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# Central Garden & Pet Co. (CENT)

Q2 2019 Earnings Call

## CORPORATE PARTICIPANTS

### Steven Zenker

*Vice President Finance - Investor Relations, FP&A and Corporate Communications, Central Garden & Pet Co.*

### George C. Roeth

*President, Chief Executive Officer & Director, Central Garden & Pet Co.*

### Nicholas Lahanas

*Chief Financial Officer, Central Garden & Pet Co.*

### Rodolfo Spielmann

*President-Pet Consumer Products, Central Garden & Pet Co.*

### J.D. Walker

*President-Garden Branded Business, Central Garden & Pet Co.*

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## OTHER PARTICIPANTS

### William B. Chappell

*Analyst, SunTrust Robinson Humphrey, Inc.*

### Christopher M. Carey

*Analyst, Bank of America Merrill Lynch*

### Christina Brathwaite

*Analyst, JPMorgan Securities LLC*

### Bradley Thomas

*Analyst, KeyBanc Capital Markets, Inc.*

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### Hale Holden

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Ladies and gentlemen, thank you for standing by. Welcome to Central Garden & Pet's Second Quarter Fiscal Year 2019 Financial Results Conference Call. My name is Kevin, and I'll be your conference operator for today. At this time, all participants are in a listen-only mode. Later, we'll conduct a question-and-answer session. Instructions will be given at that time. [Operator Instructions] As a reminder, this conference call is being recorded.

I would now like to turn the call over to Steven Zenker, Vice President, Investor Relations, FP&A and Communications. Please go ahead, sir.

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### Steven Zenker

*Vice President Finance - Investor Relations, FP&A and Corporate Communications, Central Garden & Pet Co.*

Thank you, Kevin. Good afternoon, everyone, and thank you for joining us today. With me on the call today are George Roeth, Central's President and Chief Executive Officer; Niko Lahanas, Chief Financial Officer; Howard Machek, SVP, Finance, and Chief Accounting Officer; J.D. Walker, President, Garden Branded Business; and Rodolfo Spielmann, President, Pet Consumer Products.

A press release providing results for our second quarter ended March 30, 2019 is available on our website at [www.central.com](http://www.central.com), and contains the GAAP to non-GAAP reconciliation for the non-GAAP measures discussed on this call.

Before I turn the call over to George, I would like to remind you that statements made during this conference call which are not historical facts, including adjusted EPS guidance for 2019, expectations for new product introductions, long-term organic growth goals, future acquisitions, and future revenue cost savings and profitability are forward-looking statements subject to risks and uncertainties that could cause actual results to differ materially from those implied by forward-looking statements. These risks and others are described in Central's Securities and Exchange Commission filings including our Annual Report on Form 10-K filed on November 20, 2018. Central undertakes no obligation to publicly update these forward-looking statements to reflect new information, subsequent events or otherwise.

Now, I'll turn the call over to our CEO, George Roeth. George?

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### George C. Roeth

*President, Chief Executive Officer & Director, Central Garden & Pet Co.*

Thank you, Steve. Good morning, everybody. I'm going to keep my comments relatively brief and let Niko do the heavy lifting around the finer details of the quarter's financial results.

Bottom line, we are pleased to report that we grew overall sales, organic sales, and excluding the impact of the one-time live fish write-off, organic EBITDA versus a year ago. As expected and as we foreshadowed, our overall year-over-year earnings metrics were challenged by the seasonal losses of Bell Nursery, which were not in the year ago numbers and by the shared dilution caused by our August, 2018 equity rates. We're on track and we continue our main focus on executing our current strategy and delivering on our financial commitments for the year.

Coming into the second quarter, we knew that we had our work cut out for us as we're competing against the strong 6% organic growth rate last year across our Garden and Pet segments. We're pleased to report that we ended the quarter with a robust overall sales growth of 10% due in large part to our acquisitions. However, organic sales grew as well, up 2%, driven by gains in our Garden segment. We are very encouraged by the way the garden season has started-off. Fiscal year-to-date for Q2 of garden consumption, the key track customers was up mid single digits, aided by increased distribution of existing items such as our AMDRO mosquito line, new items such as PENNINGTON Lawn Booster, as well as strong sales for our vendor partner group.

We continue to be optimistic that we will build on our market share gains in the last several years while also delivering strong sales and profit growth. Of course, there's so much in the garden season to play out especially for controlled products which tend to peak later in the season.

In our Pet segment, while our businesses collectively grew 5%, overall pet organic growth was flat, picking up 0.1%. The organic growth rate was depressed in part by our Professional business, which has underperformed over the last several quarters due in large part to unfavorable weather and customer inventory challenges. We expect these headwinds to subside in the back half of the fiscal year.

