

Bryan: All right. Good afternoon, and thanks for joining us today. My name is Bryan Spillane. I'm the Senior Equity Analyst at Bank of America Securities covering the consumer staples group.

This morning we are really pleased to have Central Garden & Pet here for a presentation and fireside chat. Walnut Creek, California based Central Garden & Pet is a leading player in both pet supplies, including companion pets, aquatics, small animal, reptile, and in garden consumables, including a strong presence in lawn care, wild bird seed, controls and fertilizers, and live plants. These products are sold through a wide variety of retailers, including Home Depot, Lowe's, Walmart, Petco, and Chewy. At the end of fiscal '20, the company had about \$2.7 billion in net sales and currently has a market cap of about \$2.3 billion.

Today's speakers, we have Chief Financial Officer, Niko Lahanas and VP of Investor Relations, Friederike Edelmann. Niko, I'll turn it over to you.

Niko: Thank you, Bryan. Happy to be here. So let's get started. We'll move on a few slides here to kick it off. We have the usual disclaimer and let's move to Slide 6 if we could. Great.

So here we have the company overview. As Bryan mentioned, we're in the pet and garden space. We are roughly 60% on the Pet side, 40% Garden. The company started as a distribution business, but has grown through acquisitions, so 50 acquisitions over the last 25 years. Nationwide footprint in terms of manufacturing, as well as distribution, and is largely a manufacturer now of pet and garden products. As Bryan mentioned net sales of \$2.7 billion and largely in the US, so 95% of the business being in the US. And we have a small business in the UK that's around 4% of our revenue. Can we move onto the next slide.

So here we have our strategy, our Central to Home strategy. We call that the five Cs. Really our purpose is to nurture happy and healthy homes. And our mission is to lead the future of the garden and pet industry. And the way we're going to do that is really through the five pillars. We've got our consumer, customer, Central, cost, and culture. This really feeds into our financial algorithm, which I'll go into a little bit later. But really those are our five pillars and our strategy of really moving forward in terms of building value in the company. Go onto the next slide.

Quick COVID-19 update on the company. We've largely remained open. We've had a little bit of disruption around COVID-19. Our COVID rates have really mirrored the entire country when you look at kind of that peeking out during the holiday season. But our number one priority has always been the health of our employees, so really making sure that they're safe at work, and then secondarily

maintaining business continuity through the pandemic. I think the company, we've done an excellent job. I really commend to all the folks in the field of really doing a fantastic job around employee safety and then making sure that we've largely remained operational. As you'll see in the results, COVID has largely been a tailwind for us, so it's a little bit of an embarrassment of riches, but both categories have done extremely well during this pandemic. We'll move onto the next slide.

And then we'll go one more slide over and we'll just talk briefly around the highlights. I won't go into a lot of detail. I let folks read. I won't clear this page as we're going to go into more depth on each of these topics during the presentation. So let's move onto the next slide, please.

We talk a little bit about the Garden industry. If you look at Central, we play in \$30 billion of a \$33 billion category, largely consumables. Our business hit over a billion dollars last year for the first time. We view it as an extremely attractive category. It's concentrated, as you think about it. So from a competitor standpoint and also a customer standpoint. We have greater than 70% of our revenue coming from three large customers. And then also you've got some really large competitors vying for market share there. So very, very concentrated as opposed to Pet, which I'll get into a little bit later.

And then a little bit under penetrated in e-com, as you think about e-commerce, it's under 5% right now in the category, but growing triple digits. So we're going to see a lot more activity in the e-commerce realm in Garden. And as you can imagine there are limitations there. You've got issues with product where you've got tendencies to be a little bit less expensive and higher cubes, so these products don't necessarily ship well. And therefore you've seen a little bit slower uptake on the e-com side.

And then also really the way the consumer views the category. When they go into a home improvement store, they're really looking to really fill out a project if you will. And so, they want to go into those stores, they want to look, they want to touch, they want to smell the product, and as they complete that project at home. So it's a little more what I would call tactile when you go into a store looking for garden products. We'll move onto the next slide and we'll talk a little bit about Pet.

