CALLOWAYS NURSERY INC
Form 10-Q
August 14, 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 June 30, 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]

6,847,797 shares of the Registrant's Common Stock, $.01 par value, were outstanding as of July 31, 2003.

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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.

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PART 1. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

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

	JUNE 30, 2003	SEPTEMBER 30, 2002
Cash and cash equivalents	$ 4,131	$ 2,475
Accounts receivable	498	356
Inventories	4,507	4,006
Prepaids and other assets	36	59
Deferred income taxes, current	219	263
Income taxes receivable	--	119
Current assets of discontinued operations	931	2,344
Total current assets	10,322	9,622
Property and equipment, net	10,959	11,342
Goodwill, net	631	631
Deferred income taxes	1,568	1,568
Other assets	189	211
Noncurrent assets of discontinued operations	--	751
Total assets	$23,669	$24,125

LIABILITIES AND SHAREHOLDERS' EQUITY

	JUNE 30, 2003	SEPTEMBER 30, 2002
Accounts payable	$ 4,296	$ 2,694
Accrued expenses	1,648	2,017
Accrued income taxes	--	--
Current portion of long-term debt	390	501
Deferred income taxes, current	--	--
Current liabilities of discontinued operations	193	544
Total current liabilities	6,527	5,756
Deferred rent payable	680	805
Long-term debt, net of current portion	7,079	8,246
Total liabilities	14,286	14,807
Commitments and contingencies		
Non-voting preferred stock, with mandatory redemption provisions	2,846	2,538
Shareholders' equity:		
Voting convertible preferred stock	--	--
Preferred stock	--	--
Common stock	71	68
Additional paid-in capital	10,127	9,885
Accumulated deficit	(2,265)	(1,777)
	7,933	8,176
Less: Treasury stock, at cost	(1,396)	(1,396)
Total shareholders' equity	6,537	6,780
Total liabilities and shareholders'		

equity	$23,669	$24,125

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

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

	NINE-MONTHS ENDED JUNE 30,		THR
	2003	2002	2003
Net sales	$40,174	$36,721	$20,090
Cost of goods sold	21,226	19,296	10,034
Gross profit	18,948	17,425	10,056
Operating expenses	13,004	9,991	4,690
Occupancy expenses	2,492	2,094	871
Advertising expenses	1,508	1,188	525
Depreciation and amortization	457	650	150
Interest expense	580	666	175
Interest income	(15)	(21)	(8
Total expenses	18,026	14,568	6,403
Income from continuing operations before income taxes	922	2,857	3,653
Income tax expense	354	1,211	1,400
Income from continuing operations	568	1,646	2,253
Discontinued operations:			
Loss from discontinued operations, net of income tax benefits of $395, $215, $45 and $170	(631)	(293)	(51
Loss on disposal of discontinued operations, net of income tax benefits of $74, $--, $331, and $--	(117)	--	(537
Loss from discontinued operations	(748)	(293)	(588
Net income (loss)	(180)	1,353	1,665
Accretion of preferred stock	(308)	(262)	(102
Net income (loss) attributable to common shareholders	$ (488)	$ 1,091	$ 1,563
Weighted average number of common shares outstanding			
Basic	6,663	6,347	6,758

Diluted	6,663	6,381	6,758
Basic net income (loss) per common share			
Income from continuing operations	$ .04	$ .22	$ .32
Loss from discontinued operations	(.11)	(.05)	(.09
Net income (loss)	($.07)	$ .17	$ .23
Diluted net income (loss) per common share			
Income from continuing operations	$ .04	$ .22	$ .32
Loss from discontinued operations	(.11)	(.05)	(.09
Net income (loss)	($.07)	$ .17	$ .23

