

06-May-2020

# Central Garden & Pet Co. (CENT)

Q2 2020 Earnings Call

## **CORPORATE PARTICIPANTS**

**Howard Machek** 

Chief Accounting Officer, Central Garden & Pet Co.

Timothy P. Cofer

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

Nicholas Lahanas

Chief Financal Officer, Central Garden & Pet Co.

J.D. Walker

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

**John Hanson** 

President-Pet Consumer Products, Central Garden & Pet Company

### OTHER PARTICIPANTS

William B. Chappell

Analyst, SunTrust Robinson Humphrey, Inc.

**Peter Graham Malone** 

Analyst, JPMorgan Asset Management (UK) Ltd.

**Bradley Thomas** 

Analyst, KeyBanc Capital Markets, Inc.

William Michael Reuter

Analyst, Bank of America Merrill Lynch

**James Chartier** 

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

Karru Martinson

Analyst, Jefferies

Carla Casella

Analyst, JPMorgan Securities LLC

# MANAGEMENT DISCUSSION SECTION

**Operator**: Ladies and gentlemen, thank you for standing by. Welcome to Central Garden & Pet's Second Quarter Fiscal 2020 Financial Results Conference Call. My name is Deb and I will be your conference operator for today. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session. [Operator Instructions] As a reminder, this conference call is being recorded.

I would now like to turn the call over to Howard Machek. Please go ahead.

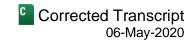
### **Howard Machek**

Chief Accounting Officer, Central Garden & Pet Co.

Thank you. Good afternoon everyone. Thank you for joining us. With me on the call today are Tim Cofer, Central's Chief Executive Officer; Niko Lahanas, Chief Financial Officer; J.D. Walker, President, Garden Branded Business; and John Hanson, President, Pet Consumer Products. A press release providing results for our second quarter ended March 28, 2020 is available on our website at 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 Tim, I would like to remind you that statements made during this conference call, which are not historical facts, including the potential impact of COVID-19 on our business, expectations for new product introductions, long-term organic growth goals, future acquisitions and future revenue, margin expansion, cost savings and profitability are forward-looking statements subject to risks and uncertainties that could cause

Q2 2020 Earnings Call



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 27, 2019. Central undertakes no obligation to publicly update these forward-looking statements to reflect new information, subsequent events, or otherwise.

Now, I will turn the call over to our CEO, Tim Cofer. Tim?

### Timothy P. Cofer

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

Thanks, Howard. Good afternoon, everyone, and thank you for joining our Q2 earnings call. I first want to extend my best wishes to all of you and your families. The COVID-19 global health crisis has been a turbulent time for us all. And our hearts go out to those who have been affected personally and professionally by this pandemic.

I'd like to start with some personal observations and an overview of how our teams had been working to take care of our employees, customers, and consumers during the COVID-19 crisis, Then, I'll provide some insight into our performance for the quarter.

Over the last few months, I've been humbled by all that our employees had done to prioritize the health and safety of fellow team members while collaborating across the enterprise to ensure our business operates as seamlessly as possible. Because Central is considered an essential business in most jurisdictions, almost all of our employees continue to work to meet essential needs, whether they are on the production floor, in stores, or at home.

To everyone in our organization, I want to express my sincere gratitude for your efforts and your commitment. I especially want to recognize our employees working in manufacturing, logistics, and merchandising roles. You have been on the frontline of this crisis every day and you continue to do your jobs with courage and integrity. Thank you.

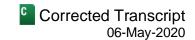
The safety and well-being of our employees is paramount and the coronavirus pandemic has our leadership team's full attention. To address the needs of our business, early in the quarter we mobilized the cross-functional task force to focus on timely critical issues related to COVID-19 developments. Given the realities of the current environment, our teams have worked hard to do the following.

One, ensure constant communication and regularly share pertinent information around health, safety, and benefits. Two, procure necessary personal protection equipment and sanitation supplies for those working in manufacturing, logistics, and merchandising roles. Three, enhance safety procedures including investing in regular deep cleanings, staggering shifts, and implementing social distancing across our facilities. Four, enable a large number of employees to work from home seamlessly and securely in accordance with shelter-in-place orders, while continuing to handle order management, customer service, accounting and finance, and sales, our IT team has done stellar work to support this effort. And five, to adhere to all local, state and federal requirements.

With more than 100 sites and approximately 6,000 employees, we've been fortunate to have only a very small proportion of employees test positive for the virus. And in each case, we work to ensure they receive the care they need as they recover. Our thoughts are with those who are still battling the virus.

Now, turning to Q2 results. We've been in constant communication with our customers and suppliers, collaborating to meet consumer needs. As you saw in our press release, overall sales growth in the quarter was 4.4% versus prior year. Our sales growth was driven by our recent Arden and C&S acquisitions. Organic sales

Q2 2020 Earnings Call



were also up 0.5% and grew almost 2% versus prior year, when you exclude the dilutive impact of last year's strategic exit of the fashion-oriented pottery product line.

In our Pet segment, organic sales were up 4%, while Garden organic sales were down 3%. Excluding the impact of the fashion-oriented pottery exit, Garden was roughly flat versus prior year. Pet gains were driven by consumables and pet distribution. We saw a notable surge in the last few weeks of March due to consumer stocking up on products as the COVID impact became more apparent. Demand in edibles, small animal supplies, and animal health more than offset continued headwinds in live fish and pet bedding.