Again, Pet is a little more attractive from a growth standpoint, so around 4% growth, 3 to 4 as an industry versus Garden, being more at that household rate of 1 to 2%. We play in \$28 billion of \$100 billion category. As Bryan mentioned, we're largely in pet supplies, so think dog and cat treats, some hard goods, aquatics, small animal, avian, reptile, equine. We don't play in food. That tends to

be dominated by large multinationals. We tend to gravitate more to niche categories, and as you'll see later in the presentation, we have usually a one, two or three market share in those niche categories. Move on to the next slide.

And then you can see our leading brands across both segments. And as I outlined before, we tend to have a number one, two or three category share in those brands. And that's something we're really proud of, and it's quite intentional, as we look to enter new adjacencies, as well as build out our core categories either through M&A or organic activity. We'll move onto the next slide.

And then we'll talk a little bit about pets. So our pet business, \$1.6 billion in sales in 2020, something we're very proud of. Excellent growth. As I mentioned, COVID being a bit of a tailwind, so we had 13% topline growth, 26% EBIT growth, and then e-com being a big part of pet with 37% growth. It's obviously the fastest growing channel in pet. As most of you know, through the pandemic we saw that acceleration in that trend of going online. And roughly e-com is right around 20% of our pet business. Amazon is now, I think the fourth largest customer on the pet side, with Chewy sort of nipping at their heels as well. And we've seen some really good growth there on the e-com side. We'll move onto the next slide.

And then Garden. Garden had a fantastic year, again driven by COVID, but also driven by an extremely favorable weather year last year. Garden tends to be very seasonal. If we have favorable weather, it can have a huge impact on a garden season. And we sort of had both tailwinds kind of kicking in at the same time and you see the 14% growth. What I would point out on Garden was midway through the year last year, so quarter ending March, business was down pre-pandemic. And it just took off in the second half. And so, it took off so much that we ended up with 14% growth on the topline, 30 on the bottom line. And then as I mentioned, e-com growing at triple digits. Albeit it's a very low base, but we think there's a lot of runway left there to be had in terms of e-com there. We'll move onto the next slide.

And one of the things we do extremely well, we pride ourselves on, is having great relationships with our retailers. We've won Vendor of the Year at places like Lowe's. Walmart, we've won the Humble Hungry Hustle Award, which is not easy to get at Walmart. We won that a few years ago. So those are things we're really proud of. Part of our portfolio mix also is private label and that's something we do with the retailers in partnership and that's something that we feel works really well. We've done it for a long time, it's part of our DNA, and really creates a very strong relationship with that retailer around product and assortment. Move onto the next slide.

And then this is really getting to the strategy, the fuel for our growth, and I'll talk about our financial algorithm a little bit later in the presentation. But it really comes from taking cost out and aligning for scale around procurement. What we've seen during the pandemic is a drop in our service levels, unfortunately. So what you're seeing from us this year is really an increase in CapEx to expand capacity, to meet that demand, and then also gain efficiencies. And we're also doing things like automating.

One of the areas that we've seen a lot of inflation is obviously labor. I think a lot of folks have seen that. A way to get around that is to automate a little bit more. The pandemic has been no friend to labor rates when you've got stimulus packages coming in and folks have to make decisions at that point. Do they want to stay at home, be safe, spend time with their children or go to work? So labor has been also a challenge, I think during this year. And those are areas that we're just looking to take cost out, as well as build efficiencies in that supply chain area, and then reinvest those costs into demand creation, and then you create sort of what we call that virtuous cycle.

And then the last pillar would be really just making sure that our overheads stay in line. The last thing you want is overhead growing faster than sales. Then you've got some serious issues around margin degradation. So it's something we always keep an eye on in terms of looking at those administrative overhead. Move onto the next slide.

And then what do we do with the money when we take those cost savings out? We want to reinvest them in things like innovation. And here you see some examples of that with our small animal bedding, as well as our broth bones on the Pet side, on the dog and cat treat and chew side. And these just give you some examples of areas where we're innovating and also picking up market share across the board. So some real successes here on the Pet side. Move onto the next slide.

