three-month and six-month periods ended March 31, 2002, adjusted for excluding the effects of goodwill amortization, would have been $715,000 and $1,792,000, respectively. The effect on adjusted net loss per share for the three-month and six-month periods ended March 31, 2002 was insignificant.

Statement 148

In December 2002 the Financial Accounting Standards Board ("FASB") issued Statement No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure, an Amendment of FASB Statement No. 123 ("Statement 148"). Statement 148 provides alternative methods of transition for a voluntary change to the fair value-based method of accounting for stock-based employee compensation. In addition, Statement 148 amends the disclosure requirements of FASB Statement No. 123, Accounting for Stock-Based Compensation ("Statement 123") to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation arrangements in each period presented, and provides for a specific tabular format of the pro forma disclosures required by Statement 123.

The Company accounts for its stock options plans under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. No stock-based employee compensation cost is reflected in net loss, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of the grant. The following table illustrates the effect on net loss and loss per share if the Company had applied the fair value recognition provisions of Statement 123 to stock-based employee compensation (amounts in thousands, except per share amounts):

	Six Month Period Ended March 31, 2003	Six Month Period Ended March 31, 2002	Three Month Period Ended March 31, 2003	Th Mo Pe En Mar 2
Net loss, as reported	$ (1,846)	$ (1,142)	$ (542)	$
Total stock-based employee compensation expense determined under fair value based method for all awards, net of related income tax effects	--	432	--	
Pro forma net loss	$ (1,846)	$ (1,574)	$ (542)	$
Net loss per share:				
Basic and diluted - as reported	$ (.31)	$ (.21)	$ (.10)	$
Basic and diluted - pro forma	$ (.31)	$ (.28)	$ (.10)	$

7. COMMITMENTS AND CONTINGENCIES

In fiscal 2002 the Company entered the San Antonio market by leasing seven retail store locations (the "San Antonio Market Entry"). Three of those leases were entered into with Mr. George J. Wechsler (the "Affiliate Leases"), who was elected to the Company's Board of Directors and was named a Vice President of the Company at the time of the San Antonio Market Entry. The Affiliate leases have three year terms. Rental expense under the Affiliate Leases was $71,000 for the six month period ended March 31, 2003 and $36,000 for the three month period ended March 31, 2003. No rental expense under the Affiliate Leases was incurred for the six month or three month periods ended March 31, 2002.

8. ADVERTISING EXPENSES

The substantial majority of the Company's advertising consists of printed newspaper advertisements and radio announcements. Occasionally the Company will use direct mail and other media.

The Company expenses all advertising costs as they are incurred.

9. SUBSEQUENT EVENT

Exit from Miller Plant Farms

In April 2003 the Company decided to sell its Miller Plant Farms growing operation and discontinue the merchandise that it produced. The Company intends to dedicate its resources towards its retail operations.

12

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

RESULTS OF OPERATIONS

INTRODUCTION

In fiscal 2001 the Company adopted a formal plan to dispose of the wholesale operations that had been a part of its wholesale and growing segment. In fiscal 2003 the Company sold its Turkey Creek Farms growing operation and discontinued the merchandise that it produced (see Note 5 to the Condensed Consolidated Financial Statements). Accordingly, the following discussion of results of operations has been separated into (i) Continuing Operations and (ii) Discontinued Operations.

The Company's Miller Plant Farms growing operation ("Miller") is included in Continuing Operations in this report. In April 2003 the Company decided to sell Miller and discontinue the merchandise that it produced. In future reports Miller will be included in Discontinued Operations.

RESULTS OF OPERATIONS

CONTINUING OPERATIONS

SIX MONTH PERIOD ENDED MARCH 31, 2003 COMPARED WITH SIX MONTH PERIOD ENDED MARCH 31, 2002

Loss from Continuing Operations before Income Taxes for the first six months of fiscal 2003 (the "March 2003 Period") was higher than it was for the first six months of fiscal 2003 (the "March 2002 Period"), primarily due to increased expenses and lower gross profit as a percentage of net sales ("Gross Margin").