Garden was impacted by last year's pottery line exit, as well as a soft start to our grass seed season. These headwinds were partially offset by growth in our Garden distribution business, wild bird feed, and live plant product lines.

All in, for EPS, we delivered \$0.78, up \$0.05 compared to \$0.73 in the second quarter of 2019. We're pleased with our EPS growth versus prior year, especially given the COVID-19 impact in the latter part of the quarter. And while the unfavorable impact of COVID-19 began to manifest in portions of our portfolio in March, we expect that most of the impact on our financial results will be in our third and fourth quarters. Obviously, given the unprecedented and rapidly evolving situation, it is impossible for us to predict the effects we will see in that timeframe.

That said, let me give you some color around what we saw in March and April across our categories, as this crisis impacted both consumer and customer behavior. What we're dealing with today is unlike any other recessionary environment we've seen in the past and Central is seeing varying impacts to the Garden and Pet businesses due to COVID-19.

On the Pet side, our business was tracking according to plan in January and February. In March, we saw an increase in consumer spending as shelter-in-place mandates were rolled out. This was most pronounced in our ecommerce channel, where we have seen dramatic spikes, especially in Pet consumables. Another favorable impact to our Pet business has been the record level of dog and cat adoptions from shelters. Pet ownership is clearly increasing as people plan to spend more time at home and seek the joy and comfort of their companion animals. This bodes well for the longer term sales of pet habitats, supplies and consumables.

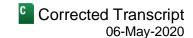
Offsetting these favorable impacts, we have seen a slowdown in specialty Pet brick and mortar retailers. In addition, many pet retailers have temporarily discontinued their order patterns for small animals, pet birds and fish. This negatively impacted our live animal business in March and April.

Now, shifting to Garden, our Q2 consumption metrics were solid and we were pleased with the momentum we saw in the category. The core Garden business finished the quarter roughly in line with prior year. We saw consumption drop in late March and April due to in-store curtailments of foot traffic and limited access to outdoor Garden departments, which are impacting some of our Garden product lines, particularly our Bell Nursery live plant business.

I also want to note that COVID-19 crisis is coinciding with the peak garden season, which typically takes place from mid-March through June. We are encouraged to see live plant department slowly reopen, but our business is feeling the effects of the pandemic during this important time of the year.

So, as you can see, across our portfolio there's an evolving mixture of COVID impacts on our consumers and customers. Thankfully, one of the benefits of having a portfolio like ours is there are some tailwinds to help at

Q2 2020 Earnings Call



least partially offset the headwinds of the pandemic. Further, I firmly believe Garden and Pet, our industries that will continue to thrive in the medium and long term. However, there is obviously unprecedented uncertainty in the near term.

Given the lack of visibility and the pace of change, we do not think attempting to give financial guidance is prudent at this time. Accordingly, like many companies, we are temporarily suspending providing guidance for fiscal 2020 until the COVID-19 situation in the US stabilizes. We will provide updates when appropriate and we'll revisit the guidance question at the end of the third quarter.

As we continue to navigate the daily realities of COVID-19, I want to assure you we are not losing sight of our future. While in the near term, we have redirected most of our resources to our business continuity efforts and the ongoing health and safety of our employees, a portion of our time has remained focused on our key longer term enterprise strategic priorities, which as I shared last quarter, we've labeled Vision 2025.

Addressing the needs of the pandemic has only reinforced the importance of evolving Central's business. It's more important than ever for us to continue to build core capabilities including e-commerce, digital marketing and innovation, invest in organic growth and pursue strategic and opportunistic M&A that create further value for our shareholders. We look forward to a time in the future when we can define our new normal post-COVID-19 and refocus our energy and resources on growth and building out our long-term strategy.

In closing, I could not be more proud of the team here at Central and how they are persevering and supporting each other through this challenging time. It further bolsters my strong confidence in the resiliency and long-term potential of this great company.

With that, let me turn it over to our CFO, Niko, to share more of the Q2 details of our company and across both Garden and Pet segments. Niko?

### Nicholas Lahanas

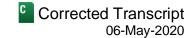
Chief Financal Officer, Central Garden & Pet Co.

Thank you, Tim. Good afternoon, everyone. Second quarter total company sales increased 4%, or \$30 million, to \$703 million from \$674 million in the second quarter of last year. Acquisitions were the primary drivers of the sales gain, accounting for \$26 million of revenues in the quarter. Organic sales were also up 0.5 point, aided by gains in our Pet segment.

And as Tim mentioned, organic sales were up close to 2% when you exclude the impact of the pottery exit. Consolidated gross profit for the quarter increased \$1 million, while our gross margin decreased to 110 basis points to 29.5%, negatively impacted by unfavorable mix of sales and the impact of the lower volumes in pottery and live fish businesses.

SG&A expense for the quarter decreased 2% or \$3 million versus a year ago. This decrease was driven by lower administrative spending and transportation costs in the base business, partially offset by higher inorganic and corporate spending. Our corporate expense increase was primarily due to higher health insurance costs. As a percent of sales, SG&A decreased 130 basis points to 20.1%. As a reminder, included in prior-year 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 and a \$3.2 million write-up of our previous minority position in Arden, 100% owned as of February 2019.

