CALLOWAYS NURSERY INC
Form 10-Q
February 13, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended December 31, 2003
Commission File No. 0-19305

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

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

4200 Airport Freeway

Fort Worth, Texas 76117-6200
817.222.1122
(Address, including zip code, of principal executive offices and Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).
YES NO x

6,961,890 shares of the Registrant's Common Stock, $.01 par value, were outstanding as of February 13, 2004.

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FORWARD-LOOKING STATEMENTS OR INFORMATION

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

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

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

Part 1. FINANCIAL INFORMATION
Item 1. Financial Statements

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

	December 31, 2003	September 30, 2003	December 31, 2002
Cash and cash equivalents	$1,881	$1,921	$2,186
Accounts receivable	90	232	92
Inventories	3,300	4,802	2,695
Prepaids and other assets	78	19	169
Deferred income taxes, current	--	--	1,117
Income taxes receivable	--	--	119
Current assets of discontinued operations	--	--	3,361
Total current assets	5,349	6,974	9,739
Property and equipment, net	10,715	10,841	11,183
Goodwill, net	--	--	631
Deferred income taxes	--	--	1,568
Other assets	175	182	204
Total assets	$16,239	$17,997	$23,325

LIABILITIES AND SHAREHOLDERS' EQUITY

	December 31, 2003	September 30, 2003	December 31, 2002
Accounts payable	$2,784	$2,919	$3,522
Accrued expenses	1,552	2,368	1,968
Current portion of long-term debt	472	474	509
Non-voting preferred stock, with mandatory redemption provisions	3,067	2,949	--
Current liabilities of discontinued operations	--	--	329
Total current liabilities	7,875	8,710	6,328
Deferred rent payable	602	641	753
Long-term debt, net of current portion	6,593	6,695	8,148
Total liabilities	15,070	16,046	15,229
Commitments and contingencies			
Non-voting preferred stock, with			

mandatory redemption provisions	2,641	--	--
Shareholders' equity:			
Common stock	72	72	69
Additional paid-in capital	10,220	10,201	9,966
Accumulated deficit	(7,727)	(6,926)	(3,184)
	2,565	3,347	6,851
Less: Treasury stock, at cost	(1,396)	(1,396)	(1,396)
Total shareholders' equity	1,169	1,951	5,455
Total liabilities and shareholders' equity	$16,239	$17,997	$23,325

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CALLOWAY'S NURSERY, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
(amounts in thousands, except per share amounts)

	Three Months Ended December 31, 2003	2002
Net sales	$10,949	$10,848
Cost of goods sold	6,024	6,456
Gross profit	4,925	4,392
Operating expenses	3,895	4,198
Occupancy expenses	783	786
Advertising expenses	574	555
Depreciation and amortization	126	177
Interest expense	286	200
Interest income	(4)	(4)
Total expenses	5,660	5,912
Loss from continuing operations before income taxes	(735)	(1,520)
Income tax expense (benefit)	66	(602)
Loss from continuing operations	(801)	(918)
Loss from discontinued operations	--	(386)
Net loss	(801)	(1,304)
Accretion of preferred stock	--	(103)
Net loss attributable to common shareholders	($801)	($1,407)
Weighted average number of common shares outstanding - basic and diluted	6,956	6,569
Net loss per common share - basic and diluted		
Loss from continuing operations	($.12)	($.15)

Loss from discontinued operations	--	($.06)
Net loss	($.12)	($.21)

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

	Three Months Ended December 31, 2003	2002
Cash flows from operating activities:		
Net loss	($801)	($1,304)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Loss from discontinued operations (net of tax)	--	386
Depreciation and amortization	126	177
Accretion of preferred stock included in interest expense	118	--
Net change in operating assets and liabilities	602	1,345
Net cash provided by operating activities	45	604
Cash flows from investing activities:		
Additions to property and equipment	--	(18)
Net cash used for investing activities	--	(18)
Cash flows from financing activities:		
Proceeds from issuance of common stock	19	82
Repayments of debt	(104)	(90)
Net cash used for financing activities	(85)	(8)
Net increase (decrease) in cash and cash equivalents from continuing operations	(40)	578
Net decrease in cash and cash equivalents from discontinued operations	--	(867)
Net decrease in cash and cash equivalents	(40)	(289)
Cash and cash equivalents at beginning of period	1,921	2,475
Cash and cash equivalents at end of period	$1,881	$2,186