And then on the Garden side, again, here's some examples of some innovation around a product called Lawn Booster. This is really designed to simplify the experience of enhancing your lawn and feeding your lawn. It can be quite a complicated process if you want to do it right. So we've really designed a product that has seed, fertilizer, and soil in it so really all you have to do is really spread it across your lawn and then it grows. So we've taken the complexity out for the consumer and it also will help balance out the pH in your soil as well, and so you end up with a much healthier, thicker lawn. That's got a little bit of science behind it. So that's a product that we came out with about a year and a half, two years ago. Done extremely well, something we're really proud of. Move onto the next slide.

And then e-com. Again, this is a huge growth vector for us. We've already seen it disrupt Pet, take off on the Pet side, and we're starting to see that acceleration over in the Garden side. We've shifted a lot of resources out of brick and mortar into digital to help support that initiative because it's obviously the channel that's growing the most. You've got to make sure that you've got that A-plus content. You've gotta manage search. All these things which we call our flywheel, our e-com flywheel in terms of capabilities and making sure that you're hitting all those notes. And really making sure you're driving consumer to that buy page on the e-com side.

So it's really a new set of capabilities that we're having to build out, but it's something that I think we're improving on. We still have a long way to go. I think in terms of e-com you can never go too fast because it is moving that fast. And so, you'll see a continuous investment there on our part to improve that platform. And you even saw it on the M&A side with our acquisition of DoMyOwn. We chose to buy some of those capabilities to accelerate that competency around e-com and digital. Move onto the next slide.

And then we have a history of growth through M&A, 50 acquisitions over 25 years. We've recently just done three. We probably spent more money in the last three months than we have in the last 10 years, 10, 12 years, so very active there. The company has a long history in doing acquisitions. I feel like it's a core competency of ours. We do a great job of sourcing, identifying, valuing, and integrating acquisitions, and it's something we're going to do into the future.

And in many cases, we are the acquirer of choice for a lot of entrepreneurs. Many times they want to stay with the business. They want to continue to work it, but they want to take some money off the table. We afford them that opportunity. We're not going to lever up their balance sheet and we're going to take a lot of the administrative day-to-day grind away from them like AP, AR, payroll, insurance, things like that. And then let them focus on really driving the topline of the business and innovating and really doing what they love. So in many cases, we are a really nice fit for a lot of entrepreneurs. We'll move onto the next slide.

And then talking a little bit about the financial metrics here. You can see nice steady growth over the five years here with sales hitting \$2.7 billion and a nice 10% growth rate. You can see gross margin also at 10% in a four-year CAGR, so we're very proud of that. These charts all include organic as well as M&A growth. And then we have the bottom-line growing faster than the top and nice margin expansion, particularly as you look from '19 to '20 where we saw volumes really take off as well as favorable product mix due to the great weather we had in 2020.

So really nice momentum is something we're really hoping to continue and into '21. And we're, frankly, we're seeing that continue. If you listened to our earnings call in Q1, you saw an acceleration in terms of growth rates on a percent basis, albeit the numbers are smaller in that quarter. So more to come on '21. Obviously. We'll go to the next slide.

Talk a little bit about the balance sheet. Some of these numbers are a little bit dated due to the acquisitions. So we ended the year in '20 with a \$653 million in cash. Largely we've torn through that. We've also gone into our ABL, so on top of the cash we have \$400 million of availability on the ABL. We now have \$200 million of availability. We needed to do some spend on working cap since we're building inventory going into the garden season, as well as paying for some of the acquisitions. So we've definitely changed our cash profile, but we feel very good about the acquisitions that we've made.

If you look at cash flow from operations, you see a nice progression there. It's something we really started to focus on in 2019 around maintaining lower inventory levels, as well as balancing out our AP and AR. We feel like we're in the early stages of that and so you kind of see that nice progression from '18 to '19 and then '19 to '20. Again, we feel like we still have a ways to go there, but we're really proud of the early results there.

And then long-term debt at \$694. Again, this is period ending 2020. We did refi our debt in Q1, so that debt number is now \$100 million dollars higher. We ended up refi-ing that debt and lowering the interest rate by 200 basis points, so some nice savings there.

And then when you put it all together we ended up with a leverage ratio of about 2.6x, and that's on a gross basis, so not a net basis. And that's well within our comfort zone. We really want to be in that 3x to 3.5x range. And for the right acquisition, we're willing to go up to 4x, but then we would quickly deliver back to 3x to 3.5x. And so, 2.6x is a good place, very comfortable place for us to be right now. And we'll move onto the next slide; talk a little bit about Q1.