Q2 2020 Earnings Call



Central's operating income for the quarter increased to \$66 million and operating margin increased 20 basis points to 9.4%, due to lower SG&A expenses and accretion from acquisitions. Offset by lower gross margin, EBITDA for the quarter increased 7% to \$79million.

Turning now to the Pet segment. Pet segment sales for the quarter rose 7%, or \$23 million, to \$361 million, and grew 4% on an organic basis. As Tim mentioned, organic sales were aided by strength and late quarter COVID-related pantry loading in the pet consumables. We also saw strength in our small animal supplies and animal health businesses. These gains were partially offset by continued headwinds in live fish and pet vetting.

Pet segment operating income for the quarter, increased by approximately \$7 million, or 25%, compared to the prior year to a total of \$34 million. Pet operating margin also increased by 130 basis points to 9%. These gains were aided by lapping the prior year \$2.5 million impairment charge in live fish. Excluding the impairment, Pet segment operating margin increased 60 basis points, driven by the organic strength mentioned previously. Pet EBITDA for the quarter increased 20% to \$42 million.

Turning to Garden, for the quarter, Garden segment sales rose 2%, or \$7 million, to \$342 million, driven by inorganic contributions from the Arden acquisition. Excluding Arden, segment organic sales declined 3%, driven by our artisan pottery exit and a soft start to our grass seed season, partially offset by strength in Garden distribution, wild birds and live plants.

Garden's base business, excluding the exited pottery business, was roughly flat. To provide a little more context on our grass seed results, currently we are seeing our shipments lag healthily consumption. This was largely due to our inventory position heading into the season as a result of soft fall, as well as some order pattern timing.

Garden segment operating income for the quarter was roughly in line with prior year at \$53 million and operating margin declined 40 basis points to 15.5%. Prior year results included a gain of \$3.2 million related to the write-up of the initial 45% interest in Arden upon acquisition. Excluding this gain, Garden segment operating margin increased 60 basis points. Garden EBITDA for the quarter was \$56 million, also roughly flat versus a year ago.

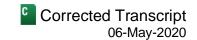
Now getting back to our consolidated results. In the second quarter, we had other expense of \$1 million compared to other income of \$500,000 a year ago. Net interest expense increased \$1 million to \$9 million, due primarily to lower interest income earned on cash balances as a softer market drove interest rate declines. Our tax rate for the quarter was 22.7% as compared to 21.3% in the second quarter a year ago.

Turning to our balance sheet and cash flow statements. Cash at the end of the second quarter increased to \$332 million, up from \$330 million at the end of the second quarter last year. For the quarter, net cash used by operations was \$75 million versus net cash used of \$86 million in the second quarter a year ago, due to favorable changes in working capital, primarily in inventory as well as increased EBITDA. CapEx increased to \$10 million from \$6 million in the second quarter of 2019.

Total debt was \$694 million, down \$4 million from the same time last year. Our gross leverage ratio at the end of the quarter decreased to 2.9 times within our target range. At the end of the second quarter, we had no borrowings under our \$400 million credit line. However, in April, we drew down \$200 million to increase financial flexibility as we navigate in uncertain COVID-19 economic environment.

Depreciation and amortization for the quarter was \$13 million, up from \$12 million a year ago and the increase was largely acquisition related.

Q2 2020 Earnings Call



During the quarter, we repurchased approximately 988,000 shares or \$25 million of our stock. There remains \$100 million under the board's previously authorized share repurchase program, an additional 800,000 shares under the board's equity dilution authorization.

**Operator**: Thank you. We will now be conducting a question-and-answer session. [Operator Instructions] The

As Tim mentioned earlier, given the uncertainties of the current COVID-19 crisis, we have withdrawn our previously issued guidance on 2020 earnings and we'll revisit upon completion of our third quarter.

Now, operator, please open the line for questions.

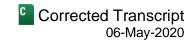
### QUESTION AND ANSWER SECTION

first question comes from the line of Bill Chappell with SunTrust. Please proceed with your question. William B. Chappell Analyst, SunTrust Robinson Humphrey, Inc. Thanks. Good afternoon. I hope you and your families are safe. Timothy P. Cofer Chief Executive Officer & Director, Central Garden & Pet Co. Thanks, Bill. **Nicholas Lahanas** Chief Financal Officer, Central Garden & Pet Co. Thank you, Bill. **Howard Machek** Chief Accounting Officer, Central Garden & Pet Co. Thanks, Bill. William B. Chappell Analyst, SunTrust Robinson Humphrey, Inc. So, I guess first question is just, is there any way you can kind of quantify as we look at March and April, the percentage of both Pet and Garden base that was closed? Because I understand like, suppose we compare to like pet food companies or even to [indiscernible] (22:47) a higher exposure to the small pets, especially pet and what have you. So, any kind of color there would be helpful. Timothy P. Cofer Chief Executive Officer & Director, Central Garden & Pet Co. Yeah, Bill. This is Tim Cofer. Good to talk to you again. When you say closed, I just want to clarify, do you mean our facilities? Do you mean the retailer customer footprint?

William B. Chappell

Analyst, SunTrust Robinson Humphrey, Inc.

Q2 2020 Earnings Call



Yeah, the retailer customers, so the small pets, especially [indiscernible] (23:13).