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

1. Liquidity and Going Concern

The accompanying condensed consolidated financial statements have been prepared assuming that the Company will continue as a going concern. The Company incurred a net loss for each of the fiscal years ended September 30, 2003, 2002 and 2001. In addition, the Company has $3.4 million of preferred stock which becomes mandatorily redeemable in September 2004.

Management believes that the Company will generate funds which will contribute to its ability to redeem the preferred stock because it has disposed of its unprofitable wholesale and growing operations and instituted tighter controls over (i) expenses, (ii) inventory and (iii) capital expenditures. However, there can be no assurance that these steps will generate sufficient funds to redeem the preferred stock by September 2004. In such event, the Company may take further actions, including the sale and/or refinancing of property and equipment, to generate funds. However, there can be no assurance that these further actions will generate sufficient funds to redeem the preferred stock by September 2004.

Furthermore, the Company's line of credit has been modified as a result of noncompliance with certain financial covenants at September 30, 2003. This line of credit expires on May 28, 2004. Management does not expect to be able to renew the line of credit with the current bank upon its expiration. Also, if certain financial targets are not met, the line of credit would be unavailable and/or the due date of any outstanding balance would be accelerated.

Given these uncertainties, there is substantial doubt about the Company's ability to continue as a going concern. The accompanying condensed consolidated financial statements do not include any adjustments relating to the recoverability and classification of assets and liabilities that might result from the outcome of this uncertainty.

2. Basis of Presentation

These interim unaudited condensed consolidated financial statements were prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). In management's opinion, all adjustments considered necessary for a fair presentation of the consolidated financial position at December 31, 2003, and the results of operations and cash flows for the three-month periods ended December 31, 2003 and 2002 have been made. Such adjustments are of a normal recurring nature.

Because of seasonal and other factors, the results of operations the cash flows for the three-month period ended December 31, 2003 is not necessarily indicative of expected results of operations and cash flows for the fiscal year ending September 30, 2004.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the SEC rules and regulations referred to above. Accordingly, these financial statements should be read in conjunction with the audited financial statements and related notes for the fiscal year ended September 30, 2003 included in the Form 10-K covering such period.

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

3. Reclassifications

Certain amounts for fiscal 2003 have been reclassified to conform to the fiscal 2004 presentation of discontinued operations.

4. Inventories

Inventories consist of finished goods.

5. Segment Information

The Company has only one reportable segment: Retail.

The Company aggregates its individual retail stores because they are all managed in a similar way, they serve a similar type of customer, they use similar methods to distribute their products and services, they carry similar product lines, and they use similar marketing approaches. For example, the retail stores sell plants, garden supplies, and other merchandise, primarily to individuals, on a cash-and-carry basis.

The reporting segment follows the same accounting policies used for the Company's condensed consolidated financial statements.

6. Stock-Based Compensation

Statement 148

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

	Three-Month Period Ended December 31, 2003	Three-Month Period Ended December 31, 2002

Net loss, as reported	($801)	($1,304)
Total stock-based employee compensation expense determined under fair value based method for all awards, net of related income tax effects	--	--
Pro forma net loss	($801)	($1,304)
Net loss per share - basic and diluted		
As reported	($.12)	($.21)
Pro forma	($.12)	($.21)

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

7. Commitments and Contingencies

In fiscal 2002 the Company entered the San Antonio market by leasing seven retail store locations. Three of those leases were entered into with Mr. George J. Wechsler (the "Affiliate Leases"), who was elected to the Company's Board of Directors and was named a Vice President of the Company at the time of the San Antonio market entry. The Affiliate leases have three year terms. Rental expense under the Affiliate Leases was $36,000 for each of the three-month periods ended December 31, 2003 and 2002.

