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Central Garden & Pet Co. (CENT)

Q2 2017 Earnings Call

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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 2017 Financial Results Conference Call. My name is Jesse and I will be your conference operator for today. [Operator Instructions] As a reminder, this conference is being recorded.

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

Steven Zenker

Vice President-Investor Relations & Communications, Central Garden & Pet Co.

Thank you, Jesse. Good afternoon, everyone. Thank you for joining us. With me on the call today are George Roeth, Central's President and Chief Executive Officer; Howard Machek, SVP Finance and Chief Accounting Officer; JD Walker, President, Garden Branded Business; Rodolfo Spielmann, President Pet Consumer Products; and Niko Lahanas, SVP Finance Operations and Management Reporting. Our press release, providing results for our second quarter ended March 25, 2017, 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 the 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 2017, expectations for new product introductions, future acquisitions and improved revenue 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 December 2, 2016. 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, George Roeth. George?

George C. Roeth

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

Thank you, Steve. Good afternoon, everybody. Let me start by saying we are pleased with how our second quarter played and the progress we are making on the business. During the quarter we continue to grow faster than our categories, gaining market share in the majority of the businesses in which we compete driven in large part by distribution gains, accelerated new product introductions and our continued ability to be faster, more flexible and more responsive to our customers' needs, including helping drive their private level business.

For the entire company, we grew sales by 5% in the second quarter. Organic sales were up 2% despite seeing a decline in the product pricing for our wild bird feed due to lower raw material costs as well as some timing offsets for the first quarter. Year-to-date, our organic sales growth is up 4% compared to the same period last year.

In our Pet business, sales grew 8% during the quarter, with much of net growth coming from the Segrest acquisition. Pet organic growth roll up just over 1% during the period and, while positive, is not representative from a trend perspective.

As we foreshadowed on our last call, comparisons versus a year ago benefited our first quarter but disadvantaged our second quarter in part due to the timing of orders around certain retailer promotions. Our POS data for the pet channels that are publicly reported to Nielsen for the last 13 weeks ending March 25 is strong showing Central consumer takeaway of plus 3%, well above the category averages.

In the aquatics, dog toys and treats, waste management and small animal categories, we are doing particularly well, aided by increased distribution and new product activity. Keep in mind this is just for the Nielsen universe, which does not include independent pet stores as well as some of the club channels and e-commerce. The latter two are growing faster than the channels represented by the Nielsen numbers, and our estimate suggests we are growing consumption at least in line with the categories in those channels.

In our Garden business, the quarter started out strong as favorable weather resulted in strong consumer takeaway early in the quarter versus a year ago, proving once again that you should never count on favorable weather. The early momentum dropped off in March as the weather turned unfavorable and the industry was comping a very strong March from a POS perspective a year ago. However, all in all, we believe our 2% growth in Garden, over the entire quarter, all organic, was a terrific performance vis-a-vis the industry, and our share estimates support that thesis.

For Q3, April started off strong versus the challenging month for POS a year ago. Comps however started to get more difficult in May and, net-net, it's much too early to be declaring victory this Garden season. However, we are encouraged by the results so far.

On the expense side of the equation, we continue to make progress toward our goal of achieving cost savings of 1% to 2% per year. For example, this year, we successfully executed in sourcing some of our Garden control offerings, which allowed us to better utilize existing production assets. We have also significantly improved our DMC pet bedding operations by automating part of our bed compression process, driving lean concepts and implementing SAP.

As we look further down the P&L, you can see that our overall net income was impacted by other expenses by roughly $1 million versus a year ago. This spending was the result of some strategic initiatives we are pursuing to deploy our excess capital, an effort to enhance our future growth rates and shareholder returns.

Specifically, in addition to making direct acquisitions, like the ones we have made over the past few years, we have also sought opportunities to partner with other companies in order to more fully leverage the strengths and capabilities we have to bring to the table while putting capital to use. This fiscal year we have entered into two strategic joint ventures and our broader categories of interest in Pet and Garden.