### Timothy P. Cofer

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

Yeah. So, what we saw on the pet side, it was most acute obviously on brick and mortar versus e-com and in particular, we saw it in small independents and we saw it in our live small animal business. So, you would know we've got a small animal business, small mammal, live fish, bird. And in particular, we saw the small independent pet stores temporarily closed down during shelter-in-place and we saw large pet national stores begin to curtail traffic and in particular for a period of time stop accepting live animals. So, it was that part of the business that was most impacted when you look across our business units and then it was vet channel. In addition, broadly, what I'd tell you is that our consumables side of the pet business, think dog treats as one example, have fared very well throughout this time whereas our slightly more durables, hard goods, think pet bedding, fared less well during this COVID period.

### William B. Chappell

Analyst, SunTrust Robinson Humphrey, Inc.

Got it. Got it. And then just switching to – I don't know if you gave any update or have any update on kind of what POS looks like for the month of April for both businesses or any early read there?

#### Timothy P. Cofer

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

Sure. Yeah, from a POS standpoint consumer consumption, it remains strong on both of our businesses, both Pet and Garden. We see obviously – as you breakdown channel or customer, we see robust quite honestly explosive growth on e-commerce. We have seen some triple-digit growth weeks on e-commerce, particularly on our Pet side and our Garden side off a smaller base is growing very strongly on e-commerce.

On the Garden side, there is some foot traffic differences across our big retailers, particularly the big three, given slightly different customer policies in terms of how they maybe have changed either opening hours or certain departments. And here again, what I'd guide you to is that it is our live plant business that we've seen some of the biggest challenges, given one of the big retailers limiting access to the live outdoor area for a period of time.

Broadly though, I would tell you that, from a consumption POS standpoint, both on the Pet and Garden standpoint, we are encouraged by continued consumer demand in both Pet and Garden.

#### William B. Chappell

Analyst, SunTrust Robinson Humphrey, Inc.

Got it. And then just last one for me. On – back on that Garden side, just kind of a – it sounds like on grass seed, you just ran into out-of-stocks and we've kind of past the grass seed season, so those look like, I guess, lost sales. I guess, first, Tim, is that the right way to look at it? And then on the Bell business, I mean, what exactly happens? I imagine you're growing plants to be at certain size for the break of the season and then you missed the break of the season in certain areas. Those plants get too big or how does that work? Or do you destroy the inventory, I mean, how does that work?

#### Timothy P. Cofer

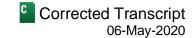
Chief Executive Officer & Director, Central Garden & Pet Co.

Yeah. Let's ask J.D. Walker.

A



Q2 2020 Earnings Call



#### William B. Chappell

Analyst, SunTrust Robinson Humphrey, Inc.

Hi, J.D.

J.D. Walker
President-Garden Branded Business. Central Garden & Pet Co.

Sure, Bill. I'll take the first part of your question, with the grass seed business. In terms of the season, you said that we're past the grass seed portion of the season. We're past in the southern markets, but the northern markets many of them haven't broken yet. So, we're still seeing fairly robust grass seed consumption. We carried some inventory and I believe that was in the script,. Niko mentioned that. We carried some inventory in from a pretty poor fall season. And fall, if you recall, was unseasonably hot late into the season, into late October. So, we missed a lot of the fall grass seed season, carried heavy inventories into the spring and it's taken some time to unwind those inventories.

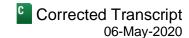
And then, another factor for the grass seed business was COVID related, the export has pretty much dried up. It's been difficult export market. We do export some – other exporters have decided not to sit on that seat and they've sold it off in the independent channel, or in the pro-turf channel and that's affected our business as well. So, the combined factors have been a negative headwind for the grass seed business.

Then on the Bell business, you hit on it. They grow for a specific period of time. Now, those – we can maintain those plants in the stores for a period of time, but over time they either have to sell or we end up scrapping that material. Now, fortunately, a lot of that season still remains in front of us as well. So, we had a headwind in the month of April, but the peak for that business is May. We're seeing strong consumption when the weather is favorable.

The good news here is the underlying demand for all of our categories and Tim touched on this, POS has been incredibly robust, when the weather favorable and it has been quite favorable and when the customer has access to our products. So, there is no limitations on head count in the store and free access to areas of the store like outside garden. So, the underlying health of the business is incredibly positive.

outside garden. 90, the didentifing health of the business is increalibly positive.	
William B. Chappell Analyst, SunTrust Robinson Humphrey, Inc.	C
Got it. Thanks so much. Please stay safe.	
Howard Machek Chief Accounting Officer, Central Garden & Pet Co.	Α
Thanks.	
<b>Operator:</b> Thank you. Our next question comes from the line of Powith your question.	eter Graham with JPMorgan. Please proceed
Peter Graham Malone Analyst, JPMorgan Asset Management (UK) Ltd.	C
Thanks, and good afternoon. I hope you all are doing well.	

Q2 2020 Earnings Call



Timothy P. Cofer Chief Executive Officer & Director, Central Garden & Pet Co.	A
Hi, Peter.	
Nicholas Lahanas Chief Financal Officer, Central Garden & Pet Co.	A
Thank you, Peter.	
Howard Machek Chief Accounting Officer, Central Garden & Pet Co.	A
Thank you, Peter.	
Peter Graham Malone Analyst, JPMorgan Asset Management (UK) Ltd.	Q

So, Tim, I wanted to ask a bit of a bigger picture question around Vision 2025. I think, we all recognize that this year was set up to be a reinvesting year to drive stronger top line growth and I know you discussed the topic briefly in your prepared remarks, but how do you handle the near-term challenges while maintaining some of that focus on the longer term? Has the outbreak influenced or changed your game plan at all? Maybe some areas of focus are now more important than they were a few months ago. Just anything you'd be willing to offer on the topic, I think, would be helpful. Thanks.