I alluded to this a little bit earlier. Again, you see the growth rates somewhat accelerating to 23% on the topline. We had some nice margin expansion of 70 basis points on the gross margin line. And then you see the bottom-line really expanding and growing quicker than the topline. A lot of this was driven by increased volumes in Q1, but then also favorable product mix. I will say we did start to see some inflationary pressure. Q1, we largely flew without the air cover of price increases, so we were still able to expand margin without price increases, something we're really proud of in Q1. And we'll move onto the next slide.

So talk a little bit about the long-term algorithm. And this really is, it's sort of our, what we call our virtuous cycle. And when you distill down the whole company of, hey, how are you guys going to grow? This is really it. It's designed around taking cost out of the supply chain and then really reinvesting that cost into demand creation activities, such as e-com, digital, innovation, brand building, and the concept is to grow the net sales, the topline, at low single digits, but also to grow enough to take market share in our respective categories. And when we do a weighted average of those market share gains, it boils up to a low single digit growth rate on the topline.

Then what we want to do is take those cost savings, half of them we want to drop to the bottom-line and drive EBIT margin expansion, as well as EBIT growth. And then that other half gets reinvested. So the idea is to grow that bottom-line faster than the top, so EBIT is to grow at mid-single digit as opposed to low single digit.

And then when you empty it all out into EPS, we want that to be at mid to high single digit. You get a little help with leverage, which gets you sometimes into that high single digit rate. So that's the algorithm. We call that our virtuous cycle. It's really sort of a flywheel that we intend on continuing to drive and it's really the engine that drives the business and think of the cost savings as the fuel going into that engine to help drive that business forward. Then we'll go to the next slide.

So this is our management team. I would tell you that this is the strength of the company. It's all about the jockey and not necessarily the horse. We've got an incredibly talented management team with a great mix of some newcomers as well as veterans of Central. And we've got a great mix of folks that have from like large CPG companies, as well as folks that are legacy entrepreneurs, who we bought the businesses from that are still there running the business 20 years later. So it's wonderful, eclectic combination of talent, thoughtfulness, and ideas and it works extremely well. And really these are the people that drive the business. And largely we owe all the success to the folks on this page. Go to the next slide. One more.

We'll talk a little bit about our outlook. And we really got off to a wonderful start in Q1, as I flipped my page here. And a lot of folks said, well, geez, why aren't you taking guidance up? Well, one of the reasons was – well, many reasons, but really there's still a lot of uncertainty, particularly the back half of the year. As I mentioned, we had a great weather year in in 2020. We're going to have to lap that along with some of the COVID tailwinds. We are seeing some inflation out on the horizon so we have to mitigate that with pricing as well as with

productivity gains. And then we don't know really what the consumer is going to do around COVID and really the vaccination. Are they going to jump on a plane and go to Hawaii or Disneyland or are they going to stay home and shelter and garden and take care of their pets?

That said, I would say, Tim and I, the CEO, are very bullish on '21. We feel like the business has a tremendous amount of momentum, particularly when you look at the Q1 results. Q2 seems to be continuing that momentum so we feel really great about it. We actually feel pretty good about the long-term as well. There may be some bumpiness over the summer, depending on what the consumer does and what weather does, but overall we are very, very bullish on the business and very excited for the future. So with that, I'd love to open it up for fireside chat and questions.

Bryan: Great. Niko, thank you for that overview. Very helpful. Maybe just to step back little bit and just a question just around strategy. Think back in December last year you guys made a presentation kind of unveiling the Central, the home strategy. And some of the key elements were strengthening the consumer orientation; M&A, which you touched on here; cost and productivity and culture. Without having to go through the entire strategy, maybe if you could just – I guess what I'm interested in is just, what do you think is the element of the – sort of the biggest change for the company? And what do you think the outcome of that or the output of that change will be?

Niko: It's a great question. I would say, and this is sort of what Tim has brought to the table, one of his strengths coming from Mondelēz, and he was their chief growth officer. I think the company in the past has had an amazing legacy around strong customer relationships, but I think the consumer orientation was a little bit weaker, and that's an area where we can get much better around understanding that consumer better, having better consumer insights. Those types of things are going to inform innovation. They let us know where those blind spots are in the assortment and really areas of opportunities. So I think that's the area where we're going to really ramp up.