For competitive reasons, we won't be disclosing specifics about these businesses at this time other than to say that, in one case, we have invested in an early-stage, high-growth company; and the other is a partial stake in a mature company where we see real near-term value at the price we pay with the added potential of upside over time. It's also important to note that we fully expect in the aggregate to turn well north of our weighted average cost of capital across these investments.

In terms of guidance for 2017, we are raising our adjusted EPS projection to $1.37 or higher, acknowledging the strong first half we have achieved. Sales trends in the second half are expected to remain strong. However, some non-operating factors are expected to negatively impact net income in the second half of the year.

Specifically, our tax rate and corporate expenses for the second half are expected to be above prior year, the latter due to some timing differences versus a year ago. In addition, the two joint ventures I referred to previously are, in aggregate, expected to have a negative impact on the second half earnings before becoming accretive next year. None of these figures include any impact from the [ph] recent (07:01) acquisition of K&H.

On the strategic front, we are continuing to make significant headway on all pillars of our strategy. First, accelerating the growth momentum of our portfolio. For example, we are driving above average company sales growth on both the recent DMC and Segrest businesses. In addition, [indiscernible] (07:21), Central has acquired K&H pet products, a leading manufacturer of premium dog and cat bedding and pet supplies. This is an innovative, growing, profitable business whose products capabilities and management are a terrific fit for the Central family of products and will benefit both companies. Overall, we continue to have an active pipeline of acquisition targets and are encouraged by our progress in this area.

Second, build strong customer relationships. Recognition by Lowe's who awarded Central the Lawn & Garden Vendor of the Year is one such example where we are building partnerships that make a difference.

Third, increasing innovation output and success rates. New products have absolutely helped drive recent share gains. For example, in the Garden segment, we have extended our successful introduction last year of our Quick Kill products under the AMDRO brand. We increased our core store program by two thirds, introduced new home perimeter and wood insects products, another Quick Kill label.

In addition, on the Pet side of business, evidence of our improved innovations was demonstrated when we won four different innovation awards at Global Pet Expo. One such award winner was our KAYTEE LED Run-About Ball for hamsters that was a hit with our retail partners.

Finally, driving cost savings and productivity improvements to fuel growth. You were seeing the impact of these efforts in both the gross and operating margin expansion while also [ph] finding (08:43) increases in growth investments. Overall, we remain committed to our strategic direction and are optimistic about the fiscal year.

Now, I'll turn it over to Howard to go over the financials in more detail.

Howard A. Machek

Senior Vice President, Corporate Controller and Chief Accounting Officer, Central Garden & Pet Co.

Thank you, George. Good afternoon, everyone. Earlier today we issued a press release with our second quarter financial results. I'd like to give you some color on the results and then we'll open it up for questions.

There were no extraordinary items during either the current quarter or the prior-year quarter, so all the quarterly numbers being discussed will be on a GAAP basis with the exception of the organic sales figures. Earnings for the quarter of $0.67, per diluted share, were up 3% from $0.65 over the same period a year ago.

As George touched on earlier, consolidated sales for the quarter, inclusive of our Segrest acquisition, rose 5% versus the prior year to $579 million aided by the acquisition as well as organic growth in both our Pet and Garden businesses. Our quarterly organic growth was 2%. Our year-to-date organic growth was 4%.

Consolidated gross profit rose $14 million and our gross margin increased 90 basis points to 32.2%, due in part to favorable mix, including the Segrest acquisition, as well as increased efficiencies due to higher planned throughput.

SG&A expense for the quarter increased to 9% or $10 million versus a year ago and, as a percent of sales, rose to 21%, increasing 70 basis points. The increase was primarily related to the inclusion of Segrest and, secondarily, to an increase in demand-building activities and costs associated with consolidating and optimizing certain facilities. Operating income for the quarter increased to $64 million compared to $59 million a year ago, principally due to the inclusion of Segrest.

Operating margin of 11.2% was up 20 basis points as the increase in gross margin was only partially offset by the higher SG&A expenses incurred to drive current and future organic growth.