### Timothy P. Cofer

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

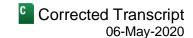
Thanks, Peter. Yeah. Well, first, I do want to reinforce right now, our number one focus and my number one focus is continuing to be on the safety and well-being of our employees, and ensuring business continuity and running a good business. That said, we can't lose sight of our future and our efforts around Vision 2025 are aimed at that. It's really charting the course and laying out some evolved moves and evolved strategy that will take this company into the next many years.

During these last couple of months, we have changed our approach a bit as it relates to that body of work. As you might imagine, the daily priority quickly shifted to business continuity and safety around this pandemic. And so, we did slow down a few things, Peter, and we did repurpose some of that team activity. Having said that, I can tell you a portion of our time, including mine as CEO, has remained on the longer-term enterprise strategic priorities.

To your question specifically, if anything as a result of this COVID environment, there are aspects that we were beginning to work on as it relates to Vision 2025, that if anything are more pronounced and more urgent. And I'll cite a couple of those now. I mean one is clearly our need to continue on our digital transformation as a company and accelerate our efforts in the e-commerce channel.

I mentioned for the last question from Bill that we've had some triple-digit growth weeks and I'm actually very pleased at our team's ability to quickly respond to that type of spike and demand and capture those consumptions. And I will say, our ability in the last six weeks to see that explosive growth and to maintain share in that e-commerce channel, is something I'm really encouraged with. There's more for us to do though and John Hanson, our Head of Pet, would agree to that. There is some additional hiring we'd like to do, some additional capability build, some additional investment. So that's one example.

Q2 2020 Earnings Call



Another would be, obviously, our continued focus on cash and liquidity. You know our balance sheet well. We feel good about that. And that continues to be a sharp focus for Niko, for me, for our business unit operators, managing cash conversion cycle well, working capital.

And then, I'd say a third is consumer orientation. That's something that I think is still an opportunity for our company to grow in and understanding how the consumer is evolving his or her shopping behavior and preferences as it relates to garden and pet in this COVID pandemic. So, there's a lot we've been working on that if anything, have a sharper focus. And I would tell you, Peter that we are still – I had mentioned in our last call, an ambition to be out by summer to share a more comprehensive view of that work. We're still working hard on that. Given COVID, I'm not ready to commit to a date here, but we will be back in due course providing a more robust review with you on Vision 2025

**Peter Graham Malone** 

Analyst, JPMorgan Asset Management (UK) Ltd.

Thanks. That was very helpful. I'll pass it on. Stay safe.

**Operator**: Thank you. Our next question comes from the line of Brad Thomas with KeyBanc Capital Markets. Please proceed with your question.

**Bradley Thomas** 

Analyst, KeyBanc Capital Markets, Inc.

Hi. Good afternoon, and thanks for taking my question. My first question was going to be just around how you maybe think about the discretionary nature of some of your products and potentially the risks that may be ahead even after consumer behavior starts to get back to normal, stores reopen, we may be facing a period of elevated unemployment. Tim, as you've had a chance to reflect on the business, look at the different brands and categories, how are you thinking about the level of risk to sales, just from that discretionary aspect of the business as we think about the quarters ahead here?

Timothy P. Cofer

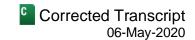
Chief Executive Officer & Director, Central Garden & Pet Co.

Sure. Thanks, Brad. Overall, I think, we feel pretty good that we're in two good industries in both pet and garden that you wouldn't say, I don't think you can say are completely recession-proof, but they're certainly recession-resistant. And I would say that while there was a spike as we look at weekly POS right at the time of that transition to shelter-in-place, I think to Bill's earlier question, POS remained strong. And so, we've got obviously POS through the end of April and now seeing kind of shipments of early May and consumption remains strong. You would know that for the most part, our portfolio it does not skew to what you call a super-premium price. I think, the underlying drivers that you look at, favor midterm strength in these two industries.

It starts with pets themselves. And as I mentioned in the prepared remarks, we have seen and you probably read about shelters all over this country, from New York to Houston to California, running out of pets. And so, we're seeing adoptions coming in really at record levels. That bodes well for the corresponding needs of that.

I think on the garden side with a shift of a normal that is going to be spending more time at home, consumers are going to be looking for those simple ways to improve their home, improve their gardens, and I think a lot of our categories lend themselves to that like grass seed, like controls, like live plants. And these aren't huge dollar rings. So again, very difficult to predict the depth of it. We certainly see the same unemployment numbers and

Q2 2020 Earnings Call



projections that you see. But overall, certainly versus airlines, restaurants, and other industries, I think pet and garden can be fairly resilient even in a downturn.

And while I wasn't here in 2008-2009, I've certainly, as part of our leadership team, we've looked back on lessons learned from 2008-2009, and I think Central and the overall consumption held up pretty well during those difficult periods.

### **Bradley Thomas**

Analyst, KeyBanc Capital Markets, Inc.

That's very helpful, Tim. If I can ask a follow-up around CapEx, Niko, I apologize I missed it, but how you're thinking about CapEx for the year and any changes in how and what you'll be spending on here?

