

FLOWERS FOODS INC  
Form 10-Q  
August 21, 2008

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**United States  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549  
FORM 10-Q**

(Mark One)

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

For the quarterly period ended July 12, 2008

**OR**

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-16247

**FLOWERS FOODS, INC.**

(Exact name of registrant as specified in its charter)

**GEORGIA**

**58-2582379**

(State or other jurisdiction  
of incorporation or organization)

(I.R.S. Employer  
Identification Number)

**1919 FLOWERS CIRCLE, THOMASVILLE, GEORGIA**

(Address of principal executive offices)

**31757**

(Zip Code)

**229/226-9110**

(Registrant's telephone number, including area code)

N/A

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

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

Yes

No

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

Large accelerated  
filer

Accelerated  
filer

Non-accelerated filer   
(Do not check if a smaller reporting  
company)

Smaller reporting  
company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

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

| TITLE OF EACH CLASS  | OUTSTANDING AT AUGUST 15, 2008 |
|--|--------------------------------|
| Common Stock, \$.01 par value with Preferred Share Purchase Rights | 94,173,334                     |

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**FORWARD-LOOKING STATEMENTS**

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

Forward-looking statements are based on current information and are subject to risks and uncertainties that could cause our actual results to differ materially from those projected. Certain factors that may cause actual results, performance, and achievements to differ materially from those projected are discussed in this report and may include, but are not limited to:

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

the loss or financial instability of any significant customer(s);

our ability to execute our business strategy, which may involve integration of recent acquisitions or the acquisition or disposition of assets at presently targeted values;

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

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

changes in consumer behavior, trends and preferences, including health and whole grain trends;

our ability to implement new technology as required;

the credit and business risks associated with our independent distributors and customers which operate in the highly competitive retail food and foodservice industries, including the amount of consolidation in these industries;

customer and consumer reaction to pricing actions; and

any business disruptions due to political instability, armed hostilities, incidents of terrorism, natural disasters or the responses to or repercussions from any of these or similar events or conditions and our ability to insure against such events.

The foregoing list of important factors does not include all such factors nor necessarily present them in order of importance. In addition, you should consult other disclosures made by the company (such as in our other filings with the Securities and Exchange Commission ( SEC ) or in company press releases) for other factors that may cause actual results to differ materially from those projected by the company. Please refer to Part I, Item 1A., *Risk Factors*, in the company s Form 10-K for the year ended December 29, 2007 for additional information regarding factors that could affect the company s results of operations, financial condition and liquidity.

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

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**FLOWERS FOODS, INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(Amounts in thousands except share data)  
(Unaudited)

|   | <b>JULY 12,<br/>2008</b> | <b>DECEMBER 29,<br/>2007</b> |
|---|--------------------------|------------------------------|
| <b>ASSETS</b>   |                          |                              |
| Current Assets:   |                          |                              |
| Cash and cash equivalents   | \$ 19,532                | \$ 19,978                    |
| Accounts and notes receivable, net of allowances of \$649 and \$131, respectively                       | 164,865                  | 137,682                      |
| Inventories, net:   |                          |                              |
| Raw materials   | 16,344                   | 14,257                       |
| Packaging materials   | 12,056                   | 10,809                       |
| Finished goods  | 23,769                   | 22,271                       |
|   | 52,169                   | 47,337                       |
| Spare parts and supplies  | 29,679                   | 28,574                       |
| Deferred taxes  | 6,228                    | 1,863                        |
| Other   | 26,547                   | 33,800                       |
| Total current assets  | 299,020                  | 269,234                      |
| Property, Plant and Equipment, net of accumulated depreciation of \$580,620 and \$556,960, respectively | 489,952                  | 486,522                      |
| Notes Receivable  | 91,334                   | 88,469                       |
| Assets Held for Sale – Distributor Routes   | 10,362                   | 12,396                       |
| Other Assets  | 36,214                   | 32,525                       |
| Goodwill  | 76,338                   | 76,338                       |
| Other Intangible Assets, net  | 21,178                   | 22,051                       |
| Total assets  | \$ 1,024,398             | \$ 987,535                   |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |                          |                              |
| Current Liabilities:  |                          |                              |
| Current maturities of long-term debt and capital leases   | \$ 3,300                 | \$ 6,920                     |
| Accounts payable  | 111,016                  | 98,302                       |
| Other accrued liabilities   | 95,945                   | 108,423                      |

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|  |              |            |
|--|--------------|------------|
| Total current liabilities  | 210,261      | 213,645    |
| Long-Term Debt and Capital Leases  | 29,372       | 22,508     |
| Other Liabilities:   |              |            |
| Deferred taxes   | 49,250       | 50,974     |
| Other  | 37,918       | 36,391     |
| Total other liabilities  | 87,168       | 87,365     |
| Minority Interest in Variable Interest Entity  | 9,109        | 7,802      |
| Commitments and Contingencies  |              |            |
| Stockholders' Equity:  |              |            |
| Preferred stock \$100 par value, 200,000 authorized and none issued  |              |            |
| Preferred stock \$.01 par value, 800,000 authorized and none issued  |              |            |
| Common stock \$.01 par value, 500,000,000 authorized shares,<br>101,659,924 shares and 101,659,924 shares issued, respectively | 1,017        | 1,017      |
| Treasury stock 9,485,247 shares and 9,755,350 shares, respectively   | (152,233)    | (154,801)  |
| Capital in excess of par value   | 485,963      | 484,472    |
| Retained earnings  | 337,760      | 303,386    |
| Accumulated other comprehensive income   | 15,981       | 22,141     |
| Total stockholders' equity   | 688,488      | 656,215    |
| Total liabilities and stockholders' equity   | \$ 1,024,398 | \$ 987,535 |

(See Accompanying Notes to Condensed Consolidated Financial Statements)



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**FLOWERS FOODS, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**  
(Amounts in thousands except per share data)  
(Unaudited)

|   | <b>FOR THE TWELVE<br/>WEEKS ENDED</b> |                          | <b>FOR THE TWENTY-EIGHT<br/>WEEKS ENDED</b> |                          |
|---|---------------------------------------|--------------------------|---|--------------------------|
|   | <b>JULY 12,<br/>2008</b>              | <b>JULY 14,<br/>2007</b> | <b>JULY 12,<br/>2008</b>                    | <b>JULY 14,<br/>2007</b> |
| Sales   | \$ 540,656                            | \$ 477,838               | \$ 1,217,363                                | \$ 1,087,785             |
| Materials, supplies, labor and other production costs (exclusive of depreciation and amortization shown separately below) | 293,594                               | 244,942                  | 643,564                                     | 551,894                  |
| Selling, marketing and administrative expenses  | 197,662                               | 183,592                  | 449,337                                     | 421,555                  |
| Depreciation and amortization   | 16,032                                | 15,116                   | 36,945                                      | 35,233                   |
| Gain on sale of assets  | 2,306                                 |                          | 2,306                                       |                          |
| Gain on insurance recovery  | 686                                   |                          | 686   |                          |
| Income from operations  | 36,360                                | 34,188                   | 90,509                                      | 79,103                   |
| Interest expense  | (494)                                 | (740)                    | (1,173)                                     | (2,149)                  |
| Interest income   | 3,151                                 | 2,672                    | 7,327                                       | 6,014                    |
| Income before income taxes and minority interest  | 39,017                                | 36,120                   | 96,663                                      | 82,968                   |
| Income tax expense  | 13,931                                | 12,914                   | 34,493                                      | 29,414                   |
| Income before minority interest   | 25,086                                | 23,206                   | 62,170                                      | 53,554                   |
| Minority interest in variable interest entity   | (1,137)                               | (1,016)                  | (2,438)                                     | (2,871)                  |
| Net income  | \$ 23,949                             | \$ 22,190                | \$ 59,732                                   | \$ 50,683                |
| Net Income Per Common Share:  |                                       |                          |   |                          |
| Basic:  |                                       |                          |   |                          |
| Net income per share  | \$ 0.26                               | \$ 0.24                  | \$ 0.65                                     | \$ 0.56                  |
| Weighted average shares outstanding   | 91,724                                | 90,761                   | 91,710                                      | 90,633                   |
| Diluted:  |                                       |                          |   |                          |
| Net income per share  | \$ 0.26                               | \$ 0.24                  | \$ 0.65                                     | \$ 0.55                  |
| Weighted average shares outstanding   | 92,501                                | 92,413                   | 92,415                                      | 92,148                   |
| Cash dividends paid per common share  | \$ 0.15                               | \$ 0.125                 | \$ 0.275                                    | \$ 0.208                 |

(See Accompanying Notes to Condensed Consolidated Financial Statements)



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**FLOWERS FOODS, INC.**  
**CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY**  
**AND COMPREHENSIVE INCOME**  
(Unaudited)

|   | Comprehensive<br>Income | Common Stock<br>Number of<br>Shares<br>Issued | Par<br>Value | Capital<br>in Excess<br>of Par<br>Value | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income | Treasury Stock<br>Number of<br>Shares | Cost        | Total      |
|---|-------------------------|---|--------------|---|----------------------|---|---------------------------------------|-------------|------------|
| (Amounts in thousands, except for share data)                 |                         |   |              |   |                      |   |                                       |             |            |
| Balances at<br>December 29,<br>2007                           |                         | 101,659,924                                   | \$ 1,017     | \$ 484,472                              | \$ 303,386           | \$ 22,141                                       | (9,755,350)                           | \$(154,801) | \$ 656,215 |
| Net Income  | \$ 59,732               |   |              |   | 59,732               |   |                                       |             | 59,732     |
| Derivative<br>instruments                                     | (6,270)                 |   |              |   |                      | (6,270)   |                                       |             | (6,270)    |
| Amortization<br>of prior service<br>costs                     | 110                     |   |              |   |                      | 110   |                                       |             | 110        |
| Comprehensive<br>income                                       | \$ 53,572               |   |              |   |                      |   |                                       |             |            |
| Exercise of<br>stock options                                  |                         |   |              | (1,588)                                 |                      |   | 252,426                               | 4,027       | 2,439      |
| Issuance of<br>restricted stock<br>award                      |                         |   |              | (3,984)                                 |                      |   | 249,880                               | 3,984       | 0          |
| Issuance of<br>deferred stock<br>award                        |                         |   |              | (294)                                   |                      |   | 24,045                                | 386         | 92         |
| Amortization<br>of deferred and<br>restricted stock<br>awards |                         |   |              | 3,181                                   |                      |   |                                       |             | 3,181      |
| Stock option<br>compensation                                  |                         |   |              | 2,318                                   |                      |   |                                       |             | 2,318      |
| Tax benefits<br>related to share<br>based awards              |                         |   |              | 1,858                                   |                      |   |                                       |             | 1,858      |
| Stock<br>repurchases  |                         |   |              |   |                      |   | (256,248)                             | (5,829)     | (5,829)    |
| Dividends paid<br>\$0.275 per<br>common share                 |                         |   |              |   | (25,358)             |   |                                       |             | (25,358)   |
|   |                         | 101,659,924                                   | \$ 1,017     | \$ 485,963                              | \$ 337,760           | \$ 15,981                                       | (9,485,247)                           | \$(152,233) | \$ 688,488 |

Balances at  
July 12, 2008

(See Accompanying Notes to Condensed Consolidated Financial Statements)

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**FLOWERS FOODS, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Amounts in thousands)  
(Unaudited)

|   | <b>FOR THE TWENTY-EIGHT WEEKS ENDED</b> |                      |
|---|---|----------------------|
|   | <b>JULY 12,<br/>2008</b>                | <b>JULY 14, 2007</b> |
| <b>CASH FLOWS PROVIDED BY (DISBURSED FOR) OPERATING ACTIVITIES:</b>               |   |                      |
| Net income  | \$ 59,732                               | \$ 50,683            |
| Adjustments to reconcile net income to net cash provided by operating activities: |   |                      |
| Stock based compensation  | 6,678                                   | 10,478               |
| Depreciation and amortization   | 36,945                                  | 35,233               |
| Deferred income taxes   | (2,232)                                 | (1,408)              |
| Provision for inventory obsolescence  | 492                                     | 497                  |
| Allowances for accounts receivable  | 901                                     | 662                  |
| Minority interest in variable interest entity                                     | 2,438                                   | 2,871                |
| Other   | (2,467)                                 | (225)                |
| Changes in assets and liabilities:  |   |                      |
| Accounts and notes receivable, net  | (27,586)                                | (8,509)              |
| Inventories, net  | (5,324)                                 | (2,336)              |
| Other assets  | (2,834)                                 | 1,870                |
| Accounts payable and other accrued liabilities                                    | (10,662)                                | 13,198               |
| <b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>                                  | <b>56,081</b>                           | <b>103,014</b>       |
| <b>CASH FLOWS PROVIDED BY (DISBURSED FOR) INVESTING ACTIVITIES:</b>               |   |                      |
| Purchase of property, plant and equipment   | (41,964)                                | (33,445)             |
| Increase of notes receivable  | (3,363)                                 | (10,130)             |
| Other   | 3,603                                   | 1,379                |
| <b>NET CASH DISBURSED FOR INVESTING ACTIVITIES</b>                                | <b>(41,724)</b>                         | <b>(42,196)</b>      |
| <b>CASH FLOWS PROVIDED BY (DISBURSED FOR) FINANCING ACTIVITIES:</b>               |   |                      |
| Dividends paid  | (25,358)                                | (19,099)             |
| Exercise of stock options   | 2,439                                   | 3,544                |
| Income tax benefit related to stock awards  | 1,713                                   | 2,547                |
| Stock repurchases   | (5,829)                                 |                      |
| Change in book overdraft  | 8,989                                   | 3,116                |
| Proceeds from debt borrowings   | 30,000                                  | 110,500              |
| Debt and capital lease obligation payments  | (26,757)                                | (162,076)            |
| <b>NET CASH DISBURSED FOR FINANCING ACTIVITIES</b>                                | <b>(14,803)</b>                         | <b>(61,468)</b>      |

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|  |           |           |
|--|-----------|-----------|
| Net decrease in cash and cash equivalents        | (446)     | (650)     |
| Cash and cash equivalents at beginning of period | 19,978    | 13,914    |
| Cash and cash equivalents at end of period       | \$ 19,532 | \$ 13,264 |

(See Accompanying Notes to Condensed Consolidated Financial Statements)

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**INTERIM FINANCIAL STATEMENTS** The accompanying unaudited condensed consolidated financial statements of Flowers Foods, Inc. ( the company ) have been prepared by the company s management in accordance with generally accepted accounting principles for interim financial information and applicable rules and regulations of the Securities Exchange Act of 1934, as amended. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for annual financial statements. In the opinion of management, the unaudited condensed consolidated financial statements included herein contain all adjustments (consisting of only normal recurring accruals) necessary to present fairly the company s financial position, the results of its operations and its cash flows. The results of operations for the twelve and twenty-eight week periods ended July 12, 2008 and July 14, 2007 are not necessarily indicative of the results to be expected for a full year. The balance sheet at December 29, 2007 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. These financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the company s Annual Report on Form 10-K for the fiscal year ended December 29, 2007.

**ESTIMATES** 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. Actual results could differ from those estimates. The company believes the following critical accounting estimates affect its more significant judgments and estimates used in the preparation of its consolidated financial statements: revenue recognition, derivative instruments, valuation of long-lived assets, goodwill and other intangibles, self-insurance reserves, income tax expense and accruals and pension obligations. These estimates are summarized in the company s Annual Report on Form 10-K for the fiscal year ended December 29, 2007.