Our Pet Consumer business did grow organically, driven by strength in our aquatics-related businesses, dog treats, equine products, and our overall digital efforts. We talked last quarter about headwinds on the Pet Consumer side with a new entrant and product issues on our Behavior Management business. The product issue has been rectified, and the newly reformulated items are now shipping. Hence, we forecast that overall Pet, including Pet Consumer business will see growth accelerating into the second half of the year, helping Pet organic growth rates to return to rates more in line with our longer term trends by the fourth quarter.

Our gross and operating margins were down for the quarter due largely to the impacts on our latest three acquisitions, Bell, Arden and General Pet. Arden is significantly burdened by the impact of purchase accounting, while all three have ongoing reported operating margins depressed by the amortization of intangibles. We're addressing this issue going forward by actively reporting EBITDA progress to provide transparency to the values being created by the cash flow generated by these acquisitions.

Our overall organic operating margin was relatively flat versus a year ago. The positive impact of price increases taken during the quarter in much of our portfolio, while able to mitigate a good deal of the inflationary pressures over the last 12 months, was unable to completely offset the cumulative inflation impact since our last pricing actions. This was influenced by the fact that we do not implement all increases on exactly January 1, although by quarter end all announced price increases were in effect. So with the full impact of pricing, additional more targeted pricing planned for Q3 and more favorable year-over-year cost comparisons, we estimate that margins for the second half of the year versus prior year will show meaningful gains.

As we look forward to the rest of the year, we are optimistic that the strong start to the garden season as well as an expected pick up in Pet organic growth in the fourth quarter will result in a fourth consecutive year of solid organic sales growth that will be within our 2% to 3% annual long-term goal. We are affirming our guidance of \$1.80 per share or higher, excluding any impact of significant one-time cost associated with our CEO transition.

Finally, I do want to address for a moment the CEO search that we're undertaking for my successor. Central is committed to finding a leader who can build upon our momentum, both generating growth organically and through acquisitions. The board is committed to the direction in which Central is headed, and is not looking for a leader who'll dramatically change the organization or its strategy. Rather, they are looking for a leader that can partner with the board to further Central's success. We have hired outside resources to work with the board's succession

committee to find the right CEO, and I will continue to lead the company until the point in time a successor is announced. We continue to expect that will be before fiscal year end in September.

Now, I'll turn it over to Niko to discuss more specifics on the quarter.

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## Nicholas Lahanas

*Chief Financial Officer, Central Garden & Pet Co.*

Thank you, George. Good afternoon, everyone. We issued our second quarter press release with our financial results earlier today. I'll delve deeper into the numbers, and then turn it back to George for his closing remarks.

Second quarter sales increased 10% or \$60.6 million to \$674 million from \$613 million in the second quarter of last year. Our three recent acquisitions of Arden Companies, Bell Nursery and General Pet were the primary drivers of the sales gain, accounting for \$48 million of the revenues in the quarter.

Organic sales growth of \$13 million was up 2%, aided by the gains in our Garden segment, which had a good start to the season. The gains came on top of a robust 6% organic growth rate in the second quarter of last year. Consolidated gross profit for the quarter increased \$12 million, and our gross margin decreased 110 basis points to 30.6%, impacted significantly by the inclusion of the three recent acquisitions. Absent the acquisitions, organic gross margin was unchanged as the price increases implemented offset inflationary cost pressures and a less favorable mix of sales.

SG&A expense for the quarter increased 12% or \$15 million versus a year ago. As a percent of sales SG&A was up 40 basis points to 21.4%, due primarily to higher freight costs. Like many companies, we have seen trucking costs in particular increase, and that has been a headwind for the last several quarters.

Included in the SG&A are two non-cash items. A \$2.5 million impairment charge of an intangible asset due to the exit from the live fish business by a major retailer that we noted on our last earnings call, and a \$3.2 million write-up of our previous minority position in Arden. With our early February purchase of Arden, we now own 100% of the company and have since consolidated its results in our Garden segment.

Central's operating income for the quarter decreased 6% to \$62 million and operating margin declined 150 basis points to 9.2%. Excluding the acquisitions and the two non-cash items I just mentioned, operating income increased and operating margin was relatively flat. EBITDA for the quarter decreased 3.7% to \$74 million, but was up excluding the acquisitions and the net gain from the two non-cash items.

Turning now to the Pet segment. Pet segment sales for the quarter increased 5% or \$17 million to \$338 million, with organic sales up slightly. Organic sales were aided by stronger results in our dog and cat, live fish and aquatics businesses, but that benefit was offset by continued weakness in the Animal Health businesses, which include our Professional and Behavior Management products. The Professional business has been impacted by weather and customer inventory issues while the Behavior Management business has experienced new competition and product performance issues which have impacted us the last few quarters. The Behavior Management products with our new formulation are now shipping, and we continue to expect the back half of the year to show improvement for both the Professional and Behavior Modification businesses.