I think also in brand building. If you look at – we have a new logo, we have a new whole way of how we communicate, and a lot of it is going to be around building some brands. Brands that we already have that are large like Pennington, making that an iconic brand, continuing to build out the Nylabone brand, as well as Kaytee.

So I would say those are probably the two areas of the biggest opportunities there. It's just getting smarter with the consumer because you've got this whole concept of democratization of retail going on, where the consumer really has all the power



and you see folks putting ratings online, so it's really empowering that consumer. I think the customers are still incredibly important, but it's really being smart around the consumer and connecting with them and understanding what they need and want.

Bryan: Makes sense. And I guess just as a follow-up to that, given all the acquisitions you've done, and you mentioned having a lot of the sort of entrepreneurs that started some of these businesses still with the company. Suppose it's going to be helpful to bring those insights kind of in a more central location for these entrepreneurs then to kind of take up on it, right. So there's a little bit of maybe integration of ideas, I guess, that kind of flows through this as well.

Niko: Yeah. Our insights team sits in corporate so that group really has access to all the Nielsen data, IRI data, e-com data via Amazon. And then they distribute that information to all the various groups and then promoting ideation around that data. So yeah, you're right. I mean that's where you're going to get the most leverage is by centralizing that discipline, and we do that here in Walnut Creek.

And then they work with all of the BUs out there. Typically the BUs will have someone that specializes in that and then they'll liaise with our corporate office. But it's something where we can align for scale in that discipline, but not compromise any of the entrepreneurial spirit that we're known for.

Bryan: Maybe if we can switch a little bit. You mentioned in the prepared remarks, you talk a little bit about the guidance and some of the tailwinds that the business has had over the last 12 months or so. So I guess two questions related to that. One is just given the pandemic and then good gardening weather, just how do you see the sustainable – like what's the growth rates for these categories as we get beyond the pandemic? Just if you give a sense of. I know you've given us kind of what your growth is, but just what's the growth rate of the categories of the industry.

Niko: Well, I mean if you look at the last 12 months, they've just outpaced any sort of historical growth rates that we've seen. That said, I think we're in a little bit of a reset with both categories. And the reason I say that is there's some really major macro trends that play into this.

If you look at the Pet side during a pandemic, you've seen a 4% growth in households, so 2.7 million households bought a pet. That's a big number. Another number is the amount of households that already – 50, I think is 56% of households that already had a pet added another pet. And I'm one of them. I had a dog. I added another dog, so I'm one of that 56%. The other thing I would tell you

is 50% – 57% of millennials and gen-Zers are pet parents now. So those are very, very strong macro tailwinds on the Pet side.

The Garden side, 8 million households got into the – or 8 – yeah 8 million households got into the category in 2020. What we also saw was younger folks getting into the hobbies, like wild bird food. That was a very aging category. We've now got a shot in the arm with a lot of young consumers coming into that category.

The other thing I would say is with the pandemic and the work from home concept that's happening now, I think just creates another tailwind for both categories in that people will be at home. They're going to want a garden. They're going to spend more time with their pets at home, meaning then they might feed them more treats so you see consumption go up. As well as what I would call the install base because you've got more live animals coming in, penetrating into the household. So we think those are all tailwinds.

And then we haven't talked about the suburbanization that's going on. Folks leaving urban areas, going to suburban areas where you have a yard, where you have more space. You're going to walk that dog. You're going to go and garden. So we feel like there's some real, real strong tailwind.

And so, you asked about the growth rates in a very elegant way, almost avoiding the question. I think they're going to go up. I don't know how high they're going to go up, but I think they're going to go up just because of all the things I just mentioned.

Bryan: Maybe we can kind of touch a little bit on M&A. I guess the first question is, the most recent ones that you referenced earlier over the last couple of months were all in lawn and garden. So I guess does that imply that the company's focus is going to be more on lawn and Garden versus Pet going forward or?

Niko: No. So we got that question a lot. No. The answer is no. It was completely by coincidence that we happened to do three, one after the other, and they all happened to be in garden. I would tell you, just to give a little history on each of the acquisitions.

