

Central Garden & Pet
Third Quarter 2021 Earnings Call & Webcast
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Presenters

Tim Cofer, CEO

Friederike Edelmann, VP Investor Relations

Niko Lahanas, CFO

John Hanson, President Pet Consumer Products

JD Walker, President Garden Consumer Products

Q&A Participants

Andrea Teixeira - JPMorgan

Bradley Thomas - KeyBanc Capital Markets

William Reuter - Bank of America

Jim Chartier - Monness, Crespi, and Hardt

Carla Casella - JPMorgan

Oliver Grossman - Jefferies

Operator

Ladies and gentlemen, thank you for standing by. Welcome to Central Garden and Pet's Fiscal 2021 third quarter earnings call. My name is Victor 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.

If anyone should require operator assistance during the call please press star followed by zero on your touchtone phone. As a reminder, this conference call is being recorded. I would now like to turn the call over to Friederike Edelmann, Vice President Investor Relations. Please go ahead.

Friederike Edelmann

Thank you, Victor. 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, JD Walker, President Garden Consumer Products, and John Hanson, President Pet Consumer Products.

Tim will provide a business update and Niko will discuss our Q3 results and our outlook for Fiscal 2021 in more detail. JD and John will join us after the prepared remarks for Q and A. Our press release providing the results for our third quarter in the June 26, 2021, and related materials are available on our website at ir.central.com and contain 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, EPS, and other guidance for Fiscal 2021, expectations for new capital investments, product launches, and future acquisitions are forward-looking statements subject to risk 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 24. 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?

Tim Cofer

Thank you, Friederike. And good afternoon everyone. Welcome to Central's Q3 earnings call. I hope you, your friends, and family remain well as we continue to navigate the still uncharted waters of this pandemic. I'm pleased to report that our business continues to grow, as consumers embark on this next chapter of their lives. While many things will look different in the months ahead, we remain committed and confident in the garden and pet industries and Central's ability to perform well despite a challenging and uncertain environment.

Today, Niko and I will discuss our third quarter results, our revised outlook for the fiscal year, and provide recent examples of our Central to home strategy in action. First and foremost, I'm thankful that our workforce continues to remain healthy and diligent. We are carefully monitoring the status of the delta variant and the CDC guidelines. We remain committed to encouraging and educating our teams about the benefits of the vaccine to ensure we keep our employees and customers safe.

All of our manufacturing facilities, greenhouses, and distribution centers remain open and fully operational. Thanks to our dedicated workforce I'm pleased to share that Central has delivered strong growth across both segments in our fiscal third quarter. We're encouraged by our continued record results especially when you consider we are lapping extraordinary growth in the prior year third quarter.

These results reflect the quality of our teams, our progress against our long-term strategy, and importantly our ability to stay agile as we react to a highly dynamic and shifting consumer and cost landscape fueled by COVID.

As we did last quarter, I'd like to share some noteworthy examples of how we are bringing our Central to home strategy to life. First, as shared in our investor day last year, we've outlined a new commitment to put the consumer at the center of our business. We want to build and grow strong brands that consumers love. We're

investing in consumer insights, strengthening our brand foundations, and developing multi-year innovation pipelines across our key brands.

In our dog and cat business, we've launched some exciting innovation including new Nylabone puppy kits, new flavor and format extensions of Nylabone Nubz dog treats, and new rawhide offerings from our Cadet brand. Another example of recent innovation success is our Aqueon aquatics brand. This year we launched a patented aquarium kit with smart clean technology. It combines the easy to clean function fish keepers need with the styling and design they want.

The smart clean technology allows consumers to perform water changes in less than two minutes and improves the water quality for a happy and healthy fish. It's easy to use and suitable for first timers and experienced fish keepers of all ages. Each of these innovations are exceeding our high expectations, and they're over indexing in our Q3 total pet branded sales growth of 11% versus prior year.

Next, to our customer strategy where our goal is to win with winning customers and channels. We've started to tap into the digital direct to consumer capabilities of one of our newest acquisitions, DoMyOwn. As part of our efforts to build a leading e-commerce platform. We are working to integrate DoMyOwn's customizable technology into the central network which should allow some of our business units to operate at an even higher level of efficiency when it comes to e-commerce. We've just kicked off our first integration project and we'll share more details in the future.

