31-Jan-2023

Central Garden & Pet Co. (CENT)

Q1 2023 Earnings Call

CORPORATE PARTICIPANTS

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

Timothy P. Cofer
Chief Executive Officer & Director, Central Garden & Pet Co.

Nicholas Lahanas
Chief Financial Officer, Central Garden & Pet Co.

J.D. Walker
President-Garden Consumer Products, Central Garden & Pet Co.

John Hanson
President-Pet Consumer Products, Central Garden & Pet Co.

OTHER PARTICIPANTS

William B. Chappell
Analyst, Truist Securities, Inc.

Stefanos Crist
Analyst, CJS Securities, Inc.

Taylor Zick
Analyst, KeyBanc Capital Markets

Andrea Teixeira
Analyst, JPMorgan Securities LLC

Carla Casella
Analyst, JPMorgan Securities LLC

Hale Holden
Analyst, Barclays Capital, Inc.

Karru Martinson
Analyst, Jefferies LLC

MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by. Welcome to Central Garden & Pet's First Quarter Fiscal 2023 Earnings Call.

My name is Shamali 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. Instructions will be given at that time. [Operator Instructions] As a reminder, this conference call is being recorded.

I would now like to turn the call over to Friederike Edelmann, Vice President of Investor Relations.

Please go ahead.

Friederike Edelmann

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

Thank you, Shamali. Good afternoon, everyone. Thank you for joining us.

With me on the call today are Tim Cofer, Chief Executive Officer; Niko Lahanas, Chief Financial Officer; J.D. Walker, President, Garden Consumer Products; and John Hanson, President, Pet Consumer Products.

As usual, Tim will provide a business update, and Niko will discuss results for our first quarter ended December 24, 2022 in more detail. After the prepared remarks, J.D. and John will join us for the Q&A.

Our press release and related materials are available at ir.central.com, and contains the GAAP to non-GAAP reconciliation for the non-GAAP measures discussed on this call. Lastly, unless otherwise stated, all growth comparisons made during this call are against the same period in the prior year.

Before I turn the call over to Tim, I would like to remind you that statements made during this call, which are not historical facts, including the potential impact of COVID-19 on our business, earnings per share and other guidance for fiscal 2023, expectations for new capital investments, product launches and future acquisitions 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 filings with the Securities and Exchange Commission, including our annual report on Form 10-K filed on November 22, 2022. Central undertakes no obligation to publicly update these forward-looking statements to reflect new information, subsequent events, or otherwise.

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

Timothy P. Cofer

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

Thank you, Friederike, and good afternoon, everyone. Let me begin by extending a sincere thank you to team Central for their perseverance and execution in yet another challenging quarter. Three key messages for today's call. First, our quarterly results. We delivered Q1 in line with the guidance we provided in November, which anticipated near-term challenges. These included unfavorable cost overhang from last year's poor garden season, higher inventories at our retail partners, and a more sluggish demand environment compared with the strong growth quarter a year ago. As expected, these challenges put downward pressure on our key financial metrics. Net sales were $628 million, gross margin was 27.4%, and operating income was $400,000. We had a loss per share of $0.16 in line with our guidance.

Second, our outlook for the year. Our fiscal first quarter is traditionally our smallest quarter. As such, we don't usually draw any major conclusions from Q1, especially since the 2023 garden season is still in front of us. For the remainder of the year, we assume a normal weather garden season and that inventory dynamics will stabilize and we expect our pricing actions and cost control measures to largely offset inflation. As such, we are maintaining our EPS guidance of $2.60 to $2.80 for the year.

And third, our long-term outlook remains favorable. Both Pet and Garden are dynamic growth categories, with numerous consumer trends that underpin sustainable growth potential for years to come. We remain confident in the competitive strength of Central and our Central to Home strategy as the road map to create value for our customers and shareholders.

Now, let's take a look at our two segments, starting with Pet. Sales in the Pet segment were 5% below prior year, largely due to our decision to discontinue low-profit private label product lines, especially in pet beds. On a positive note, we saw a robust sales growth in our dog and cat brands as well as outdoor cushions.

Pet remains an attractive growth category. And while our sales were down in the quarter, we drove an increase in our POS by 6% versus prior year. This is a further indication that retailers are still working down their inventories and we expect that to normalize by the middle of the year. Thanks to our investments in capacity expansion and automation in the last two years, our pet service levels are no longer a headwind and are now in the mid to upper 90s. Moreover, our efforts to grow capabilities around consumer insights, brand marketing and innovation are beginning to payoff, as evidenced by market share gains in dog treats, dog toys, small animal, pet bird, aquatics and equine.