Pet segment operating income for the quarter declined by \$6 million inclusive of the \$2.5 million intangible asset write-down or 18% compared to prior year to \$27 million. Pet operating margin decreased 220 basis points to 8%. Pet organic margins were also down as lower volumes in the Animal Health business had a negative impact on

both mix and margins. Pet EBITDA for the quarter decreased 12% to \$35 million for the same reasons as the decline in operating income.

Turning now to Garden. For the quarter, Garden segment sales increased 15% or \$44 million to \$336 million, due in large part to the Arden and Bell acquisitions as well as organic growth of 4%. Organic growth was led by grass seed and wild bird feed as well as positive timing shift from one large retailer. As you may recall, we saw our strongest sales increases last year in our second quarter, with lower third quarter sales, while others in the industry experience the opposite.

Garden's operating income was \$53 million in the quarter compared to \$51 million in the second quarter of last year. The gain of \$3.2 million from the write-up of the initial 45% interest in Arden that we acquired in 2017 was the driver of the increase. Excluding that gain, Garden operating income was down slightly versus a year ago due to the inclusion of Bell results in the quarter. Bell's loss for the quarter was significant, which is normal for that business, which makes all its profit in our fiscal third quarter. Excluding Bell, Garden organic operating income was up in the high single-digit. Operating margin decreased 150 basis points to 15.9%, with Bell Nursery and Arden responsible for much of the decline. Organic garden operating margin was up. Garden EBITDA of \$56 million increased versus a year ago and was up even more organically.

Now, getting back to our consolidated results. In the second quarter, we had other income of \$0.5 million compared to other income of \$1.5 million a year ago. The decline was primarily due to the absence of two months of income from our minority interest in Arden this quarter compared to a full quarter of Arden income in last year's second quarter. As I said earlier, we purchased Arden at the beginning of February and at that time began reporting Arden as a fully consolidated entity in our Garden segment. So we lost the Arden income in the other income line item and we did not recoup those gains in Garden's operating income because we were required to write up Arden's inventory at the time of purchase under purchase price accounting rules. So Arden, as part of the Garden segment, excluding the write-up of the 45% interest, generated very little operating income for the quarter.

Net interest expense decreased \$1 million to \$8 million, primarily due to the interest earned on our higher cash balance this year versus a year ago. We also benefited from a higher interest rate earned on that cash balance. Our tax rate for the quarter was 21.3% as compared to 20.3% in the second quarter a year ago.

Turning now to our balance sheet and cash flow statements. Cash at the end of the second quarter was \$330 million, up from \$132 million at the end of the second quarter last year. The increase reflects the inclusion of the proceeds of the equity offering we closed in August of 2018. Total debt was \$698 million, relatively unchanged from last year. Our gross leverage ratio at the end of the quarter remained at 3.2 times, the same as a year ago and well within our target range. We also had \$374 million of availability on our credit line at the end of the quarter. For the quarter, cash used by operations was \$86 million versus cash used by operations of \$70 million in the second quarter a year ago, due primarily to working capital changes. CapEx was \$6 million, down from \$9 million in the second quarter of 2018. Depreciation and amortization for the quarter was \$12 million, up from \$11 million a year ago, primarily due to recent acquisitions. During the quarter, we've not repurchased any of our outstanding stock, and approximately \$35 million remains available under the board-approved stock repurchase program.

Now, I'll turn it back over to George.

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**George C. Roeth**

*President, Chief Executive Officer & Director, Central Garden & Pet Co.*

Thanks, Niko.

I just want to wrap up by saying that we continue to be on track with the execution of our strategy and associated financial commitments for the year. We knew at the outset of the fiscal year that our earnings growth is back half loaded. This always puts more risk into the plan. But due to all the timing issues associated with our acquisitions and with pricing, this was unavoidable in order to do what we believe was in the best long-term interest of the company. While we believe that we will deliver these commitments, we are not raising any projections at this point in time. It's just way too early in the game.

So, thanks for your continued engagement. And with that said, I'd like to turn the meeting over to questions from our listeners.

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## QUESTION AND ANSWER SECTION

**Operator:** Thank you. And I'll be conducting a question-and-answer session. [Operator Instructions] Our first question today is coming from Bill Chappell from SunTrust Robinson Humphrey. Your line is now live.

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**William B. Chappell**

*Analyst, SunTrust Robinson Humphrey, Inc.*

Q

Thanks. Good afternoon.

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**George C. Roeth**

*President, Chief Executive Officer & Director, Central Garden & Pet Co.*

A

Hi, Bill.

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**Nicholas Lahanas**

*Chief Financial Officer, Central Garden & Pet Co.*

A

Hey, Bill.

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**William B. Chappell**

*Analyst, SunTrust Robinson Humphrey, Inc.*

Q

I guess, first, on the Pet side. Was there any impact from the lost customer on the live fish side or is that still to come?