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

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

	NINE-MONT JUNE
	2003
Cash flows from operating activities:	
Net income (loss)	($180)
Adjustments to reconcile net loss to net cash provided by operating activities:	
Loss from discontinued operations (net of tax)	748
Depreciation and amortization	457
Net change in operating assets and liabilities	673
Net cash provided by operating activities	1,698
Cash flows from investing activities -	
Additions to property and equipment	(74)
Cash flows from financing activities:	
Proceeds from issuance of common stock	245
Repayments of debt	(1,278)
Net cash used for financing activities	(1,033)
Net increase in cash and cash equivalents from continuing operations	591
Net increase in cash and cash equivalents from discontinued operations	1,065
Net increase in cash and cash equivalents	1,656
Cash and cash equivalents at beginning of period	2,475

Cash and cash equivalents at end of period	$ 4,131
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The accompanying notes are an integral part of these condensed consolidated financial statements.

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CALLOWAY'S NURSERY, INC. AND SUSIDIARIES
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 June 30, 2003, and the results of operations and cash flows for the nine-month and three-month periods ended June 30, 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 nine-month and three-month periods ended June 30, 2003, and the cash flows for the nine-month period ended June 30, 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 4 - "Exit from Growing Segment")

3. INVENTORIES

Inventories consist of finished goods.

4. 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. 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 Growing Segment

The Company has operated two growing facilities: Turkey Creek Farms ("Turkey"), near Houston, and Miller Plant Farms ("Miller"), near Tyler. Together, Turkey and Miller comprised the growing segment of the Company's business.

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

Turkey Creek Farms

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

Turkey 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 have been reclassified as discontinued operations in the accompanying condensed consolidated financial statements in accordance with Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets ("Statement 144"). (See Note 2 - "Reclassifications")

Miller Plant Farms

In April 2003 the Company decided to sell Miller and discontinue the merchandise it produced. The strategic move will allow the Company to dedicate its resources toward the growth of its retail operations. The assets, liabilities and results of operations for Miller have been reclassified as discontinued operations in the accompanying condensed consolidated financial statements in accordance with Statement 144. (See Note 2 - "Reclassifications"). In July 2003 the Company entered into a contract to sell Miller. An impairment loss of $537,000 (net of tax) was recorded on the assets of Miller for the three-month and nine-month periods ended June 30, 2003 in accordance with Statement 144. (See Note 9 - "Subsequent Event")

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

	June 30, 2003	September 30, 2002
Cash	$ 3	$ 15
Accounts receivable	--	1
Inventories	200	1,152
Property and equipment held for sale	728	1,176
Current assets of discontinued operations	$931	$2,344
Noncurrent assets of discontinued operations - property and equipment	$ --	$ 751
Accounts payable	$154	$ 531
Accrued expenses	39	13

Current liabilities of discontinued operations	$193	$ 544

The property and equipment of the discontinued Turkey Creek Farms operation was classified as a current asset at September 30, 2002 since it was sold in fiscal 2003.

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CALLOWAY'S NURSERY, INC. AND SUSIDIARIES
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):

	Nine-month Period Ended June 30, 2003	Nine-month Period Ended June 30, 2002	Three-mon Period En June 30, 2003
Sales	$ 1,553	$5,031	$ 837
Cost of goods sold	1,553	4,954	837
Gross profit	--	77	--
Expenses	1,026	585	96
Loss from discontinued operations before income taxes	(1,026)	(508)	(96)
Income tax benefit	(395)	(215)	(45)
Loss from discontinued operations	($631)	($293)	($51)

5. SEGMENT INFORMATION

In April 2003 the Company decided to dispose of its only remaining growing operation, Miller Plant Farms, near Tyler, Texas (see Note 4 - "Exit from Growing Segment"). Accordingly, historical results of the growing segment are classified as discontinued operations. The Company now has only one reportable segment: Retail.

6. RECENT 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 nine-month periods ended June 30, 2003. The Company's reported net income for the three-month and nine-month periods ended June 30, 2002, adjusted for excluding the effects of goodwill amortization, would have been $2,522,000 and $1,434,000, respectively. The effect on adjusted net loss per share for the three-month and nine-month periods ended June 30, 2002 was insignificant.