Our third strategic pillar focuses on strengthening our company's portfolio. And a key element here is our M&A agenda. As you may have seen just last month, we announced the acquisition of the D&D bird feed business. This latest addition to our family will allow Central to continue to build scale in a core category and leverage the D&D premium brand portfolio. Since the outbreak of the pandemic, the wild bird food category has experienced incredible demand. In fact, an estimated 34 million households participated in the category in 2020, an increase of 11% over the prior year.

And we're seeing new and younger consumers continue to join the category throughout 2021. With the addition of D&D we will now have more capacity and portfolio breadth to meet our customers' and consumers' needs. This is our fourth acquisition in the last eight months. And we feel good about our integration progress. We continue to prioritize growth, both organically and by our M&A agenda, and we are actively looking for additional attractive assets in both pet and garden. We look forward to keeping you posted on what's to come.

The fourth pillar in our strategy, cost, is focused on reducing cost to improve margins and fuel growth across the enterprise. An example of work under way in this area is a project involving our pet bedding business and Arden, our industry leading outdoor cushion business. These two businesses use the same raw materials, utilize suppliers with the same skillsets, and have some of the same large retail customers in common.

Our teams are excited to collaborate with each other as they capture scale benefits, realize synergies, and fuel growth through strategic sourcing and the implementation of technology and automation. We expect benefits in both efficiency and effectiveness as we pursue the synergistic opportunities across these two businesses.

And finally, our culture pillar, which is dedicated to our greatest asset, the 7,000 employees here at Central. As mentioned last quarter we're very focused on creating training programs centered around capability building and we're seeing high engagement and early results from those efforts. In Q3 we rolled out a new online learning platform that allows us to provide thousands of on demand training courses and develop learning paths for critical skills ranging from e-commerce to gross margin management for all of our employees across the company.

Lastly, for the first time in the company's history Central was named one of America's best mid-size employers by Forbes. Inclusion in this list is especially meaningful because it's compiled from data provided by our employees. And this recognition is a direct reflection of the efforts and achievements of our entire team. Our world class team members are at the heart of our company and we're very proud to be included on this list.

Now to provide some color on our Q3 performance, net sales increased 24% driven by our three recent acquisitions, as well as organic growth in both segments. Gross margin decreased 50 basis points to 30.9%, largely due to initial inventory related purchase accounting adjustments from our recent acquisitions. And to a lesser extent, from cost inflation headwinds which were only partially offset by our pricing and net productivity efforts.

Operating margin of 11% declined 170 basis points driven by gross margin compression, rising logistics costs, and purposeful heightened investment spending. Importantly, our strong growth led to EPS expansion of eight percent over the prior year. Given this performance, we are raising our outlook for Fiscal 2021 and Niko will share more details in his remarks.

Now turning to our two segments, while we've recently seen consumers' personal travel, entertainment, and dining pick up, and many of us are returning to the office at least part time, long term trends such as rural revitalization, homesteading, pet humanization, health and wellness, and sustainability continue to bring new consumers, especially Millennials, into both the garden and pet industries.

Sales in our pet segment increased 10% versus prior year, driven in particular by our dog and cat business, live animals, pet distribution, and our aquatics business. We gained share in dog treats with our Nylabone and Cadet brands, in pet bird with our Kaytee brand, and cat calming with our Comfort Zone brand, and we maintained share in most of our other pet categories.

E-commerce continues to be an important part of our pet business. In Q3 we lapped almost 50% growth in the prior year quarter as consumers shifted to online purchasing and avoided traditional brick and mortar channels due to COVID concerns. This quarter, e-commerce represents a meaningful part of our business at approximately 20% of pet branded sales and will play a critical role in our future growth algorithm.

Shifting to garden, you will recall last year was an excellent weather year for lawn and garden, and the industry experienced unprecedented growth given consumers staying at home and beautifying their outdoor spaces. While we saw some declines in foot traffic in the quarter across many of our leading retail partners and our POS consumption has slowed, we still delivered organic growth of five percent versus prior year.