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**Rodolfo Spielmann**

*President-Pet Consumer Products, Central Garden & Pet Co.*

A

The transition already started. The impact was minimal, and we need to remind you for that business, this exit is a relevant matter. For Pet, it's a small issue and for the total company [indiscernible] (00:16:09) in Q2.

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**William B. Chappell**

*Analyst, SunTrust Robinson Humphrey, Inc.*

Q

Okay. And then in terms of – George, just with your planned departure, just trying to understand how that affects M&A. I mean, obviously, we're now seven months since the equity offering. There has been a whole lot done. And

so, I didn't know if that's postponed even further with not having somebody kind of necessarily know where the vision is going six months from now.

**George C. Roeth**

*President, Chief Executive Officer & Director, Central Garden & Pet Co.*

A

I'd say a few things on that front. I would say, no, it hasn't slowed us down. I'm partnering with our [indiscernible] (00:16:42) board and doing that so the board is actively engaged. We also have a very actively engaged team here. Niko is obviously a key member of that. So our philosophy and effort against it is unchanged and full bore ahead.

**William B. Chappell**

*Analyst, SunTrust Robinson Humphrey, Inc.*

Q

And then on the pricing standpoint, I mean, you said all pricing is now in for this year. Can you just remind us or give us some kind of idea how much that might have been either for Pet or Garden or whether that was for both Pet and Garden, and does that mean we see that kind of pick up in terms of overall sales. I assume it's not impacting volumes as we move to 3Q and 4Q.

**George C. Roeth**

*President, Chief Executive Officer & Director, Central Garden & Pet Co.*

A

Bill, I'd say a couple of things, and then I'll turn it over to Rodolfo and J.D. to answer for their particular segments. I wouldn't say that all pricing is in for the year. There will be some tactical pricing taken on some businesses, likely in Q3. So I want to be clear on that front. In terms of volumes, there is some elasticity to pricing, so you would expect some volume impact, although it's not dollar-for-dollar. And I'll let Rodolfo and J.D. talk about their specific segments. So, J.D., why don't you start with Garden?

**J.D. Walker**

*President-Garden Branded Business, Central Garden & Pet Co.*

A

Right. So with Garden, I'd say that the pricing went into effect January 1. It has been accepted obviously by all customers. And as George said, we'll have some surgical pricing in Q3 on some commodity-type items, but we're seeing the market move as well. So I don't think it's having a big impact on POS or takeaway because the entire market moved.

**William B. Chappell**

*Analyst, SunTrust Robinson Humphrey, Inc.*

Q

Got it.

**Rodolfo Spielmann**

*President-Pet Consumer Products, Central Garden & Pet Co.*

A

And in the case of Pet, primarily, all pricing were processed around, accepted during Q2. It trickled. Not every customer does do the reset for the same time, so it's trickled throughout the quarter. But most of it is in place in Q2. We have still some trickling new pricing coming in Q3, but the vast majority was Q2. Elasticity wise, to be honest, way too many categories. And in fact, what we have seen is some decreasing volume, but not enough to affect the pricing.

**William B. Chappell**

*Analyst, SunTrust Robinson Humphrey, Inc.*

Q

Okay. And then last one for me just, Scotts certainly had a very strong quarter. They indicated that some of their key customers, they were gaining some shelf space. I know that has been said by every company, every year that I can remember. But I'm just trying to understand, was your growth in Garden weighted towards one mass customer, or are you seeing incremental gains in other customers out there?

J.D. Walker

*President-Garden Branded Business, Central Garden & Pet Co.*

A

Bill, this is J.D. I'll take that question. So we're seeing gains really across all of our customers. I can't say it's weighted more towards one customer than another. I'm aware what our competition said. I'm having a little bit of a hard time triangulating some of their data points, and they quoted a double-digit POS increase. We're in the high single digits during that same period, but we're also comping against a stronger quarter a year ago. It's difficult to make apples-to-apples comparison between the two because they play in a lot of categories where we don't like mulch where they had a 30% increase. So I'd say that we feel good about where we are right now, we feel good about our year-over-year gains in POS and in sell-in, and with a lot of the season still left in front of us, but we like where we are right now.

William B. Chappell

*Analyst, SunTrust Robinson Humphrey, Inc.*

Q

Got it. Thanks so much.

J.D. Walker

*President-Garden Branded Business, Central Garden & Pet Co.*

A

Thanks, Bill.

**Operator:** Thank you. Our next question today is coming from Chris Carey from Bank of America. Your line is now live.

Christopher M. Carey

*Analyst, Bank of America Merrill Lynch*

Q

Hi. Thanks so much for the question. I thought I heard something about a shift in sales from fiscal Q3 to fiscal Q2 in the Garden segment. Can you just elaborate on that and maybe elaborate on your expectations for Q3 in Garden? And then, secondly, and completely separately, why has it taken so long to get acquisitions across the line? So maybe if you could comment on that as well.