Green Garden, the big one, so the one that we bought for \$532 million, we looked at that two years ago. That's a company we'd been looking at for quite a while. We've liked it for quite a while. We love the category. It's an adjacency to the current categories that we're in. So that was one that was on the radar for quite a while. Hopewell, the live tree and shrub business, we had been speaking to them for nearly a year before we did that deal. So they all kind of came at us all at once,

but they were all in play for quite a while. And then DMO was a little bit more recent.

I would tell you we're pretty agnostic whether it's pet or garden, but you make a great point in that we've done three on the Garden side so I think it's time we start looking over on the Pet side for some more deals,

Bryan: And then I guess that kind of flows into, will you need to pause? You've done three deals, will you have to pause to integrate? I think your net leverage is around two times, so I don't think the balance sheet's a constraint. Does having just done three deals kind of affect you at the pacing of M&A in the near term?

Niko: Yes and no, I would say very near term. So would I do another deal in the next 60 to 90 days? Probably not. I do have to have pity for my accounting and IT teams. They're the ones that do a lot of the heavy lifting on the integration front and certainly they're very busy around doing that. So I would say very near term, probably not.

That said, the pipeline is very active. We're in numerous discussions right now. And deals take time. So even discussions we started a month ago, I don't anticipate those closing for another three months. But I would say, let us get a quarter or two under our belts, and then I think we'll be open for business to actually consummate a deal.

Bryan: And then maybe if you could touch on just valuations. I think historically you've made acquisitions in kind of the six to nine times EBITDA range, and is that still kind of a good range in this environment? Are valuations getting pushed up? Just kind of what the landscape looks like and more specifically just what it might imply with regards to the multiple?

Niko: Yeah. Great question. And the answer, like everything, it depends. We've always been value buyers of growth companies. We've always tried to stay disciplined in that six to nine range. That said, things have changed. You've got a lot more private equity players in the market. That means more competition. That means higher multiples. And then when you have the public markets trading at higher multiples, that obviously is going to reflect down into the private market.

I think if you want the higher quality businesses you're going to have to pay, and in many cases that's going to be double digits, particularly if you're looking for businesses of scale. Those will always command a higher multiple. So we have moved our thinking a little bit on that. Tim and I share a desire to go after businesses that have a stronger brand, that have an accretive margin percent

profile, and are also growing and taking share. Those type of assets you will have to pay a premium for it and we understand that.

And you're starting to see a little bit of that with the recent acquisitions we did. Green Garden, everyone will be able to do the math. We will file an 8K on that. But you have to normalize that business because they had an incredible bump during 2020. And so, if you do the math, that's going to imply a high single digit multiple, but when you normalize it in my mind we paid double digits for that. And that's a really high quality business. And I think you could probably expect a little bit more of that going forward.

In the past we've been very, very value conscious. Those have worked for us, but if you want those high flyers, you do have to pay. And we want to balance out that portfolio. You want to make sure you've got some real "invest for growth" type opportunities there, as opposed to just a pure value type portfolio, and that's what we aim to do.

Bryan: Niko, with just about a minute or so we have left. I just wanted to sneak a couple of shorter term questions in, if that's okay. One is just, there's been a lot of reporting about the backlog on ports, stuff coming in from China because of the backlog on the ports. And then you had referenced service levels earlier in the presentation. So is that something that we should be concerned of? And I guess in addition to that, Texas with the power outages and everything that went on in Texas in February, is there anything there that would have affected your supply chain as well?

Niko: Yeah. So real quick. Eight percent of our COGS comes out of China. I would tell you that it is a challenge. In many cases you're talking about 90-day lead times. Our lowest fill rates are from the China sourced, our China sourced businesses, there's no question about it, so that continues to be a challenge. As far as the weather in Texas, and really it was the weather more than anything, it did have an impact. We did have some shutdowns. You saw challenges in terms of trucking. So you saw a muted sort of activity in February for about 7 to 10 days so it did have an impact. That said, we are now starting to normalize as we get deeper into March.

Bryan: All right. Well, we're out of time, so. Although I think I could have sat here and asked the questions for another 30 minutes, so. But listen, thanks again for spending time with us, both Niko, you, and Friederike, and look forward to see you again soon. Thank you.

Niko: Thank you, Bryan.

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