Statement 148

In December 2002 the 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):

	Nine-month Period Ended June 30, 2003	Nine-month Period Ended June 30, 2002	Three-month Period Ended June 30, 2003
Net income (loss), as reported	($180)	$1,353	$1,665

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 income (loss)	($180)	$ 921	$1,665
Net income per share - basic			
As reported	($.07)	$ .17	$ .23
Pro forma	($.07)	$ .10	$ .23
Net income per share - diluted			
As reported	($.07)	$ .17	$ .23
Pro forma	($.07)	$ .10	$ .23

Statement 150

In May 2003 the FASB issued Statement No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity ("Statement 150"). Statement 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity.

Statement 150 requires an issuer to classify the following instruments as liabilities (or assets in some circumstances):

- A financial instrument issued in the form of shares that is mandatorily redeemable -- that embodies an unconditional obligation requiring the issuer to redeem it by transferring its assets at a specified or determinable date (or dates) or upon an event that is certain to occur

- A financial instrument, other than an outstanding share, that, at inception, embodies an obligation to repurchase the issuer's equity shares, or is indexed to such an obligation, and that requires or may require the issuer to settle the obligation by transferring assets (for example, a forward purchase contract or written put option on the issuer's equity shares that is to be physically settled or net cash settled)

- A financial instrument that embodies an unconditional obligation, or a financial instrument other than an outstanding share that embodies a conditional obligation, that the issuer must or may settle by issuing a variable number of its equity shares, if, at inception, the monetary value of the obligation is based solely or predominantly on any of the following:

    a. A fixed monetary amount known at inception, for example, a payable settleable with a variable number of the issuer's equity shares.

b. Variations in something other than the fair value of the issuer's equity shares, for example, a financial instrument indexed to the S&P 500 and settleable with a variable number of the issuer's equity shares.

c. Variations inversely related to changes in the fair value of the issuer's equity shares, for example, a written put option that could be net share settled.

The requirements of Statement 150 apply to issuers' classification and measurement of freestanding financial instruments, including those that comprise more than one option or forward contract.

Statement 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003, except for mandatorily redeemable financial instruments of nonpublic entities. It is to be implemented by reporting the cumulative effect of a change in an accounting principle for financial instruments created before the issuance date of the Statement and still existing at the beginning of the interim period of adoption. Restatement is not permitted.

The Company is required to adopt Statement 150 on July 1, 2003. At June 30, 2003 the Company had outstanding 34,202 shares of Non-Voting Acquisition Preferred Stock (the "Preferred Stock"), $.01 par value, that were issued in 1999 in connection with an acquisition, with a carrying amount of $2,846,000. Any unredeemed shares outstanding at September 21, 2004 must be redeemed for $100 per share. Adoption of Statement 150 will cause the Preferred Stock to be classified as a current liability on the balance sheet at September 30, 2003.

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 $107,000 for the nine-month period ended June 30, 2003 and $36,000 for the three-month period ended June 30, 2003. No rental expense under the Affiliate Leases was incurred for the nine-month or three-month periods ended June 30, 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

In July 2003 the Company entered into a contract to sell Miller (see Note 4 - "Discontinued Operations - Exit from Growing Segment - Miller Plant Farms"). An impairment loss of $537,000 (net of tax) was recorded on the assets of Miller for the three-month and nine-month periods ended June 30, 2003 in accordance with Statement 144.

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 ("Turkey") growing operation and discontinued the merchandise that it produced, and in April 2003 the Company decided to sell its Miller Plant Farms growing operation ("Miller") and discontinue the merchandise that it produced. (see Note 4 to Condensed Consolidated Financial Statements). Accordingly, the following discussion of results of operations has been separated into (i) Continuing Operations and (ii) Discontinued Operations.