We believe most of the new gardeners gained during the pandemic will continue to be engaged with our brands as we settle into the new normal. Our live plants business, garden distribution, and wild bird feed drove the organic growth.

And in particular, we gained share in wild bird feed. In addition to our legacy garden business our three new acquisitions from earlier this year added \$137 million in net sales. And they are delivering consistent with our business propositions. As you know, D&D closed just after quarter end and will be included as of the fourth quarter.

While we're certainly pleased with our strong results the ongoing elevated demand for our pet and garden brands continues to put pressure on our manufacturing capacity. And while our service levels have improved, we can still do better. As you recall, we are investing in capacity expansion and automation to meet the continuing strong demand. We are on track to double our capital expenditures in Fiscal 2021 versus historic levels, with most of the spending aimed at increasing manufacturing capacity.

Additionally, we continue to face the inflationary pressures stemming from the COVID-19 operating environment including notable increases in costs for key commodities, labor, and logistic costs both domestic transportation and ocean freight. As such, we remain focused on our net productivity agenda, leveraging our scale across the enterprise and pricing to offset these inflationary pressures.

Let me wrap with a view towards our priorities for the fourth quarter. First, we are making important investments to drive future profitable growth. These include investments in brand building, consumer insights, innovation, and e-commerce. Second, we are focused on integrating our four recent acquisitions with excellence, ensuring they deliver on our investment thesis and we capture any smart synergies along the way.

And finally, we are addressing the challenging supply chain environment through significant capacity expansion to improve our service levels and pursue cost out opportunities and pricing to help offset cost inflation headwinds.

With that, let me turn it over to Niko who will share more details of the Q3 results and our revised outlook for the fiscal year. Niko?

Niko Lahanas

Thank you, Tim. Good afternoon everyone. We are once again extremely pleased with the performance of our business, especially in light of the extraordinary results in the prior year quarter. Third quarter net sales broke the one-billion-dollar mark for the first time in the company's history, reaching \$1,037 million. The increase of 24% or \$204 million was driven by \$137 million of inorganic contribution from our three recent acquisitions, as well as organic sales increasing nine percent, or \$67 million.

Consolidated gross profit increased \$58 million to \$320 million. However gross margin decreased 50 basis points to 30.9% due to the impact of initial purchase accounting related to our three recent acquisitions. Cost inflation in key commodities such as milo, millet, and sunflower, as well as in labor and freight, most notably ocean freight. SG&A expense increased 32% to \$207 million driven by inorganic increases in the garden segment related to our recent acquisitions, higher commercial investment and increased logistics costs resulting from volume growth and inflation.

SG&A as a percentage of net sales increased 110 basis points to 20%. Operating income increased nine million to \$113 million while operating margin decreased 170 basis points to 10.9% due to gross margin compression, rising logistics costs, especially ocean freight, and heightened investment spending into capacity expansion, brand building, consumer insights, and e-commerce. Adjusted EBITDA increased \$16 million, or 14% to \$134 million.

Turning now to our garden segment, garden segment sales increased 42% or \$157 million to \$529 million. Excluding the contribution from acquisitions, organic sales increased five percent with the most notable growth coming from our Bell live plant business, garden distribution, and wild bird feed driven by our Pennington brand.

Garden segment operating income was \$67 million, an increase of three percent. Garden segment operating margin declined by 480 basis points to 12.7%, due to the impact of initial purchase counting related to our three acquisitions, cost inflation, and higher investment spend. Garden segment adjusted EBITDA increased \$10 million, or 15% to \$78 million.

Turning now to pet, pet segment sales increased 10% or \$46 million to \$508 million. We saw particular strength in dog and cat treats and toys, our Segrest live animal business, pet distribution and aquatics with our leading Aqueon brand. Pet segment operating income increased by 12% to \$71 million and operating margin rose by 20 basis points to

14% thanks to strong sales contribution as well as improved operating leverage. Pet segment adjusted EBITDA increased seven million, or 10% to \$80 million.