J.D. Walker

*President-Garden Branded Business, Central Garden & Pet Co.*

A

Sure. This is J.D. I'll take the first part of the question. The shift in sales of some shipments, that really shifted between Q1 to Q2, and that was a customer who typically set their stores for the spring season. They would start to receive those shipments in December. They pushed those shipments into January. So we saw that shift, and it was referenced in the script, I believe George mentioned it earlier today. I would say that even accounting for that shift, we did have a year-over-year organic increase in shipments even factoring that out.

Nicholas Lahanas

*Chief Financial Officer, Central Garden & Pet Co.*

A

Chris, this is Niko. As far as the M&A goes, the comment I would make is the results so far have just not been reflective of the activity going on. So there is a lot of activity going behind the scenes that obviously most folks are

unaware of. That said, we have done three deals over the last year. We continue to have a very active pipeline and we're pushing hard to get some deals over the line here. So we're continuing to press it.

Christopher M. Carey

*Analyst, Bank of America Merrill Lynch*

Q

If you could comment on the sorts of maybe deal size or the flavor of deals that you're looking at. My understanding [indiscernible] (00:22:00) that you were looking at more growth acquisitions, higher margin, would potentially pay up on a multiple basis if you thought that you could get something into the pipeline that could deliver faster growth over the long-term. Thanks.

Nicholas Lahanas

*Chief Financial Officer, Central Garden & Pet Co.*

A

Yeah. So, I mean, the bias is to go after a higher margin accretive deals right now. What I can tell you about the pipeline is it's filled with Pet and Garden deals. So, right now, there's nothing that's third leg in the pipeline. And again, it's a full pipeline, and we continue to have deals in numerous stages and at numerous valuations. So we're looking at deals everywhere from \$10 million to several hundreds of millions of dollars. So it's across the entire board. But the bias, again, would be margin accretive.

**Operator:** Thank you. Our next question is coming from Christina Brathwaite from JPMorgan. Your line is now live. Ms. Brathwaite, perhaps your phone is on mute.

Christina Brathwaite

*Analyst, JPMorgan Securities LLC*

Q

Sorry about that. Can you hear me now?

George C. Roeth

*President, Chief Executive Officer & Director, Central Garden & Pet Co.*

A

Hi, Christina.

Christina Brathwaite

*Analyst, JPMorgan Securities LLC*

Q

Hi, guys. Sorry about that. So, first, can you just talk a little bit about the financial impact from Arden and just give us color within the guidance for \$1.80 for this year? What's the Arden both topline and margin implication in there?

Nicholas Lahanas

*Chief Financial Officer, Central Garden & Pet Co.*

A

So, as we mentioned earlier in the script, Arden really had no real impact because of the purchase accounting. So we ended up buying the business at really its peak. It is seasonal, and the highest inventory level that it has, and so we had to mark up that inventory from a purchase accounting standpoint, which wipes out the bulk of the profits. So really no impact this year. As far as size, we typically don't give that out on deals, so that's about all we've got on Arden.

Christina Brathwaite

*Analyst, JPMorgan Securities LLC*

Q

Okay. And I guess continue on that the Garden side, so just how are things shaping up for the Bell Nursery business now that you're about – you're in peak season? What are you seeing in terms of the initial merchandise sets for nurseries and the performance there. Just trying to get an idea for how we should be thinking about it since it's been largely difficult the last couple of quarters?

J.D. Walker

*President-Garden Branded Business, Central Garden & Pet Co.*

A

Yes. Christina, this is J.D. I'll take that question. So we feel great about the business right now. And it's everything we thought it would be when we purchased the company. And as you mentioned, in the last couple of quarters we knew this going in, they make all their money really in one quarter of the year. So the last couple of quarters, it's been tough, and because we're – it's decreitive to our overall financial position. However, now that we're in their season, we're seeing strong consumption, great execution by the Bell team, they grow fantastic, high quality flowers, and that's resonating with the consumers. They have also this year picked up some adjacent markets to there, so they've picked up some new geographies, as well as some new subclasses including vegetables, the first time that they've been in the vegetable business, which came directly from our competition. So it's – and they're executing extremely well against that. So we feel very good about that business.

Christina Brathwaite

*Analyst, JPMorgan Securities LLC*

Q

Okay, great. And then I guess last one for me, just the overall environment has been a headwind for you for a couple of quarters. When do you expect that to kind of stabilize going forward? And just any kind of guidance there would be really helpful.

Nicholas Lahanas

*Chief Financial Officer, Central Garden & Pet Co.*

A

Well, we're expecting the second half of the year to be much better. We're seeing the full effect of price increases in that second half of the year. Also we're seeing the stabilization of the cost increases that we've experienced over the last year. The other thing too is what we're assuming going into the year is the normalized weather pattern as well. So we'll be expecting a nice thump in our Pro business as well as flea and tick. So there'll be assumptions going into that second half, and we feel like we'll see some margin expansion under those assumptions.