RESULTS OF OPERATIONS

CONTINUING OPERATIONS

NINE-MONTH PERIOD ENDED JUNE 30, 2003 COMPARED WITH NINE-MONTH PERIOD ENDED JUNE 30, 2002

During the quarter ended September 30, 2002 the Company entered the San Antonio, Texas market by opening seven (7) retail stores there (the "San Antonio Market Entry"). Results for the first nine months of fiscal 2003 (the "June 2003 Period") include revenues and expenses for the San Antonio Market Entry, while results for the first nine months of fiscal 2002 (the "June 2002 Period") do not.

Income from Continuing Operations before Income Taxes for the June 2003 Period was lower than it was for the June 2002 Period, primarily due to expenses that increased at a higher rate than sales.

Sales increased 9%, from $36.7 million for the June 2002 Period to $40.2 million for the June 2003 Period. The increase was primarily attributable to the San Antonio Market Entry. The San Antonio Market Entry was also the primary factor in the 60% increase in inventories, from $2.8 million at June 30, 2002 to $4.5 million at June 30, 2003.

Same-store sales declined 4%, from $36.0 million for the June 2002 Period to $34.7 million for the June 2003 Period, indicating reduced demand for the Company's living plants and related gardening products.

Gross Profit increased 9%, from $17.4 million for the June 2002 Period to $18.9 million for the June 2003 Period. Gross Profit as a percentage of net sales ("Gross Margin"), was unchanged at 47% for both the June 2002 Period and the June 2003 Period.

Operating expenses increased 30%. The increase was primarily attributable to the San Antonio Market Entry. Same-store operating expenses increased 7%. The increase in same-store operating expenses was primarily attributable to increased labor costs associated with increased staffing.

Occupancy expenses increased 19%. The increase was primarily attributable to the San Antonio Market Entry.

Advertising expenses increased 27%. The increase was primarily attributable to the San Antonio Market Entry.

Depreciation and amortization declined 30%. 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 13%. 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 expense declined 71%. The increase was primarily attributable to the reduced income from continuing operations before income taxes. The effective tax rate was 38.4% for the June 2003 Period compared to 42.4% for the June 2002 Period. The difference was primarily attributable to state income tax adjustments recorded in the June 2002 Period that were not necessary for the June 2003 Period.

QUARTER ENDED JUNE 30, 2003 COMPARED WITH QUARTER ENDED JUNE 30, 2002

Income from Continuing Operations before Income Taxes for the third quarter of fiscal 2003 (the "June 2003 Quarter") was lower than it was for the third quarter of fiscal 2002 (the "June 2002 Quarter"), primarily due to expenses that increased at a higher rate than sales.

Sales increased 3%, from $19.5 million for the June 2002 Quarter to $20.1 million for the June 2003 Quarter. The increase was primarily attributable to the San Antonio Market Entry.

Same-store sales declined 8%, from $19.1 million for the June 2002 Quarter to $17.5 million for the June 2003 Quarter, indicating reduced demand for the Company's living plants and related gardening products.

Gross Profit increased 4%, from $9.7 million for the June 2002 Quarter to $10.1 million for the June 2003 Quarter. The increase was primarily attributable to the increased sales. Gross Margin was unchanged at 47% for both the June 2002 Quarter and the June 2003 Quarter.

Operating expenses increased 30%. The increase was primarily attributable to the San Antonio Market Entry. Same-store operating expenses increased 8%. The increase in same-store operating expenses was primarily attributable to increased labor costs associated with increased staffing.

Occupancy expenses increased 25%. The increase was primarily attributable to the San Antonio Market Entry.

Advertising expenses increased 13%. The increase was primarily attributable to the San Antonio Market Entry.

Depreciation and amortization declined 24%. 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 22%. The decline was primarily attributable to (i) lower amounts of long-term debt and (iii) lower interest rates.

Income tax expense declined 22%. The increase was primarily attributable to the reduced income from continuing operations before income taxes. The effective tax rate was 38.3% for the June 2003 Quarter compared to 39.7% for the June 2002 Quarter.