8. Advertising Expenses

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

The Company expenses all advertising costs as they are incurred.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Executive-Level Overview

The Company achieved improved results of operations for its first fiscal quarter ended December 31, 2003 (the "December 2003 Quarter"). The Company typically incurs losses for its first fiscal quarter. For the December 2003 Quarter, the Company had a pre-tax loss from continuing operations of $0.7 million compared to a pre-tax loss from continuing operations of $1.5 million for the quarter ended December 31, 2002 (the "December 2002 Quarter"). Furthermore, because the Company sold all of its discontinued growing operations in fiscal 2003, there was no loss from discontinued operations for the December 2003 Quarter compared to a pre-tax loss of $0.6 million for the December 2002 Quarter.

Results of Operations

Introduction

As noted above, the Company disposed of all of its growing operations in fiscal 2003. Accordingly, the following discussion is presented as (i) continuing operations and (ii) discontinued operations.

RESULTS OF OPERATIONS

Continuing Operations

Three-month Period Ended December 31, 2003 Compared with Three-month Period Ended December 31, 2002

Pre-tax loss from continuing operations improved 52% for the December 2003 Quarter compared to the December 2002 Quarter. The improvement was primarily attributable to (i) an improvement in gross margin, and (ii) a 4% reduction in expenses.

The following table shows the comparative amounts (in millions) and percentages of sales for gross profit, total expenses, and loss from continuing operations before income taxes:

	December 2003 Quarter		December 2002 Quarter	
	Amount	% of Sales	Amount	% of Sales
Sales	$10.9		$10.8	
Gross profit	4.9	45.0%	4.4	40.5%
Total expenses	5.7	51.7%	5.9	54.5%
Loss from continuing operations before income taxes	($0.7)	(6.7%)	($1.5)	(14.0%)

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Sales increased from $10.8 million for the December 2002 Quarter to $10.9 million for the December 2003 Quarter. There was higher demand for the Company's plants and gardening-related merchandise partially offset by lower demand for the Company's Christmas merchandise. Same-store results were the same, since the Company operated twenty-six retail stores for both periods.

Gross Profit increased 12%, from $4.4 million for the December 2002 Quarter to $4.9 million for the December 2003 Quarter. Gross margin improved from 40.5% for the December 2002 Quarter to 45.0% for the December 2003 Quarter. The improvement was primarily attributable to improved buying practices for Christmas merchandise.

Operating expenses declined 7%. The decline was primarily attributable to tighter controls over labor and other operating expenses in the retail stores and administrative offices.

Occupancy expenses were substantially unchanged, since no new stores were added and no existing stores were closed during either period.

Advertising expenses increased 3%. The increase was primarily attributable to the increase in sales. Management planned to, and did, spend approximately 5% of sales on advertising for both the December 2002 Quarter and the December 2003 quarter.

Depreciation and amortization declined 28%. Capital expenditures have been curtailed in recent years. For the fiscal years ended September 30, 2003, 2002 and 2001, capital expenditures were $91,000, $204,000 and $248,000, respectively. Depreciation expense for those same three fiscal years was $592,000, $748,000 and $783,000, respectively. Accordingly, many assets are becoming fully depreciated. The Company intends to continue limiting capital expenditures; it has no significant capital projects planned for the remainder of fiscal 2004.

Interest expense increased 41%. The increase was primarily attributable to accretion of preferred stock, which was not recorded as interest expense before July 2003, when the Company adopted Statement of Financial Accounting Standards No. 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity ("Statement 150"). Adoption of Statement of 150 caused (i) the company's preferred stock to be reclassified as a current liability on the balance sheets at December 31, 2003 and September 30, 2003, and (ii) the related accretion on the preferred stock to be classified as interest expense for the December 2003 Quarter. Accretion of the preferred stock was a non-cash expense of $118,000 for the December 2003 Quarter.