Turning now to the Pet segment, Pet segment sales for the quarter increased 8% or $23 million to $298 million. The company's latest acquisition, Segrest, made up the bulk of the gain with strength in the dog & cat and animal health businesses driving an organic sales increase of 1%. The timing differences, which benefited our first quarter this year, negatively impacted our second quarter sales.

The timing of promotions and order patterns, at some of our major customers can result in differences when comparing periods to the prior year. We believe our year-to-date Pet organic growth rate of 4%, which is well above average in most categories, is more indicative of our current approximate growth rate.

Pet segment operating income increased $2 million or 7% compared to the prior year. The Pet operating margin decreased to 20 basis points to 11.6% impacted by the Segrest acquisition as well as investments made to cultivate sustainable growth in the years ahead. These investments include efforts to increase capacity and optimize our distribution capabilities.

Moving to Garden. For the quarter, Garden segment sales increased 2% or $6 million to $272 million. Higher control in fertilizer revenues and increased sales of other manufacturer's products drove the sales increase. Garden's operating income improved to $46 million from $44 million in the second quarter of last year and operating margin was 16.9%, up 20 basis points. The improvement in both operating profit and margin were due in part to additional volume, which leveraged our fixed operating costs and helped to offset higher marketing costs and other demand-creating expenditures intended to drive future sales growth.

Moving back to our consolidated results. In the second quarter, other expense rose to $1 million from $100,000 reflecting investments to drive future growth. As George referenced earlier, we have made recent investments in two different joint ventures. These are reported in the other income line of our income statement. One is a startup and one is seasonal in nature as results on this line will tend to be more volatile quarter-to-quarter going forward.

Net interest expense was flat at $7 million. Our net income for the quarter was $35 million and diluted earnings per share was $0.67 compared to $33 million or $0.65 in the second quarter of 2016.

Turning to our balance sheet and cash flow statements. For the quarter, cash flow used by operations increased approximately $32 million, from the second quarter a year ago, due primarily to increases in working capital accounts to support growth. CapEx was $14 million versus $8 million in the second quarter of 2016. The increase was predominantly driven by investments in expanding and consolidating our facilities.

Depreciation and amortization for the quarter was $20 million, up from $18 million a year ago. The primary driver of the increase was the new businesses we have acquired. Our total debt decreased to $496 million from $497 million a year earlier. We made an acquisition of $60 million just a few months ago. Again, our debt level is still down $1 million year-over-year. And our leverage ratio is 2.5 compared to 3.1 a year ago. We also had $239 million of availability on our credit line as of the end of the quarter.

During the quarter, we did 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 to George.

George C. Roeth

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

Thank you, Howard. So, to summarize, we had a strong first half to the fiscal year. We are driving share and consumption gains. We are successfully securing and then integrating acquisitions, and we are on track executing our strategic initiatives. Having said all that, we still have more than half of the Garden season ahead of us and [ph] facing (15:48) all these competitive marketplace. As always, we remain on strategy, focused on executing with excellence and staying nimble.

So, with that said, operator, please open the line for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Thank you. Our first question is coming from the line of Bill Chappell with SunTrust. Please proceed with you question.

William B. Chappell

Analyst, SunTrust Robinson Humphrey, Inc.

Q

Thanks. Good afternoon.

George C. Roeth

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

A

Hi, Bill.

William B. Chappell

Analyst, SunTrust Robinson Humphrey, Inc.

Q

I know this might be an effort in futility, but any chance you could give us a little more color on just the impact of the recent acquisition? And on the joint ventures, just how it will affect the P&L over the next two quarters?

George C. Roeth

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

A

I guess I'll start with that. On the recent acquisition of the K&H, if then you're speaking to that, we just secured that on Friday. So, I don't have a lot to tell you other than we do not expect it to be dilutive this fiscal year. And we'll have more to say on that front going forward.

In terms of the two joint ventures, I think what we told you is one of the business is a mature seasonal business, the other is high growth. There's going to be volatility on that line in the P&L. We expect, for the back half of the year, that will negatively impact us and be accretive next year. That's all I can tell you at this point.

William B. Chappell
Analyst, SunTrust Robinson Humphrey, Inc.