**REPORTING PERIODS** The company operates on a 52-53 week fiscal year ending the Saturday nearest December 31. Fiscal 2008 consists of 53 weeks, with the company s quarterly reporting periods as follows: first quarter ended April 19, 2008 (sixteen weeks), second quarter ended July 12, 2008 (twelve weeks), third quarter ending October 4, 2008 (twelve weeks) and fourth quarter ending January 3, 2009 (thirteen weeks).

**SEGMENTS** The company consists of two business segments: direct-store-delivery ( DSD ), formerly referred to as Flowers Foods Bakeries Group, and warehouse delivery, formerly referred to as Flowers Foods Specialty Group. The DSD segment focuses on the production and marketing of bakery products to customers in the southeastern, southwestern and mid-Atlantic areas of the United States primarily through its direct-store-delivery system. The warehouse delivery segment produces snack cakes for sale to co-pack, retail and vending customers as well as frozen bread, rolls and buns for sale to retail and foodservice customers primarily through warehouse distribution.

**SIGNIFICANT CUSTOMER** Following is the effect our largest customer, Wal-Mart/Sam s Club, had on the company s sales for the twelve and twenty-eight weeks ended July 12, 2008 and July 14, 2007. No other customer accounted for 10% or more of the company s sales.

|                    | <b>FOR THE TWELVE<br/>WEEKS ENDED</b> |                          | <b>FOR THE<br/>TWENTY-EIGHT WEEKS<br/>ENDED</b> |                          |
|--------------------|---------------------------------------|--------------------------|---|--------------------------|
|                    | <b>JULY<br/>12, 2008</b>              | <b>JULY 14,<br/>2007</b> | <b>JULY 12,<br/>2008</b>                        | <b>JULY 14,<br/>2007</b> |
|                    | <b>(Percent of Sales)</b>             |                          | <b>(Percent of Sales)</b>                       |                          |
| DSD                | 18.3%                                 | 17.6%                    | 18.1%   | 17.1%                    |
| Warehouse delivery | 2.8                                   | 2.6                      | 2.5   | 2.7                      |

|       |       |       |       |       |
|-------|-------|-------|-------|-------|
| Total | 21.1% | 20.2% | 20.6% | 19.8% |
|-------|-------|-------|-------|-------|

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Other comprehensive income (loss) results from derivative financial instruments and amortization of prior service costs related to the company's defined benefit and postretirement plans pursuant to Statement of Financial Accounting Standard (SFAS) No. 158, *Employers Accounting for Defined Benefit Pension and other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132R* (SFAS 158). Total comprehensive income, determined as net income adjusted by other comprehensive income (loss), was \$1.4 million and \$53.6 million for the twelve and twenty-eight weeks ended July 12, 2008, respectively. Total comprehensive income was \$25.1 million and \$54.5 million for the twelve and twenty-eight weeks ended July 14, 2007, respectively.

During the twenty-eight weeks ended July 12, 2008, changes to accumulated other comprehensive income, net of income tax, were as follows (amounts in thousands):

|  |           |
|--|-----------|
| Accumulated other comprehensive income, December 29, 2007  | \$ 22,141 |
| Derivative transactions:   |           |
| Net deferred gains on closed contracts, net of income tax of \$(958)                             | (1,530)   |
| Reclassified to earnings, net of income tax of \$182   | 291       |
| Effective portion of change in fair value of hedging instruments, net of income tax of \$(3,149) | (5,031)   |
| Amortization of prior service costs, net of income tax of \$69                                   | 110       |
| Accumulated other comprehensive income, July 12, 2008  | \$ 15,981 |

**3. GAIN ON SALE OF ASSETS**

During the second quarter of fiscal 2008 the company completed the sale and closure of a plant in Atlanta, Georgia resulting in a gain of \$2.3 million. The company incurred \$1.3 million of cost of goods sold expenses primarily for employee severance, obsolete inventory, and equipment relocation costs. An additional \$0.3 million is included in selling, marketing and administrative expenses.

**4. GOODWILL AND OTHER INTANGIBLES**

There were no changes in the carrying amount of goodwill for the twenty-eight weeks ended July 12, 2008. The balance as of July 12, 2008 is as follows (amounts in thousands):

|                    |           |
|--------------------|-----------|
| DSD                | \$ 71,861 |
| Warehouse delivery | 4,477     |
| Total              | \$ 76,338 |

As of July 12, 2008 and December 29, 2007, the company had the following amounts related to amortizable intangible assets (amounts in thousands):

| Asset                  | July 12, 2008 |                          |           | December 29, 2007 |                          |           |
|------------------------|---------------|--------------------------|-----------|-------------------|--------------------------|-----------|
|                        | Cost          | Accumulated Amortization | Net Value | Cost              | Accumulated Amortization | Net Value |
| Trademarks             | \$ 12,208     | \$ 1,040                 | \$ 11,168 | \$ 12,208         | \$ 826                   | \$ 11,382 |
| Customer relationships | 13,434        | 4,090                    | 9,344     | 13,434            | 3,426                    | 10,008    |
| Non-compete agreements | 1,874         | 1,208                    | 666       | 1,874             | 1,213                    | 661       |
| Total                  | \$ 27,516     | \$ 6,338                 | \$ 21,178 | \$ 27,516         | \$ 5,465                 | \$ 22,051 |

In connection with the sale of Mrs. Smith's Bakeries frozen dessert business in April 2003, the company entered into a 5-year non-compete agreement (agreement) with Schwan valued at \$3.0 million recorded as an intangible

liability. The company recognized income related to this agreement as a reduction of amortization expense over the life of the agreement. The carrying amount of this liability at December 29, 2007 was \$0.2 million and was fully accreted to income during the twenty-eight weeks ended July 12, 2008.

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Aggregate amortization expense for the twelve weeks ended July 12, 2008 and July 14, 2007 were as follows (amounts in thousands):

|   | <b>2008</b>   | <b>2007</b>   |
|---|---------------|---------------|
| Amortizable intangible assets expense       | \$ 393        | \$ 539        |
| Amortizable intangible liabilities (income) | (12)          | (138)         |
| Other                                       | (10)          | (11)          |
| <b>Total</b>                                | <b>\$ 371</b> | <b>\$ 390</b> |

Aggregate amortization expense for the twenty-eight weeks ended July 12, 2008 and July 14, 2007 were as follows (amounts in thousands):

|   | <b>2008</b>   | <b>2007</b>   |
|---|---------------|---------------|
| Amortizable intangible assets expense       | \$ 873        | \$ 1,259      |
| Amortizable intangible liabilities (income) | (196)         | (323)         |
| Other                                       | (23)          | (25)          |
| <b>Total</b>                                | <b>\$ 654</b> | <b>\$ 911</b> |

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

|                   | <b>Amortization<br/>of<br/>Intangibles</b> |
|-------------------|--|
| Remainder of 2008 | \$ 777                                     |
| 2009              | 1,658                                      |
| 2010              | 1,633                                      |
| 2011              | 1,633                                      |
| 2012              | 1,633                                      |

**5. RECENT ACCOUNTING PRONOUNCEMENTS**

In September 2006, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 establishes a common definition for fair value to be applied to U.S. GAAP requiring use of fair value, establishes a framework for measuring fair value, and expands disclosure about such fair value measurements. SFAS No. 157 is effective for financial assets and financial liabilities for fiscal years beginning after November 15, 2007. The implementation of SFAS No. 157 for financial assets and financial liabilities, effective December 30, 2007, did not have a material impact on our consolidated financial position and results of operations. Please refer to Note 5 Derivative Financial Instruments for a detailed discussion.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations (SFAS No. 141R). SFAS No. 141R provides revised guidance on how acquirers recognize and measure the consideration transferred, identifiable assets acquired, liabilities assumed, noncontrolling interests, and goodwill acquired in a business combination. SFAS No. 141R also expands required disclosures surrounding the nature and financial effects of business combinations. SFAS No. 141R is effective, on a prospective basis, for fiscal years beginning after December 15, 2008. The Company is currently assessing the impact of SFAS No. 141R on its consolidated balance sheet and statements of income.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements (SFAS No. 160). SFAS No. 160 establishes requirements for ownership interests in subsidiaries held by parties other than the company (sometimes called minority interests ) be clearly identified, presented, and disclosed in the consolidated statement of financial position within equity, but separate from the parent's equity. All changes in the

parent's ownership interests are required to be accounted for consistently as equity transactions and any noncontrolling equity investments in unconsolidated subsidiaries must be measured initially at fair value. SFAS No. 160 is effective, on a prospective basis, for fiscal years beginning after December 15, 2008. However, presentation and disclosure requirements must be retrospectively applied to comparative financial statements. The company is currently assessing the impact of SFAS No. 160 on its consolidated financial position and results of operations.

In March 2008, the FASB issued SFAS No. 161, Disclosures About Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 (SFAS No. 161). SFAS No. 161 expands quarterly disclosure requirements in SFAS No. 133 about an entity's derivative instruments and hedging activities. SFAS No. 161 is effective for fiscal years beginning after November 15, 2008. The company is currently evaluating the requirements of SFAS No. 161. The adoption of SFAS No. 161 is not expected to have an impact on the company's financial position, results of operations or cash flows as the pronouncement addresses disclosure requirements only.

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In May 2008, the FASB issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles (SFAS 162). SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles. SFAS 162 is effective 60 days following the Securities and Exchange Commission's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles. We do not anticipate that the adoption of SFAS 162 will materially impact the company.

In June 2008, the FASB issued FSP EITF No. 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities. The FSP addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and therefore need to be included in the earnings allocation in calculating earnings per share under the two-class method described in SFAS No. 128, Earnings per Share. The FSP requires companies to treat unvested share-based payment awards that have non-forfeitable rights to dividend or dividend equivalents as a separate class of securities in calculating earnings per share. The FSP is effective for fiscal years beginning after December 15, 2008; earlier application is not permitted. The company does not expect adoption of FSP EITF No. 03-6-1 to have a material effect on its results of operations or earnings per share.

**6. DERIVATIVE FINANCIAL INSTRUMENTS**

In the first fiscal quarter of fiscal 2008 the company began measuring the fair value of its derivative portfolio using common definitions under SFAS No. 157, which defines fair value as the price that would be received to sell an asset or paid to transfer a liability in the principal market for that asset or liability. Under SFAS No. 157, measurements are classified into a hierarchy by the inputs used to perform the fair value calculation as follows:

Level 1: Fair value based on unadjusted quoted prices for identical assets or liabilities in active markets

Level 2: Modeled fair value with model inputs that are all observable market values

Level 3: Modeled fair value with at least one model input that is not an observable market value

This change in measurement technique had no material impact on the reported value of our derivative portfolio.

**COMMODITY PRICE RISK**

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

As of July 12, 2008, the company's commodity hedge portfolio contained derivatives with a fair value of \$13.9 million, which is recorded in the following accounts with fair values measured as indicated (amounts in millions):

|                 | Level 1 | Level 2 | Level 3 | Total   |
|-----------------|---------|---------|---------|---------|
| Assets:         |         |         |         |         |
| Other current   | \$ 10.9 | \$ 2.9  | \$      | \$ 13.8 |
| Other long-term | 0.0     | 0.1     |         | 0.1     |
| Total           | 10.9    | 3.0     |         | 13.9    |
| Liabilities:    |         |         |         |         |
| Other current   |         |         |         |         |
| Other long-term |         |         |         |         |
| Total           |         |         |         |         |
| Net Fair Value  | \$ 10.9 | \$ 3.0  | \$      | \$ 13.9 |

The positions held in the portfolio are used to hedge economic exposure to changes in various raw material prices and effectively fix the price, or limit increases in prices, for a period of time extending into fiscal 2009. Under SFAS 133, these instruments are designated as cash-flow hedges. The effective portion of changes in fair value for these derivatives is recorded each period in other comprehensive income (loss), and any ineffective portion of the change in fair value is recorded to current period earnings in selling, marketing and administrative expenses. The company held no commodity derivatives at July 12, 2008 or December 29, 2007 that did not qualify for hedge accounting under SFAS 133. During the twenty-eight weeks ended July 12, 2008, an immaterial amount was recorded to income due to changes in fair value of these instruments.

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As of July 12, 2008, the balance in accumulated other comprehensive income related to commodity derivative transactions was \$13.3 million. Of this total, approximately \$7.6 million and \$0.9 million were related to instruments expiring in 2008 and 2009, respectively, and \$4.8 million was related to deferred gains on cash flow hedge positions.

**INTEREST RATE RISK**

On July 9, 2008, the company entered an interest rate swap with a notional amount of \$85.0 million to fix the interest rate on a portion of the \$150 million term loan secured on August 1, 2008 to fund the acquisitions of ButterKrust Bakery and Holsum Bakery, Inc.

The interest rate swap agreement results in the company paying or receiving the difference between the fixed and floating rates at specified intervals calculated based on the notional amount. The interest rate differential to be paid or received will be recorded as interest expense. Under SFAS 133, this swap transaction is designated as a cash-flow hedge. Accordingly, the effective portion of the change in the fair value of the swap transaction is recorded each period in other comprehensive income. Any ineffective portion of the change in fair value is recorded to current period earnings in selling, marketing and administrative expenses.

As of July 12, 2008, the fair value of the interest rate swap was \$(0.1) million, which is recorded in the following accounts with fair values measured as indicated (amounts in millions):

|                 | Level 1 | Level 2  | Level 3 | Total    |
|-----------------|---------|----------|---------|----------|
| Assets:         |         |          |         |          |
| Other current   | \$      | \$       | \$      | \$       |
| Other long-term |         | 0.5      |         | 0.5      |
| Total           |         | 0.5      |         | 0.5      |
| Liabilities:    |         |          |         |          |
| Other current   |         | (0.6)    |         | (0.6)    |
| Other long-term |         |          |         |          |
| Total           |         | (0.6)    |         | (0.6)    |
| Net Fair Value  | \$      | \$ (0.1) | \$      | \$ (0.1) |

During the twenty-eight weeks ended July 12, 2008, interest expense was not impacted by periodic settlements of the swaps.

As of July 12, 2008, the balance in accumulated other comprehensive income related to interest rate derivative transactions was \$(0.05) million. Of this total, approximately \$(0.15) million, \$(0.35) million, \$0.05 million, \$0.17 million, \$0.17 million and \$0.06 million, were related to instruments expiring in 2008 through 2013, respectively.

**7. DEBT AND OTHER OBLIGATIONS**

Long-term debt and capital leases consisted of the following at July 12, 2008 and December 29, 2007 (amounts in thousands):

|                           | JULY 12,<br>2008 | DECEMBER 29,<br>2007 |
|---------------------------|------------------|----------------------|
| Unsecured credit facility | \$ 6,000         | \$                   |
| Capital lease obligations | 22,854           | 23,796               |
| Other notes payable       | 3,818            | 5,632                |
|                           | 32,672           | 29,428               |
| Less current maturities   | 3,300            | 6,920                |

|   |    |        |    |        |
|---|----|--------|----|--------|
| Total long-term debt and capital leases | \$ | 29,372 | \$ | 22,508 |
|---|----|--------|----|--------|

The company has a five-year, \$250.0 million unsecured revolving loan facility (the credit facility ) expiring October 5, 2012. The company may request to increase its borrowings under the credit facility up to an aggregate of \$350.0 million upon the satisfaction of certain conditions. Proceeds from the credit facility may be used for working capital and general corporate purposes, including acquisition financing, refinancing of indebtedness and share repurchases. The credit facility includes certain customary restrictions, which, among other things, require maintenance of financial covenants and limit encumbrance of assets and creation of indebtedness. Restrictive financial covenants include such ratios as a minimum interest coverage ratio and a maximum leverage ratio. The company believes that, given its current cash position, its cash flow from operating activities and its available credit capacity, it can comply with the current terms of the credit facility and can meet presently foreseeable financial requirements. As of July 12, 2008 and December 29, 2007, the company was in compliance with all restrictive financial covenants under its credit facility.