#### Nicholas Lahanas

Chief Financal Officer, Central Garden & Pet Co.

Yeah. So, if you recall, we had guided to \$45 million to \$50 million CapEx number for the year. Year-to-date, we're at about \$20 million. We are reassessing all cash expenditures, be it CapEx, stock buybacks, all of that stuff. We're going to be looking at next week with the board, because as you know, right now, in this environment, cash is king and we'll probably be sharpening our pencils around some of those initiatives. So, we'll probably give an update a little bit later on that but we are reassessing all of those things.

#### **Bradley Thomas**

Analyst, KeyBanc Capital Markets, Inc.

Got you. Thank you so much.

**Operator**: Thank you. Our next question comes from the line of William Reuter with Bank of America Merrill Lynch. Please proceed with your question.

#### William Michael Reuter

Analyst, Bank of America Merrill Lynch

Good afternoon. It sounds like a lot of the softness or some of the softness in the Lawn and Garden segment was based upon channel disruption, but I guess some of the smaller lawn and garden retailers as well as one of the larger ones. I guess are those disruptions still in place, meaning have a lot of those retail customers reopened their doors at this point or do they remain closed?

### Timothy P. Cofer

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

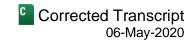
J.D.?

# J.D. Walker

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

This is J.D. Sure, I'll speak to that. We are seeing some of the smaller independent lawn and garden centers that had closed for a period of time. We're starting to see them come back onboard, reopened and engaged again, where we had some state and local authorities that had closed off some garden centers, we're seeing those reopen again. Vermont and Michigan are two areas that come to mind.

Q2 2020 Earnings Call



We're starting to see retailers increase their store hours again and increase the number of people, consumers, customers that they're allowing in the store, so all positive trends. We're starting to see them reengage once again, the retailers. So, I think that bodes well for our business.

I think that what we saw with short-term headwinds in late March through part of April, but as Tim said our POS still remains strong in April, which gives us great encouragement. And more recently, here we've seen strong demand for our products. So, like historically strong demand for our products, so we feel very good about them.

#### William Michael Reuter

Analyst, Bank of America Merrill Lynch

It's good to hear. And when you're mentioning the challenges, I didn't hear anything really around supply chain and you certainly were kind of talking about how strongly your team had performed, I guess did you experience any meaningful amounts of downtime or are you experiencing elevated operating costs? And if so, how much?

#### Timothy P. Cofer

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

Yes. We have been fortunate overall as I said in my remarks that a very small percentage of our employee base tested positive. I'm also pleased to report that with – we've got about 100 sites across the US if you include our manufacturing, distribution, offices, et cetera, and as of right now, there is only one that is not fully operational.

We did, over the course of these six weeks, have temporary disruption in some of our facilities, based on either a local jurisdiction order at the time, or based on our proactive measures given COVID, to do a temporary close, deep clean, and then reopen. So again, every day is a new day. But at this point, as you look across our supply chain, manufacturing, distribution centers, merchandising, et cetera, we feel good. We weren't immune to issues, but we're certainly in, I would say, overall good shape.

And then, let's see, the second part of your question was?

#### William Michael Reuter

Analyst, Bank of America Merrill Lynch

Whether operating costs elevated...

[indiscernible] (42:10)

#### Timothy P. Cofer

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

Yes. Thank you. Yes. And on this one, I would say, yes. Obviously, it starts with PPE and we have, as you would expect, marshaled quite a bit of incremental PPE to all of our facilities, both manufacturing and distribution. This would be masks, gloves, sanitizers, et cetera, on top of what would be normal course of business, infrared thermometers, as well as some changes in the structure to include greater separation, to include some temporary shielding in between some of the plant employees. And obviously, all of these do bring a higher cost; exact value, obviously not going to comment on at this stage. But it is fair to say that there are incremental costs in our supply chain as we evolve in this new environment.

#### William Michael Reuter

Analyst, Bank of America Merrill Lynch



Q2 2020 Earnings Call



And just one last one if I can, a couple of years ago, when you raised equity, I think, you had hoped that there may be some M&A opportunities, which I think valuations weren't what you hoped that they would be. Do you expect to try and take advantage of potentially some lower multiples in this environment, or will you move forward with a more cautious, just to get through this environment? That's all for me. Thanks.

Nicholas Lahanas

Chief Financal Officer, Central Garden & Pet Co.

A

Well, I think it depends on the opportunities. Our balance sheet is, as everybody knows, remains rock solid, fortress balance sheet. We feel like the business is performing well through the crisis. We're feeling very good about our day-to-day operations. So, I think if the right opportunity came up, I don't think we would dismiss it. We would certainly have to look at that and maybe lean into something there. So, yeah, we would be open to looking at the right opportunity at the right time.

William Michael Reuter

Analyst, Bank of America Merrill Lynch

Thank you.

**Operator**: Thank you. Our next question comes from the line of Jim Chartier with Monness, Crespi, Hardt. Please proceed with your question.

James Chartier

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



Hi. Good afternoon. Thanks for taking my questions. Tim, I just want to follow up on some of the earlier questions about the investment spending, your plan this year for significant step-up in investment spending. How much of that is continuing this year? Was there any spend related to that in second quarter?