Another near-term dynamic impacting portions of our business is the change in pet adoption rates. Following a few years of growing pet ownership during the early COVID period, we are now seeing a flat to declining trend. This unfavorably impacts consumer demand for durables such as fish tanks, small animal enclosures and other new pet durable goods. The difference between consumable and durable sales trends is more than a 10-point spread in the recent quarter. Our e-commerce business continues to significantly outperform brick-and-mortar channels with solid growth in the first quarter, including double-digit gross sales increases in our dog and cat businesses.

E-commerce now represents approximately 23% of our pet consumer sales. We are continuing to prioritize investments in digital capabilities and talent, and we're pleased with our e-commerce market share performance. Similar to our fiscal 2022 fourth quarter, we gained share broadly across pet supply categories on a leading pure play e-tailer including aquatics, reptile, small animal, pet bird, dog treats and dog toys. We keep a close eye on consumer behavior, including any change in purchasing patterns. While there may be a shift to private label in a future recessionary environment, in aggregate, we continue to see our branded pet business outperforming private label.

Turning now to our Garden segment. Our fiscal first quarter typically represents only about 15% of annual Garden sales. So, we're careful not to read too much into this quarter since the garden season is still in front of us.

We anticipated our first quarter would be challenged largely as a result of the overhang from last year's poor garden season, including higher inventory levels, unfavorable fixed cost absorption and weaker demand. In addition, our top three customers saw a lower foot traffic ranging from mid-single to low-double digits below prior year.

With that backdrop, our Garden sales declined 6% versus prior year, driven by weakness in live goods and controls and fertilizers. Bright spots were wild bird and grass seed, which both saw sales and market share growth. Wild bird continues to be a strong business for us. The category has been reignited post-COVID, with more and younger households participating in the hobby. And our Pennington brand is on its third consecutive year of market share growth.

Grass seed also grew sales and market share in the quarter, driven by recent innovation and improved marketing. While our overall Garden sales were down, we are encouraged by the low-single digit growth in POS, which is lapping 14% POS growth in the prior year. This indicates that consumers remain engaged in the garden categories. And as we move into Q2 and the back half, we will be lapping softer comps.

Our customer fill rates are now consistently in the high-90s; back to historic levels. And while still a relatively small part of our Garden business, we're pleased with our Q1 e-commerce POS growing 30% versus prior year.

Now, let me share a few quick comments on our strategy. We remain committed to our Central to Home strategy as the strategic roadmap to unlock value for our shareholders. And we continue to make good progress across a number of key priorities. In today's call, I will focus on two of our strategic pillars, consumer and cost.

First, our consumer pillar. Over the last few years, we've made investments in advancing our growth capabilities through talent acquisition, increased working media, bigger and better consumer-driven marketing and innovation ideas, and importantly, improved tracking and measurement tools. The latest quarter suggests that our investments are beginning to payoff. While the Q1 demand environment was sluggish for the reasons I've previously outlined, we are growing our POS and our market share. Across both Pet and Garden in Q1, we are growing faster than our competition across the majority of our categories. And in the fastest-growing sales channel, e-commerce, we are growing market share, especially in the largest pure play platform.

Second, shifting to our cost pillar. In fiscal 2023, the theme internally is all about cost and cash. This means we will take additional short-term actions to cut costs while developing longer-term initiatives to build margins. It also means we are concentrating our efforts on reducing inventory and converting it into cash. We believe there's a meaningful opportunity across Central to simplify our network, optimize our footprint, streamline our portfolio, and better leverage our supply chain scale across procurement, manufacturing, and distribution to improve our cost structure and build margins over time. We are taking a measured approach here. This is about evolution, not revolution, and we'll share more as we firm up our longer-term plans to improve margins and fuel growth.

So, to summarize, we remain confident in the competitive strength of Central and our Central to Home strategy, and the fundamental trends that support Pet and Garden industry growth. We knew that Q1 would be a challenging start to the year, and as the year progresses, we assume a normal weather garden season and that inventory dynamics will stabilize, and we expect pricing actions and cost control efforts to largely offset inflation. I remain confident in our team's ability to navigate and perform. As such, we are maintaining our EPS guidance of $2.60 to $2.80 for the year.