Q

And maybe the better than $1.37 doesn't include the dilution from that either.

George C. Roeth
President & Chief Executive Officer, Central Garden & Pet Co.

A

The $1.37 includes everything but the K&H, and I'll say $1.37 or better.

William B. Chappell
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Okay. And that would fall in the other income line, the joint ventures that is?

George C. Roeth
President & Chief Executive Officer, Central Garden & Pet Co.

A

Yes, it would.

William B. Chappell
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Okay. The second question, just trying to understand the Garden season. Certainly, your results were a lot better than what we've seen from Scotts and Spectrum in terms of just season, kind of poor or weak start to the season. Is that more due just to product mix or did you really have some pretty meaningful market share gains that give you that kind of growth?

JD Walker
President, Garden Brands, Central Garden & Pet Co.

A

Bill, it's JD Walker. I'll take that question. So, I think the answer is a combination of both. So, as I've said before, our portfolio is different than our competitors in that there's certain categories we compete in which they don't and vice versa. Having said that, as George said in the script, I think we are on [indiscernible] (18:33) of our own strategy. We've introduced new products this year like the Quick Kill that he noted, also the PENNINGTON, Smart Seed product that has gotten very strong acceptance in the marketplace.

I think that it says that our two private label launches that we had with two major retailers have been successful and our low-cost producer initiatives that we started previously have started to pay dividends. Along the way, that allowed us to invest in our conversion model, in other words, driving trial of our products. So, I think it's a combination of things. We are in some categories in which Scotts and Spectrum don't play, and, at the same time, it says that we're perfectly on strategy, and that's translated.

Where we do overlap with them, we know that we have taken share. So we've been successful in the marketplace at the same time.

William B. Chappell
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Okay. Great. And then last one for me. You talked about the online channel growing faster for Pet and your total. But on the kind of Pet specialty, are you seeing the similar type of weakness in the big-box stores whereas the smaller stores are holding their own or have you seen things really change over the past three or four months?

Rodolfo Spielmann
President-Pet Consumer Products, Central Garden & Pet Co.
A

Hi, Bill. This is Rodolfo. I'm going to take that question. So, if you see the total Pet category, the key driver for category growth don't change that quickly, don't change from month to month. This is about how many consumers you have in the country, how many of them own pets. and then, by the way, how attached they are to their pets. And we're seeing that the trend of them becoming part of the family, that it's not stopping anytime soon. So, in this perspective, there's no big change in terms of category trend.

We are seeing in this quarter changes in the track channels where you'll see some deceleration in them, which is also being offset in the channels that are not being tracked by Nielsen like e-commerce [ph] plot (20:34) and then smaller stores.

William B. Chappell
Analyst, SunTrust Robinson Humphrey, Inc.
Q

Okay. Thanks for the color.

Operator: Thank you. Our next question is coming from the line of Brian Nagel with Oppenheimer. Please proceed with your question.

Brian Nagel
Analyst, Oppenheimer & Co., Inc.
Q

Hi. Good afternoon.

George C. Roeth
President & Chief Executive Officer, Central Garden & Pet Co.
A

Hi, Brian.

Brian Nagel
Analyst, Oppenheimer & Co., Inc.
Q

Nice quarter. Congratulations.

George C. Roeth
President & Chief Executive Officer, Central Garden & Pet Co.
A

Thanks.

Brian Nagel
Analyst, Oppenheimer & Co., Inc.
Q

So, a couple of questions here. Maybe I'll start with a short one. With regard to the organic Pet sales that were discussed here and then going back to the comments you made in your fiscal Q1. So, as you're looking at the third quarter now, should those quarter-to-quarter disruptions be over? Do we get back to our normal like somewhat of an – I guess, we would assume is a normal growth rate?

George C. Roeth
President & Chief Executive Officer, Central Garden & Pet Co.
A

I guess I'll take a crack at that and let Rodolfo chime in. We aren't aware of anything that would cause any major anomalies in Q3 sales on Pet. Having said that, you don't know how Q3 is going to play out in terms of retail and order patterns or changes in promotions. So, going into it, there's no expectation but things can happen.