Income tax expense was $66,000 for the December 2003 Quarter compared to income tax benefits of $602,000 for the December 2002 Quarter. The Company recorded a valuation allowance on all of its deferred tax assets during the fourth quarter of fiscal 2003, and does not currently record income tax expense or benefits during interim periods, except to the extent that income taxes are paid and/or income tax benefits are actually realized. The Company paid $66,000 in state income taxes during the December 2003 Quarter.

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Discontinued Operations

Three-month Period Ended December 31, 2003 Compared with Three-month Period Ended December 31, 2002

As noted above, the Company disposed of all of its growing operations in fiscal 2003. Accordingly, there were no revenues or expenses from discontinued operations for the December 2003 Quarter. For the December 2002 Quarter, discontinued operations results were as follows (amounts in thousands):

Sales	$322
Cost of goods sold	305
Gross profit	17
Expenses	655

Loss before income taxes	(638)
Income tax benefit	(252)
Loss from discontinued operations	($386)

Financial Condition - Capital Resources and Liquidity

Cash Flows Provided by Operating Activities were $45,000 for the December 2003 Quarter compared to $604,000 for the December 2002 Quarter. The decline was primarily attributable to reduced accounts payable and accrued expenses. Accounts payable and accrued expenses totaled $4.3 million at December 31, 2003 compared to $5.5 million at December 31, 2002. That reduction more than offset the improvement in pre tax net loss from continuing operations for the December 2003 Quarter compared to the December 2002 Quarter.

Cash flows Used for Investing Activities were $-0- for the December 2003 Quarter compared to $18,000 for the December 2002 Quarter. The decline was primarily attributable to a difference in the timing of certain replacements of furniture, fixtures and vehicles. The Company continues to limit the amount spent on capital expenditures during each fiscal year, and has no significant capital projects planned for the remainder of fiscal 2004.

Cash Flows Used for Financing Activities were $85,000 for the December 2003 Quarter compared to $8,000 for the December 2002 Quarter. The increase was primarily attributable to the October 2003 termination of the Company's stock purchase plan, which allowed employees to purchase the Company's common stock. Cash flows in from employee purchases of stock through the stock purchase plan declined from $82,000 for the December 2002 Quarter to $18,000 for the December 2003 Quarter.

Cash Flows Used for Discontinued Operations were $-0- for the December 2003 Period compared to $0.9 million for the December 2002 Period. In fiscal 2003 the Company disposed of all of its growing operations.

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Line of Credit Arrangement

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

Typically, the Company borrows from the Line of Credit during the quarter ending March 31, and repays those borrowings during the spring selling season included in the quarter ending June 30. The amount which may be borrowed under the line of credit is tied to amounts of accounts receivable and inventories, with a maximum of $3.0 million.

The Company owed $-0- under the Line of Credit as of December 31, 2003 and 2002 and September 30, 2003. The maximum and weighted average amounts borrowed under the Line of Credit were as follows (amounts in thousands):

	Three Month Period Ended December 31 2003	Three Month Period Ended December 31 2002
Maximum amount borrowed	$--	$--
Weighted-average amount borrowed	$--	$--

The Line of Credit contains financial covenants requiring the Company to meet a minimum amount for tangible net worth, a maximum ratio of liabilities to tangible net worth, and an annual ratio of earnings before interest and non-cash charges to current maturities of long-term debt. At September 30, 2003 the Company was not in compliance with the financial covenants required by the Line of Credit. In December 2003 the Company entered into a forbearance agreement with the bank. The bank agreed to not enforce the aforementioned financial covenants through the expiration of the Line of Credit on May 28, 2004. In return, the Company agreed to (i) a reduction in the maximum borrowing amount from $3.0 million to $1.5 million, (ii) an increase in the interest rate from prime to prime plus 2%, and (iii) certain requirements for net sales and net income. At December 31, 2003 the Company was in compliance with those requirements for net sales and net income.

Management believes that the Line of Credit, assuming its continued availability, will be adequate to support the Company's short term working capital requirements because: (i) working capital requirements will be lower than in prior years because the Company has disposed of its unprofitable wholesale and growing operations and instituted tighter controls over expenses, inventory and capital expenditures, and (ii) seasonal borrowing needs are expected to be substantially lower and of shorter duration than in previous years. Management believes that it is likely that the Company will attain the requirements for net sales and net income provided in the forbearance agreement.