DISCONTINUED OPERATIONS

NINE-MONTH PERIOD ENDED JUNE 30, 2003 COMPARED WITH NINE-MONTH PERIOD ENDED JUNE 30, 2002

Sales declined from $5,031,000 for the June 2002 Period to $1,553,000 for the June 2003 Period. The decline was primarily attributable to the exit from Turkey (see Note 4 to Condensed Consolidated Financial Statements).

Gross Profit declined from $77,000 for the June 2002 Period to $-0- for the June 2003 Period. The decline was primarily attributable to the decline in sales.

Expenses increased from $585,000 for the June 2002 Period to $1,026,000 for the June 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 (see Note 6 to Condensed Consolidated Financial Statements). The estimated costs of discontinuing the wholesale operations had been accrued during fiscal 2001. The Company early adopted Statement 144 in fiscal 2002; therefore, the costs of exiting Turkey were expensed as incurred in fiscal 2003, and the costs of exiting Miller are being expensed as incurred.

The aforementioned factors caused the Loss before Income Taxes to increase from $508,000 for the June 2002 Period to $1,026,000 for the June 2003 Period.

QUARTER ENDED JUNE 30, 2003 COMPARED WITH QUARTER ENDED JUNE 30, 2002

Sales declined from $2,713,000 for the June 2002 Quarter to $837,000 for the June 2003 Quarter. The decline was primarily attributable to the exit from Turkey (see Note 4 to Condensed Consolidated Financial Statements).

Gross Profit was $-0- for both the June 2002 Quarter and the June 2003 Quarter.

Expenses declined from $388,000 for the June 2002 Quarter to $96,000 for the June 2003 Quarter. The decline was primarily attributable to the exit from Turkey.

The aforementioned factors caused the Loss before Income Taxes to decline from $388,000 for the June 2002 Quarter to $96,000 for the June 2003 Quarter.

FINANCIAL CONDITION - CAPITAL RESOURCES AND LIQUIDITY

Cash Flows Provided by Operating Activities were $1.7 million for the June 2003 Period compared to $6.1 million for the June 2002 Period. The decline was primarily attributable to: (i) the decline in income from continuing operations, from $1.6 million for the June 2002 period to $0.5 million for the June 2003 period; (ii) an increase in Inventories of $0.5 million for the June 2003

Period, compared to a reduction in Inventories of $1.1 million for the June 2002 Period; and (iii) the reduction in income tax refunds receivable from $1.2 million for the June 2002 Period to $0.1 million for the June 2002 Quarter.

Cash flows Used for Investing Activities were $74,000 for the June 2003 Period compared to $209,000 for the June 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 both the June 2003 Period and the June 2002 Period.

Cash Flows from Discontinued Operations were $1.1 million for the June 2003 Period compared to $0.9 million for the June 2002 Period. The loss from discontinued operations was higher for the June 2003 Period (see "Results of Operations - Discontinued Operations"). In addition, Company realized a gain on disposal of discontinued operations of $0.4 million (net of tax) on the Sale of Turkey in March 2003 and a loss of $0.5 million (net of tax) on the impairment of the Miller assets in June 2003.

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 June 30, 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 $3.0 million.

The Company owed $-0- under the Line of Credit as of June 30, 2003 and 2002, and September 30, 2002. The maximum and weighted average amounts borrowed under the Line of Credit were as follows (amounts in thousands):

	Nine-month Period Ended June 30, 2003	Nine-month Period Ended June 30, 2002	Three-month Period Ended June 30, 2003
Maximum amount borrowed	$2,985	$1,676	$-0-
Weighted-average amount borrowed	$379	$200	$-0-

The Line of Credit was renewed on May 29, 2003 for a one year term expiring May 28, 2004. 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 June 30, 2003 the Company was in compliance with the financial covenants required by the Line of Credit.