Sales increased 17%, from $17.2 million for the March 2002 Period to $20.1 million for the March 2003 Period. The increase was primarily attributable to the addition of 7 new retail stores in the San Antonio Market in the fourth quarter of fiscal 2002. The addition of the San Antonio retail stores was also the primary factor in the 22% increase in inventories, from $6.1 million at

March 31, 2002 to $7.4 million at March 31, 2003.

Same-store sales were increased 1%, from $16.9 million for the March 2002 Period to $17.1 for the March 2003 Period.

Gross Profit increased 15%, from $7.8 million for the March 2002 Period to $8.9 million for the March 2003 Period. However, Gross Margin declined from 45% for the March 2002 Period to 44% for the March 2003 Period. The decline was primarily attributable to aggressive price discounting at Christmas to increase sales.

Operating expenses increased 30%. The increase was primarily attributable to the opening of 7 retail stores in the San Antonio market. Same-store operating expenses increased 6%. The increase in same-store operating expenses was primarily attributable to increased labor costs associated with increased staffing.

Occupancy expenses increased 16%. The increase was primarily attributable to the leasing of 7 retail stores in the San Antonio market.

Advertising expenses increased 36%. The increase was primarily attributable to the advertising in the San Antonio market to support the opening of 7 retail stores there, and to increased advertising intended to help drive the increased sales.

Depreciation and amortization declined 31%. The decrease was primarily attributable to (i) goodwill no longer being amortized (See Note 6 to the Condensed Consolidated Financial Statements) and (ii) lower capital expenditures over the past several fiscal years, which has resulted in an increasing number of assets becoming fully-depreciated.

Interest expense declined 9%. The decline was primarily attributable to (i) lower amounts of long-term debt, (ii) lower seasonal borrowings under the revolving line of credit, and (iii) lower interest rates.

Income tax benefit increased 79%. The increase was primarily attributable to the increased loss from continuing operations before income taxes.

QUARTER ENDED MARCH 31, 2003 COMPARED WITH QUARTER ENDED MARCH 31, 2002

Loss from Continuing Operations before Income Taxes for the second quarter of fiscal 2003 (the "March 2003 Quarter") was higher than it was for the second quarter of fiscal 2003 (the "March 2002 Quarter"), primarily due to increased expenses.

Sales increased 32%, from $7.0 million for the March 2002 Quarter to $9.2 million for the March 2003 Quarter. The increase was primarily attributable to the addition of 7 new retail stores in the San Antonio Market in the fourth quarter of fiscal 2002.

Same-store sales increased 12%, from $6.8 for the March 2002 Quarter to $7.7 for the March 2003 Quarter, indicating increased demand for the Company's living plants and related gardening products.

Gross Profit increased 32%, from $3.4 million for the March 2002 Quarter to $4.5 million for the March 2003 Quarter. The increase was directly related to the increased demand for the Company's living plants and related gardening products.

Operating expenses increased 34%. The increase was primarily attributable to the opening of 7 retail stores in the San Antonio market. Same-store operating expenses increased 16%. The increase in same-store operating expenses was primarily attributable to increased labor costs associated with increased staffing.

Occupancy expenses increased 12%. The increase was primarily attributable to the leasing of 7 retail stores in the San Antonio market.

Advertising expenses increased 70%. The increase was primarily attributable to the advertising in the San Antonio market to support the opening of 7 retail stores there.

Depreciation and amortization declined 40%. The decrease was primarily attributable to (i) goodwill no longer being amortized (See Note 6 to the Condensed Consolidated Financial Statements) and (ii) lower capital expenditures over the past several fiscal years, which has resulted in an increasing number of assets becoming fully-depreciated.