Brian Nagel
Analyst, Oppenheimer & Co., Inc.

Q

Okay. And then the second question I had on the Garden side, and this is a bit of a follow-up on one of the prior questions. But you talked about the weakness in March and then it rebound in April. And there's been a lot of talk out there about weather disruptions in that category. So, the question is, I mean, the rebound you saw in April, was that – I guess, is the business performing as you'd expect it to as the weather began to cooperate?

JD Walker
President, Garden Brands, Central Garden & Pet Co.

A

Yes, Brian. This is JD It has. It's been a strange year but I think I'll say this on most of the calls that we have. January and February were very strong from a consumption standpoint. March was difficult, unfavorable weather and we were comping against a very strong March a year ago, and then we saw that rebound nicely in April.

So, I think that when the conditions are right and the controllable causal factors, all shelf displays, promotion activity, things like that are in place and they have been for us, and we've seen the business perform very nicely and it's very robust.

Brian Nagel
Analyst, Oppenheimer & Co., Inc.

Q

Perfect. And then the final question I have and, I guess, bigger picture on the Pet side. So, just recently, there was a pretty significant merger announced with the physical and online retailer. I assume both the customers of Central, as you think about that consolidation or any further consolidation, how should that impact in any way your business? Either positive or negative.

Rodolfo Spielmann
President-Pet Consumer Products, Central Garden & Pet Co.

A

This is Rodolfo again, I will take that. So, we no longer do business with both customers but we're partnered very well with both of them. It's clearly too early to tell what the impact will be, that, honestly, it wouldn't take anything significant for Central. For us, we will continue going where the consumers go. And in our categories, that is I can include some mix between brick and mortar and the e-commerce channel.

So, our job doesn't change. It's about the right product, the growth plans, the policies that makes sense for the customers and the consumer channel were compete. So, no changes that we're seeing in the near future.

Brian Nagel
Analyst, Oppenheimer & Co., Inc.

Q

Got it. Thank you.

Operator: Thank you. The next question is coming from the line of Jason Gere with KeyBanc. Please proceed with your question.

Jason M. Gere
Analyst, KeyBanc Capital Markets, Inc.

Q

Okay. Great. Good afternoon. I guess – I was wondering if you can give us a little bit more color on just some of the distribution gains that you're seeing out there both on Garden and on the Pet side. And maybe if you could talk a little bit or elaborate a little bit more on the private label opportunity that you guys are pursuing especially as you're seeing retailers right now are really trying to push a little bit more on the – their own brand. And just wondering if you can give a little bit more context in terms of what you're seeing and then maybe what the opportunity still lies ahead. Thanks.

George C. Roeth
President & Chief Executive Officer, Central Garden & Pet Co.

A

I guess, I'll answer that at a high level first and see if Rodolfo or JD want to chime in with any specifics. So, I don't want to get too granular on the account by account distribution gain. But I will say, on the private label front, our philosophy is that if we're the low cost producer and we have excess capacity and we do, we're going to pursue private label. We're good at it. We're profitable in doing that and we have very strong retail partnerships. And, in some cases, we act very much like, I would call it, best-in-class CPG marketer as we develop the product, support the client, do the packaging graphics, basically market the retailers brands and do it quite successfully.

So, we like private label. We're continuing to pursue it and I expect that to continue going forward. And I think that on, consumer tailwinds, with the bifurcation of income, importance of value, the retailer's needs to provide value to consumer, we think we're in a sweet spot of where we need to be on that front and we'll continue to successfully expand the private label business.

And then just in terms of the blocking and tackling, increasing distribution on the branded business, which are very important to us, and I gave one example in the script of our AMDRO Quick Kill. We expanded the short count and the items under that, that's been quite successful. And I don't know if JD or Rodolfo want to give any more color.

JD Walker
President, Garden Brands, Central Garden & Pet Co.