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Interest is due quarterly in arrears on any outstanding borrowings at a customary Eurodollar rate or the base rate plus the applicable margin. The underlying rate is defined as rates offered in the interbank Eurodollar market or the higher of the prime lending rate or federal funds rate plus 0.5%. The applicable margin ranges from 0.0% to 0.30% for base rate loans and from 0.40% to 1.275% for Eurodollar loans. In addition, a facility fee ranging from 0.10% to 0.35% is due quarterly on all commitments under the credit facility. Both the interest margin and the facility fee are based on the company's leverage ratio. Outstanding borrowings under the credit facility were \$6.0 million at July 12, 2008. There were no outstanding borrowings under the credit facility at December 29, 2007. Subsequent to the end of the second quarter of fiscal 2008, the company borrowed \$19.6 million under the credit facility to partially fund the acquisitions of ButterKrust and Holsum that closed during the third quarter of fiscal 2008 (see Note 15). As of August 15, 2008, the amount outstanding under the credit facility was \$15 million.

The company paid financing costs of \$0.3 million during fiscal 2007 in connection with an amendment of its credit facility. These costs, along with unamortized financing costs on the company's former credit facility of \$0.6 million, were deferred and are being amortized over the term of the credit facility.

Currently, the company's credit ratings by Standard and Poor's and Fitch Ratings are BBB- and BBB, respectively. During the first quarter of fiscal 2008, Moody's Investor Services revised the company's credit rating up to Baa2. Changes in the company's credit ratings do not trigger a change in the company's available borrowings or costs under the credit facility, but could affect future credit availability.

Included in accounts payable in the condensed consolidated balance sheets are book overdrafts of \$21.2 million and \$12.2 million as of July 12, 2008 and December 29, 2007, respectively.

**8. VARIABLE INTEREST ENTITY**

The company maintains a transportation agreement with a thinly capitalized entity. This entity transports a significant portion of the company's fresh bakery products from the company's production facilities to outlying distribution centers. The company represents a significant portion of the entity's revenue. This entity qualifies as a Variable Interest Entity (VIE), but not a Special Purpose Entity and under FASB Interpretation No. 46 (FIN 46), *Consolidation of Variable Interest Entities*, the company is the primary beneficiary. In accordance with FIN 46, the company consolidates this entity. The VIE has collateral that is sufficient to meet its capital lease and other debt obligations, and the owner of the VIE personally guarantees the obligations of the VIE. The VIE's creditors have no recourse against the general credit of the company.

Following is the effect of the VIE during the twelve and twenty-eight weeks ended July 12, 2008 and July 14, 2007:

|  | <b>TWELVE WEEKS ENDED</b>     |              |                      |              | <b>TWENTY-EIGHT WEEKS ENDED</b> |              |                      |              |
|--|-------------------------------|--------------|----------------------|--------------|---------------------------------|--------------|----------------------|--------------|
|  | <b>JULY 12, 2008</b>          |              | <b>JULY 14, 2007</b> |              | <b>JULY 12, 2008</b>            |              | <b>JULY 14, 2007</b> |              |
|  | <b>% OF</b>                   | <b>% OF</b>  | <b>% OF</b>          | <b>% OF</b>  | <b>% OF</b>                     | <b>% OF</b>  | <b>% OF</b>          | <b>% OF</b>  |
|  | <b>VIE</b>                    | <b>TOTAL</b> | <b>VIE</b>           | <b>TOTAL</b> | <b>VIE</b>                      | <b>TOTAL</b> | <b>VIE</b>           | <b>TOTAL</b> |
|  | <b>(Dollars in thousands)</b> |              |                      |              |                                 |              |                      |              |
| Assets as of<br>respective quarter<br>ends             | \$ 33,421                     | 3.3%         | \$ 31,634            | 3.4%         | \$ 33,421                       | 3.3%         | \$ 31,634            | 3.4%         |
| Sales  | \$ 2,698                      | 0.5%         | \$ 3,247             | 0.7%         | \$ 5,498                        | 0.5%         | \$ 6,455             | 0.6%         |
| Income before<br>income taxes and<br>minority interest | \$ 1,137                      | 2.9%         | \$ 1,016             | 2.8%         | \$ 2,438                        | 2.5%         | \$ 2,871             | 3.5%         |

The assets consist primarily of \$23.0 million and \$22.8 million as of July 12, 2008 and July 14, 2007, respectively, of transportation equipment recorded as capital lease obligations.

**9. LITIGATION**

The company and its subsidiaries from time to time are parties to, or targets of, lawsuits, claims, investigations and proceedings, including personal injury, commercial, contract, environmental, antitrust, product liability, health and safety and employment matters, which are being handled and defended in the ordinary course of business. While the

company is unable to predict the outcome of these matters, it believes, based upon currently available facts, that it is remote that the ultimate resolution of any such pending matters will have a material adverse effect on its overall financial condition, results of operations or cash flows in the future. However, adverse developments could negatively impact earnings in a particular future fiscal period.

**Table of Contents****10. EARNINGS PER SHARE**

The following table calculates basic earnings per common share and diluted earnings per common share for the twelve and twenty-eight weeks ended July 12, 2008 and July 14, 2007 (amounts in thousands, except per share data):

|   | FOR THE TWELVE<br>WEEKS ENDED |                  | FOR THE TWENTY-EIGHT<br>WEEKS ENDED |                  |
|---|-------------------------------|------------------|-------------------------------------|------------------|
|   | JULY 12,<br>2008              | JULY 14,<br>2007 | JULY 12,<br>2008                    | JULY 14,<br>2007 |
| <b>Basic Earnings Per Common Share:</b>   |                               |                  |                                     |                  |
| Net income  | \$ 23,949                     | \$ 22,190        | \$ 59,732                           | \$ 50,683        |
| Basic weighted average shares outstanding   | 91,724                        | 90,761           | 91,710                              | 90,633           |
| Basic earnings per common share   | \$ 0.26                       | \$ 0.24          | \$ 0.65                             | \$ 0.56          |
| <b>Diluted Earnings Per Common Share:</b>   |                               |                  |                                     |                  |
| Net income  | \$ 23,949                     | \$ 22,190        | \$ 59,732                           | \$ 50,683        |
| Basic weighted average shares outstanding   | 91,724                        | 90,761           | 91,710                              | 90,633           |
| Add: Shares of common stock assumed issued upon exercise of stock options and vesting of restricted stock | 777                           | 1,652            | 705                                 | 1,515            |
| Diluted weighted average shares outstanding   | 92,501                        | 92,413           | 92,415                              | 92,148           |
| Diluted earnings per common share   | \$ 0.26                       | \$ 0.24          | \$ 0.65                             | \$ 0.55          |

Stock options to purchase 850,200 shares of common stock were not included in the computation of diluted earnings per share for the twelve and twenty-eight weeks ended July 12, 2008 and stock options to purchase 831,525 shares were not included in the computation of diluted earnings per share for the twelve and twenty-eight weeks ended July 14, 2007 because their effect would have been anti-dilutive.

**11. STOCK BASED COMPENSATION**

The company accounts for its stock-based compensation in accordance with SFAS 123R, *Share-Based Payment* ( SFAS 123R ).

Flowers Foods 2001 Equity and Performance Incentive Plan ( EPIP ) authorizes the compensation committee of the board of directors to make awards of options to purchase our common stock, restricted stock, performance stock and performance units and deferred stock. Our officers, key employees and non-employee directors (whose grants are generally approved by the full board of directors) are eligible to receive awards under the EPIP. The aggregate number of shares that may be issued or transferred under the EPIP is 14,625,000 shares. Over the life of the EPIP, the company has only issued options, restricted stock and deferred stock. Options granted prior to January 3, 2006 may not be exercised later than ten years after the date of grant, and become exercisable four years from the date of grant and generally vest at that time or upon death, disability or retirement of the optionee or upon change in control of Flowers Foods. Options granted on January 3, 2006 and thereafter may not be exercised later than seven years after the date of grant, become exercisable three years from the date of grant, generally vest at that time or upon death, disability or retirement of the optionee or upon change in control of Flowers Foods. In order to exercise these options

the optionees are required to pay the market value calculated as the average high/low trading value at date of grant for pre-2007 awards and the closing market price on the date of grant for post-2006 awards. Non-employee director options generally become exercisable one year from the date of grant and vest at that time. The following is a summary of stock options, restricted stock, and deferred stock outstanding under the EPIP. Information relating to the company's stock appreciation rights which are not issued under the EPIP is also disclosed below.

*Stock Options*

The following non-qualified stock options ( NQSOs ) have been granted under the EPIP with service period remaining. The Black-Scholes option-pricing model was used to estimate the grant date fair value (amounts in thousands, except price data):

| <b>Grant date</b>                           | <b>1/3/2006</b> | <b>2/5/2007</b> | <b>2/4/2008</b> |
|---|-----------------|-----------------|-----------------|
| Shares granted                              | 656             | 832             | 850             |
| Exercise price                              | 18.68           | 19.57           | 24.75           |
| <b>Vesting date</b>                         | <b>1/3/2009</b> | <b>2/5/2010</b> | <b>2/4/2011</b> |
| Fair value per share (\$)                   | 6.20            | 6.30            | 5.80            |
| Dividend yield (%) <sup>(1)</sup>           | 1.60            | 1.70            | 1.90            |
| Expected volatility (%) <sup>(2)</sup>      | 36.00           | 33.90           | 27.30           |
| Risk-free interest rate (%) <sup>(3)</sup>  | 4.25            | 4.74            | 2.79            |
| Expected option life (years) <sup>(4)</sup> | 5.00            | 5.00            | 5.00            |
| Outstanding at July 12, 2008                | 647             | 826             | 850             |

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1. Dividend yield estimated yield based on the historical dividend payment for the four most recent dividend payments prior to the grant date.
2. Expected volatility based on historical volatility over the expected term using daily stock prices.
3. Risk-free interest rate United States Treasury Constant Maturity rates as of the grant date over the expected term.
4. Expected option life for the 2006 and 2007 grants the assumption is based on the simplified formula determined in accordance with Staff Accounting Bulletin No. 107. The 2008 grant assumption is based on the simplified

formula determined in accordance with Staff Accounting Bulletin No. 110. The company does not have sufficient historical exercise behavior data to reasonably estimate the expected option life and the terms of the awards issued in 2008 are different from the awards that have fully vested.

The stock option activity for the twenty-eight weeks ended July 12, 2008 pursuant to the EPIP is set forth below (amounts in thousands, except price data):

|                                  | <b>Options</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> | <b>Weighted<br/>Average<br/>Remaining<br/>Contractual<br/>Term</b> | <b>Aggregate<br/>Intrinsic<br/>Value</b> |
|----------------------------------|----------------|--|--|--|
| Outstanding at December 29, 2007 | 2,417          | \$ 15.15   |  |  |
| Granted                          | 850            | \$ 24.75   |  |  |
| Exercised                        | (252)          | \$ 9.65  |  |  |
| Outstanding at July 12, 2008     | 3,015          | \$ 18.31   | 5.41   | \$ 33,267                                |
| Exercisable at July 12, 2008     | 694            | \$ 8.58  | 4.68   | \$ 14,397                                |

As of July 12, 2008, all options outstanding under the EPIP had an average exercise price of \$18.31 and a weighted average remaining contractual life of 5.41 years.

During the twenty-eight weeks ended July 12, 2008 and July 14, 2007, the company recorded stock-based compensation expense of \$2.3 million and \$2.9 million, respectively, relating to NQSOs using the *Black-Scholes* option-pricing model. During the twelve weeks ended July 12, 2008 and July 14, 2007, the company recorded stock-based compensation expense of \$1.0 and \$1.3 million, respectively.

As of July 12, 2008, there was \$7.3 million of total unrecognized compensation expense related to outstanding stock options. This cost is expected to be recognized on a straight-line basis over a weighted-average period of 2.2 years.

Cash received from option exercises for the twenty-eight weeks ended July 12, 2008 and July 14, 2007 was \$2.4 million and \$3.5 million, respectively. The cash tax benefit realized for the tax deductions from option exercises

was \$2.0 million and \$2.5 million, respectively, for the twenty-eight weeks ended July 12, 2008 and July 14, 2007. The total intrinsic value of stock options exercised was \$3.7 million and \$6.6 million for the twenty-eight weeks ended July 12, 2008 and July 14, 2007, respectively.

*Restricted Stock*

On January 4, 2004, the effective date of his election as Chief Executive Officer, George Deese was granted 112,500 shares of restricted stock pursuant to the EPIP. The fair value of these restricted shares on the date of grant was approximately \$1.3 million. These shares became fully vested on January 4, 2008. The company recorded \$0.0 million and \$0.1 million in compensation expense during the twelve weeks ended July 12, 2008 and July 14, 2007, respectively, related to this restricted stock. The company recorded \$0.0 million and \$0.2 million in compensation expense during the twenty-eight weeks ended July 12, 2008 and July 14, 2007, respectively, related to this restricted stock.

During the second quarter of fiscal 2006, non-employee directors were granted an aggregate of 38,460 shares of restricted stock. The fair value of these restricted shares on the date of grant was \$0.7 million. These shares fully vested on the first anniversary of the date of grant. The company recorded \$0.1 million in compensation expense during the twelve weeks ended July 14, 2007 and \$0.3 million during the twenty-eight weeks ended July 14, 2007 related to this restricted stock.

Certain key employees have been granted restricted stock. Vesting generally occurs two years from the date of grant for the 2006 and 2007 awards if, on this date, the company's average return on invested capital over the vesting period equals or exceeds its weighted average cost of capital for the same period (the ROI Target). The 2008 awards require the return on invested capital to

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exceed the weighted average cost of capital by 2.5% for the same period. Furthermore, each grant of performance-contingent restricted stock will be adjusted as set forth below:

if the ROI Target is satisfied, then the performance-contingent restricted stock grant may be adjusted based on the company's total return to shareholders ( Company TSR ) percent rank as compared to the total return to shareholders of the S&P Packaged Food & Meat Index ( S&P TSR ) in the manner set forth below:

If the Company TSR rank is equal to the 50th percentile of the S&P TSR, then no adjustment;

If the Company TSR rank is less than the 50th percentile of the S&P TSR, the grant shall be reduced by 1.3% for each percentile that the Company TSR is less than the 50th percentile of S&P TSR, but in no event shall the reduction exceed 20%; or

If the Company TSR rank is greater than the 50th percentile of the S&P TSR, the grant shall be increased by 1.3% for each percentile that Company TSR is greater than the 50th percentile of S&P TSR, but in no event shall such increase exceed 20%.