Interest expense declined 5%. The decline was primarily attributable to (i) lower amounts of long-term debt, (ii) lower seasonal borrowings under the revolving line of credit, and (iii) lower interest rates.

Income tax benefit increased 23%. The increase was primarily attributable to the increased loss from continuing operations before income taxes.

DISCONTINUED OPERATIONS

SIX MONTH PERIOD ENDED MARCH 31, 2003 COMPARED WITH SIX MONTH PERIOD ENDED MARCH 31, 2002

Sales declined from $1,784,000 for the March 2002 Period to $210,000 for the March 2003 Period. For the March 2002 Period, the Company's Turkey Creek Farms growing operation was (i) selling its remaining wholesale inventories to unrelated third parties, and (ii) producing for and selling to the Company's own retail stores. For the fiscal 2003 Period, the Company used the remaining inventories of its discontinued Turkey Creek Farms growing operation in its own retail stores.

Gross Profit declined from $257,000 for the March 2002 Period to $-0- for the March 2003 Period. The decline was primarily attributable to the decline in sales.

Expenses increased from $320,000 for the March 2002 Period to $872,000 for the March 2003 Period. The increase was primarily attributable to the requirements of Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets ("Statement 144"), which requires that costs and expenses of discontinued operations be recognized as they are incurred. The estimated costs of discontinuing the wholesale operations had been accrued during fiscal 2001. The Company early adopted Statement 144 in fiscal 2002.

The aforementioned factors caused the Loss before Income Taxes to increase from $63,000 for the March 2002 Period to $872,000 for the March 2003 Period. See Note 5 to the Condensed Consolidated Financial Statements.

QUARTER ENDED MARCH 31, 2003 COMPARED WITH QUARTER ENDED MARCH 31, 2002

Sales declined from $432,000 for the March 2002 Quarter to $39,000 for the March 2003 Quarter. For the March 2002 Quarter, the Company's Turkey Creek Farms growing operation was producing for and selling to the Company's own retail stores. For the fiscal 2003 Quarter, the Company used the remaining inventories of its discontinued Turkey Creek Farms growing operation in its own retail stores.

Gross Profit declined from $38,000 for the March 2002 Quarter to $-0- for the March 2003 Quarter. The decline was primarily attributable to the decline in sales.

Expenses increased from $44,000 for the March 2002 Quarter to $251,000 for the March 2003 Quarter. The increase was primarily attributable to the requirements of Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets ("Statement 144"), which requires that costs and expenses of discontinued operations be recognized as they are incurred. The estimated costs of discontinuing the wholesale operations had been accrued during fiscal 2002. The Company early adopted Statement 144 in fiscal 2003.

The aforementioned factors caused the Loss before Income Taxes to increase from $6,000 for the March 2002 Quarter to $251,000 for the March 2003 Quarter. See Note 5 to the Condensed Consolidated Financial Statements.

FINANCIAL CONDITION - CAPITAL RESOURCES AND LIQUIDITY

Cash Flows Provided by Operating Activities were $1.1 million for the March 2002 Period compared to Cash Flows Used by Operating Activities of $1.4 million for the March 2003 Quarter. The decline was primarily attributable to (i) a increase in Inventories of $2.4 million for the March 2003 Period, compared to an increase in Inventories of $0.8 for the March 2002 Quarter, and (ii) a Net Loss of $1.8 million for the March 2003 Quarter compared to a Net Loss of $1.1 million for the March 2002 Quarter.

Cash flows Used for Investing Activities were $77,000 for the March 2003 Period compared to $143,000 for the March 2002 Period. The decrease was primarily attributable to a difference in the timing of certain replacements of furniture, fixtures and vehicles. The Company continues to limit the amount spent on capital expenditures during each fiscal year, and has no significant capital projects planned for the remainder of fiscal 2003.

Cash Flows Used for Financing Activities were $1.0 million for the March 2003 Period compared to $0.7 million for the March 2002 Period. During the March 2003 Period the Company paid off one note payable that had a balance of $1.0 million. By comparison, during the March 2002 Period the Company had repaid $0.7 million in short-term borrowings under its revolving line of credit arrangement.