Now getting back to our consolidated results. Other expense was one million compared to four million a year ago. The difference was primarily due to the prior year impairment of two investments in private companies that were impacted by the pandemic. Net interest expense was \$13 million compared to \$11 million a year ago. The increase was primarily driven by higher debt balances outstanding during the quarter.

Net income grew 11% to \$76 million from \$69 million a year ago. Diluted earnings per share increased eight percent to \$1.37 from \$1.27 in the prior year quarter. Our tax rate was 22.5%, in line with the prior year quarter. Cash and cash equivalence at the end of the third quarter rose to \$517 million from \$495 million a year ago. The increase reflects the proceeds from raising \$400 million through the sale of our senior notes in April 2021 as well as cash flow from operations offset by the repayment of all borrowings under our ABL. Thanks to our strong cash position, we continue to be on the lookout for great growth in margin accretive companies in both pet and garden.

Net cash provided by operations was \$299 million for the quarter, up from \$182 million a year ago driven by higher adjusted EBITDA and favorable changes in working capital primarily due to higher collection of receivables during the quarter. CapEx increased 220% to \$23 million as we have heightened our focus on capacity expansion and automation. For example, during the quarter we invested primarily in our dog and cat, avian and small animal, as well as animal health businesses on the pet side, and in our bird feed, grass seed controls, and fertilizers as well as live plants on the garden side.

Total debt was \$1.2 billion, up from \$694 million at the same time last year. Our gross leverage ratio as defined in our credit agreement was 2.9 times at the end of the quarter compared to 2.4 times a year ago, well within our target range. We had no borrowings under our \$400 million credit line at the end of the third quarter.

Depreciation and amortization for the quarter was \$21 million compared to \$13 million in the prior year quarter, primarily driven by our recent acquisitions. During the quarter we did not repurchase any of our stock. There remains 100 million under the board's previously authorized share repurchase program as well as additional shares under the board's equity dilution authorization.

And finally, turning to our Fiscal 21 outlook. We are certainly pleased with our year-to-date results and anticipate our strong business momentum to carry on. Hence, we are leaning in with increased strategic investment spending, capacity expansion and automation, brand building and e-commerce to drive profitable, sustainable growth. In the near term however, we are lapping almost ideal gardening weather in 2020. Our supply chain remains stressed with outstripped capacity and labor shortages across many of our business units.

And we are anticipating further increases in cost for raw material and freight. While we have and continue to take pricing, we do not expect to be able to offset all of the impact this fiscal year. And finally, there remains uncertainty around the impact of lapping COVID tailwinds in the remaining months of Fiscal 2021.

Taking all of this into consideration we are increasing our guidance and now anticipate full year 2021 GAAP EPS of \$2.45 or higher. This compares to our previous guidance of 2021 GAAP EPS of \$2.25 or higher and translates to 2021 adjusted diluted EPS of \$2.62 or higher. Please note this outlook excludes the impact of acquisitions, as we are still finalizing purchase accounting. Our estimates indicate that our three acquisitions, Hopewell, Green Garden, and DoMyOwn will be accretive for Fiscal 2021 EPS in the range of 11 to 16 cents. This does not include our recent addition of D&D which closed after quarter end.

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

Operator

Ladies and gentlemen, we will now have our question-and-answer session. If you would like to ask a question please press star one on your telephone keypad. A confirmation tone will indicate that your line is in the question queue. You may also press star two if you would like to remove your question from the queue. One moment please while we now pull for questions.

Our first question comes from Andrea Teixeira with JPMorgan. Please proceed with your question.

Unknown

Hey, good afternoon everyone. It's actually Kojo on for Andrea, so thanks for taking the question.

Tim Cofer

Afternoon.

Unknown

You said high level--afternoon. So we've heard from quite a few companies recently around retail customers, you know, kind of readjusting their inventory position sort of given the increased foot traffic and physical retail and maybe a little bit less shopping, you know, kind of from an e-commerce standpoint. So just at a high level, have you observed any of these adjustments so far with your retail partners? And has this had any impact on orders?

And then if I could just have one more, I guess are you guys--you know you mentioned, you know, kind of the elevated demand and its stress on your service levels. So can you just comment again on just the level of disruption across your supply chain if there is

any just given the elevated demand. And I guess how confident are you as we kind of look ahead to service this elevated demand across both divisions. Thanks a lot.