If the grantee dies, becomes disabled or retires, the performance-contingent restricted stock generally vests immediately. In addition, the performance-contingent restricted stock will immediately vest at the grant date award level without adjustment if the company undergoes a change in control. During the vesting period, the grantee is treated as a normal shareholder with respect to dividend and voting rights on the restricted shares. The fair value estimate was determined using a *Monte Carlo* simulation model, which utilizes multiple input variables to determine the probability of the company achieving the market condition discussed above. Inputs into the model included the following for the company and comparator companies: (i) total stockholder return from the beginning of the performance cycle through the measurement date; (ii) volatility; (iii) risk-free interest rates; and (iv) the correlation of the comparator companies' total stockholder return. The inputs are based on historical capital market data.

The following restricted stock awards have been granted under the EPIP (amounts in thousands, except price data):

| <b>Grant date</b>   | <b>1/3/2006</b> | <b>2/5/2007</b> | <b>2/4/2008</b> |
|---|-----------------|-----------------|-----------------|
| Shares granted  | 204             | 224             | 210             |
| Vesting date  | 1/3/2008        | 2/5/2009        | 2/4/2010        |
| Fair value per share                                      | \$ 19.44        | \$ 20.98        | \$ 27.03        |
| Expense during the twelve weeks ended July 12, 2008       | \$              | \$ 509          | \$ 655          |
| Expense during the twelve weeks ended July 14, 2007       | \$ 453          | \$ 542          | \$              |
| Expense during the twenty-eight weeks ended July 12, 2008 | \$              | \$ 1,189        | \$ 1,310        |
| Expense during the twenty-eight weeks ended July 14, 2007 | \$ 1,056        | \$ 1,085        | \$              |

A summary of the status of the company's nonvested shares as of July 12, 2008, and changes during the twenty-eight weeks ended July 12, 2008, is presented below (amounts in thousands, except price data):

|                                | <b>Shares</b> | <b>Weighted Average Grant Date Fair Value</b> |
|--------------------------------|---------------|---|
| Nonvested at December 29, 2007 | 537           | \$ 18.42                                      |
| Granted                        | 210           | \$ 27.03                                      |
| Vested                         | (314)         | \$ 16.59                                      |
| Forfeited                      |               | \$  |
| Nonvested at July 12, 2008     | 433           | \$ 23.92                                      |

As of July 12, 2008, there was \$5.6 million of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted by the EPIP. That cost is expected to be recognized over a weighted-average period of 1.0 years. The fair value of restricted share awards that vested during fiscal 2008 was \$7.1 million on the vesting date.

*Stock Appreciation Rights*



The company previously awarded stock appreciation rights ( rights ) to key employees throughout the company. These rights vest at the end of four years and are payable in cash equal to the difference between the grant price and the fair market value of the rights on the vesting date. On July 16, 2007 (the company s third quarter), 448,350 rights granted in 2003 vested. The company recorded compensation expense for these rights on measurement dates based on changes between the grant price and an estimated fair value of

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the rights using the *Black-Scholes* option-pricing model. During the twelve weeks ended July 12, 2008 and July 14, 2007, respectively, the company recorded expense of \$0.0 million and \$1.1 million related to these rights. During the twenty-eight weeks ended July 12, 2008 and July 14, 2007, respectively, the company recorded expense of \$0.0 million and \$3.7 million related to these rights.

Prior to 2007, the company allowed non-employee directors to convert their retainers and committee chairman fees into rights. These rights vest after one year and can be exercised over nine years. The company records compensation expense for these rights at a measurement date based on changes between the grant price and an estimated fair value of the rights using the *Black-Scholes* option-pricing model. During the twelve weeks ended July 12, 2008 and July 14, 2007, respectively, the company recorded expense of \$0.8 million and \$0.2 million related to these rights. During the twenty-eight weeks ended July 12, 2008 and July 14, 2007, respectively, the company recorded expense of \$1.2 million and \$1.0 million related to these rights.

The fair value of the rights at July 12, 2008 ranged from \$14.45 to \$25.69. The following assumptions were used to determine fair value of the rights discussed above using the *Black-Scholes* option-pricing model at July 12, 2008: dividend yield 2.2%; expected volatility 28.0%; risk-free interest rate 3.3% and expected life of 1.55 years to 3.95 years.

The rights activity for the twenty-eight weeks ended July 12, 2008 is set forth below (amounts in thousands except price data):

|                                  | Rights | Weighted<br>Average<br>Exercise<br>Price | Weighted Average<br>Remaining<br>Contractual Term<br>(Years) | Aggregate<br>Intrinsic<br>Value |
|----------------------------------|--------|--|--|---------------------------------|
| Outstanding at December 29, 2007 | 231    | \$ 11.14                                 |  |                                 |
| Rights exercised                 |        |  |  |                                 |
| Rights forfeited                 |        |  |  |                                 |
| Outstanding at July 12, 2008     | 231    | \$ 11.14                                 | 5.40   | \$ 4,228                        |

**Deferred Stock**

The company allows non-employee directors to convert their retainers into deferred stock. The deferred stock has a minimum two year vesting period and will be distributed to the individual after that time at a designated time selected by the individual at the date of conversion. During the first quarter of fiscal 2007 and 2008 an aggregate of 20,520 and 22,160 shares, respectively, were converted. The company records compensation expense for this deferred stock over the two-year minimum vesting period based on the closing price of the company's common stock on the date of conversion.

During the second quarter of fiscal 2007 and 2008, non-employee directors were granted an aggregate of 34,350 and 35,800 shares, respectively, of deferred stock that has a minimum one year vesting period. The deferred stock will be distributed to the grantee after that time at a designated time selected by the grantee at the date of grant. Compensation expense is recorded on this deferred stock over the one year minimum vesting period.

The deferred stock activity for the twenty-eight weeks ended July 12, 2008 is set forth below (amounts in thousands, except price data):

|                                  | Shares | Weighted<br>Average<br>Grant<br>Price | Weighted Average<br>Remaining<br>Contractual Term<br>(Years) | Aggregate<br>Intrinsic<br>Value |
|----------------------------------|--------|---------------------------------------|--|---------------------------------|
| Outstanding at December 29, 2007 | 55     | \$ 21.03                              |  |                                 |
| Deferred stock issued            | 58     | \$ 25.22                              |  |                                 |
| Deferred stock exercised         | (24)   | 21.91                                 |  |                                 |

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Outstanding at July 12, 2008    89        \$     23.53    1.37        \$         516

The following table summarizes the company's stock based compensation expense for the twelve and twenty-eight week periods ended July 12, 2008 and July 14, 2007, respectively (amounts in thousands):

|                                | FOR THE TWELVE<br>WEEKS ENDED |                  | FOR THE TWENTY-EIGHT<br>WEEKS ENDED |                  |
|--------------------------------|-------------------------------|------------------|-------------------------------------|------------------|
|                                | JULY 12,<br>2008              | JULY 14,<br>2007 | JULY 12,<br>2008                    | JULY 14,<br>2007 |
| Stock options                  | \$ 1,047                      | \$ 1,303         | \$ 2,318                            | \$ 2,930         |
| Restricted stock               | 1,164                         | 1,128            | 2,498                               | 2,604            |
| Stock appreciation rights      | 759                           | 1,313            | 1,181                               | 4,736            |
| Deferred stock                 | 310                           | 161              | 681                                 | 208              |
| Total stock based compensation | \$ 3,280                      | \$ 3,905         | \$ 6,678                            | \$ 10,478        |

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On September 29, 2006, the FASB issued SFAS No. 158, which requires recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. Under SFAS 158, gains and losses, prior service costs and credits, and any remaining transition amounts under SFAS 87 and FASB Statement No. 106, *Employers Accounting for Postretirement Benefits Other Than Pensions* ( SFAS 106 ) that have not yet been recognized through net periodic benefit costs will be recognized in accumulated other comprehensive income, net of tax benefits, until they are amortized as a component of net periodic cost. SFAS 158 does not change how pensions and other postretirement benefits are accounted for and reported in the income statement. Companies will continue to follow the existing guidance in SFAS 87, FASB Statement No. 88, *Employers Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits* and SFAS 106. SFAS 158 was effective for public companies for fiscal years ending after December 15, 2006. The company adopted the balance sheet recognition provisions of SFAS 158 at December 30, 2006, the end of its fiscal year 2006. SFAS 158 also requires that employers measure the benefit obligation and plan assets as of the fiscal year end for fiscal years ending after December 15, 2008 (the company's fiscal 2008). In fiscal 2006 and earlier, the company used a September 30 measurement date for its pension and other postretirement benefit plans. The company eliminated the early measurement date in fiscal 2007 and applied the remeasurement alternative in accordance with SFAS 158. Under this alternative, postretirement benefit income measured for the three-month period October 1, 2006 to December 31, 2006 (determined using the September 2006 measurement date) was credited to beginning 2007 retained earnings. As result, the company increased retained earnings \$0.7 million, net of taxes of \$0.5 million and increased the postretirement benefit asset and liability by \$1.3 million and \$0.1 million, respectively. The funded status of the company's postretirement benefit plans was then remeasured at January 1, 2007, resulting in an adjustment to the balance sheet asset, liability and accumulated other comprehensive income. As a result, the postretirement benefit asset was increased \$7.4 million and the postretirement benefit liability was decreased \$0.7 million, with an offsetting credit to accumulated other comprehensive income of \$5.0 million, net of taxes of \$3.1 million.

The following summarizes the company's balance sheet related pension and other postretirement benefit plan accounts at July 12, 2008 as compared to accounts at December 29, 2007 (amounts in thousands):

|  | <b>JULY<br/>12,<br/>2008</b> | <b>AS OF<br/>DECEMBER<br/>29,<br/>2007</b> |
|--|------------------------------|--|
| Noncurrent benefit asset               | \$ 38,348                    | \$ 34,471                                  |
| Current benefit liability              | \$ 403                       | \$ 403                                     |
| Noncurrent benefit liability           | \$ 7,036                     | \$ 6,599                                   |
| Accumulated other comprehensive income | \$ 2,735                     | \$ 2,625                                   |

**Defined Benefit Plans**

The company has trustee, noncontributory defined benefit pension plans covering certain employees. The benefits are based on years of service and the employees' career earnings. The plans are funded at amounts deductible for income tax purposes but not less than the minimum funding required by the Employee Retirement Income Security Act of 1974 ( ERISA ). As of July 12, 2008, the assets of the plans included certificates of deposit, marketable equity securities, mutual funds, corporate and government debt securities, private and public real estate partnerships, other diversifying strategies and annuity contracts. Effective January 1, 2006, the company curtailed the defined benefit plan that covers the majority of its workforce. Benefits under this plan were frozen, and no future benefits will accrue under this plan. The company continues to maintain a plan that covers a small number of certain union employees.

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

**FOR THE TWELVE  
WEEKS ENDED**

**FOR THE TWENTY-EIGHT  
WEEKS ENDED**

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|                                   | <b>JULY 12,<br/>2008</b> | <b>JULY 14,<br/>2007</b> | <b>JULY 12,<br/>2008</b> | <b>JULY 14,<br/>2007</b> |
|-----------------------------------|--------------------------|--------------------------|--------------------------|--------------------------|
| Service cost                      | \$ 68                    | \$ 60                    | \$ 158                   | \$ 140                   |
| Interest cost                     | 3,920                    | 3,770                    | 9,146                    | 8,796                    |
| Expected return on plan assets    | (5,649)                  | (5,307)                  | (13,180)                 | (12,383)                 |
| Total net periodic benefit income | \$ (1,661)               | \$ (1,477)               | \$ (3,876)               | \$ (3,447)               |

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**Table of Contents****Post-retirement Benefit Plan**

The company provides certain medical and life insurance benefits for eligible retired employees. The medical plan covers eligible retirees under the active medical plan. The plan incorporates an up-front deductible, coinsurance payments and retiree contributions at COBRA premium levels. Eligibility and maximum period of coverage is based on age and length of service. The life insurance plan offers coverage to a closed group of retirees.

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

|                                    | FOR THE TWELVE<br>WEEKS ENDED |                  | FOR THE<br>TWENTY-EIGHT WEEKS<br>ENDED |                  |
|------------------------------------|-------------------------------|------------------|--|------------------|
|                                    | JULY<br>12, 2008              | JULY 14,<br>2007 | JULY 12,<br>2008                       | JULY 14,<br>2007 |
| Service cost                       | \$ 88                         | \$ 70            | \$ 206                                 | \$ 163           |
| Interest cost                      | 99                            | 90               | 232                                    | 210              |
| Amortization of prior service cost | 77                            | 77               | 179                                    | 179              |
| Total net periodic benefit cost    | \$ 264                        | \$ 237           | \$ 617                                 | \$ 552           |

**401(k) Retirement Savings Plan**

The Flowers Foods 401(k) Retirement Savings Plan (the Plan) covers substantially all of the company's employees who have completed certain service requirements. The cost and contributions for certain employees who also participate in the defined benefit pension plan is 25% of the first \$400 contributed by the employee. Prior to January 1, 2006, the costs and contributions for employees who do not participate in the defined benefit pension plan was 2% of compensation and 50% of the employees' contributions, up to 6% of compensation. Effective January 1, 2006, the costs and contributions for employees who do not participate in the defined benefit pension plan increased to 3% of compensation and 50% of the employees' contributions, up to 6% of compensation. During the twelve weeks ended July 12, 2008 and July 14, 2007, the total cost and contributions were \$3.3 million and \$3.0 million, respectively. During the twenty-eight weeks ended July 12, 2008 and July 14, 2007, the total cost and contributions were \$8.1 million and \$7.8 million, respectively.

**13. INCOME TAXES**

The company's effective tax rate for the twelve and twenty-eight weeks ended July 12, 2008 was 35.7% for both periods. This rate is down slightly from the 2007 annual effective tax rate of 35.9%, due to favorable discrete items recognized during the twenty-eight weeks ended July 12, 2008. The difference in the effective rate and the statutory rate is primarily due to state income taxes, the non-taxable earnings of the consolidated variable interest entity and the Section 199 qualifying production activities deduction.

During the twelve and twenty-eight weeks ended July 12, 2008, the company's activity with respect to its FIN 48 reserve and related interest expense accrual was immaterial. At this time, we do not anticipate significant changes to the amount of gross unrecognized tax benefits over the next twelve months.