LINE OF CREDIT ARRANGEMENT

The Company's business is seasonal, and it relies on a revolving line of credit arrangement provided by a bank (the "Line of Credit") to supplement its working capital during seasons of lower sales volumes.

Typically, the Company borrows from the Line of Credit during the quarter ending March 31, and repays those borrowings during the spring selling season included in the quarter ending June 30. The amount which may be borrowed under the line of credit is tied to amounts of accounts receivable and inventories, with a maximum of $5.0 million. The amounts owed under the Line of Credit as of March 31, 2003 and 2002, and September 30, 2002 were $-0-, $70,000 and $-0-, respectively.

The maximum and weighted average amounts borrowed under the Line of Credit were as follows (amounts in thousands):

	Six Month Period Ended March 31, 2003	Six Month Period Ended March 31, 2002	Three Month Period Ended March 31, 2003	Th Mo Pe En Mar 2
Maximum amount borrowed	$ 2,985	$ 1,676	$ 2,985	$
Weighted-average amount borrowed	$ 772	$ 300	$ 1,544	$

The Line of Credit has a one year term expiring May 29, 2003. The Company typically renews the Line of Credit for an additional one-year term each year. The Company expects to be able to renew the current Line of Credit.

The Line of Credit contains financial covenants requiring the Company to meet a minimum amount for tangible net worth, a maximum ratio of liabilities to tangible net worth, and an annual ratio of earnings before interest and non-cash charges to current maturities of long-term debt. At March 31, 2003 the Company was in compliance with the financial covenants required by the Line of Credit.

16

CONTRACTUAL OBLIGATIONS AND COMMITMENTS

As of March 31, 2003 the Company had the following contractual obligations (amounts in thousands):

	FISCAL YEAR ENDING SEPTEMBER 30					
	2003(1)	2004	2005	2006	2007	Th a
Long-term debt (including current portion)	$ 195	$ 500	$ 550	$ 620	$ 600	$5
Future minimum lease payments under noncancellable operating leases	1,240	2,408	1,923	1,366	850	1
Preferred stock with mandatory redemption provisions (2)	--	3,420	--	--	--	
Totals	$ 1,435	$ 6,328	$ 2,473	$ 1,986	$ 1,450	$6

(1) Amounts for 2003 represent obligations due during the remainder of fiscal 2003 (six months).

(2) Carrying amount of $2,538 as of September 30, 2002 and $2,743 as of March 31, 2003.

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;

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, 2003 and 2002, and September 30, 2002 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, 2003 and September 30, 2002 management believes that no impairment has occurred and that no reduction of the estimated useful lives is warranted.

Goodwill - As discussed in Note 6 to the Condensed Consolidated Financial Statements, the Company adopted Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets ("Statement 142") effective October 1, 2002, and no longer amortizes goodwill.

In connection with the transitional goodwill impairment evaluation, Statement 142 required the Company to perform an assessment of whether there was an indication that goodwill is impaired as of the date of adoption. To accomplish this, the Company identified its reporting units and determined the carrying value of each reporting unit by assigning the assets and liabilities, including the existing goodwill and intangible assets, to those reporting units as of the date of adoption. The Company then determined the fair value of each reporting unit and compared it to the reporting unit's carrying amount.

Based on those tests, there was no indication that any reporting unit's goodwill was impaired. Accordingly, no transitional impairment losses were required to be recognized as the cumulative effect of a change in accounting principle.

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.

SUPPLIERS

The wholesale market for living plants, related gardening products and Christmas merchandise is highly competitive. The Company uses dozens of suppliers for its living plants, related gardening products and Christmas merchandise, and there are readily available alternative sources for substantially all of the products sold by the Company. The Company has not encountered significant difficulties in procuring merchandise to sell. The Company considers its relations with suppliers to be good.