A

And Niko, I'll just build on to that. As you mentioned, weather, but there are many of the northern markets that are just now coming onboard. We're starting to see some consumption. One of the positive things that we've seen on the Garden side, Christina, is that when the weather is decent we're getting a consumer that's highly engaged in our category and the demand is there. So we feel good about having plenty of runway still in front of us.

Christina Brathwaite

*Analyst, JPMorgan Securities LLC*

Q

Great. Thanks, guys.

A

Thanks.

**Operator:** Thank you. Our next question is coming from Brad Thomas from KeyBanc Capital Markets. Your line is now live.

**Bradley Thomas**

*Analyst, KeyBanc Capital Markets, Inc.*

Q

Hey, good afternoon. Thank you for taking my questions.

**George C. Roeth**

*President, Chief Executive Officer & Director, Central Garden & Pet Co.*

A

Hi, Brad.

**Bradley Thomas**

*Analyst, KeyBanc Capital Markets, Inc.*

Q

Hey, George. Just a follow-up for J.D. on the cadence of the business. I guess, just to be clear in this current third quarter here, are there any impacts from timing that we should anticipate on the garden season in terms of maybe deliveries that you already did in 2Q or that slipped into 3Q here?

**J.D. Walker**

*President-Garden Branded Business, Central Garden & Pet Co.*

A

No, Brad. No timing issues to factor into Garden performance for Q3, and I'd say that as it's widely been reported, consumption has been very strong in April. We do have some strong comps in front of us for May and June, so it's too early to call the quarter, but we feel good about the position we're in right now, but no unusual circumstances.

**Bradley Thomas**

*Analyst, KeyBanc Capital Markets, Inc.*

Q

Okay, great. And then just in terms of the full year, as we think about – your prior guidance, I believe, was for organic sales growth of about 2% to 3%. You're tracking a little bit below that two quarters in. It does sound like you expect some of the new product in Pet as well as easier weather comparisons to help you accelerate the growth rate. Anything else that we should contemplate as we think about organic growth the next couple of quarters here?

**George C. Roeth**

*President, Chief Executive Officer & Director, Central Garden & Pet Co.*

A

No. You captured it. We expect that the sales should accelerate over the back half of the year, particularly in Q4, and we do expect to be within our long-term guidance.

**Bradley Thomas**

*Analyst, KeyBanc Capital Markets, Inc.*

Q

Great. Maybe one last one for me. Just as you all look at e-commerce in that channel shift, anything new happening from that perspective?

**George C. Roeth**

*President, Chief Executive Officer & Director, Central Garden & Pet Co.*

A

Yeah, I would basically say it's all systems go. They continue – well, Chewy in Amazon, when you look at the Pet side of things, continue to grow very rapidly. You have to be fast of foot. Amazon is a very sophisticated customer who's changing their models and the way they do business day to day. But we have a customer-facing team there. We put a lot of sophisticated tools in place to grow that business, we're on top of it, and we feel really good about where we're at. And we feel particularly good where we're at but Chewy has decided to really go after pet supplies in a much stronger way than they have previously. They were largely a food company, and we're benefiting from that quite significantly.

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Rodolfo Spielmann

*President-Pet Consumer Products, Central Garden & Pet Co.*

A

And I know this is a little, but I would only add that, after you go through Amazon Chewy, then you open all the omni-channel and the growth is fantastic on that area for us. We opened a new customer in Q4 last year, which is going really well, and we have a partnership with customers who are understanding how to manage both brick and mortar and the e-commerce avenue, and how to grow both together, so also good growth in that area.

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Bradley Thomas

*Analyst, KeyBanc Capital Markets, Inc.*

Q

Very helpful. Thank you, guys.

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**Operator:** Thank you. Our next question today is coming from Karru Martinson from Jefferies. Your line is now live.

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Karru Martinson

*Analyst, Jefferies*

Q

Good afternoon. I'm just wondering, what impact are you seeing if any – on the store shelves when you go up against the Roundup products?

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J.D. Walker

*President-Garden Branded Business, Central Garden & Pet Co.*

A

This is J.D., I'll take that question. So I've heard when our competitors said about takeaway of the Roundup brand, I know there's been quite a bit of publicity out there. We don't have a branded product that competes directly against Roundup in the grass and weeds space. We do have some private label brands that compete directly against it. And from what they reported, brick sales on the Roundup brand, that's not what we've seen at retail, and they've also taken that Roundup brand into other products as well. And we're not seeing this strong velocity that they're reporting, but that may be because we're not paying close enough attention to that. And I think that – yeah, I think the court of public opinion is still out on that, and in over time we'll see where that goes. We're monitoring it very closely and making plans for the future related to that.