**14. SEGMENT REPORTING**

The DSD segment produces fresh and frozen packaged bread and rolls and the warehouse delivery segment produces frozen bread and rolls and fresh and frozen snack products. The company evaluates each segment's performance based on income or loss before interest and income taxes, excluding unallocated expenses and charges which the company's management deems to be an overall corporate cost or a cost not reflective of the segments' core operating businesses. During the second quarter of fiscal 2008, the company's Tucker, Georgia operation was transferred from the DSD segment to the warehouse delivery segment. Prior period information has been reclassified to reflect this change. Information regarding the operations in these reportable segments is as follows (amounts in thousands):

|   | <b>FOR THE TWELVE<br/>WEEKS ENDED</b> |                          | <b>FOR THE TWENTY-EIGHT<br/>WEEKS ENDED</b> |                          |
|---|---------------------------------------|--------------------------|---|--------------------------|
|   | <b>JULY 12,<br/>2008</b>              | <b>JULY 14,<br/>2007</b> | <b>JULY 12,<br/>2008</b>                    | <b>JULY 14,<br/>2007</b> |
| <b>SALES:</b>                             |                                       |                          |   |                          |
| DSD                                       | \$ 445,065                            | \$ 389,071               | \$ 1,003,139                                | \$ 880,948               |
| Warehouse delivery                        | 122,921                               | 110,434                  | 276,736                                     | 256,817                  |
| <b>Eliminations:</b>                      |                                       |                          |   |                          |
| Sales from warehouse delivery to DSD      | (23,067)                              | (18,867)                 | (54,056)                                    | (44,258)                 |
| Sales from DSD to warehouse delivery      | (4,263)                               | (2,800)                  | (8,456)                                     | (5,722)                  |
|   | \$ 540,656                            | \$ 477,838               | \$ 1,217,363                                | \$ 1,087,785             |
| <b>DEPRECIATION AND<br/>AMORTIZATION:</b> |                                       |                          |   |                          |
| DSD                                       | \$ 12,153                             | \$ 11,931                | \$ 28,111                                   | \$ 27,849                |
| Warehouse delivery                        | 3,656                                 | 3,216                    | 8,378                                       | 7,473                    |
| Unallocated                               | 223                                   | (31)                     | 456   | (89)                     |
|   | \$ 16,032                             | \$ 15,116                | \$ 36,945                                   | \$ 35,233                |

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|  | <b>FOR THE TWELVE<br/>WEEKS ENDED</b> |                          | <b>FOR THE TWENTY-EIGHT<br/>WEEKS ENDED</b> |                          |
|--|---------------------------------------|--------------------------|---|--------------------------|
|  | <b>JULY 12,<br/>2008</b>              | <b>JULY 14,<br/>2007</b> | <b>JULY 12,<br/>2008</b>                    | <b>JULY 14,<br/>2007</b> |
| INCOME BEFORE INCOME TAXES<br>AND MINORITY INTEREST: |                                       |                          |   |                          |
| DSD  | \$ 36,387                             | \$ 33,454                | \$ 89,779                                   | \$ 78,523                |
| Warehouse delivery                                   | 6,461                                 | 6,782                    | 14,720                                      | 14,961                   |
| Unallocated  | (6,488)                               | (6,048)                  | (13,990)                                    | (14,381)                 |
| Interest income, net                                 | 2,657                                 | 1,932                    | 6,154                                       | 3,865                    |
|  | \$ 39,017                             | \$ 36,120                | \$ 96,663                                   | \$ 82,968                |

Sales by product category in each reportable segment are as follows (amounts in thousands):

|                          | <b>For the twelve weeks ended July 12,<br/>2008</b> |                               |              | <b>For the twelve weeks ended July 14,<br/>2007</b> |                               |              |
|--------------------------|---|-------------------------------|--------------|---|-------------------------------|--------------|
|                          | <b>DSD</b>  | <b>Warehouse<br/>delivery</b> | <b>Total</b> | <b>DSD</b>  | <b>Warehouse<br/>delivery</b> | <b>Total</b> |
| Branded Retail           | \$ 264,527  | \$ 27,765                     | \$ 292,292   | \$ 229,517  | \$ 22,882                     | \$ 252,399   |
| Store Branded<br>Retail  | 63,831  | 13,013                        | 76,844       | 54,596  | 10,694                        | 65,290       |
| Foodservice and<br>Other | 112,444   | 59,076                        | 171,520      | 102,158   | 57,991                        | 160,149      |
| Total                    | \$ 440,802  | \$ 99,854                     | \$ 540,656   | \$ 386,271  | \$ 91,567                     | \$ 477,838   |

|                          | <b>For the twenty-eight weeks ended July 12,<br/>2008</b> |                               |              | <b>For the twenty-eight weeks ended July 14,<br/>2007</b> |                               |              |
|--------------------------|---|-------------------------------|--------------|---|-------------------------------|--------------|
|                          | <b>DSD</b>  | <b>Warehouse<br/>delivery</b> | <b>Total</b> | <b>DSD</b>  | <b>Warehouse<br/>delivery</b> | <b>Total</b> |
| Branded Retail           | \$ 594,227  | \$ 58,758                     | \$ 652,985   | \$ 517,271  | \$ 51,974                     | \$ 569,245   |
| Store Branded<br>Retail  | 136,590   | 27,512                        | 164,102      | 116,575   | 24,804                        | 141,379      |
| Foodservice and<br>Other | 263,866   | 136,410                       | 400,276      | 241,380   | 135,781                       | 377,161      |
| Total                    | \$ 994,683  | \$ 222,680                    | \$ 1,217,363 | \$ 875,226  | \$ 212,559                    | \$ 1,087,785 |

**15. SUBSEQUENT EVENTS**

On August 1, 2008, the company entered into a Credit Agreement ( term loan ) with various lending parties. The term loan provides for borrowings through the maturity date of August 4, 2013 for the purpose of completing the acquisition of ButterKrust and Holsum. The maximum amount permitted to be outstanding under the term loan is \$150 million. The term loan includes certain customary restrictions, which, among other things, require maintenance of financial covenants and limit encumbrance of assets and creation of indebtedness. Restrictive financial covenants include such ratios as a minimum interest coverage ratio and a maximum leverage ratio. The company believes that, given its current cash position, its cash flow from operating activities and its available credit capacity, it can comply



with the current terms of the term loan and can meet presently foreseeable financial requirements.

Interest is due quarterly in arrears on any outstanding borrowings at a customary Eurodollar rate or the base rate plus the applicable margin. The underlying rate is defined as the rate offered in the interbank Eurodollar market or the higher of the prime lending rate or federal funds rate plus 0.5%. The applicable margin ranges from 0.000% to 1.375% for base rate loans and from 0.875% to 2.375% for Eurodollar loans and is based on the company's leverage ratio. Principal payments are due quarterly under the term loan beginning on December 31, 2008 at an annual amortization of 10% of the then outstanding principal balance for the first two years, 15% during the third year, 20% during the fourth year, and 45% during the fifth year until the maturity date when the balance is due. The company will also pay legal, accounting and other fees and expenses in connection with the term loan which will be amortized over the life of the term loan.

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On August 4, 2008, the company acquired 100% of the outstanding shares of capital stock of C & G Holdings, Inc. which operates under the name ButterKrust Bakery ( ButterKrust ). ButterKrust manufactures fresh breads and rolls in Lakeland, Florida and its products are available throughout Florida under the *Country Hearth*, *Rich Harvest*, and *Sunbeam* brands as well as store brands. The purchase price was \$90 million in cash including the payoff of certain indebtedness and other payments. ButterKrust will be included in the company's DSD operating segment in the third quarter of fiscal 2008.

On August 11, 2008, a wholly owned subsidiary of the company merged with Holsum Holdings, LLC. ( Holsum ). Holsum operates two bakeries in the Phoenix, Arizona area and serves customers in Arizona, New Mexico, southern Nevada and southern California with fresh breads and rolls under the *Holsum*, *Aunt Hattie's*, and *Roman Meal* brands. As a result of the merger, the company expands into new geographic markets. The purchase price was \$150 million including the payoff of certain debt and other obligations of Holsum. Approximately one half of the net purchase price was paid in cash and the other half in company common stock. Holsum will be included in the company's DSD operating segment in the third quarter of fiscal 2008.

On August 13, 2008, the company entered an interest rate swap with a notional amount of \$65.0 million to fix the interest rate on the remaining portion of the \$150 million term loan secured on August 1, 2008 to fund the acquisitions of ButterKrust and Holsum. On July 9, 2008, an interest rate swap with a notional amount of \$85.0 million was entered into and is discussed in Note 6 of Notes to Condensed Consolidated Financial Statements in this Form 10-Q.

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

The following discussion of the financial condition and results of operations of the company as of and for the twelve and twenty-eight week periods ended July 12, 2008 should be read in conjunction with the company's Annual Report on Form 10-K for the fiscal year ended December 29, 2007.

The company consists of two business segments: direct-store-delivery ( DSD ), formerly referred to as Flowers Foods Bakeries Group and warehouse delivery, formerly referred to as Flowers Foods Specialty Group. The DSD segment focuses on the production and marketing of bakery products to customers in the southeastern, southwestern and mid-Atlantic areas of the United States primarily through its direct store delivery system. The warehouse delivery segment produces snack cakes for sale to co-pack, retail and vending customers as well as frozen bread, rolls and buns for sale to retail and foodservice customers primarily through warehouse distribution.

### **OVERVIEW:**

Flowers Foods, Inc. is one of the nation's leading producers and marketers of packaged bakery foods for retail and foodservice customers. The company produces breads, buns, rolls, snack cakes and pastries that are distributed fresh in the Southeast, Southwest and Mid-Atlantic regions and frozen to customers nationwide. Our businesses are organized into two reportable segments. The DSD segment produces fresh and frozen packaged bread and rolls and the warehouse delivery segment produces frozen bread and rolls, as well as fresh snack products. This organizational structure is the basis of the operating segment data presented in this report.

We aim to achieve consistent and sustainable growth in sales and earnings by focusing on improvement in the operating results of our existing businesses and, after detailed analysis acquiring businesses, such as ButterKrust and Holsum as discussed in Note 15 of Notes to Condensed Consolidated Financial Statements in this Form 10-Q, that add value to the company. We believe this consistent and sustainable growth will build value for our shareholders. In November 2007, the company purchased property in Bardstown, Kentucky. In January 2008, the company began construction of a bakery facility on this property that will produce fresh breads and buns for markets in Tennessee, Kentucky, Ohio, and Indiana. Due to weather delays, the company expects that the facility will begin production in the spring of 2009 rather than the fall of 2008 as reported in the company's Form 10-K for the year ended December 29, 2007.

Sales are principally affected by pricing, quality, brand recognition, new product introductions and product line extensions, marketing and service. The company manages these factors to achieve a sales mix favoring its higher-margin branded products, while using store brand products to absorb overhead costs and maximize use of production capacity. Sales for the twelve weeks ended July 12, 2008 increased 13.1% as compared to the twelve weeks ended July 14, 2007. Contributing to this increase were favorable



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pricing/mix and volume. Sales for the twenty-eight weeks ended July 12, 2008 increased 11.9% as compared to the twenty-eight weeks ended July 14, 2007.

For the twelve weeks ended July 12, 2008, diluted net income per share was \$0.26 as compared to \$0.24 per share for the twelve weeks ended July 14, 2007, a 8.3% increase. Net income was \$23.9 million, a 7.9% increase over \$22.2 million reported for the twelve weeks ended July 14, 2007.

For the twenty-eight weeks ended July 12, 2008, diluted net income per share was \$0.65 as compared to \$0.55, a 18.2% increase. Net income was \$59.7 million, a 17.9% increase over \$50.7 million reported for the twenty-eight weeks ended July 14, 2007.

**CRITICAL ACCOUNTING POLICIES:**

Our financial statements are prepared in accordance with generally accepted accounting principles ( GAAP ). These principles are numerous and complex. Our significant accounting policies are summarized in the company's Annual Report on Form 10-K for the fiscal year ended December 29, 2007. In many instances, the application of GAAP requires management to make estimates or to apply subjective principles to particular facts and circumstances. A variance in the estimates used or a variance in the application or interpretation of GAAP could yield a materially different accounting result. In our Form 10-K for the fiscal year ended December 29, 2007, we discuss the areas where we believe that the estimates, judgments or interpretations that we have made, if different, would have yielded the most significant differences in our financial statements and we urge you to review that discussion.

**RESULTS OF OPERATIONS:**

Results of operations, expressed as a percentage of sales, for the twelve and twenty-eight week periods ended July 12, 2008 and July 14, 2007, are set forth below:

|  | <b>FOR THE TWELVE</b> |                 | <b>FOR THE</b>            |                 |
|--|-----------------------|-----------------|---------------------------|-----------------|
|  | <b>WEEKS ENDED</b>    |                 | <b>TWENTY-EIGHT WEEKS</b> |                 |
|  | <b>JULY 12,</b>       | <b>JULY 14,</b> | <b>JULY 12,</b>           | <b>JULY 14,</b> |
|  | <b>2008</b>           | <b>2007</b>     | <b>2008</b>               | <b>2007</b>     |
| Sales  | 100.00%               | 100.00%         | 100.00%                   | 100.00%         |
| Gross margin                                     | 45.70                 | 48.74           | 47.13                     | 49.26           |
| Selling, marketing and administrative expenses   | 36.56                 | 38.42           | 36.91                     | 38.75           |
| Depreciation and amortization                    | 2.97                  | 3.16            | 3.03                      | 3.24            |
| Gain on sale of assets                           | 0.43                  |                 | 0.19                      |                 |
| Gain on insurance recovery                       | 0.13                  |                 | 0.06                      |                 |
| Interest income, net                             | 0.49                  | 0.40            | 0.51                      | 0.36            |
| Income before income taxes and minority interest | 7.22                  | 7.56            | 7.94                      | 7.63            |
| Income tax expense                               | 2.58                  | 2.70            | 2.83                      | 2.70            |
| Minority interest in variable interest entity    | (0.21)                | (0.21)          | (0.20)                    | (0.26)          |
| Net income                                       | 4.43%                 | 4.65%           | 4.91%                     | 4.67%           |

**CONSOLIDATED AND SEGMENT RESULTS**

TWELVE WEEKS ENDED JULY 12, 2008 COMPARED TO TWELVE WEEKS ENDED JULY 14, 2007

*Consolidated Sales.*

|  | <b>For the twelve weeks ended</b> |          | <b>For the twelve weeks ended</b> |          | <b>% Increase</b> |
|--|-----------------------------------|----------|-----------------------------------|----------|-------------------|
|  | <b>July 12, 2008</b>              |          | <b>July 14, 2007</b>              |          |                   |
|  | <b>\$</b>                         | <b>%</b> | <b>\$</b>                         | <b>%</b> |                   |

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|                       | <b>(Amounts<br/>in<br/>thousands)</b> |        | <b>(Amounts<br/>in<br/>thousands)</b> |        |       |
|-----------------------|---------------------------------------|--------|---------------------------------------|--------|-------|
| Branded Retail        | \$ 292,292                            | 54.1%  | \$ 252,399                            | 52.8%  | 15.8% |
| Store Branded Retail  | 76,844                                | 14.2   | 65,290                                | 13.7   | 17.7% |
| Foodservice and Other | 171,520                               | 31.7   | 160,149                               | 33.5   | 7.1%  |
| Total                 | \$ 540,656                            | 100.0% | \$ 477,838                            | 100.0% | 13.1% |

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The 13.1% increase in sales was attributable to a favorable pricing/mix of 10.9% and unit volume increases of 2.2%. The 2.2% increase in volume resulted primarily from expansion markets. The increase in branded retail sales was due primarily to favorable pricing/mix and increased sales of brand soft variety and white bread. The company's *Nature's Own* products and its branded white bread labels were the key components of these sales. The increase in store branded retail sales was due to favorable pricing/mix and, to a lesser extent, volume increases. The increase in foodservice and other sales was due to favorable pricing/mix, partially offset by volume declines.

*Direct-Store-Delivery Sales.*

|                       | For the twelve weeks<br>ended<br>July 12, 2008 |        | For the twelve weeks<br>ended<br>July 14, 2007 |        | %<br>Increase |
|-----------------------|--|--------|--|--------|---------------|
|                       | \$<br>(Amounts<br>in<br>thousands)             | %      | \$<br>(Amounts<br>in<br>thousands)             | %      |               |
| Branded Retail        | \$ 264,527                                     | 60.0%  | \$ 229,517                                     | 59.4%  | 15.3%         |
| Store Branded Retail  | 63,831   | 14.5   | 54,596   | 14.1   | 16.9%         |
| Foodservice and Other | 112,444  | 25.5   | 102,158  | 26.5   | 10.1%         |
| Total                 | \$ 440,802                                     | 100.0% | \$ 386,271                                     | 100.0% | 14.1%         |

The 14.1% increase in sales was attributable to favorable pricing/mix of 12.1% and volume increases of 2.0%. The increase in branded retail sales was due to favorable pricing/mix and, to a lesser extent, volume increases. The volume increases were primarily the result of market expansions. *Nature's Own* products and branded white bread labels were the key components of these sales. The increase in store branded retail sales was primarily due to favorable pricing/mix and, to a lesser extent, increased volume. The increase in foodservice and other sales was primarily due to pricing/mix.