And with that, let me turn it over to Niko, who will share more details of our Q1 results. Niko?

Nicholas Lahanas

Chief Financial Officer, Central Garden & Pet Co.

Thank you, Tim. Good afternoon, everyone. Building on Tim's remarks, I'll share with you details of our first quarter results for fiscal 2023. Net sales were $628 million, a decline of 5% as we are comping strong growth in the prior-year first quarter. Consolidated gross profit was $172 million, a decrease of 13%. Gross margin of 27.4% was down 260 basis points, largely driven by our Garden segment due to further cost inflation in commodities and much lighter sales volumes, resulting in unobserved overhead, which were partially offset by our pricing actions.

SG&A expense of $171 million was in line with prior year. However, SG&A as a percentage of net sales increased 130 basis points to 27.3% due to lower sales. Operating income declined by $26 million to $406,000, and operating margin decreased 390 basis points to 0.1%. The decline was largely driven by our Garden segment, which saw continued cost inflation and unabsorbed overhead due to lower sales, which were partially offset by lower commercial spend.

Net interest expense of $14 million was in line with the prior-year quarter. We had a net loss of $8 million compared to net income of $9 million a year ago. Our loss per share was $0.16 compared to earnings per share of $0.16 in the prior-year quarter. And adjusted EBITDA was $29 million compared to $52 million in the prior year. Our tax rate was 24.2% compared to 20.7% in the prior-year quarter due to a lower benefit from stock-based compensation.

Now, I'll provide some insights in the segments, starting with Pet. Pet segment sales of $416 million declined by 5%, driven by our decision to discontinue some low-profit private label pet bedding product lines and SKU rationalization, lower demand in durables, especially in Aquatics. Strength in dog and cat and outdoor cushions partially offset the declines. Pet segment operating income declined by 13% to $40 million and operating margin decreased 90 basis points to 9.5%, largely driven by inflation and lower sales, partially offset by our pricing actions. Pet segment adjusted EBITDA was $50 million compared to $55 million a year ago.

Turning now to Garden. Garden segment sales were $212 million, down 6% due to lower sales in our live plant business and Controls & Fertilizer, which were partially offset by continued strength in Wild Bird and Grass Seed. Garden segment operating loss was $11 million. Garden segment operating margin decreased to a negative 5.1%, mainly driven by inflation and the impact from lower sales, partially offset by our pricing actions. Garden segment adjusted EBITDA was breakeven compared to $16 million a year ago.

Now, moving to the balance sheet and cash flows. Cash and cash equivalents at the end of the first quarter were $88 million compared to $296 million a year ago. The decrease was mainly driven by inventory build over the last 12 months. About half of this build was cost inflation and the rest was volume to improve fill rates and also prebuilt, leading up to the garden season. Net cash used by operations was $63 million for the quarter compared to $92 million a year ago. The decrease was mainly driven by lower working capital requirements. As Tim mentioned, we entered the year with higher inventory and built less inventory this quarter than in the first quarter a year ago.

CapEx was $18 million for the quarter, 27% below prior year. Remember last year, we significantly invested in capacity expansion across our businesses. This quarter, we invested in dog and cat, small animal bedding, live plants, and our bird feed businesses. Total debt of $1.2 billion was in line with prior year. Our leverage ratio was 3.1 times at the end of the quarter compared to 2.9 times a year ago, well within our target range. We had no borrowings under our credit facility at the end of the first quarter. Depreciation and amortization for the quarter was $22 million compared to $20 million in the prior-year quarter, primarily driven by higher depreciation due to our recent investments and capacity expansions across our businesses. During the quarter, we repurchased approximately 251,000 shares or $9 million of our stock.

And finally, turning to our fiscal 2023 outlook, which remains unchanged from our guidance in November. That said, we continue to take into account the ongoing economic uncertainty, continued cost inflation, unfavorable retailer inventory dynamics, as well as changing consumer preferences as they continue to adjust to increased cost of living pressures. Nevertheless, we remain committed to our Central to Home strategy. However, in the near-term, we are taking a more deliberate approach to investments in our consumer growth agenda.