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Karru Martinson

*Analyst, Jefferies*

Q

Okay. And my apologies if I missed it. Did you talk about the magnitude of the surgical pricing for the third quarter that's being implemented?

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George C. Roeth

*President, Chief Executive Officer & Director, Central Garden & Pet Co.*

A

Yeah. We're not giving out specifics, but I would say it's very tactical relative to what we did in Q2. So, few businesses.

Karru Martinson

*Analyst, Jefferies*

Q

Okay. And just lastly, pardon my ignorance, but the Behavior Management drag, could you go into a little detail and provide a little color on what that business is struggling with?

Rodolfo Spielmann

*President-Pet Consumer Products, Central Garden & Pet Co.*

A

So, when we talk about behavior modification, this is mainly our Comfort Zone brand, which you plug it in the wall then with pheromones you get your cat to stop destructive behavior in the house. So it really calms them down, that's why we call it behavior modification. We have two things going on in this segment after growing pretty rapidly for several years; A, we had our former vendor entering the category. So, obviously, that's a bit of a hit. And the second one is our new product had – a minimal amount of consumers had issues with the aroma of the product. So we had to change that aroma, and we started shipping the new product now in Q2.

Now, it's important to understand that this is a challenge that around 40% of the household see, and the category have a penetration of 0.4%. So we're just starting. So, yes, it's a bit of an issue year-over-year. It does bother to have a new competitor on an area that we're competing alone before, but we're still number one. We're launching the new – we launched, actually, the improved new product in Q2. And we have a lot more innovation coming afterwards in the year, so very comfortable with where we're going here.

Karru Martinson

*Analyst, Jefferies*

Q

Okay. And then, where do you guys stand on CBD oil for pet and infused products as we're seeing so much and reading so much about that now?

Rodolfo Spielmann

*President-Pet Consumer Products, Central Garden & Pet Co.*

A

I'll tell you, there's nothing to report at this time, but obviously we see the trend in the category and it's an area we're exploring. One of the benefits of having a fairly large portfolio which includes distribution is we can track everything that is going on very closely. So whenever is the time, we will be ready.

Karru Martinson

*Analyst, Jefferies*

Q

Okay. Thank you very much, guys. Appreciate it.

**Operator:** Thank you. Our next question today is coming from Jim Chartier from Monness, Crespi, Hardt. Your line is now live.

Jim A. Chartier

*Analyst, Monness, Crespi, Hardt & Co., Inc.*

Q

Good afternoon. Thanks for taking my questions.

George C. Roeth

*President, Chief Executive Officer & Director, Central Garden & Pet Co.*

Hi, Jim.

A

Nicholas Lahanas

*Chief Financial Officer, Central Garden & Pet Co.*

Hey, Jim.

A

Jim A. Chartier

*Analyst, Monness, Crespi, Hardt & Co., Inc.*

Hey, guys. So I think you'd, coming into the year, expected Bell to be, I think, about a \$0.10 drag in the first half of the year for EPS. Did that come in in that range? Was it bigger or smaller than that?

Q

George C. Roeth

*President, Chief Executive Officer & Director, Central Garden & Pet Co.*

I'll say, I don't remember giving a \$0.01 target for the Bell's impact specifically, but I will say, Bell has been tracking pretty much as we thought for the year.

A

Jim A. Chartier

*Analyst, Monness, Crespi, Hardt & Co., Inc.*

okay. And then, on the Pet distributor business, organically it looks like that was down 4% in second quarter and it was down in first quarter after pretty good growth last year. So, anything going on there that's noteworthy that's kind of lapped the sell-ins – the ramp-up of the large grocery customer last year.

Q

Rodolfo Spielmann

*President-Pet Consumer Products, Central Garden & Pet Co.*

I can tell you, I'm not sure where the numbers are coming. Our Pet Distribution business is fine. That's not growing as fast as we were growing a year ago when we're adding new businesses, but the business is fine, so now no major concerns there.

A

Jim A. Chartier

*Analyst, Monness, Crespi, Hardt & Co., Inc.*

Okay. And then on the behavior modification, have customers started buying that? And then, how confident are you in the new formulation that you're knocking out the same issues?

Q

Rodolfo Spielmann

*President-Pet Consumer Products, Central Garden & Pet Co.*

So all the customers that partnered with us last year, they're still with us, and they are still betting on the new product. [indiscernible] (00:35:10) we also liquidate the old one. And we're comfortable in the new formulation. We have done all the testing to make sure that the aroma area we estimate have been taken care of.

A

George C. Roeth

*President, Chief Executive Officer & Director, Central Garden & Pet Co.*

Hey, Jim, by the way, the Pet D business, as it sits within our portfolio, is flat. So not down. Overall, that business is flat.

A

Jim A. Chartier

*Analyst, Monness, Crespi, Hardt & Co., Inc.*

Okay.