Tim Cofer

Sure. Well I'll start and certainly invite JD and John to comment on some specifics in their respective garden and pet businesses. I think on your first question, we are seeing that shift from a channel standpoint on a year over year basis. So in other words, if you think about Q3 of 20, you know, we were in the kind of early lockdown period. And from a consumer and shopper behavior standpoint you saw a massive migration to online that really favored the e-commerce channel particularly in pet but also in garden relative to traditional brick and mortar.

There were also at that time prior year some, you know, restrictions that certain retailers had particularly as it relates to garden center offerings. So then as you look at this year on the year over year comparison, when you're lapping those call it on the pet side, you know, 50% increase last year in our e-commerce channel, on the garden side triple digit increases in the e-commerce channel, what you're seeing this year is on a year over year basis a more muted e-commerce growth and a more on a relative basis an accelerated brick and mortar growth.

And those, you know, those dynamics then add up to the numbers that we shared which on both pet, which was a 10% growth on the quarter and on garden which was, you know, call it a mid-single digit organic growth obviously with the acquisitions much higher, that's how you see that dynamic shake out.

As it relates to inventory and kind of sales versus consumption, very much in line on the pet side. So, you know, sales growth of around 10%. We saw POS growth also around the 10% range. So don't see any real issues there. On garden you see a slight difference on POS versus sales. But I'd say overall, you know, again last year we had inventory levels that were lower at garden retailers and this year retailers were prepared for that season and did a better job.

So I don't know. JD, any other color you wanna talk about garden inventories related to his question?

JD Walker

Tim, I think you touched on the major points there, you know, with regards to that shifting from e-commerce back to more traditional modes of shopping. A year ago many of our retailers still had their garden centers locked and consumers couldn't gain access to outside garden. So this year we're seeing less buy online pick up in store, less curb side pickup, and more people venturing out and shopping lawn and garden consumables the way they traditionally have.

And I think, you know, what you said about inventory levels, it's absolutely accurate. I'm not alarmed by the inflated inventories at retail. The retailers don't appear to be either.

You know, they came into this year very aggressive on inventory and, you know, as we've gotten into the summer months we're now comparing a period last year where they had widespread out of stocks. So it's a little bit of a difficult comparison if you will. Year over year you would expect inventory to be up somewhat.

And they remain very bullish on the year. So I think that, you know, we haven't had any difficult conversations with customers around inventory, inventory balancing, or anything like that. But we are somewhat inflated versus prior year.

And John, I'll turn it over to you.

John Hanson

Yeah, no, I'd just echo what Tim said. I think he described it well. You know, foot traffic in brick and mortar is definitely up and we lapped, you know, significant growth in e-commerce prior year, you know, and our POS, you know, for the most part matches our shipments.

Tim Cofer

Yep, that's right. So not an issue there. And then the second part of your question was related to service levels. And indeed as we've shared in the last couple of quarters and again in the call today, you know, really it's a situation where we've experienced two consecutive years of unprecedented increase in demand in both pet and garden industries, significant expansion in household penetration, and in buy rate and category participation.

And that has left us in a situation where on a number of our businesses demand has exceeded supply. On top of that, we all know across the industries across the world the global supply chain is tighter. And that impacts everything in terms of raw materials, components, ocean freight, domestic transportation, and labor. And so that has all culminated in a service level that quite honestly is not up to our historic standards and one that we're working very aggressively to improve with our retail partners.

Accordingly, that's why you've seen a doubling of our CapEx expenditure year over year. I think Niko and I have shared earlier a \$70 to \$80 million figure of CapEx. We'd put that at the high end of that range at this point which is about double what we spent last year and in the prior years. The vast majority of that CapEx is being spent on adding capacity on a number of our businesses. This would include dog and cat on our dog treats and dog toys business. This would include wild bird, aquatics, grass seed controls. Each of these businesses we are adding incremental capacity.

And then in terms of, okay, when does all of this come on? Obviously BU--business unit by business unit the answer differs. But in aggregate I think certainly by the middle of next year we're gonna be in good shape in terms of these capacity expansions and back to service levels that we're proud of and that our customers expect.