As Tim said, for fiscal 2023, we are squarely focused on cost and cash. This means, we are tightening our belt, including a pause on hiring, a reduction in travel expenses, decrease CapEx to $70 million to $80 million, of which the majority is carryover and maintenance, and we are working on converting inventories into cash. Thanks to our strong financial position and the amount remaining on our credit facility, we remain on the lookout for great growth and margin-accretive companies in both Pet and Garden. Lastly, we expect a tax rate in the range of 22% to 24%, similar to 2022. All said, we continue to expect earnings per share for the year to be in the range of $2.60 to $2.80.

Our guidance reflects our belief in the competitive strength of Central and the long-term trend supporting growth in the Pet and Garden industries. Consumers remain engaged in our categories, as demonstrated by our POS consumption trends that have been consistently stronger than our shipments in both Pet and Garden. This gives us confidence in our full year guidance, and as we indicated in our November call, we expect fiscal 2023 to be skewed to the back half, with EPS in the first two quarters below the prior-year quarters and EPS growth in the second half. As always, this outlook excludes any impact of potential acquisitions or restructuring activities undertaken during the year.

And with that, we'd like to open the line for questions.

QUESTION AND ANSWER SECTION

Operator: At this time, we will be conducting a question-and-answer session. [Operator Instructions] Our first question comes from Bill Chappell with Truist Securities. Please proceed with your question.

William B. Chappell
Analyst, Truist Securities, Inc.

Q

Thanks. Good afternoon.

Timothy P. Cofer
Chief Executive Officer & Director, Central Garden & Pet Co.

A

Hey, Bill.

Nicholas Lahanas
Chief Financial Officer, Central Garden & Pet Co.

A

Hi, Bill.

William B. Chappell
Analyst, Truist Securities, Inc.

Q

Hey. Just want to talk a little bit more about the POS numbers in the quarter and try to break that down between price and volume. I mean, I would expect that you had at least kind of a 5-point – or 5-percentage-point tailwind from pricing into this quarter. And so, I didn't know if you're seeing volume still up on a year-over-year basis in Pet and Garden, and kind of as you look forward, will you lap that pricing where we could see things turn downward on POS or do you have enough pricing to carry sales growth into 2023?

Timothy P. Cofer
Chief Executive Officer & Director, Central Garden & Pet Co.

A

Sure. Thanks, Bill. Look, our pricing continues to be an important part of the overall algorithm in this inflationary environment, and as you look at Q1, we priced again in the high-singles, that's – a good chunk of that is carryover on pricing actions that we took in the last fiscal, and then some select new pricing actions in the first quarter. As it relates, the volume impact of that, we monitor that closely on a regular basis, business by business. We continue to see an elasticity around one, meaning we're seeing that upper single-digit volume decay up that upper single-digit pricing, and that's more or less our expectation. Obviously, the mileage varies, we have some BUs that are more elastic some businesses and brands than others, but in aggregate, that's what you see.

As you go to the balance of the year, we still have new pricing. We've got some pricing in this quarter, meaning now we're in the second quarter, as you know, our fiscal second quarter, that's landed. Our overall pricing envelope, when you look at in aggregate, around a couple hundred million bucks, it is north of 90% landed with our customer, so we feel good that it will come through. Again, the wildcard, if there is one, is any sort of changes in elasticity versus our assumptions. And I think, when you look at that pricing envelope for the balance of the year and you compare that our view on the inflationary envelope, we feel pretty good, as I said in my prepared remarks, that we'll be able to between pricing and our cost control efforts, largely cover that inflation. POS finally is, as you heard remains strong and in positive territory, so while net sales was down in both Pet and Garden for the reasons that you heard on the prepared remarks call, POS is up and it's up mid-single-digits on Pet and it's up single-digits on Garden. So, that we feel good about.

William B. Chappell
Analyst, Truist Securities, Inc.
Q

Great. And then, on gross margin, it was obviously down year-over-year, but still a little bit better than I was anticipating. Is that driven in part by just the mix shift in Pet of more consumables versus durables, and is that something that continues, or was that not that significant?

Nicholas Lahanas
Chief Financial Officer, Central Garden & Pet Co.
A

Yeah. I mean, that played a role. The other piece too is we also got out of some private label bedding, which is lower margin. So, some of that was also intentional on the Pet side and – but, yeah, a lot of it is the shift to consumables from the durable area.

Timothy P. Cofer
Chief Executive Officer & Director, Central Garden & Pet Co.
A

And Bill, the good news on Pet is gross margin on the quarter was basically flat, the gross margin degradation at a company level was Garden driven as Niko said on the call, and that's for the reasons that I think Niko shared and we certainly can elaborate on further. But overall, I'd say, in gross margin, feeling pretty good about being able to hold on the waterline on Pet and a little bit challenged in the first quarter on Garden as we anticipated.