A

So, it'd be difficult to run down the list. We had some new products in each of the categories, each of our categories. I mentioned a couple today, PENNINGTON, Smart Seed, a new launch of that, the AMDRO Quick Kill, which we talked about, the PENNINGTON UltraGreen fertilizers. I think that was on our last call, we called that out. So, those were all nice, accretive new product distribution gains for 2017.

One comment I'd add to George's comments about the private label business. Another reason why the retailers are going there is for differentiation versus other retailers and margin enhancement. So, if they are shifting their strategy, this is an area that we would play with them. And, by the way, our branded products benefit from that as well because it's running through our plans, the favorable variances through the better plant utilization impacts positively on our branded products, and then we tried to use that relationship, that we built with the retailer, which becomes a much more strategic relationship because you're working on this private label brand together to leverage additional distribution and opportunities for our branded products. Rodolfo?

Rodolfo Spielmann
President-Pet Consumer Products, Central Garden & Pet Co.

A

And I'll just add, from what JD was mentioning in terms of the relationship with our partners and retailers. So, when we talk about distribution gains, it talks about we partner with our customers to do what is right for the consumer. And when you see the breadth and depth of our portfolio, we can do that in a very unique way. So, at the end of the day, we can drive growth for our customers, and that's why we [ph] have that in the end in distribution. (27:27)

Jason M. Gere
Analyst, KeyBanc Capital Markets, Inc.

Q

Okay. Great. And then I just have one other question, more of a clarification. I think you were talking about Pet and kind of looking at the balance of the year. And I think you said 4% year-to-date was kind of the organic sales and that seems to be the trend. I guess, does that assume that the other manufacturer's product, which has been a little bit weaker on some tougher comparisons, does that kind of smooth out or is there any color that you can provide in terms of that 4%.

George C. Roeth
President & Chief Executive Officer, Central Garden & Pet Co.

A

I would just say that's an aggregate number. We're not going to give more granularity for that, but it does include both factors.

Jason M. Gere
Analyst, KeyBanc Capital Markets, Inc.

Q

Okay. Thanks guys.

Operator: Thank you. The next question is coming from the line William Reuter with Bank of America Merrill Lynch. Please proceed with your question.

William Michael Reuter
Analyst, Bank of America Merrill Lynch

Q

Good afternoon, guys.

George C. Roeth
President & Chief Executive Officer, Central Garden & Pet Co.

A

Hi.

Rodolfo Spielmann
President-Pet Consumer Products, Central Garden & Pet Co.

A

Hello.

William Michael Reuter
Analyst, Bank of America Merrill Lynch

Q

Based upon some of the challenges that brick-and-mortar pet retailers are having, we've heard some examples where they've come to their vendors and asked for pricing concessions. Have you been seeing this much from your brick-and-mortar customers?

Rodolfo Spielmann
President-Pet Consumer Products, Central Garden & Pet Co.

A

We don't comment in any of the negotiations we have with our brick-and-mortar partners or any partner at all. I can tell you that the business hasn't changed today versus what it was 5 years ago, 10 years ago in terms of what customers want and what we can offer.

William Michael Reuter
Analyst, Bank of America Merrill Lynch

Q

Okay. Secondarily, you guys have continued to be relatively active with M&A looking for smaller acquisitions. I guess, can you talk to us a little bit about what your pipeline looks like at this point and I guess if you can remind us where you would take leverage to finance the transaction?

Howard A. Machek
Senior Vice President, Corporate Controller and Chief Accounting Officer, Central Garden & Pet Co.

A

Sure. You heard our leverage ratio right now is at 2.5. Sorry, this is Howard. We're comfortable in about the 3 to 3.5 range generally. And for the right acquisition, as we've said, we are willing to go above that, but our objective would be to pay that down [ph] with what we got (29:29). So, we want to stay in that 3 to 3.5 range.

So in terms of the pipeline, we're looking at opportunities across Gardens and Pet to leverage our current capabilities and kind of right into the core. I will tell you, in both Garden and Pet, we have a very active pipeline. [indiscernible] (29:46) for me is if you look across the Pet business, I think there's 1,400 manufacturers, not more than a handful really, more than a $100 million in sales. So, there's a lot of opportunities in the sweet spot in which we're looking and we feel very good about our process to continue to acquire going forward.