EMPLOYEES

The Company's employees are not covered by collective bargaining agreements. The Company has not experienced any work stoppages. The Company considers its relations with employees to be good.

COMPETITION

On February 13, 2003 The Home Depot ("Home Depot") opened a free-standing nursery store ("Landscape Supply") in the Dallas-Fort Worth Market, where Calloway's operates sixteen of its twenty-six retail stores. Home Depot is a much larger competitor with substantially greater financial resources than Calloway's.

In a press release dated February 6, 2003 Home Depot stated that Landscape Supply will be "focusing on the professional landscapers and avid do-it-yourself garden enthusiasts." In addition, Home Depot stated that it intends to open four additional Landscape Supply stores in the Dallas-Fort Worth market, and has already opened some of those four stores.

The retail nature of Landscape Supply's locations, and the retail orientation of its merchandise, causes management to believe it could represent a change in the competitive environment in Dallas-Fort Worth. However, management does not believe that the Landscape Supply stores had a significant impact on the Company's results of operations for the six month or three month periods ended March 31, 2003.

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, 2003, 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 operations and cash flows, assuming other factors are held constant.

At March 31, 2003 Calloway's had variable rate debt of $2.0 million, out of total long-term debt of $7.6 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 $20,000 for the variable-rate debt.

19

ITEM 4. CONTROLS AND PROCEDURES

On March 31, 2003 (the "Evaluation Date") an evaluation was performed by the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on that evaluation, the CEO and CFO concluded that the Company's disclosure controls and procedures were effective as of the Evaluation Date. Subsequent to the Evaluation Date there have been no significant changes in the Company's internal controls or in other factors that could significantly affect internal controls and procedures for financial reporting.

20

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 19, 2003. The voting results of that meeting were as follows:

ELECTION OF DIRECTORS

Nominee	For	Withheld
Dr. Stanley Block	5,393,853	44,850
James C. Estill	5,399,353	39,350
C. Sterling Cornelius	5,399,953	38,750
John T. Cosby	5,393,353	44,350
Daniel R. Feehan	5,392,953	45,750
Timothy J. McKibben	5,393,353	45,350
John S. Peters	5,393,353	45,350
George J. Wechsler	5,377,953	60,750

APPROVAL OF CALLOWAY'S NURSERY, INC. 2002 STOCK OPTION PLAN

For	Against	Abstain	Broker
5,229,754	194,529	14,420	

APPOINTMENT OF KPMG LP AS AUDITORS FOR FISCAL YEAR 2003

For	Against	Abstain	Broker
5,362,794	25,650	50,259	

ITEM 5. OTHER INFORMATION.
None.

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

(a) Exhibits:

Exhibit 99(m) Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2003.

(b) Reports on Form 8-K:

On February 18, 2003 the Company filed a Form 8-K disclosing that on February 13, 2003 The Home Depot ("Home Depot") opened a free-standing nursery store ("Landscape Supply") in the Dallas-Fort Worth Market, where

Calloway's operates sixteen of its twenty-six retail stores.

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 8, 2003

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

CERTIFICATIONS

I, Daniel G. Reynolds, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Calloway's Nursery, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

    a. Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

    b. Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c. Presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the evaluation date.

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or other persons performing the equivalent functions):

   a. significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 8, 2003

/s/ Daniel G. Reynolds

Daniel G. Reynolds
Vice President and Chief Financial Officer

23

CERTIFICATIONS (CONT.)

I, James C. Estill, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Calloway's Nursery, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for

establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a. Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b. Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c. Presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the evaluation date.

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or other persons performing the equivalent functions):

d. All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

e. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 8, 2003

/s/ James C. Estill

James C. Estill
President and Chief Executive Officer

EXHIBIT INDEX

EXHIBIT NUMBER	DESCRIPTION
99(m)	Certification Pursuant to 18 U.S.C. Section 1350 as Adopted

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2003.