Nicholas Lahanas
Chief Financial Officer, Central Garden & Pet Co.
A

We also had some of our higher margin businesses outperform in the quarter on the Pet side as well, so that that helped margin.

William B. Chappell
Analyst, Truist Securities, Inc.
Q

Got it. And last one for me, just kind of early read in terms of how the retailers are thinking on the Garden season. This is – obviously, the season hasn't really kicked off with the weather, but I mean, imagine you have a pretty good idea whether they're all in, half in, not really sure if they're in for the season. Thinking of last year, trying to figure out whether it was more – last year's weakness was more weather related or more return to normal consumer patterns related. So, what are you hearing or seeing from your retail partners right now in terms of how they're set up for 2023?

J.D. Walker
President-Garden Consumer Products, Central Garden & Pet Co.
A

Hi, Bill, it's J.D. I'll take that question.

William B. Chappell
Analyst, Truist Securities, Inc.
Q

Hey, J.D.

J.D. Walker
President-Garden Consumer Products, Central Garden & Pet Co.
A

I'd say the feedback we're getting from our retailers is overall very bullish. They do think that last year was mainly a weather-driven challenge more than anything else. This year, what they've done is take a more measured approach to flowing the goods to the stores, to set the stores at the beginning of the season, but we've seen some nice pickup in POS. In fact, POS and shipments have both rebounded very nicely after the end of the quarter, in early January here. So, in my conversations with the retailers, they're saying that they're going to take an aggressive approach once the season starts to break.

The good news is we're up against some pretty weak comps for the next couple of months, and I think as the retailers see that, it's going to embolden them to be more – even more bullish on the season. I think, most of our season is going to – our consumption is going to take place between March and mid-June, and I think by then – first of all, we feel very good about our off-shelf activity, our promotional activity. The retailers seem to be remain engaged. And when we've had decent weather, it doesn't have to be stellar, when we've had just decent weather, the consumer is very active. So, I think, once all that comes together, we are cautiously optimistic, but the retailers are very much engaged and bullish.

William B. Chappell
Analyst, Truist Securities, Inc.
Q

Great. Thanks so much.

Operator: Our next question comes from the line of Stefanos Crist with CJS Securities. Please proceed with your question.

Stefanos Crist
Analyst, CJS Securities, Inc.
Q

Hi. Thanks for taking my questions. First, just on inventory, just the timing of converting that, is that expected to happen in the next quarter or is that maybe more of starting in the back half of the year?

Nicholas Lahanas
Chief Financial Officer, Central Garden & Pet Co.
A

No. The way our business is, you see the working cap build kind of through the tail end of Q1, and then it peaks out sort of mid-Q2, and then starts to come down. A couple comments on inventory, in absolute dollars, it was obviously up about $180 million. A couple things I want to point out, we mentioned our focus on cost and cash. If you look at the quarter itself, the inventories were actually down. A year ago in Q1, we came up about $160 million, and if you flip through the cash flow, you'll see that, and then this quarter, this last quarter, we were only up $85 million. And then, that's reflected in cash used from operations, which was only $63 million versus $92 million a year ago. So, you can kind of see the early sort of fruits of our labor. We were very serious when we said we were going to focus on cost and cash, and I think we're starting to see the early stages of that with a lot more to come as the year plays out.

Stefanos Crist
Analyst, CJS Securities, Inc.
Q

That's great color. Thank you. And then, just thinking about acquisitions, just talk about what you're seeing in the M&A pipeline and maybe deal flow versus what you saw 12 months ago.

Timothy P. Cofer
Chief Executive Officer & Director, Central Garden & Pet Co.
A

Yeah. I mean, we've sort of said this on a couple of past calls. The deal flow has definitely slowed down. I think, as we look at the volatility in the public markets, the private market tends to follow that. So, clearly, deal flow has slowed. The pipeline is not quite what it was 12 to 18 months ago, but we're still out there and we still have a number of deals that are in play and discussions that are going on. So, it's not going to deter us. For us, it's all about finding the right fit, the right company, management team, and the right margin profile for us. So, we're still going full speed ahead.

Stefanos Crist
Analyst, CJS Securities, Inc.
Q

Great. Thank you.