Q

George C. Roeth

*President, Chief Executive Officer & Director, Central Garden & Pet Co.*

We usually don't – typically, we don't call out individual businesses. I think you were referring more to third-party business, but that's effectively overall the Pet D business is flat, so not down.

A

Jim A. Chartier

*Analyst, Monness, Crespi, Hardt & Co., Inc.*

Okay. Thank you.

Q

**Operator:** Thank you. [Operator Instructions] Our next question today is coming from Hale Holden from Barclays. Your line is now live.

Hale Holden

*Analyst, Barclays Capital, Inc.*

Hi. Thanks for taking the call. I just had two questions. Circling back to the M&A commentary, I was wondering if you have seen any inflation in multiples in your discussions over the last six months with the equity market or if you were still kind of holding the line in terms of price discipline.

Q

Nicholas Lahanas

*Chief Financial Officer, Central Garden & Pet Co.*

Well, I mean, as far as the last six months, we haven't seen any inflation from the previous 12 or 18 months. The multiples still are tracking fairly high, and I think to some extent you get what you pay for. So, if you're looking for companies that have great brands, that are growing their top line pretty aggressively and have great margins, you can expect to pay a higher multiple for those. So I think that's just the lay of the land. We've been fortunate. Our last few acquisitions, we've been finding sort of these diamonds in the rough, paying lower multiples. But again, if you look at a lot of those businesses, they're good businesses but they're not exactly ones where you've got some killer brand that's out there, that's just crushing the category. So we will expect to pay more for higher margin, higher growth businesses. It's as simple as that.

A

Hale Holden

*Analyst, Barclays Capital, Inc.*

Got it. And my second question is you talked a little bit about trucking costs or transport costs. But I was wondering, as you look at your broader kind of input or commodity basket, if there any others that have changed that you won't want to call out over the last quarter or so?

Q

Nicholas Lahanas

*Chief Financial Officer, Central Garden & Pet Co.*

I mean, overall, freight looks like it's stabilized. Labor continues to be an issue. We have little pockets where we're seeing some inflation. Within our grain category, millet, we see a little bit of a run up there. Our fertilizer business, our inputs there are fairly flat. So it's subsided a little bit, I would say, overall I had a comment. And then there are

A

pockets of grass seeds that are up as well, like your Bermuda. And some of those we won't have a good handle on until later in the year.

Hale Holden

*Analyst, Barclays Capital, Inc.*

Yeah.

Q

Nicholas Lahanas

*Chief Financial Officer, Central Garden & Pet Co.*

Some of those are dependent on a crop yield. And for example, in some of the grains that go into wild bird feed. Those are just being planted now. Long-term weather forecast looks favorable, so we think it's going to be a good harvest, but too early to tell, we won't know until later in the year.

A

George C. Roeth

*President, Chief Executive Officer & Director, Central Garden & Pet Co.*

The only thing I'll add is the cost that would flow to this year's P&L increases would be contemplated in the forecast that we're giving you.

A

Hale Holden

*Analyst, Barclays Capital, Inc.*

Great. Thank you so much. I appreciate it.

Q

George C. Roeth

*President, Chief Executive Officer & Director, Central Garden & Pet Co.*

Thanks.

A

**Operator:** Thank you. Our next question today is coming from William Reuter from Bank of America Merrill Lynch. Your line is now live.

Q

Hi, guys. This is [ph] Mike (00:38:42), for Bill. Just one for me. Can you talk about the current conversations you're having with retailers in regards to the current U.S.-China tariff situation? Obviously, that was big news over the weekend. Thanks.

Rodolfo Spielmann

*President-Pet Consumer Products, Central Garden & Pet Co.*

Yeah. Clearly – this is Rodolfo. I cannot tell you conversations from the last few hours because these are new news, but what I can tell you is that when the last couple of rounds of tariffs came, we took a very flexible approach, which is both with the retailer, we explained to them what we're doing to reduce costs, what we're doing from opportunities [indiscernible] (00:39:16). And what we did is we made it very clear what was the price increase and also what was the tariff increase. And we did say that as long as the tariff were in place, that [indiscernible] (00:39:30) charge or surcharge will be in place. If tariff increase more, we will increase it more. If they get repeal, we will take it out. So we were very transparent. They appreciated that. 100% of them accepted our behavior. We expect the same thing to happen if it comes to that.

A



Thanks.

**Operator:** Thank you. We've reached the end of our question-and-answer session. I'd like to turn the floor back over to George for any further or closing comments.

**George C. Roeth**

*President, Chief Executive Officer & Director, Central Garden & Pet Co.*

I just want to thank everybody for attending the call, and have a great day.

**Operator:** Thank you. That does conclude today's teleconference. You may disconnect your line at this time, and have a wonderful day. We thank you for your participation today.

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