*Warehouse Delivery Sales.*

|                       | For the twelve weeks<br>ended<br>July 12, 2008 |        | For the twelve weeks<br>ended<br>July 14, 2007 |        | %<br>Increase<br>(Decrease) |
|-----------------------|--|--------|--|--------|-----------------------------|
|                       | \$<br>(Amounts<br>in<br>thousands)             | %      | \$<br>(Amounts<br>in<br>thousands)             | %      |                             |
| Branded Retail        | \$ 27,765                                      | 27.8%  | \$ 22,882                                      | 25.0%  | 21.3%                       |
| Store Branded Retail  | 13,013   | 13.0   | 10,694   | 11.7   | 21.7%                       |
| Foodservice and Other | 59,076   | 59.2   | 57,991   | 63.3   | 1.9%                        |
| Total                 | \$ 99,854                                      | 100.0% | \$ 91,567                                      | 100.0% | 9.1%                        |

The 9.1% increase in sales was attributable to favorable pricing/mix of 6.3% and volume increases of 2.8%. The increase in branded retail sales was primarily the result of favorable volume, partially offset by unfavorable pricing/mix. The increase in store branded retail sales was primarily due to volume. The increase in foodservice and other sales, which include contract production and vending, was due to favorable pricing/mix, partially offset by unfavorable volume.

*Gross Margin (defined as sales less materials, supplies, labor and other production costs, excluding depreciation, amortization and distributor discounts).* Gross margin for the twelve weeks ended July 12, 2008 was \$247.1 million, or 6.1% higher than gross margin reported for the same period of the prior year of \$232.9 million. As a percent of sales, gross margin was 45.7% as compared to 48.7% for the second quarter of fiscal 2007. This decrease as a percent of sales was primarily due to significantly higher ingredient costs which were up 34% over the prior year quarter, partially offset by sales gains and improved manufacturing efficiencies. The significantly higher ingredient costs were primarily driven by increases in flour costs. Also negatively impacting gross margin were costs of \$1.3 million relating to the sale and closure of a facility in Atlanta, Georgia.

The DSD segment's gross margin decreased to 50.2% of sales for the second quarter ended July 12, 2008, compared to 53.2% of sales for the prior year's second quarter. This decrease as a percent of sales was primarily due to the higher ingredient costs, partially offset by sales gains, improved manufacturing efficiencies and lower labor costs as a percent of sales. The higher ingredient costs were driven primarily by higher flour costs.

The warehouse delivery segment's gross margin decreased to 25.6% of sales for the second quarter of fiscal 2008, compared to 29.9% of sales for the same period of fiscal 2007. This decrease as a percent of sales was primarily a result of the higher ingredient costs, partially offset by lower labor, packaging, freezer storage, rent costs, and improved manufacturing efficiencies. Also negatively impacting gross margin were costs of \$1.3 million relating to the sale and closure of a facility in Atlanta, Georgia.

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*Selling, Marketing and Administrative Expenses.* For the second quarter of fiscal 2008, selling, marketing and administrative expenses were \$197.7 million, or 36.6% of sales as compared to \$183.6 million, or 38.4% of sales reported for the second quarter of fiscal 2007. This decrease as a percent of sales was due to sales gains and lower labor, distribution, stock-based compensation, and advertising expense as a percent of sales, partially offset by higher distributor discounts and fuel costs. Sales gains resulted in the increase in distributor discounts. The \$0.6 million decrease in stock-based compensation was primarily the result of the company's higher stock appreciation rights expense during the second quarter of fiscal 2007, partially offset by the issuance of new stock option and restricted stock awards during the first quarter of fiscal 2008. See Note 11 of Notes to Condensed Consolidated Financial Statements of this Form 10-Q for further information regarding the company's stock-based compensation.

The DSD segment's selling, marketing and administrative expenses include discounts paid to the independent distributors utilized in our DSD system. The DSD segment's selling, marketing and administrative expenses were \$173.6 million, or 39.4% of sales during the second quarter of fiscal 2008, as compared to \$160.2 million, or 41.5% of sales during the same period of fiscal 2007. The decrease as a percent of sales was primarily due to sales gains, lower labor, stock-based compensation and advertising expense as a percent of sales, partially offset by significantly higher distributor discounts, and higher fuel costs.

The warehouse delivery segment's selling, marketing and administrative expenses were \$17.8 million, or 17.8% of sales during the second quarter of fiscal 2008, as compared to \$17.4 million, or 18.9% of sales during the second quarter of fiscal 2007. This decrease as a percent of sales was primarily attributable to lower labor, distribution and freezer storage costs, partially offset by higher rent costs.

*Depreciation and Amortization.* Depreciation and amortization expense was \$16.0 million for the second quarter of fiscal 2008, an increase of 6.1% from the second quarter of fiscal 2007, which was \$15.1 million.

The DSD segment's depreciation and amortization expense increased to \$12.2 million for the second quarter of fiscal 2008 from \$11.9 million in the same period of fiscal 2007. This increase was primarily the result of increased depreciation expense due to capital expenditures placed in service subsequent to the second quarter of fiscal 2007.

The warehouse delivery segment's depreciation and amortization expense increased to \$3.7 million for the second quarter of fiscal 2008 from \$3.2 million in the same period of fiscal 2007. This increase was primarily the result of increased depreciation expense due to capital expenditures placed in service subsequent to the second quarter of fiscal 2007.

*Gain on sale of assets.* During the second quarter of fiscal 2008 the company completed the sale and closure of a plant facility in Atlanta, Georgia resulting in a gain of \$2.3 million. The company incurred \$1.3 million of cost of goods sold expenses primarily for employee severance, obsolete inventory, and equipment relocation costs. An additional \$0.3 million is included in selling, marketing and administrative expenses.

*Gain on insurance recovery.* During fiscal 2007, the company recorded a gain related to insurance proceeds on a distribution facility destroyed by fire at its Lynchburg, Virginia location. An additional \$0.7 million related to insurance proceeds in excess of the net book value was received during the second quarter ended July 12, 2008. The receipt of these proceeds closed the claim.

*Income from operations.* Income from operations for the second quarter of fiscal 2008 was \$36.4 million, an increase of \$2.2 million from the \$34.2 million reported for the second quarter of fiscal 2007.

The improvement was primarily the result of improvements in the operating results of the DSD segment of \$2.9 million, partially offset by a decrease in the warehouse delivery segment of \$0.3 million and an increase in unallocated corporate expenses of \$0.4 million. The increase in the DSD segment was primarily attributable to higher sales, and improved manufacturing efficiencies. The increase in unallocated corporate expenses was primarily due to depreciation. The decrease in the warehouse delivery segment was primarily a result of higher commodity prices and secondarily to lower sales volume in foodservice.

*Net Interest Income.* For the second quarter of fiscal 2008, net interest income was \$2.7 million, an increase of \$0.8 million from the second quarter of fiscal 2007, which was \$1.9 million. The increase was related to lower interest expense due to lower average debt outstanding and increased interest income related to the sale of new territories to independent distributors.



*Income Taxes.* The effective tax rate for the second quarter of fiscal 2008 was 35.7% compared to 35.8% in the second quarter of the prior year. The difference in the effective rate and the statutory rate is primarily due to state income taxes, the non-taxable earnings of the consolidated variable interest entity and the Section 199 qualifying production activities deduction.

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*Minority Interest.* Minority interest represents all the earnings of the company's VIE under the consolidation provisions of FIN 46. All the earnings of the VIE are eliminated through minority interest due to the company not having any equity ownership in the VIE. The company is required to consolidate this VIE due to the VIE being capitalized with a less than substantive amount of legal form capital investment and the company accounting for a significant portion of the VIE's revenues. See Note 8 of Notes to Condensed Consolidated Financial Statements of this Form 10-Q for further information regarding the company's VIE.

TWENTY-EIGHT WEEKS ENDED JULY 12, 2008 COMPARED TO TWENTY-EIGHT WEEKS ENDED JULY 14, 2007

*Consolidated Sales.*

|                       | For the twenty-eight weeks<br>ended<br>July 12, 2008 |        | For the twenty-eight weeks<br>ended<br>July 14, 2007 |        | %<br>Increase |
|-----------------------|--|--------|--|--------|---------------|
|                       | \$<br>(Amounts in<br>thousands)                      | %      | \$<br>(Amounts in<br>thousands)                      | %      |               |
| Branded Retail        | \$ 652,985   | 53.6%  | \$ 569,245   | 52.3%  | 14.7%         |
| Store Branded Retail  | 164,102  | 13.5   | 141,379  | 13.0   | 16.1%         |
| Foodservice and Other | 400,276  | 32.9   | 377,161  | 34.7   | 6.1%          |
| Total                 | \$ 1,217,363   | 100.0% | \$ 1,087,785   | 100.0% | 11.9%         |

The 11.9% increase in sales was attributable to a favorable pricing/mix of 10.2% and unit volume increases of 1.7%. The 1.7% increase in volume resulted primarily from expansion markets. The increase in branded retail sales was due primarily to increases in pricing/mix and, to a lesser extent, volume increases. Brand soft variety and white bread were the key components of these sales. The company's *Nature's Own* products and its branded white bread labels were the key components of these sales. The increase in store branded retail sales was due to favorable pricing/mix and, to a lesser extent, volume increases. The increase in foodservice and other sales was due to favorable pricing/mix, partially offset by volume declines.

*Direct-Store-Delivery Sales.*

|                       | For the twenty-eight weeks<br>ended<br>July 12, 2008 |        | For the twenty-eight weeks<br>ended<br>July 14, 2007 |        | %<br>Increase |
|-----------------------|--|--------|--|--------|---------------|
|                       | \$<br>(Amounts in<br>thousands)                      | %      | \$<br>(Amounts in<br>thousands)                      | %      |               |
| Branded Retail        | \$ 594,227   | 59.7%  | \$ 517,271   | 59.1%  | 14.9%         |
| Store Branded Retail  | 136,590  | 13.7   | 116,575  | 13.3   | 17.2%         |
| Foodservice and Other | 263,866  | 26.6   | 241,380  | 27.6   | 9.3%          |
| Total                 | \$ 994,683   | 100.0% | \$ 875,226   | 100.0% | 13.6%         |

The 13.6% increase in sales was attributable to favorable pricing/mix of 11.2% and volume increases of 2.4%. The increase in branded retail sales was due to favorable pricing/mix and, to a lesser extent, volume increases. The volume increases were primarily the result of market expansions. *Nature's Own* products and branded white bread labels

were the key components of these sales. The increase in store branded retail sales was primarily due to favorable pricing/mix and, to a lesser extent, increased volume. The increase in foodservice and other sales was primarily due to pricing/mix.

*Warehouse Delivery Sales.*

|                       | For the twenty-eight weeks ended |        | For the twenty-eight weeks ended |        | % Increase (Decrease) |
|-----------------------|----------------------------------|--------|----------------------------------|--------|-----------------------|
|                       | July 12, 2008                    |        | July 14, 2007                    |        |                       |
|                       | \$                               | %      | \$                               | %      |                       |
|                       | (Amounts in thousands)           |        | (Amounts in thousands)           |        |                       |
| Branded Retail        | \$ 58,758                        | 26.4%  | \$ 51,974                        | 24.5%  | 13.1%                 |
| Store Branded Retail  | 27,512                           | 12.4   | 24,804                           | 11.7   | 10.9%                 |
| Foodservice and Other | 136,410                          | 61.2   | 135,781                          | 63.8   | 0.5%                  |
| Total                 | \$ 222,680                       | 100.0% | \$ 212,559                       | 100.0% | 4.8%                  |

The 4.8% increase in sales was attributable to favorable pricing/mix of 4.5% and increased volume of 0.3%. The increase in branded retail sales was primarily the result of favorable pricing/mix. The increase in store branded retail sales was primarily due to volume, partially offset by unfavorable pricing/mix. The increase in foodservice and other sales, which include contract production and vending, was due to favorable pricing/mix.

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*Gross Margin (defined as sales less materials, supplies, labor and other production costs, excluding depreciation, amortization and distributor discounts).* Gross margin for the twenty-eight weeks ended July 12, 2008 was \$573.8 million, or 7.1% higher than gross margin reported for the same period of the prior year of \$535.9 million. As a percent of sales, gross margin was 47.1% as compared to 49.3% for the prior year. This decrease as a percent of sales was primarily due to significantly higher ingredient costs, which were up 31% over the prior year, and \$1.7 million of costs related to the closure of the Atlanta, Georgia Snack facility, partially offset by sales gains, better stales control, and improved manufacturing efficiencies. The significantly higher ingredient costs were primarily driven by increases in flour costs.

The DSD segment's gross margin decreased to 51.6% of sales for the twenty-eight weeks ended July 12, 2008, compared to 54.0% of sales for the same period in the prior year. This decrease as a percent of sales was primarily due to the higher ingredient costs, partially offset by sales gains and better stales control, improved manufacturing efficiencies and lower labor costs as a percent of sales. The higher ingredient costs were driven primarily by higher flour costs.

The warehouse delivery segment's gross margin decreased to 27.4% of sales for the twenty-eight weeks ended July 12, 2008, compared to 29.9% of sales for the same period of fiscal 2007. This decrease as a percent of sales was primarily a result of the higher ingredient costs, partially offset by improved manufacturing efficiencies and lower labor, packaging, freezer storage and rent costs as a percent of sales. Also negatively impacting gross margin were costs of \$1.7 million relating to the sale and closure of the plant facility in Atlanta, Georgia as discussed above.

*Selling, Marketing and Administrative Expenses.* For the twenty-eight weeks ended July 12, 2008, selling, marketing and administrative expenses were \$449.3 million, or 36.9% of sales as compared to \$421.6 million, or 38.8% of sales reported for the same period of fiscal 2007. This decrease as a percent of sales was due to sales gains and lower labor, distribution, and advertising expense as a percent of sales, partially offset by higher distributor discounts and higher fuel costs. Sales gains and the sale of certain routes to independent distributors resulted in the increase in distributor discounts. The \$3.8 million decrease in stock-based compensation was the result of the company's higher stock appreciation rights expense during the first two quarters of fiscal 2007, partially offset by the issuance of new stock option and restricted stock awards during the first quarter of fiscal 2008. See Note 11 of Notes to Condensed Consolidated Financial Statements of this Form 10-Q for further information regarding the company's stock-based compensation.

The DSD segment's selling, marketing and administrative expenses include discounts paid to the independent distributors utilized in our DSD system. The DSD segment's selling, marketing and administrative expenses were \$395.6 million, or 39.8% of sales during the twenty-eight weeks ended July 12, 2008, as compared to \$365.9 million, or 41.8% of sales during the same period of fiscal 2007. The decrease as a percent of sales was primarily due to sales gains, lower labor, stock-based compensation and advertising expense as a percent of sales, partially offset by significantly higher distributor discounts and rising fuel costs.

The warehouse delivery segment's selling, marketing and administrative expenses were \$40.2 million, or 18.0% of sales during the twenty-eight weeks ended July 12, 2008, as compared to \$41.2 million, or 19.4% of sales during the same period of fiscal 2007. This decrease as a percent of sales was primarily attributable to lower labor, advertising and distribution costs as a percent of sales.