Unknown

Great. Thank you so much. Good luck.

Operator

Thank you. Our next question comes from Bradley Thomas with KeyBanc Capital Markets. Please proceed with your question.

Andrew

Good afternoon, everyone. This is Andrew on for Brad. Thanks for taking our questions here. Was wondering if we could start by talking a little bit more about weather. We've heard from many others in the industry that weather was unfavorable particularly in May and June. Could you talk about what you saw from a weather perspective during the quarter and how you thought that that impacted your own results and POS sales in the quarter?

JD Walker

Hi, Andrew. It's JD. Sure, I'll be glad to take that. You know, with--I'll keep it very general but I would say that, you know, we saw some extreme weather in the quarter. And for lack of a better explanation, I'd say the eastern part of the U.S. saw too much rain and the western part of the U.S. saw not enough. You know, so drought conditions and extreme heat.

And that affected many of our markets. It's also affecting, you know, some of the crops that we would be dependent on for grains and things like that. And for our grass seed business as well. So but we saw some extreme, you know, we saw two extremes I should say with regard to weather in different parts of the country. And it has definitely impacted consumption, and we could see that on a week-to-week basis as we compare versus prior year.

Particularly in markets when we're looking at markets where they had a strong comp last year and we're looking at a weekend where it rained the entire weekend in the eastern market, we could see it in the POS consumption. So we've referenced it many times that last year was near perfect and this year's been anything but that. And I know our competitors talked about that earlier today as well and I would concur with regard to that.

Andrew

Thank you. That's very helpful. And you mentioned that the impact of acquisitions would be accretive to the year by the range of 11 to 16 cents on a EPS basis. Could you share how much of that was realized this quarter and how much we should expect to be realized next quarter? And then how does your, you know, your recent acquisition of D&D provide upside to this?

Niko Lahanas

This is Niko. So last quarter we called out seven cents accretion on the acquisitions. What I will tell you this quarter will be--was higher than that. We're not gonna give out specifics at this time. And then I think as we look at Q4 that'll turn negative. The bulk of those acquisitions are very seasonal and will not be contributing to EPS in Q4. So that's kind of the color there.

Andrew

Understood. And so the guidance you've given for 2021 has been pretty helpful here. But as we think about Fiscal 2022 are there any high-level thoughts or guardrails you think we should keep in mind for our models?

Niko Lahanas

Look, I'd say first we're actually in the process in the next couple of weeks of putting together our Fiscal 2022 operating plan. In addition, we're in, you know, very productive discussions right now with our customers both on the garden and on the pet side in range reviews and agreeing on product listings and early promotional calendars. So it is a little premature to talk Fiscal 22. Obviously, we will do that and expect to give guidance in our next quarterly call here in about 90 days.

You know, what I would tell you broadly is obviously, you know, starting at the top line I mean we've had two extraordinary years of growth on the organic side. And I think on the pet side we would expect given the significant increase in pet adoptions that some level of returning to, you know, normative growth levels on pet is probably likely. On the garden side it's a situation where, you know, two incredible years. Weather's always the wild card. And, you know, we'll need a little bit more time to make a determination on that.

On top of that we will have the benefit of our four new acquisitions that a lot of that, you know, year over year will prove to be favorable going into Fiscal 22 both top and importantly bottom line. So at this stage, you know, that's about all we'll share. We're keeping a keen eye on the cost envelope. Obviously this year has been a very inflationary year across key commodities across our labor and across transportation domestic and ocean freight.

And we'll have better visibility on Fiscal 22 when we talk to you again here in a few weeks.

Andrew

Understood. Thank you. That's all for me.

Operator

Thank you. Our next question comes from William Reuter with Bank of America. Please proceed with your question.

William Reuter

Hi. I just have one with I guess a couple parts to it. But once again you're in a situation where you have a lot of cash on the balance sheet. You have a lot of acquisitions that you're still continuing to integrate. I guess can you talk a little bit about what the pipeline looks at this point, where in which segment you're seeing more opportunities? And then I guess how valuations are in the market generally. Thanks.