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

Taylor Zick
Analyst, KeyBanc Capital Markets
Q

All right. This is Taylor Zick on for Brad Thomas. Thanks for taking my question. I'm curious on some of the factors – that you can touch on some of the factors that have been impacting the business from an inflation standpoint and kind of how you're thinking about those for the rest of the year. And then additionally, if you can kind of just talk about maybe what your customers are saying in terms of pricing as you kind of continue to push these prices through? Thanks.

Nicholas Lahanas
Chief Financial Officer, Central Garden & Pet Co.
A

Yeah. I mean, as far as inflation goes, last year was unprecedented. We're still seeing some continued inflation into 2023, but it's certainly moderating in our opinion. Everyone has seen labor has sort of flattened out. Delivery certainly has moderated, especially ocean freight. Fortunately, we can't take full advantage of a lot of like the ocean freight because, we do have heavy inventory. So, we're not bringing in as much product right now. We need to sell through what we've got. But I would say overall, the trend, there's a moderation going on. That said, we're still at historically very, very high levels. So, we're still combating that.

Timothy P. Cofer
Chief Executive Officer & Director, Central Garden & Pet Co.
A

Yeah. And to build on Nico's comments, I think he said it well, Taylor. Look, we're still in an inflationary environment and our total cost envelope is going up year-over-year. It is unfavorable. And you would ask for a little bit some of the details. I mean, certain of our commodities around grains, grass inputs, wheat and potato starch for dog treats, et cetera, these are still year-over-year an unfavorable cost input into our total envelope. And so – and that's why we're pricing as we price because we have that pressure and we are seeking to do our best to maintain, if not expand margin. But the order of magnitude of the increase is definitely diminished 2023 versus 2022 compared to 2022 versus 2021, as Niko said.

Taylor Zick
Analyst, KeyBanc Capital Markets
Q

Got it. Thank you. And then if I could just squeeze one last one. How do that pet destocking kind of turnout this quarter relative to what you had expected last quarter?

John Hanson
President-Pet Consumer Products, Central Garden & Pet Co.

A

Yeah. For Q1, as Tim mentioned, our POS was 6% and our shipments ran close to that. Right? So, you can see customers continue to tighten their inventories. Our expectation is that will continue to impact us in Q2 and then it will normalize mid-year.

Taylor Zick
Analyst, KeyBanc Capital Markets

Q

Great. Thank you.

Operator: Our next question comes from the line of Andrea Teixeira with JPMorgan. Please proceed with your question.

Andrea Teixeira
Analyst, JPMorgan Securities LLC

Q

Thank you. So – and good afternoon. I have two clarifications, please. On the exit of the private label contract, I understand that it started last quarter. So, you're through the first half of it. So, want to just clarify that and then you're going to lap in the fourth quarter. So, what is the magnitude of that impact? And on the EPS guide, of course, I understand this is like a small quarter, but can you talk about like cadence, if we should expect basically a inflection in the second quarter and how to think about it? And lastly, if you can talk about market share trends. Thank you.

Timothy P. Cofer
Chief Executive Officer & Director, Central Garden & Pet Co.

A

All right. We'll have John Hanson take the pet bedding, Nico will take EPS, I'll take market share. John?

John Hanson
President-Pet Consumer Products, Central Garden & Pet Co.

A

Yeah. So, on pet betting, we have a meaningful private label pet bed business. In Q1 of 2022, we proactively rationalized SKUs and then in the back half, we decided to exit some low-margin product lines to improve margins profitability. We started lapping that in the back half of fiscal 2023. We'll see that throughout 2023. On this business and other businesses, we're going to continue to critically assess our cost competitiveness to improve margin and improve profitability. So, it'll be a – it's an ongoing effort from us and to a degree normal part of our business.

Nicholas Lahanas
Chief Financial Officer, Central Garden & Pet Co.

A

Yeah. And just speaking EPS, Andrea. So, next quarter, Q2, we're still expecting EPS to come in a little bit lower than a year ago. As I mentioned in my prepared remarks, it's really a back-half story for us here. As more pricing kicks in, we see a little bit more normalization in terms of retail inventories throughout the year. And then, we're assuming a more normal sort of weather pattern as we go through that. And then all along, we're going to be controlling costs in cash. So, it's going to be a Q3 for story as we head to the $2.60 to $2.80 guide.