William Michael Reuter
Analyst, Bank of America Merrill Lynch

Q

Okay. And then just lastly for me. Based upon your guidance, it seems like you guys should do some relatively [indiscernible] (30:10) free cash flow. But recently you guys haven't been completing many share repurchases. How are you guys viewing share repurchases at this point?

George C. Roeth
President & Chief Executive Officer, Central Garden & Pet Co.

A

Right now our capital is focused on operations where you see us increasing our capital spending particularly around cost savings and increasing capacity and M&A. And right now that's where our focus is.

<Q – [06T3KZ-E Bill Reuter

Q

Okay. I'll pass it to others. Thank you.

George C. Roeth
President & Chief Executive Officer, Central Garden & Pet Co.

A

Thanks.

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

Karru Martinson
Analyst, Jefferies

Q

Good afternoon. Just on the joint ventures, are they going to require any additional investments or CapEx as we go forward?

George C. Roeth
President & Chief Executive Officer, Central Garden & Pet Co.

A

We're not going to get in the specifics of them, but the simple answer to that would be it depends on the joint venture and the particular arrangement that we have. So, I wouldn't say it's prescribed in every case.

Karru Martinson
Analyst, Jefferies

Q

Okay. And in terms of CapEx for the year, how should we think about the spend for the core of the business?

George C. Roeth
President & Chief Executive Officer, Central Garden & Pet Co.

A

We're still looking. I think the range that we said before and I think it was in the $45 million range for the year, that's what we think. We're still on track to that.

Karru Martinson
Analyst, Jefferies

Q

Okay. And then in terms of just inventory at retail, just wondering how you feel about the health for both Pet and Garden given that a lot of headlines about folks trying to work those levels down.

JD Walker
President, Garden Brands, Central Garden & Pet Co.

A

Yes, this is JD. So, I will speak to Garden first. Before looking at Q2, historically speaking, sell-in outpaces consumption in Q2 and then that reverses in Q3 and then to Q4 where consumption outpaces sell-in. So, we ended Q2 as expected even though March was unfavorable as we said with some pipeline or some inventory at store level. As we mentioned earlier, we had a very strong April, feel good about where we are right now. So, as we're coming into the heart of the season in May, we feel like we're on balance. Our inventories are in very good shape.

Rodolfo Spielmann
President-Pet Consumer Products, Central Garden & Pet Co.

A

So, this is Rodolfo. I'm the one on Pet. So, I would say that, for the quarter, this is not a major variable for the [indiscernible] (32:25) you do expect the customers to keep tightening their inventories and we do have a couple who have done it in the quarter. But again, in the big scheme of things, this is not a variable for us in the quarter.

Karru Martinson
Analyst, Jefferies

Q

Thanks very much, guys. I appreciate it.

Operator: [Operator Instructions] Our next question is coming from the line of Carla Casella with JPMorgan. Please proceed with your question.

Carla Casella
Analyst, JPMorgan Securities LLC

Q

Hi. One housekeeping. I may have missed it. When you said D&A $20 million, was that for the six months or was that for the second quarter, depreciation and amortization? And I guess what you are looking with that. Go ahead.

Howard A. Machek
Senior Vice President, Corporate Controller and Chief Accounting Officer, Central Garden & Pet Co.

A

Sorry. It's $20 million for the six months.

Carla Casella
Analyst, JPMorgan Securities LLC

Q

Okay. Great. And then, I mean – I guess, Karru kind of alluded to this or asked about this in the Lawn & Garden, but can you just talk to inventories by retail, by category and then by channel? How are inventories at the retailers and do you feel like, at this point, you're matching sell-in to sell-through?

George C. Roeth
President & Chief Executive Officer, Central Garden & Pet Co.

A

Yeah. So, Carla, that's more detail than we typically – more guidance than we typically give. But what I would say is, as I've just said earlier, I think we're in a very good position at the end of April, so no real issues. And I don't think that will have any negative impact on our performance. So, I think inventories are just fine.