Tim Cofer

Sure. Yeah, all of it's true. And all of it is quite intentional. So, you know, M&A being one of the cornerstones to our growth initiatives, we always wanna make sure that we've got the appropriate liquidity on the balance sheet. So as we've acquired we've also replenished that cash on the balance sheet.

I would say the integration is going extremely well. We're really pleased with the acquisitions. You know, we've inherited some great businesses and some great management teams. So we're very, very pleased there. I would say, you know, the pipeline is still robust and, you know, we meet, you know, monthly, weekly on looking at deals. So we're seeing a lot of deals still come across our desk. I would say it's largely balanced between pet and garden. So not more of one than the other.

You know, and valuations are still a bit on the frothy side. And again, you know, you've gotta look at a lot of times the larger ones tend to command sort of the higher multiples. So we're still remaining disciplined. We're looking at a lot of deals and, you know, we're gonna continue to do what we do irrespective of the market. We're always gonna look for, you know, value growth investments if you will. Really that's what we look for.

William Reuter

Great. Thank you.

Operator

Thank you. Our next question comes from Jim Chartier with Monness, Crespi, and Hardt. Please proceed with your question.

Jim Chartier

Hi, thanks for taking my questions. I was hoping you can provide some color on fourth quarter. You know, looks like a big swing from positive 25 cents EPS last year to, you know, negative, you know, maybe 25 or so cents this year and wanted to, you know, know if you could give us some color in terms of is it freight costs and input costs and, you know, cost pressure that's a primary factor in continuing to invest in, you know, SG&A? You know, I think some color there would be helpful. Thanks.

Niko Lahanas

Sure, Jim. This is Niko. You know, the way I would kind of characterize Q4, I think you've gotta take a step and look back at Q4 a year ago. And we were in an incredible environment between the weather in garden, the lockdown. Things were just hitting on

all cylinders. So, you know, to say we're lapping a tough comp would be a massive understatement. So I would kinda start there.

And then, you know, look at the environment we're in now where you've got some commodities really taking off, you know, we're trying to manage that. The other thing I would point out is the acquisitions that we've done which I alluded to earlier, they're gonna go negative in Q4 probably two of the three, actually two of the four now if I include D&D. So they probably will not be accretive to earnings. So we've kinda had that headwind as well.

And then, you know, looking at ocean freight and logistics costs we don't know what's gonna go on there. As well as our investments. So, you know, we feel really bullish about the business. We feel like now's the time to invest. And so we're gonna take that opportunity now and that's obviously gonna contribute to a little bit of movement there on the bottom line.

Jim Chartier

Okay. And then can you talk about the, you know, latest adoption trends that you're seeing for dog, cat, and small animals? Is that still continuing to grow or has that kind of flattened out?

Tim Cofer

Sure. We continue to feel very good about what we're seeing on the pet ownership standpoint. You know, the data that we see suggests that in 2020 there was that huge initial spike with the COVID lockdown. You know, growth somewhere in the, you know, mid-single digits. We saw, you know, household penetration of dog up eight percent. Cats were up five percent. Other pets, everything from small animals to bird to reptile in aggregate up double digits.

We also saw a third of existing pet households adding another pet. And we saw a disproportionate relative to existing consumer cohorts a disproportionate increase came from younger generations. When we look at year to date data this year we see that growth rate continuing albeit at a more muted level. And I think what all that suggests is, you know, the pet industry and the ability to throw off, you know, a consistent low to mid-single digit type growth is the type of opportunity we've got in front of us for the next few years.

Jim Chartier

Great. And then on the capacity expansion projects, you know, you talked about potentially, you know, having some of those come on in the second half of this year. Is that happening or have they kind of been delayed and pushed out into next year?

Tim Cofer

Quite honestly a bit of both, Jim. So in a couple of cases we've had both some weather delays on some major expansions in facilities consistent with what JD said around

significant rain in some of our Midwest and southeast locations as well as quite honestly, you know, given the tight global supply chain some equipment delays, some ocean freight delays. So that's been a bit of the story in some.