If the Company were unable to attain the targets for net sales and net income, making the Line of Credit unavailable and accelerating the due date, the Company would take further actions, including the sale and/or refinancing of real and personal property and equipment, to generate funds. However, any such borrowing would reduce access by the Company to funds, if any, necessary through the same sources to retire the preferred stock in September 2004.

Management does not expect to be able to renew the Line of Credit with the current bank upon its expiration. However, management expects it will be able to negotiate acceptable alternatives to support its working capital requirements for fiscal 2005.

Contractual Obligations and Commitments

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

	Fiscal Year Ending September 30,						
	2004(1)	2005	2006	2007	2008	There-after	Totals
Long-term debt (including current portion)	$370	$505	$542	$528	$542	$4,578	$7,065
Future minimum lease payments under noncancellable operating leases	1,694	2,039	1,195	1,021	681	2,056	8,686
Preferred stock with mandatory redemption provisions(2)	3,420	--	--	--	--	--	3,420
Totals	$5,484	$2,544	$1,737	$1,549	$1,223	$6,634	$19,171

(1)Amounts for 2004 represent obligations due during the remainder of fiscal 2004 (nine months).
(2)Carrying amount of $3,067 as of December 31, 2003, $2,949 as of September 30, 2003 and $2,641 as of December 31, 2002.

The Company has outstanding $3.4 million of preferred stock which becomes mandatorily redeemable in September 2004. Management believes that the Company will generate funds which will contribute to its ability to redeem the preferred stock because it has disposed of its unprofitable wholesale and growing operations and instituted tighter controls over (i) expenses, (ii) inventory and (iii) capital expenditures. However, there can be no assurance that these steps will generate sufficient funds to redeem the preferred stock by September 2004. In such event, the Company may take further actions, including the sale and/or refinancing of real and personal property and equipment, to generate funds. However, there can be no assurance that these further actions will generate sufficient funds to redeem the preferred stock by September 2004.

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Near Term Working Capital Requirements

The Company is in a transition from its operation of both a retail segment and a growing segment. Losses from the discontinuance and disposition of the growing segment, and the $3.4 million cost to retire the Company's Acquisition Preferred Stock have reduced, and will reduce, the Company's liquidity. In addition, the Company's assets were reduced as of September 30, 2003 by: (i) a charge of $631,000 for the fourth quarter of fiscal 2003 to record impairment of goodwill, and (ii) establishment in the fourth quarter of fiscal 2003 of a $2,672,000 valuation allowance against all of the Company's deferred tax assets. Management believes that the Company will be able to meet its working capital requirements through a combination of (i) cash generated from operations, (ii) short term financing, and (iii) additional borrowings on its real estate. All of these sources will be affected by the Company's ability to operate profitably, and, therefore, the Company can give no assurance that these sources will be available in the amounts necessary to meet the

Company's working capital requirements. Given these uncertainties, there is substantial doubt about the Company's ability to continue as a going concern.

CRITICAL ACCOUNTING POLICIES

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

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

- Inventories;
- Deferred income taxes;
- Property and equipment;
- Accrued expenses.

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

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

Deferred income taxes - As of December 31, 2003 and September 30, 2003 the Company has recorded a valuation allowance for all of its deferred tax assets on the weight of available evidence at those balance sheet dates. The primary factor in providing for a valuation allowance is the expectation that future taxable income and the reversal of temporary differences will not be sufficient for the Company to realize the deferred tax assets. Such estimate could change in the future based on the occurrence of future taxable income.

Property and Equipment - The Company reevaluates the propriety of the carrying amounts of its properties as well as the amortization periods when events and circumstances indicate that impairment may have occurred. Recoverability of assets to be held and used is measured by the comparison of the carrying amount of an asset to future cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. As of December 31, 2003 and September 30, 2003 management believes that no impairment has occurred and that no reduction of the estimated useful lives is warranted.