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CONTRACTUAL OBLIGATIONS AND COMMITMENTS

As of June 30, 2003 the Company had the following contractual obligations (amounts in thousands):

	FISCAL YEAR ENDING SEPTEMBER 30					
	2003(1)	2004	2005	2006	2007	There
Long-term debt (including current portion)	$ 93	$ 500	$ 550	$ 620	$ 600	$5
Future minimum lease payments under noncancellable operating leases	620	2,408	1,923	1,366	850	1
Preferred stock with mandatory redemption provisions (2)	--	3,420	--	--	--	
Totals	$713	$6,328	$2,473	$1,986	$1,450	$6

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

(2) Carrying amount of $2,846 as of June 30, 2003, $2,538 as of September 30, 2002 and $2,442 as of June 30, 2002.

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;
- Impairment of assets held for sale.

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.

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Deferred income taxes - As of June 30, 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 June 30, 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.

Impairment of assets held for sale - The Company has recorded an impairment loss of $536,000 (net of tax) based on estimated net proceeds from the sale of Miller (see Note 9 to Condensed Consolidated Financial Statements). The sale price of certain of the assets will be determined by a physical inventory to be taken on or near the closing date.

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.

The Company has experienced reduced consumer demand for its living plants and related gardening products in most of its market areas over the past two years. Such reduced demand is the result of many factors, including, but not limited to: economic conditions in the market areas served by the Company's retail stores, the impact of weather and other growing conditions, and the impact of competition. Management does not believe that the Landscape Supply stores, by themselves, had a significant impact on the Company's results of operations for the nine-month or three-month periods ended June 30, 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 June 30, 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 June 30, 2003 Calloway's had variable rate debt of $1.9 million, out of total long-term debt of $7.5 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 $19,000 for the variable-rate debt.

ITEM 4. CONTROLS AND PROCEDURES

Management, including the Company's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), has conducted an evaluation of the effectiveness of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a 15(b), as of the end of the period covered by this report. Based on that evaluation, the CEO and CFO concluded that the Company's disclosure controls and procedures are effective in ensuring that all material information required to be disclosed in this report has been made known to them in a timely manner. There were no changes in the Company's internal control over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

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.

None.

ITEM 5. OTHER INFORMATION.

None.

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

(a) Exhibits Required by Item 601 of Regulation S-K:

A list of the exhibits required by Item 601 of Regulation S-K and filed as part of this report is set forth in the Index to Exhibits on page 23, which immediately precedes such exhibits.

(b) Reports on Form 8-K:

(1) On April 30, 2003 the Company filed a Form 8-K disclosing that On October 24, 2002 the Company received a letter from NASDAQ indicating that the Company's common stock had closed below

the minimum $1.00 per share requirement for continued inclusion under Marketplace Rule 4310(c)(4), and that the Company would be provided 180 calendar days, or until April 22, 2003, to demonstrate compliance. On April 23, 2003 the Company received a letter from NASDAQ indicating that the Company meets the initial listing requirements for the NASDAQ SmallCap Market under Marketplace Rule 4310(c)(2)(A). Since the Company meets the initial listing requirements, the Company was granted an additional 180 calendar day grace period, or until October 20, 2003, to demonstrate compliance. If compliance with the aforementioned rule cannot be demonstrated by October 20, 2003, the NASDAQ will again determine whether the Company meets the initial listing requirements; if so, the Company will then be granted an additional 90 calendar day grace period to demonstrate compliance.

(2) On May 21, 2003 the Company filed a Form 8-K disclosing that on May 7, 2003, the Registrant issued a press release setting forth its results of operations and financial condition as of and for the three-month and six-month periods ended March 31, 2003.

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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: August 14, 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

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INDEX TO EXHIBITS

Exhibit Number	Description
31(a)(1)	Rule 13a-14(a) Certification of the Chief Financial Officer of Callowa
31(b)(1)	Rule 13a-14(a) Certification of the Chief Executive Officer of Callowa

32(1)	Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant of the Sarbanes-Oxley Act of 2002.

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(1) Filed with this report