In others, we are ramping up the new capacity as we speak here in what was late Q3 and into fourth quarter. But as you look at all of them, and I think earlier in the call I listed six or seven of our major business units where we've added some of that capacity, all of that's gonna be online by mid-22. Really starting from the last month or so through mid-Fiscal 22.

Jim Chartier

Great. Thanks, and best of luck in the fourth quarter.

Tim Cofer

Thank you.

Operator

Thank you. Our next question comes from Carla Casella with JPMorgan. Please proceed with your question.

Carla Casella

Hi. I'm wondering if you have any comments in terms of how high you're comfortable taking leverage in the event of M&A.

Niko Lahanas

Sure. So we've been pretty consistent. Our, you know, optimal structure would be in that three to three and a half times range. For the right deal we'd be willing to lever up into the low fours and then quickly delever back down to that three to three and a half range.

Carla Casella

Okay, great. And then just given that retailers are better inventoried today and not chafing as much, are you starting to see any kind of pick up in the promotional environment?

Tim Cofer

JD, you wanna comment on garden?

JD Walker

Sure. Hi, Carla. It's JD here. We're seeing some pick up in promotional activity versus prior year. But I would say that we're not back to pre-pandemic levels of promotion. So if last year, I mean last year it went to practically zero. And this year I'd say that, you know, in a range, you know, less than 50% of where they were in 2019 and before. So, you know, we're not back to that level yet. And I do think that that has a pretty profound impact on our business model.

Our business model is to trade that consumer all in the store. And that, you know, we rely on promotions and off shelf activity. And I think that that's hurt us somewhat over the last year, year plus. But we look forward to next year and beyond when it returns to normal levels.

John Hanson

Yeah, and I agree--

Carla Casella

--Okay, great. Thank you--

John Hanson

--On the pet side, very consistent. You know, we're seeing a pickup in promotional activity but it's nowhere near where it was pre-pandemic. And we look forward to, you know, accelerated activity in our Q1.

Carla Casella

Okay, great.

Operator

Thank you. Our next question comes from Oliver Grossman with Jefferies. Please proceed with your question.

Oliver Grossman

Good afternoon. I was wondering if you could provide any color on how you plan on offsetting inflationary pressures. Would you say it's more pricing or more cost reduction initiatives? And then how are retailers responding to those price increases if that's present?

Tim Cofer

Sure. Yeah, I mean it's definitely a combination of what you said. I mean, we have not been shy about pricing in this fiscal year. And that's both on the garden and on the pet side. If you look at the total cost pressure envelope that's hitting us, and it's hitting us on all fronts, right? It's hitting us on key commodities, it's hitting us on higher labor costs, it's hitting us on domestic transportation logistics as well as ocean freight.

Pricing to offset that has been the biggest lever this year. The second has been, you know, what is a growing discipline around cost out and what we call our net productivity agenda. If you add the pricing efforts and our productivity efforts, we will come up shy of matching that inflationary pressure, but we will cover the majority. Not all of it, but the majority. As we look to Fiscal 22, we would expect some additional pricing, particularly as we're, you know, talking about, you know, line reviews and going into season on the garden and the pet side.

To the end of your question, that's obviously right now part of the dialogue discussion and negotiation with our customers. You know, pricing is never a, you know, a welcome discussion with our customer partners. But at the same time, they realize that, you know, we're not alone. That these increased costs are fairly common across the industry. And, you know, they're seeing it pretty well broad based. So both JD's team and John's team are doing a good job of, you know, providing the right rationale and, you know, we're in this for the win win with our retail partners.

We want them to make a reasonable margin. We need to make a reasonable margin. And we need to continue to pass on good value to our end consumers.

Oliver Grossman

Great. Thanks very much.

Tim Cofer

I think we have time, Operator, for one more question if there is one.

Operator

There are no further questions at this time. So I'd like to turn the floor back to Tim Cofer for any closing remarks.

Tim Cofer

Thank you. I want to thank everyone for joining today's Q3 earnings call. We appreciate your interest in Central Garden and Pet. We wish you a good week, and we'll talk again soon. Thank you.

Operator

Ladies and gentlemen, this concludes today's webcast. You may now disconnect your lines at this time. Thank you for your participation and have a great day.