Timothy P. Cofer
Chief Executive Officer & Director, Central Garden & Pet Co.
A

And then, Andrea, on your third question on market share, I will say that we feel good that our market share performance is definitely a bright spot on the quarter. It continues a trend that started in the back half of last year. If I break it, out across Garden and Pet, starting first with Pet, we had broad market share gains across pet supplies. In my prepared remarks, I mentioned many of them. We grew market share in dog treats, dog toys, small animal, pet bird, aquatics, equine, feel good that we are outpacing those supply categories in which we compete.

Notably as well, if I drill into e-commerce, as you would know, Andrea, e-commerce remains the fastest-growing channel by far relative to the brick-and-mortar footprint out there in the channel landscape and on e-commerce and in particular, the largest pure play player whom you know, we expanded market share there as well. And that's the fast-growing channel.

So, I'd say, sales on the quarter, they are what they are. They were down 6% in Pet. But you've kind of peel that back and say as per your first question, a big part of it was a purposeful decision to exit lower margin private label pet beds. That will still continue in the next quarter or two as John said. But you look at POS, POS up 6% and then you look at market share, Nielsen syndicated data, and you feel good about our performance relative to competition.

Shifting to Garden. Garden was more muted in the quarter for the reasons we stated. But we gained market share in two of our biggest and most important categories. First in wild bird. This is our third consecutive year of market share expansion, primarily behind brand Pennington and wild bird, and we continue to grow market share in grass seed, a very important category for us and one we turned the corner on grass seed market share mid-last year with some of the launch of new innovation that we've talked to you about, Smart Patch, as well as a new fully digital marketing campaign. And we saw that positive share performance continue in the first quarter of this fiscal.

Andrea Teixeira
Analyst, JPMorgan Securities LLC
Q

Very helpful. Thank you. I was confused in the first part of my question on the EPS, because when you said the first half, I didn't know if you're adding back the losses and could – the losses in the second quarter could still be higher or not. But it seems that it's on isolation. The quarter is also going to be down from last year. Appreciate the qualification.

Timothy P. Cofer
Chief Executive Officer & Director, Central Garden & Pet Co.
A

Yeah.

Andrea Teixeira
Analyst, JPMorgan Securities LLC
Q

Thanks.

Operator: Our next question comes from the line of Carla Casella with JPMorgan. Please proceed with your question.

Carla Casella
Analyst, JPMorgan Securities LLC
Q

Great. Thank you. How much of your overall business in Pet and Garden is private level? You mentioned you've got a sizable Pet business, but can you just give us a little more color on how you see private label?

Timothy P. Cofer
Chief Executive Officer & Director, Central Garden & Pet Co.
A

Sure. I mean, in aggregate, a private label is approximately 10% of our sales. There's a little noise on the line. But private label is about 10% of our sales. The vast majority of our sales are our own branded products that we manufacture and bring to market. That's two-thirds of our portfolio. And then the balance of the portfolio would be our distribution business, where we are a distributor on both the Pet and Garden side for select third-party brands.

Carla Casella
Analyst, JPMorgan Securities LLC
Q

Okay. Great. And then on the business you exited, did you say how much sales you had done in that business in the fourth quarter – in the first quarter last year?

Nicholas Lahanas
Chief Financial Officer, Central Garden & Pet Co.
A

No, we didn't give that. We didn't give that out.

Carla Casella
Analyst, JPMorgan Securities LLC
Q

Okay. Okay, great. And then how much supply chain savings are built into your guide for 2023? Any kind of a ballpark that you can give us there?

Nicholas Lahanas
Chief Financial Officer, Central Garden & Pet Co.
A

Okay. We haven't given that out either. A lot of the supply chain savings are early stage, and the timing of it is going to be a little bit tricky. So, we were a little remiss in our November call to give firm numbers for the year. That said, we've got a number of work streams in progress right now.

Timothy P. Cofer
Chief Executive Officer & Director, Central Garden & Pet Co.
A

And building on Nico's comments, I mean, generally, look, we've got a continuous improvement, net productivity cost out mind set in the company. I think ideally we'd like to look at around 1% of costs that we can impact and try to take out each year. That's at a high level. But we don't as Nico said, we didn't guide to it to a given number.

Carla Casella
Analyst, JPMorgan Securities LLC
Q

Okay, great. Thanks so much.

Operator: Our next question comes from the line of Hale Holden with Barclays. Please proceed with your question.

Hale Holden
Analyst, Barclays Capital, Inc.