*Depreciation and Amortization.* Depreciation and amortization expense was \$36.9 million for the twenty-eight weeks ended July 12, 2008, an increase of 4.9% from the same period of fiscal 2007, which was \$35.2 million.

The DSD segment's depreciation and amortization expense increased to \$28.1 million for the twenty-eight weeks ended July 12, 2008 from \$27.8 million in the same period of fiscal 2007. This increase was primarily the result of increased depreciation expense due to capital expenditures placed in service subsequent to the second quarter of fiscal 2007.

The warehouse delivery segment's depreciation and amortization expense increased to \$8.4 million for the twenty-eight weeks ended July 12, 2008 from \$7.5 million in the same period of fiscal 2007. This increase was primarily the result of increased depreciation expense due to capital expenditures placed in service subsequent to the second quarter of fiscal 2007.

*Gain on sale of assets.* During the second quarter the company completed the sale and closure of a plant facility in Atlanta, Georgia resulting in a gain of \$2.3 million. The company incurred \$1.7 million of cost of goods sold expenses primarily for employee severance, obsolete inventory, and equipment relocation costs. Costs of \$0.3 million is included in selling, marketing and administrative expenses relating to the sale and closure.

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*Gain on insurance recovery.* During fiscal 2007, the company recorded a gain related to insurance proceeds on a distribution facility destroyed by fire at its Lynchburg, Virginia location. An additional \$0.7 million related to insurance proceeds in excess of the net book value was received during the twenty-eight weeks ended July 12, 2008. The payment closed the claim.

*Income from operations.* Income from operations for the twenty-eight weeks ended July 12, 2008 was \$90.5 million, an increase of \$11.4 million from the \$79.1 million reported for the same period of fiscal 2007.

The improvement was primarily the result of improvements in the operating results of the DSD segment of \$11.2 million and a decrease in unallocated corporate expenses of \$0.4 million, partially offset by a decrease in the warehouse delivery segment of \$0.2 million. The increase in the DSD segment was primarily attributable to higher sales, better sales control and improved manufacturing efficiencies. The decrease in unallocated corporate expenses was primarily due to lower stock based compensation discussed above. The decrease in the warehouse delivery segment was primarily a result of higher commodity prices and secondarily to lower sales volume in foodservice.

*Net Interest Income.* For the twenty-eight weeks ended July 12, 2008, net interest income was \$6.2 million, an increase of \$2.3 million from the same period of fiscal 2007, which was \$3.9 million. The increase was related to lower interest expense due to lower average debt outstanding and increased interest income related to the sale of new territories to independent distributors.

*Income Taxes.* The effective tax rate for the twenty-eight weeks ended July 12, 2008 was 35.7% compared to 35.5% in the same period of the prior year. The difference in the effective rate and the statutory rate is primarily due to state income taxes, the non-taxable earnings of the consolidated variable interest entity and the Section 199 qualifying production activities deduction.

*Minority Interest.* Minority interest represents all the earnings of the company's VIE under the consolidation provisions of FIN 46. All the earnings of the VIE are eliminated through minority interest due to the company not having any equity ownership in the VIE. The company is required to consolidate this VIE due to the VIE being capitalized with a less than substantive amount of legal form capital investment and the company accounting for a significant portion of the VIE's revenues. See Note 8 of Notes to Condensed Consolidated Financial Statements of this Form 10-Q for further information regarding the company's VIE.

**LIQUIDITY AND CAPITAL RESOURCES:**

Liquidity represents our ability to generate sufficient cash flows from operating activities to meet our obligations and commitments as well as our ability to obtain appropriate financing and convert into cash those assets that are no longer required to meet existing strategic and financing objectives. Therefore, liquidity cannot be considered separately from capital resources that consist primarily of current and potentially available funds for use in achieving long-range business objectives. Currently, the company's liquidity needs arise primarily from working capital requirements, capital expenditures and stock repurchases. The company's strategy for use of its cash flow includes paying dividends to shareholders, making acquisitions, growing internally and repurchasing shares of its common stock when appropriate.

**Cash Flows**

Flowers Foods' cash and cash equivalents decreased to \$19.5 million at July 12, 2008 from \$20.0 million at December 29, 2007. The decrease resulted from \$56.1 million provided by operating activities, offset by \$41.7 million and \$14.8 million disbursed for investing activities and financing activities, respectively.

*Cash Flows Provided by Operating Activities.* Net cash of \$56.1 million provided by operating activities during the twenty-eight weeks ended July 12, 2008 consisted primarily of \$59.7 million in net income, adjusted for the following non-cash items (amounts in thousands):

|   |           |
|---|-----------|
| Depreciation and amortization                 | \$ 36,945 |
| Stock-based compensation                      | 6,678     |
| Deferred income taxes                         | (2,232)   |
| Provision for inventory obsolescence          | 492       |
| Allowances for accounts receivable            | 901       |
| Minority interest in variable interest entity | 2,438     |

|       |           |
|-------|-----------|
| Other | (2,467)   |
| Total | \$ 42,755 |

Cash disbursed for working capital and other activities was \$46.4 million.

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*Cash Flows Disbursed for Investing Activities.* Net cash disbursed for investing activities during the twenty-eight weeks ended July 12, 2008 of \$41.7 million consisted primarily of capital expenditures of \$42.0 million. Capital expenditures in the DSD segment and the warehouse delivery segment were \$33.2 million and \$7.7 million, respectively. The company estimates capital expenditures of approximately \$95.0 million to \$100.0 million during fiscal 2008. The company also leases certain production machinery and equipment through various operating leases.

*Cash Flows Disbursed for Financing Activities.* Net cash disbursed for financing activities of \$14.8 million during the twenty-eight weeks ended July 12, 2008 consisted primarily of dividends paid of \$25.4 million, stock repurchases of \$5.8 million, partially offset by debt proceeds of \$3.2 million and proceeds of \$2.4 million from the exercise of stock options.

**Credit Facility**

The company has a five-year, \$250.0 million unsecured revolving loan facility (the credit facility) that expires October 5, 2012. The company may request to increase its borrowings under the credit facility up to an aggregate of \$350.0 million upon the satisfaction of certain conditions. Proceeds from the credit facility may be used for working capital and general corporate purposes, including acquisition financing, refinancing of indebtedness and share repurchases. The credit facility includes certain customary restrictions, which, among other things, require maintenance of financial covenants and limit encumbrance of assets and creation of indebtedness. Restrictive financial covenants include such ratios as a minimum interest coverage ratio and a maximum leverage ratio. The company believes that, given its current cash position, its cash flow from operating activities and its available credit capacity, it can comply with the current terms of the credit facility and can meet presently foreseeable financial requirements. As of July 12, 2008 and December 29, 2007, the company was in compliance with all restrictive financial covenants under its credit facility.

Interest is due quarterly in arrears on any outstanding borrowings at a customary Eurodollar rate or the base rate plus the applicable margin. The underlying rate is defined as rates offered in the interbank Eurodollar market or the higher of the prime lending rate or federal funds rate plus 0.5%. The applicable margin ranges from 0.00% to 0.30% for base rate loans and from 0.40% to 1.275% for Eurodollar loans. In addition, a facility fee ranging from 0.10% to 0.35% is due quarterly on all commitments under the credit facility. Both the interest margin and the facility fee are based on the company's leverage ratio. There were \$6.0 million in outstanding borrowings under the credit facility at July 12, 2008 and no outstanding borrowings under the credit facility at December 29, 2007. Subsequent to the end of the second quarter of fiscal 2008, the company borrowed \$19.6 million under the credit facility to partially fund the acquisitions of ButterKrust and Holsum that closed during the third quarter of fiscal 2008. As of August 15, 2008 the amount outstanding under the credit facility was \$15 million.

The company paid financing costs of \$0.3 million during fiscal 2007 in connection with an amendment of its credit facility. These costs, along with unamortized financing costs on the company's former credit facility of \$0.6 million, were deferred and are being amortized over the term of the credit facility.

Currently, the company's credit ratings by Standard and Poor's and Fitch Ratings are BBB- and BBB, respectively. During the first quarter of fiscal 2008, Moody's Investor Services revised the company's credit rating up to Baa2. Changes in the company's credit ratings do not trigger a change in the company's available borrowings or costs under the credit facility, but could affect future credit availability.

On August 1, 2008, the company entered into a Credit Agreement (term loan) with various lending parties. The term loan provides for borrowings through the maturity date of August 4, 2013 for the purpose of completing acquisitions. The maximum amount permitted to be outstanding under the term loan is \$150 million. The term loan includes certain customary restrictions, which, among other things, require maintenance of financial covenants and limit encumbrance of assets and creation of indebtedness. Restrictive financial covenants include such ratios as a minimum interest coverage ratio and a maximum leverage ratio. The company believes that, given its current cash position, its cash flow from operating activities and its available credit capacity, it can comply with the current terms of the term loan and can meet presently foreseeable financial requirements. As of August 15, 2008, the amount outstanding under the term loan was \$150 million.

Interest is due quarterly in arrears on any outstanding borrowings at a customary Eurodollar rate or the base rate plus the applicable margin. The underlying rate is defined as the rate offered in the interbank Eurodollar market or the



higher of the prime lending rate or federal funds rate plus 0.5%. The applicable margin ranges from 0.0% to 1.375% for base rate loans and from 0.875% to 2.375% for Eurodollar loans and is based on the company's leverage ratio. Principal payments are due quarterly under the term loan beginning on December 31, 2008 at an annual amortization of 10% of the then outstanding principal balance for the first two years, 15% during the third year, 20% during the

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fourth year, and 45% during the fifth year until the maturity date when the balance is due. The company will also pay legal, accounting and other fees and expenses in connection with the term loan, which will be amortized over the life of the term loan.

**Uses of Cash**

On February 8, 2008, the board of directors declared a dividend of \$0.125 per share on the company's common stock that was paid on March 7, 2008 to shareholders of record on February 22, 2008. This dividend payment was \$11.6 million.

On May 30, 2008, the board of directors declared a dividend of \$0.15 per share on the company's common stock that was paid on June 27, 2008 to shareholders of record on June 13, 2008. This dividend payment was \$13.8 million.

On December 19, 2002, the board of directors approved a plan that authorized stock repurchases of up to 16.9 million shares of the company's common stock. On November 18, 2005, the board of directors further increased the number of authorized shares to 22.9 million shares. On February 8, 2008, the board of directors increased the number of authorized shares to 30.0 million shares. Under the plan, the company may repurchase its common stock in open market or privately negotiated transactions at such times and at such prices as determined to be in the company's best interest. These purchases may be commenced or suspended without prior notice depending on then-existing business or market conditions and other factors. During the twenty-eight weeks ended July 12, 2008, 256,248 shares, at a cost of \$5.8 million, of the company's common stock were purchased under the plan. From the inception of the plan through July 12, 2008, 19.4 million shares, at a cost of \$286.2 million, have been purchased under the plan.

During the first quarter of fiscal 2008, the company paid \$21.9 million in performance-based cash awards under the company's bonus plan.

On June 23, 2008, the company announced it has entered into a definitive merger agreement with Holsum Bakery, Inc. The acquisition was completed on August 11, 2008. Consideration was paid in cash and company stock for approximately \$150 million of which 50% is in cash and 50% in company stock, less certain obligations of Holsum Bakery, Inc.

On June 26, 2008, the company announced it executed a definitive agreement to acquire ButterKrust Bakery. The acquisition was completed on August 4, 2008. Consideration was paid in cash for \$90 million, less certain indebtedness and other payments.

On August 1, 2008, the company secured a term loan for \$150 million for a portion of the cash consideration for the acquisitions of ButterKrust Bakery and Holsum Bakery, Inc.

**NEW ACCOUNTING PRONOUNCEMENTS:**

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS No. 157). SFAS No. 157 establishes a common definition for fair value to be applied to U.S. GAAP requiring use of fair value, establishes a framework for measuring fair value, and expands disclosure about such fair value measurements. SFAS No. 157 is effective for financial assets and financial liabilities for fiscal years beginning after November 15, 2007. The implementation of SFAS No. 157 for financial assets and financial liabilities, effective January 1, 2008, did not have a material impact on our consolidated financial position and results of operations. Please refer to Note 5, *Derivative Financial Instruments* for a detailed discussion.

In December 2007, the FASB issued SFAS No. 141(revised 2007), *Business Combinations* (SFAS No. 141R). SFAS No. 141R provides revised guidance on how acquirors recognize and measure the consideration transferred, identifiable assets acquired, liabilities assumed, noncontrolling interests, and goodwill acquired in a business combination. SFAS No. 141R also expands required disclosures surrounding the nature and financial effects of business combinations. SFAS No. 141R is effective, on a prospective basis, for fiscal years beginning after December 15, 2008. The Company is currently assessing the impact of SFAS No. 141R on its consolidated financial position and results of operations.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements* (SFAS No. 160). SFAS No. 160 establishes requirements for ownership interests in subsidiaries held by parties other than the company (sometimes called *minority interests*) be clearly identified, presented, and disclosed in the consolidated statement of financial position within equity, but separate from the parent's equity. All changes in the parent's ownership interests are required to be accounted for consistently as equity transactions and any noncontrolling

equity investments in unconsolidated subsidiaries must be measured initially at fair value. SFAS No. 160 is effective, on a prospective basis, for fiscal years beginning after December 15, 2008.

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However, presentation and disclosure requirements must be retrospectively applied to comparative financial statements. The company is currently assessing the impact of SFAS No. 160 on its consolidated financial position and results of operations.

In March 2008, the FASB issued SFAS No. 161, Disclosures About Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 (SFAS No. 161). SFAS No. 161 expands quarterly disclosure requirements in SFAS No. 133 about an entity's derivative instruments and hedging activities. SFAS No. 161 is effective for fiscal years beginning after November 15, 2008. The company is currently evaluating the requirements of SFAS No. 161. The adoption of SFAS No. 161 is not expected to have an impact on the company's financial position, results of operations or cash flows as the pronouncement addresses disclosure requirements only.

In May 2008, the FASB issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles (SFAS 162). SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles. SFAS 162 is effective 60 days following the Securities and Exchange Commission's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles. We do not anticipate that the adoption of SFAS 162 will materially impact the company.

In June 2008, the FASB issued FSP EITF No. 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities. The FSP addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and therefore need to be included in the earnings allocation in calculating earnings per share under the two-class method described in SFAS No. 128, Earnings per Share. The FSP requires companies to treat unvested share-based payment awards that have non-forfeitable rights to dividend or dividend equivalents as a separate class of securities in calculating earnings per share. The FSP is effective for fiscal years beginning after December 15, 2008; earlier application is not permitted. The company does not expect adoption of FSP EITF No. 03-6-1 to have a material effect on its results of operations or earnings per share.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

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

**COMMODITY PRICE RISK**

The company enters into commodity forward, futures and option contracts and swap agreements for wheat and, to a lesser extent, other commodities in an effort to provide a predictable and consistent commodity price and thereby reduce the impact of market volatility in its raw material and packaging prices. As of July 12, 2008, the company's hedge portfolio contained commodity derivatives with a fair value of \$13.9 million.

A sensitivity analysis has been prepared to quantify the company's potential exposure to commodity price risk with respect to its derivative portfolio. Based on the company's derivative portfolio as of July 12, 2008, a hypothetical ten percent increase (decrease) in commodity prices would increase (decrease) the fair value of the derivative portfolio by \$23.1 million. The analysis disregards changes in the exposures inherent in the underlying hedged items; however, the company expects that any increase (decrease) in fair value of the portfolio would be substantially offset by increases (decreases) in raw material and packaging prices.