And then, Niko, are you taking any measures, revenue initiatives in place to manage expenses given the near-term uncertainty? And then, just – and related to that, other people have talked about pulling back on advertising as stores are closed, what have you done with your advertising and what's the plan going forward? Thanks.

Timothy P. Cofer

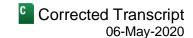


Chief Executive Officer & Director, Central Garden & Pet Co.

Sure. I'll start, Jim, and pass over to Niko to build. As you said, part of our initial guidance back at the beginning of this year, coming out of Q4 last year, did contemplate incremental investments. And I think, I highlighted a number of those in marketing and brand building and innovation, in digital and e-commerce initiatives, select additional personnel in some key areas, et cetera.

And what I'd tell you is in some cases, we have already made those investments, because they're absolutely the right thing to do. And in others, Jim, we are reassessing. And in the third bucket is, in some cases, we have pulled back and we have decided that in today's environment, today is not the day for that investment, all in. And so, we're taking a very measured and thoughtful approach to each of those growth initiatives. Back it up, I would say, in the January timeframe, I sat with Niko and John and JD among others. Did a very detailed review, kind of line by line on those incremental growth-oriented investments, had a plan and a gating throughout the balance of the year.

Q2 2020 Earnings Call



Since COVID-19 hit, we have reassessed each of those one by one. And what I'd tell you, it's a mixture. We're not going to blindly just go do what we said – what we felt was right in January given the new environment. So, we're taking a measured and thoughtful approach on that.

And I'll quickly touch on the second one and pass it to Niko. The answer to the second one is absolutely yes. We are business unit by business unit looking at, what I would call, belt tightening initiatives to offset some of the headwinds. In some BUs, obviously they are greater than others, I mentioned some of those earlier in the call. But both at a business unit level and at a corporate level, we are tightening the belt. Niko, any build on that?

#### **Nicholas Lahanas**

Chief Financal Officer, Central Garden & Pet Co.

Yeah, just to build on what Tim has said, like a lot of companies, we've done extensive scenario planning on the business to look at what we would need to take out if we had volume declines of 2%, 5%, 10% to 20%. So we have those in place. I think what we've seen to what Tim was alluding to earlier is, we've seen a few of our businesses get hit really hard, in live animal, live plants and to a lesser extent, our bedding business. So, we have made cuts in those areas already, they've been very, very surgical.

But as a company, I think, what we've really focused on is cash. Cash is the king right now. We're doing things, as I mentioned earlier, reevaluating our CapEx, looking at the stock buyback program. We're really looking at receivables and credit worthiness, particularly in the independent channel. So, we have weekly calls, reviewing how healthy that channel is. We've had a number of actually larger customers come to us and want more gating. So, we're dealing with all of that and I think, really the key for us is preservation of cash and cash conversion, and we're very focused on that. And then also looking at the business and the fixed and variable costs there.

But so far we've been fortunate because we've largely remained intact and we've surgically downsized some areas, but I would say, so far so good. And the other thing I would say is, just looking out, the POS on both sides, both Pet and Garden, looks good. So, we're going to continue for [ph] John (49:18), but really micro-manage the expense in the cash side.

#### **James Chartier**

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

Great. And then if I could ask just another question. You mentioned the spike in dog and cat adoption rates. Does that correlate with small animals and the disruptions in small animals, was that just the stores being closed and what does your research tell you in terms of consumers wanting to adopt maybe a small animal in lieu of a cat or dog? And then on fish, one of the competitors spoke to some increased interest in live fish as well, what are you seeing there? Thanks.

#### Timothy P. Cofer

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

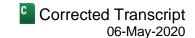
John, you want to take those pets?

#### John Hanson

President-Pet Consumer Products, Central Garden & Pet Company

Sure. Yeah. We've seen the majority in dog and cat adoptions for sure. We do believe there's some pent-up demand for live animals, small animal. The pet specialty [ph] channel (50:19) certainly is a prime place that shoppers have gotten those in the past and will continue to do so. And as Tim mentioned, we've seen suspended shipments there and we've seen suspended shipments on the small animal, as well as our fish business. But

Q2 2020 Earnings Call



going forward, it's a little hard to predict right now, but as pet specialty continues to open, extend their hours, we fully expect that as they regain traffic, we'll regain that business. Does that answer your question?

**James Chartier** 

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

Yes. That's helpful. Thanks and best of luck.

**Operator:** Thank you. Our next question comes from the line of Karru Martinson with Jefferies. Please proceed with your question.

Karru Martinson

Analyst, Jefferies

Good afternoon. With the strong POS that you're seeing, how is inventory at retail and given the control that retailers have instituted, are there any bottlenecks in terms of getting supply to retailers?

Timothy P. Cofer

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

I think, our inventory positions are a little different across our two big businesses. I'd say the kind of the alignment of consumption and shipments or of sales and POS on the Pet side is closer. And we're seeing high velocity both at consumer level and through our supply chain. And at present, we're fortunate in that we don't have any major bottlenecks, or I would say, real disconnects. We've got some businesses that are flying, like dog and cat treats, that are, I would say, we're having to really keep up with that demand. But overall, in the Pet side, it correlates pretty well and feeling pretty good.

On the Garden side, it's a little different in terms of the inventory, particularly in grass seed. And maybe, J.D. Walker, you'd want to comment a little on inventory and POS on the Garden side.