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

SUPPLIERS

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

EMPLOYEES

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

COMPETITION

The retail nursery business is highly competitive. In the Dallas, Fort Worth, Houston and San Antonio markets, the Company competes with both (i) other retail nurseries, and (ii) home centers and mass merchandisers.

There are hundreds of retail nurseries in the Dallas, Fort Worth, Houston and San Antonio markets.

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The home centers and mass merchandisers include The Home Depot, Lowe's and Wal-Mart. These competitors are much larger than the Company and have many more store locations in the Dallas, Fort Worth, Houston and San Antonio markets. Additionally, they attract customers for other products and have operations which are not as dependent on the spring planting season to cover year around operating costs.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

The Company is exposed to certain market risks, including fluctuations in interest rates. The Company does not enter into transactions designed to mitigate such market risk, nor does it enter into any transactions in derivative securities for trading or speculative purposes. As of December 31, 2003, the Company had no foreign exchange contracts or options outstanding.

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

At December 31, 2003 the Company had variable rate debt of $1.8 million, out of total long-term debt of $7.1 million. Holding other variables, such as debt levels, constant, a one percentage point increase in interest rates would be expected to have an estimated impact on pre-tax earnings and cash flows for next year of $18,000 for the variable-rate debt.

Item 4. Controls and Procedures

Management, including the Company's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), has conducted an evaluation of the effectiveness of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-15(b), as of the end of the period covered by this report. Based on that evaluation, the CEO and CFO concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information required to be disclosed in reports under the Exchange Act. Management applied its judgment in assessing the costs and benefits of such controls and procedures, which, by their nature, can provide only reasonable assurance regarding management's control objectives. There were no changes in the Company's internal control over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

While the Company believes that its existing disclosure controls and procedures have been effective to accomplish their objectives, the Company intends to continue to examine, refine and document its disclosure controls and procedures, and to monitor ongoing developments in this area.

Part 2. OTHER INFORMATION

Item 1. Legal Proceedings.

None.

Item 2. Changes in Securities and Use of Proceeds.

None.

Item 3. Defaults upon Senior Securities.

None.

Item 4. Submission of Matters to a Vote of Security Holders.

None.

Item 5. Other Information.

None.

Item 6. Exhibits and Reports on Form 8-K.

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

A list of the exhibits required by Item 601 of Regulation S-K and filed as part of this report is set forth in the Index to Exhibits on page 20, which immediately precedes such exhibits.

(b) Reports on Form 8-K:

(1) On October 24, 2003 the Company filed a Form 8-K disclosing that it had received a letter from NASDAQ indicating that the Company had not regained compliance with the NASDAQ minimum bid price requirements in accordance with Marketplace Rule 4310(c)(8)(D). However, since the Company met the initial listing requirements for the NASDAQ SmallCap Market under Marketplace Rule 4310(c)(2)(A), the Company was granted an additional 90 calendar day grace period, or until January 21, 2004, to demonstrate compliance. If compliance with the aforementioned rule was not demonstrated by January 21, 2004, NASDAQ would provide written notification that the Company's common stock would be delisted.

(2) On January 23, 2004 the Company filed a Form 8-K disclosing that it had issued a press release announcing that the Company had received a letter from NASDAQ providing written notification that the Company's common stock would be delisted on January 30, 2004.

SIGNATURES

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

Dated: February 13, 2004

CALLOWAY'S NURSERY, INC.
By /s/ James C. Estill
James C. Estill, President and
Chief Executive Officer

By /s/ Daniel G. Reynolds
Daniel G. Reynolds, Vice
President and Chief Financial Officer

INDEX TO EXHIBITS

Exhibit
Number   Description

31(a)(1)	Rule 13a-14(a) Certification of the Chief Financial Officer of Calloway's Nursery, Inc.
31(b)(1)	Rule 13a-14(a) Certification of the Chief Executive Officer of Calloway's Nursery, Inc.
32(1)	Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2003.

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1 Filed with this report.