**INTEREST RATE RISK**

On July 9, 2008, the company entered an interest rate swap with a notional amount of \$85.0 million to fix the interest rate on a portion of the \$150 million term loan that is being secured to fund the acquisition of ButterKrust Bakery and Holsum Bakery, Inc. As of July 12, 2008, the fair value of this interest rate swap was \$(0.1) million.

A sensitivity analysis has been prepared to quantify the company's potential exposure to interest rate risk with respect to the interest rate swap. As of July 12, 2008, a hypothetical ten percent increase (decrease) in interest rates would increase (decrease) the fair value of the interest rate swap by \$1.0 million. The analysis disregards changes in the exposures inherent in the underlying debt;



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however, the company expects that any increase (decrease) in payments under the interest rate swap would be substantially offset by increases (decreases) in interest expense.

**ITEM 4. CONTROLS AND PROCEDURES****Management's Evaluation of Disclosure Controls and Procedures**

We have established and maintain a system of disclosure controls and procedures that are designed to ensure that material information relating to the company, which is required to be timely disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934, as amended (the Exchange Act), is accumulated and communicated to management in a timely fashion and is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms. An evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) was performed as of the end of the period covered by this quarterly report. This evaluation was performed under the supervision and with the participation of management, including our Chief Executive Officer (CEO), Chief Financial Officer (CFO) and Chief Accounting Officer (CAO). Based upon that evaluation, our CEO, CFO and CAO have concluded that these disclosure controls and procedures were effective as of the end of the period covered by this quarterly report.

**Changes in Internal Control Over Financial Reporting**

There were no changes in our internal control over financial reporting that occurred during our fiscal quarter ended July 12, 2008 that have materially affected or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

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

The company's facilities are subject to various federal, state and local laws and regulations regarding the discharge of material into the environment and the protection of the environment in other ways. The company is not a party to any material proceedings arising under these regulations. The company believes that compliance with existing environmental laws and regulations will not materially affect the consolidated financial condition or the competitive position of the company. The company is currently in substantial compliance with all material environmental regulations affecting the company and its properties.

**ITEM 1A. RISK FACTORS**

Please refer to Part I, Item 1A., *Risk Factors*, in the company's Form 10-K for the year ended December 29, 2007 for information regarding factors that could affect the company's results of operations, financial condition and liquidity. There have been no changes to our risk factors during the second quarter of fiscal 2008.

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

On December 19, 2002 our board of directors approved a plan that authorized stock repurchases of up to 16.9 million shares of the company's common stock. On November 18, 2005, the board of directors increased the number of authorized shares to 22.9 million shares. On February 8, 2008, the board of directors further increased the number of authorized shares to 30.0 million shares. Under the plan, the company may repurchase its common stock in open market or privately negotiated transactions at such times and at such prices as determined to be in the company's best interest. These purchases may be commenced or suspended without prior notice

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depending on then-existing business or market conditions and other factors. The company did not repurchase any of its common stock under the repurchase plan during the second quarter of fiscal 2008.

Certain of our employees who participate in the Company's 401(k) Retirement Savings Plan were inadvertently permitted to purchase in the open market approximately 658,000 shares of the Company's common stock that were not registered for purchase by the Plan utilizing a registration statement on Form S-8 under the Securities Act of 1933 from July 2005 through June 2008. All the shares were purchased by the trustee of our 401(k) Plan on behalf of participants through open market purchases and the Company received no proceeds from these transactions. In such situations, a number of remedies may be available to regulatory authorities and the employees who purchased the common stock, including, without limitation, a right of rescission and other damages that could be imposed by regulatory authorities. Pursuant to the rescissionary rights, employees may be entitled to return their shares to the Company and receive back from us the full price they paid, plus interest. The rescissionary rights lapse on various dates as prescribed in the federal securities laws. Based on our current stock price, we believe that our current potential liability for rescission claims is not material to our consolidated financial balance sheet, statements of income or cash flows; however, our potential liability could become material in the future if our stock price were to fall below participants' acquisition prices for their interest in our common stock.

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

The company's Annual Meeting of Shareholders was held on May 30, 2008 in Thomasville, Georgia for the following purposes and with the following voting results:

(1) To elect four nominees as directors of the company to serve for a term of three years:

| Class I Directors:       | For        | Withheld   | Broker-Non<br>Votes |
|--------------------------|------------|------------|---------------------|
| Benjamin H. Griswold, IV | 69,226,918 | 18,486,798 |                     |
| Joseph L. Lanier, Jr.    | 69,211,217 | 18,502,499 |                     |
| Jackie M. Ward           | 67,860,209 | 19,853,507 |                     |
| C. Martin Wood III       | 69,228,019 | 18,485,697 |                     |

(2) To approve an amendment to the company's Restated Articles of Incorporation to increase the number of authorized shares of common stock to 500,000,000.

|                  |            |
|------------------|------------|
| For              | 52,309,755 |
| Against          | 34,239,499 |
| Abstain          | 151,691    |
| Broker Non-Votes | 0          |

(3) To ratify the selection of PricewaterhouseCoopers LLP to serve as the independent registered public accounting firm for Flowers Foods for the fiscal year ending January 3, 2009.

|                  |            |
|------------------|------------|
| For              | 84,826,760 |
| Against          | 1,797,359  |
| Abstain          | 76,826     |
| Broker Non-Votes | 0          |

Director-nominees received a plurality of votes cast in the election of directors and were elected to serve until 2011. Proposal 2 received the affirmative vote of a majority of the outstanding shares of common stock and passed and Proposal 3 received a majority of votes cast and passed.

**ITEM 6. EXHIBITS**

Exhibits filed as part of this report are listed in the Exhibit Index attached hereto.

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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.

FLOWERS FOODS, INC.

By: /s/ GEORGE E. DEESE

Name: George E. Deese

Title: *Chairman of the Board, President and  
Chief Executive Officer*

By: /s/ R. STEVE KINSEY

Name: R. Steve Kinsey

Title: *Executive Vice President and  
Chief Financial Officer*

By: /s/ KARYL H. LAUDER

Name: Karyl H. Lauder

Title: *Senior Vice President and  
Chief Accounting Officer*

Date: August 21, 2008



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**EXHIBIT INDEX**

**Exhibit**

| <b>No.</b> | <b>Name of Exhibit</b>  |
|------------|---|
| 2.1        | Distribution Agreement by and between Flowers Industries, Inc. and Flowers Foods, Inc., dated as of October 26, 2000 (Incorporated by reference to Flowers Foods Registration Statement on Form 10, dated February 9, 2001, File No. 1-16247).  |
| 2.2        | Amendment No. 1 to Distribution Agreement, dated as of March 12, 2001, between Flowers Industries, Inc. and Flowers Foods, Inc. (Incorporated by reference to Flowers Foods Annual Report on Form 10-K, dated March 30, 2001, File No. 1-16247).  |
| 3.1        | Restated Articles of Incorporation of Flowers Foods, Inc. as amended on June 1, 2007 (Incorporated by reference to Flowers Foods Quarterly Report on Form 10-Q, dated August 23, 2007, File No. 1-16247).   |
| 3.2        | Amended and Restated Bylaws of Flowers Foods, Inc. as amended on February 8, 2008 (Incorporated by reference to Flowers Foods Current Report on Form 8-K/A dated February 25, 2008, File No. 1-16247).  |
| 3.3        | Articles of Amendment to the Restated Articles of Incorporation of Flowers Foods, Inc. (Incorporated by reference to Flowers Foods Current Report on Form 8-K dated June 2, 2008, File No. 1-16247).  |
| 4.1        | Share Certificate of Common Stock of Flowers Foods, Inc. (Incorporated by reference to Flowers Foods Annual Report on Form 10-K, dated March 30, 2001, File No. 1-16247).   |
| 4.2        | Rights Agreement between Flowers Foods, Inc. and First Union National Bank, as Rights Agent, dated March 23, 2001 (Incorporated by reference to Flowers Foods Annual Report on Form 10-K, dated March 30, 2001, File No. 1-16247).  |
| 4.3        | Amendment No. 1, dated November 15, 2002, to Rights Agreement between Flowers Foods, Inc. and Wachovia Bank, N.A. (as successor in interest to First Union National Bank), as rights agent, dated March 23, 2001. (Incorporated by reference to Flowers Foods Registration Statement on Form 8-A, dated November 18, 2002, File No. 1-16247). |
| 10.1       | Flowers Foods, Inc. Retirement Plan No. 1 (Incorporated by reference to Flowers Foods Annual Report on Form 10-K, dated March 30, 2001, File No. 1-16247).  |
| 10.2       | Flowers Foods, Inc. 2001 Equity and Performance Incentive Plan, as amended and restated as of February 11, 2005 (Incorporated by reference to Flowers Foods Proxy Statement on Schedule 14A, dated April 29, 2005, File No. 1-16247).   |
| 10.3       | Flowers Foods, Inc. Stock Appreciation Rights Plan. (Incorporated by reference to Flowers Foods Annual Report on Form 10-K, dated March 27, 2002, File No. 1-16247).  |
| 10.4       | Flowers Foods, Inc. Annual Executive Bonus Plan. (Incorporated by reference to Flowers Foods Annual Report on Form 10-K, dated March 27, 2002, File No. 1-16247).   |

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- 10.5 First Amendment to the Flowers Foods, Inc. Annual Executive Bonus Plan. (Incorporated by reference to Flowers Foods Annual Report on Form 10-K, dated February 27, 2008, File No. 1-16247).
- 10.6 Flowers Foods, Inc. Supplemental Executive Retirement Plan. (Incorporated by reference to Flowers Foods Annual Report on Form 10-K, dated March 27, 2002, File No. 1-16247).
- 10.7 Form of Indemnification Agreement, by and between Flowers Foods, Inc., certain executive officers and the directors of Flowers Foods, Inc. (Incorporated by reference to Flowers Foods Annual Report on Form 10-K, dated March 28, 2003, File No. 1-16247).
- 10.8 Form of Separation Agreement, by and between Flowers Foods, Inc. and certain executive officers of Flowers Foods, Inc. (Incorporated by reference to Flowers Foods Annual Report on Form 10-K dated March 1, 2006, File No. 1-16247).
- 10.9 Ninth Amendment dated November 7, 2005 to the Flowers Foods, Inc. Retirement Plan No. 1 as Amended and restated effective as of March 26, 2001. (Incorporated by reference to Flowers Foods Quarterly Report on Form 10-Q dated November 17, 2005, File No. 1-16247).
- 10.10 Form of Restricted Stock Agreement, by and between Flowers Foods, Inc. and certain executive officers of Flowers Foods, Inc. (Incorporated by reference to Flowers Foods Annual Report on Form 10-K dated March 1, 2006, File No. 1-16247).
- 10.11 Form of 2008 Restricted Stock Agreement, by and between Flowers Foods, Inc. and certain executive officers of Flowers Foods, Inc. (Incorporated by reference to Flowers Foods Annual Report on Form 10-K dated February 27, 2008, File No. 1-16247).

**Table of Contents****Exhibit**

| <b>No.</b> | <b>Name of Exhibit</b>  |
|------------|---|
| 10.12      | Form of Option Agreement, by and between Flowers Foods, Inc. and certain executive officers of Flowers Foods, Inc. (Incorporated by reference to Flowers Foods Annual Report on Form 10-K dated March 1, 2006, File No. 1-16247).   |
| 10.13      | Form of 2008 Option Agreement, by and between Flowers Foods, Inc. and certain executive officers of Flowers Foods, Inc. (Incorporated by reference to Flowers Foods Annual Report on Form 10-K dated February 27, 2008, File No. 1-16247).  |
| 10.14      | Amended and Restated Credit Agreement, dated as of June 6, 2006, among Flowers Foods, Inc., the Lenders Party thereto from time to time, Bank of America N.A., Harris N.A. and Cooperative Centrale Raiffeisen-Boerenleen Bank, B.A., Rabsbank International, New York Branch, as co-documentation agents, SunTrust Bank, as syndication agent, and Deutsche Bank AG, New York Branch, as administrative agent. (Incorporated by reference to Flowers Foods Current Report on Form 8-K dated June 7, 2006, File No. 1-16247). |
| 10.15      | First Amendment dated August 25, 2006 to the Flowers Foods, Inc. 2001 Equity and Performance Incentive Plan, as previously amended and restated as of February 11, 2005. (Incorporated by reference to Flowers Foods Annual Report on Form 10-K dated February 28, 2007, File No. 1-16247).   |
| 10.16      | Second Amendment dated January 2, 2007 to the Flowers Foods, Inc. 2001 Equity and Performance Incentive Plan, as previously amended and restated as of February 11, 2005. (Incorporated by reference to Flowers Foods Annual Report on Form 10-K dated February 28, 2007, File No. 1-16247).  |
| 10.17      | Third Amendment dated January 23, 2007 to the Flowers Foods, Inc. 2001 Equity and Performance Incentive Plan, as previously amended and restated as of February 11, 2005. (Incorporated by reference to Flowers Foods Annual Report on Form 10-K dated February 28, 2007, File No. 1-16247).  |
| 10.18      | Fourth Amendment to the Flowers Foods, Inc. 2001 Equity and Performance Incentive Plan, as previously amended and restated as of February 11, 2005. (Incorporated by reference to Flowers Foods Annual Report on Form 10-K dated February 27, 2008, File No. 1-16247).  |
| 10.19      | Employment Agreement, effective September 15, 2007, by and between Flowers Foods, Inc. and Jimmy M. Woodward. (Incorporated by reference to Flowers Foods Current Report on Form 8-K dated August 31, 2007, File No. 1-16247).  |
| 10.20      | First Amendment and Waiver, dated October 5, 2007, among Flowers Foods, Inc., a Georgia corporation, the lenders party to the Credit Agreement and Deutsche Bank AG New York Branch, as Administrative Agent. (Incorporated by reference to Flowers Foods Current Report on Form 8-K dated October 11, 2007, File No. 1-16247).   |
| 10.21      | Agreement and Plan of Merger, dated June 23, 2008, by and among, Flowers Foods, Inc., Peachtree Acquisition Co., LLC, Holsum Bakery, Inc., Lloyd Edward Eisele, Jr. and The Lloyd Edward Eisele, Jr. Revocable Trust (Incorporated by reference to Flowers Foods Current Report on  |

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Form 8-K/A dated June 25, 2008, File No. 1-16247).

- 10.22 Credit Agreement, dated as of August 1, 2008, among Flowers Foods, Inc., the Lenders Party thereto from time to time, Bank of America N.A., Cooperative Centrale Raiffeisen-Boerenleen Bank, B.A., Rabobank International, New York Branch, and Branch Banking & Trust Company as co-documentation agents, SunTrust Bank, as syndication agent, and Deutsche Bank AG, New York Branch, as administrative agent (Incorporated by reference to Flowers Foods Current Report on Form 8-K dated August 6, 2008, File No. 1-16247).
- \*21 Subsidiaries of Flowers Foods, Inc.
- \*31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- \*31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- \*31.3 Certification of Chief Accounting Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- \*32 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, by George E. Deese, Chief Executive Officer, R. Steve Kinsey, Chief Financial Officer and Karyl H. Lauder, Chief Accounting Officer for the Quarter Ended July 12, 2008.

\* Filed herewith