J.D. Walker

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

Sure. I'd say that in aggregate, our inventory is in great shape. Just, I would call, it low single-digit increase year-over-year and that includes new items that we shipped in this year. So, in aggregate, I think it looks great. And in a environment like we're in right now with robust consumption, shipments and replenishment is following as we would expect. So, we feel good about that.

As Tim mentioned, there are some lumpiness there, particularly in grass seed and we're still working through. In parts of the grass seed line are perfectly fine, but we do have some varieties of grass seed where we're heavy at retail and we're working through those still. But I'd say that overall, in aggregate, as I mentioned, inventory is in great shape and in this – with this type of POS, shipments will follow. And we're not having any issues to answer the second part of the question and getting that supply to the retailers.

Karru Martinson

Analyst, Jefferies

Okay, great. And then, I think, Bill touched on this, but are you seeing any retailers already coming into the shutdowns, in terms of I'm just trying to get out what the health of that consumer base is, especially the smaller independent channels for both Pet and Garden?

Q2 2020 Earnings Call



### Timothy P. Cofer

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

You guys want to quickly comment, J.D. and John, on your two businesses?

A

#### J.D. Walker

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

Sure. I think, the question was around the shut – the complete closure of retailers. We haven't seen that. We've seen some close temporarily, but we have literally thousands of customers. So, there may be one or two single store chains out there that have closed and we expect them to reopen and they may not, but we haven't seen that. I don't have confirmation of that. And with that large percentage of our business still flowing through three customers, we have the confidence that they're not going anywhere. So, we feel good about that.

John Hanson

President-Pet Consumer Products, Central Garden & Pet Company

And from the Pet side, very similar, we've seen very limited closures. We've seen some pull back in hours, in reduction hours, but we would expect that to change and open up as well.

Karru Martinson

Analyst, Jefferies

Okay. And then just lastly, where does liquidity stand today or thereabouts since quarter end?

Nicholas Lahanas

Chief Financal Officer, Central Garden & Pet Co.

Yeah. So, we have about \$332 million of cash on the balance sheet, and then we drew down \$200 million of the \$400 million on our ABL, so roughly, \$552 million of cash when you include the two.

Karru Martinson

Analyst, Jefferies

All right. Thank you very much guys. Appreciate it.

**Operator:** Thank you. [Operator Instructions]

Timothy P. Cofer

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

Yeah. Operator, are we at the hour now?

**Operator**: We are just about at the hour.

Timothy P. Cofer

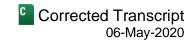
Chief Executive Officer & Director, Central Garden & Pet Co.

Okay.

**Operator**: Let me know if you want to continue with the Q&A session or close out the call.



Q2 2020 Earnings Call



### Timothy P. Cofer

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

Yeah. Okay. We have time for one more, operator.

**Operator**: Perfect. Our last question is from the line of Carla Casella with JPMorgan. Please proceed with your question.

#### Carla Casella

Analyst, JPMorgan Securities LLC

Hi. Thank you for squeezing me in. Just on your comments in the quarter, you mentioned that there was a negative mix shift that pressured gross margin. And you did talk a bit to categories, but can you just say how that – what drove the most of the mix shift and then how that trended after quarter end?

#### Nicholas Lahanas

Chief Financal Officer, Central Garden & Pet Co.

Sure. This is Niko. If you look at the mix, a big portion of it was on the Garden side, where, again we mentioned we had a little bit of a slow start to the grass seed season, that tends to be higher margin. The other piece of it was getting rid of the pottery business, which had a higher gross margin, not a great operating margin but it's dilutive to the growth. And then if you pivot down to the Pet side, our live animal business has a very high gross margin as well. And as we mentioned, a lot of the retailers were not taking orders of live animals. So that's been sort of the biggest movers as far as our mix shift.

And then the second part was as it relates to POS, the mix. Is that the question?

### Timothy P. Cofer

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

Yeah.

#### Nicholas Lahanas

Chief Financal Officer, Central Garden & Pet Co.

Yeah. So, we're seeing a pick-up. I mean, we – as I look at the POS, it's not that long of a timeframe. So, I don't want to lead anyone to false conclusions, but we are very positive on the mix of the POS. I will say on the live animal side, we still have yet to see those orders resume. So that's been a little bit slower. And then on the live plant side, we have to see how these next few weeks go. The season typically peaks out this weekend and if the weather holds up and consumers have access to that outdoor area, then we're very optimistic. So, we'll have to wait and see. But again, our POS data is only going out about four weeks and we have 12, 13 weeks in a quarter, so more to come.

#### Carla Casella

Analyst, JPMorgan Securities LLC

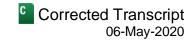
Okay. Great. That's helpful. Thank you very much.

### Nicholas Lahanas

Chief Financal Officer, Central Garden & Pet Co.

Thank you.

Q2 2020 Earnings Call



### Timothy P. Cofer

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

Thank you. I want to thank everyone for joining our call today. We appreciate your time. And everyone, stay safe and stay healthy.

**Operator:** This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation and have a wonderful day.

#### Disclaimer

The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, Factset Calistreet, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.

The contents and appearance of this report are Copyrighted FactSet CallStreet, LLC 2020 CallStreet and FactSet CallStreet, LLC are trademarks and service marks of FactSet CallStreet, LLC. All other trademarks mentioned are trademarks of their respective companies. All rights reserved.