Howard A. Machek
Senior Vice President, Corporate Controller and Chief Accounting Officer, Central Garden & Pet Co.

A

[indiscernible] (34:00).

Rodolfo Spielmann
President-Pet Consumer Products, Central Garden & Pet Co.

A

[indiscernible] (34:02).

Carla Casella
Analyst, JPMorgan Securities LLC

Q

Okay. And then, the JV's, did you say are those businesses that you've invested in on the kind of manufacturing wholesale side of the business or more like the distributor brand businesses?

George C. Roeth
President & Chief Executive Officer, Central Garden & Pet Co.

A

I can tell you they're both manufacturers and they are in the Pet and Garden categories. We don't get into specifics on them but they're nothing at the ordinary.

Carla Casella
Analyst, JPMorgan Securities LLC

Q

Okay. Great. And then $60 million on M&A, that was one transaction?

George C. Roeth
President & Chief Executive Officer, Central Garden & Pet Co.

A

Yes, it's the Segrest acquisition we made in Q1.

Carla Casella
Analyst, JPMorgan Securities LLC
Q

Okay. Trying to make sure that was all Segrest. Okay. That's all I have. Thanks.

George C. Roeth
President & Chief Executive Officer, Central Garden & Pet Co.
A

Thanks.

Operator: Thank you. Our next question is coming from the line of Mayank Prasad with Kayne Anderson Capital Advisors. Please proceed with you question.

Mayank Prasad
Analyst, Kayne Anderson Capital Advisors, L.P.
Q

Hey, guys. This is Mayank. Thank you for taking the call.

George C. Roeth
President & Chief Executive Officer, Central Garden & Pet Co.
A

Hi.

Mayank Prasad
Analyst, Kayne Anderson Capital Advisors, L.P.
Q

I just have a high level question. Could you give a bit of a more color on your online channel. I see that you guys are seeing the volume growth there compared to the big box specialty retail, but in terms of a bit color on the margin side, specifically operating margins compared to the specialty big box.

Rodolfo Spielmann
President-Pet Consumer Products, Central Garden & Pet Co.
A

Okay. So, I'll [indiscernible] (35:33) growing obviously at a much faster pace over the market, but that is also the case for us or probably to our brands. Now, importantly, and this is not only us but the rest of the industry, brick and mortars still the vast majority of the market, and this what the consumer is choosing to buy today. We are only and we mentioned that before, we are gaining share in the brick and mortar channels and we're having very high growth in the e-commerce channel. So, we feel very comfortable that – being where the consumers chooses to buy. And in terms of the operating margins, we don't disclose that on a customer base.

Mayank Prasad
Analyst, Kayne Anderson Capital Advisors, L.P.
Q

Okay. And just one more question. In terms of your independent retail channel, does that include a Pet retail franchisers?

Rodolfo Spielmann
President-Pet Consumer Products, Central Garden & Pet Co.
A

Yes , t does.

Mayank Prasad
Analyst, Kayne Anderson Capital Advisors, L.P.

Q

Okay. And given the recent acquisition of PetSmart with Chewy, could you give like bit of a color what, going forward, what percent of sales will drive from that combined consolidation?

Rodolfo Spielmann
President-Pet Consumer Products, Central Garden & Pet Co.

A

I'm sorry. I will not, to what I mentioned before, that we do mingle with both customers, we are good partners with both of them and we expected to be doing that in the future where we have the conversation with the two of them. By the way we do expect to continue growing with the two of them.

Mayank Prasad
Analyst, Kayne Anderson Capital Advisors, L.P.

Q

Okay. That is all I have. Thank you.

George C. Roeth
President & Chief Executive Officer, Central Garden & Pet Co.

A

Thanks.

Operator: Thank you. We have reached the end of our question-and-answer session. So, I'd like to pass the floor back over to Mr. Roeth for any additional concluding comments.

George C. Roeth
President & Chief Executive Officer, Central Garden & Pet Co.

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

Operator: Ladies and gentlemen, this does conclude today's teleconference. Again, we thank you for your participation and you may disconnect your lines at this time.