Q

Thanks. Afternoon. I had one question. I was wondering how you were thinking about the guidance you provided in November versus today relative to what you're seeing in the consumer. So, things have changed. And I was just wondering if you were feeling that the consumer was tracking to where your guidance was potentially better or potentially worse?

Timothy P. Cofer
Chief Executive Officer & Director, Central Garden & Pet Co.

A

I would say broadly we feel the same. We guided at the end of November, so we're only a couple of months on since our last guide. There's no doubt that the consumer is under pressure. And I think our crystal ball like many others would suggest that that's not going away any time soon. Having said that, looking at things like point of sale trends, as you heard, the consumer is still voting with his or her dollars in our categories and they're spending more than prior year. And that is true on both Pet, which was low-single digit POS growth lapping a 14% POS growth in the prior Q1. And then, Pet in the mid-single digits, I think we quoted 6%. So, there is the ultimate test.

Now, a big part of that is the pricing, right? Our goods as well as competitive goods are more expensive. So, on a unit basis, you'd see a slight downtick as a result of that. But overall, I think that the consumer remains highly engaged in both of these categories. Certainly, when you look at recessionary environments over the last call it, 30 years, both of these categories are resilient. We like to say here they're not recession proof, but they're recession resilient. And consumers continue to love to spend time with their pets and treating them and aiding their health and wellness and then spend time, beautifying it. It's a small cost outlay to beautify your backyard and improve things in your lawn and garden.

So, I'd say in general, back to the core of your question, nothing has – we have seen nothing in the last 90 days that gives us a very different view on state of consumer as it relates to Pet and Garden.

Hale Holden
Analyst, Barclays Capital, Inc.

Q

Great. Thank you so much. And fingers-crossed for good weather pattern.

Timothy P. Cofer
Chief Executive Officer & Director, Central Garden & Pet Co.

A

Thank you.

Nicholas Lahanas
Chief Financial Officer, Central Garden & Pet Co.

A

Thank you. Yeah.

Operator: And our next question comes from the line of Karru Martinson with Jefferies. Please proceed with your question.

Karru Martinson
Analyst, Jefferies LLC

Q

Good afternoon. Just on the Pet side and the consumer behavior, certainly it sounds like dog and cat, you're seeing that resilience in the pets' family member. But on the aquatic side, is it that the consumer is not shelling out for the durable goods or not getting involved in a new category or perhaps not replacing the fish when it dies?

John Hanson
President-Pet Consumer Products, Central Garden & Pet Co.

A

Yeah. On the aquatics, which we did call out, that's durable product, right? And we have seen live animal sales slowing. And a bit of a decline. And that does impact durable purchases. When somebody does buy that live fish, they often buy a fish tank, right? When somebody does buy the guinea pig, they often buyout the small animal enclosure. So that certainly has had an impact.

Karru Martinson
Analyst, Jefferies LLC

Q

Okay. And then just lastly, when you look at M&A, you mentioned that that slowed, is it just that the financing is not there or is it that folks have kind of pulled down and pulled back and hunkered down and saying, I'm not going to sell into this environment?

Nicholas Lahanas
Chief Financial Officer, Central Garden & Pet Co.

A

Yeah, I think it's more of the latter, especially for us, because our balance sheet is in good shape. So, we are a great buyer from the standpoint of financing and whatever we can't finance from the balance sheet we can get on the outside. So, it's really more of the latter. We're not seeing the volume of deals out there that we saw 12 to 18 months ago. And again, I think, just looking at the public markets and the volatility that's there, I think, a lot of folks are scratching their heads in terms of what's deemed a fair valuation in this day and age and then especially in our categories that got such a great lift during COVID, and for the most part, they're starting to flatten out. And so, if you're a seller, you may opt to wait and see how things play out. So, just the overall volume is a little more muted.

Karru Martinson
Analyst, Jefferies LLC

Q

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

Timothy P. Cofer
Chief Executive Officer & Director, Central Garden & Pet Co.

A

Thank you.

Operator: And we have reached the end of the question-and-answer session. And I'll now turn the call back over to Tim Cofer for closing remarks.

Timothy P. Cofer
Chief Executive Officer & Director, Central Garden & Pet Co.

Thanks everyone for your continued interest at Central Garden & Pet. We wish everyone a good week.

Operator: And this concludes today's conference, and you may disconnect your line at this time. Thank you for your participation.