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Central Garden & Pet Co. (CENT)

Q1 2017 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to Central Garden & Pet's First Quarter Fiscal Year 2017 Financial Results Conference Call. My name is Darren, 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 is being recorded.

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

Steven Zenker

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

Thank you, Darren. 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; J. D. Walker, President, Garden Branded business; and Niko Lahanas, SVP, Finance Operations and Management Reporting.

Our press release provided results for our first quarter ended December 24, 2016, is available on our website at www.central.com. It contains the GAAP to non-GAAP reconciliation to the non-GAAP measures discussed on this call.

Before I 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 the forward-looking statements. These risks and others are described in Central's Securities and Exchange Commission filing, 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, everyone. Since we reported our year-end results just two months ago, I'm going to keep my comments relatively brief today. Our fiscal year first quarter started out on track, delivering earnings of \$0.15 per share, or \$0.12, if we exclude the sale of a distribution facility during the quarter. It's important to note that over half of the non-GAAP gain of \$0.11 was due to acquisitions, favorable timing of revenues and expenses was also a factor.

All in, sales were up 17%. Importantly, organic sales growth was a strong 7%, behind a favorable off-season Garden corner and share gains across much of our Pet business. I do want to caution you that our first quarter is typically our smallest of the year and that we still have a full Garden season ahead of us, as well as more difficult comps in the three remaining quarters of our fiscal year. For those reasons, we are keeping our non-GAAP earnings per share estimates for the year at \$1.34 or higher.

Having said all that, we're pleased with where we're at. We're making significant strides on all of the changed vectors I spoke to you about on the last earnings call. First, we continue to work diligently on accelerating our portfolio momentum. For example, in our AVODERM and PINNACLE dog food business, an area that has been challenging for us in the last few years, we're in a reset mode.

We recently made strategic decisions around which channels and geographies to emphasize in order to improve our focus and drive sustainable profit growth. In addition, we have secured and are seeking partnerships to drive growth and scale. This business is already in a better place than it was just six months ago and we're encouraged by our progress.

Beyond the makeup of our current portfolio, we continue to dial up our efforts on evaluating M&A opportunities and have built a solid pipeline of targets. Our strong cash flow generation and low leverage ratio gives us the ability to continue to make meaningful acquisitions. We have closed deals totaling over \$150 million over the last 18 months, and in each case, they have been accretive by the end of year one.

Another changed vector I mentioned in our last earnings call was increasing our innovation, output and success rates. We feel great about our progress in our upcoming product launch. For example, in Garden, we're introducing two product enhancements that utilize technological advances to improve the growing process, while meeting [indiscernible] (04:16). Our PENNINGTON SMART SEED grass products will be utilizing a coding with a biostimulus to help the seeds establish quickly, while continuing to acquire 30% less water than regular grass seed.

Our reformulated Ultragreen plant fertilizer product now under our PENNINGTON brand will be utilizing a patented technology that also reduces watering needs and maintains more nutrients in the soil. This helps to grow deeper roots and grow bigger plants with more blooms and greener leaves.

In our Pet business, our new product efforts continue to target the treats and chews category, which is one of the better performing categories in the pet industry of late. We're adding to our successful line of treats and chews under our NYLABONE and CADET brands. For example, in our NYLABONE business, we'll be adding to our successful healthy edibles line in 2017 with new Healthy Edibles Wild with unique alternative proteins like Bison, Venison and Turkey. These are just a few examples across our Garden and Pet business of what we believe is a robust pipeline of new product launches slated for this fiscal year.

The third strategic change vector has been around the efforts we're making to drive cost savings and productivity improvements to fuel growth. Our program here is on track and we continue to target cost savings of 1% to 2% of controllable cost per year in an effort to reinvest in generating organic growth, while also enhancing our margins.

For example, in our Garden controls business, we have brought some additional product manufacturing in-house where we believe will be more economical. A great example of strategic cost savings on the Pet side of the business is in our small animal bedding unit. Since we began producing our own proprietary product in-house, sales have increased dramatically and we have rolled out a better product at a lower cost.

Finally, we have talked at length about our network reorganization in our dog and cat business, designed to increase capacity and lower cost. Suffice to say, we are making good progress and are on track to meet our goals. However, the timing for some elements have been slightly delayed as we weren't sure that we can execute with excellence in the face of rapid growth and demand for our products in those business.

Now, there are costs implementing our strategies and these expenditures as well as their timing will be factors in this year's results versus year ago. However, to be clear that the market share gains that we have achieved and the organic growth we expect, we continue to believe that we will show good earnings growth overall this year, consistent with our \$1.34 or higher estimate. All in all, I'm very pleased with how the company is executing and I'm looking forward to another strong year in 2017.

Now, I'll turn it over to Howard to give you some more details on the quarter.

Howard A. Machek

Senior Vice President and Chief Accounting Officer (Principal Accounting Officer), Central Garden & Pet Co.

Thank you, George. Good afternoon, everyone. Earlier today, we issued a press release with our first quarter financial results. I'd like to discuss these results with you, and then we'll open it up for questions.

For the first quarter, the company recorded GAAP earnings of \$0.15 per diluted share, up from a loss of \$0.18 over the same period last year. Included in this year's results is a \$2 million gain on the sale of a distribution facility. Included in last year's first quarter, there was incremental interest expense of \$14 million related to our note refinancing. Excluding the distribution facility sale in Q1 2017 and the note refinancing in Q1 2016, earnings for our first fiscal quarter for this year were \$0.12 per diluted share compared to \$0.01 per diluted share in the first quarter of last year.

As George mentioned earlier, this quarter's results benefited from the conclusion of our new acquisitions, Segrest and DMC, as well as favorable revenue and expense timing.

Consolidated sales for the quarter increased 17% versus the prior year to \$419 million, aided by recent acquisitions as well as organic growth in both our Pet and Garden businesses. Our quarterly organic growth was 7%.

Consolidated gross profit rose 21% and our gross margin increased 110 basis points to 28.8%, due in part to favorable mix and lower input costs. SG&A expense for the quarter increased 11%, or \$10 million, versus a year ago. Included in the SG&A numbers is the \$2 million gain from the sale of the distribution facility. Excluding this facility sale, SG&A increased \$12 million, and as a percent of sales was 24.5%, declining 80 basis points.

Operating income for the quarter rose to \$20 million compared to \$9 million a year ago. Our operating margin of 4.8% was up 240 basis points, due in part to the facility sale, additional volume leveraging fixed operational costs and sales mix changes compared to a year ago. Excluding the facility sale, operating margin of 4.3% was up 190 basis points.

Turning now to the Pet segment. Pet segment sales for the quarter increased 22%, or \$55 million, to \$304 million. The quarter sale included two months from our newest acquisition, Segrest, and a full quarter of DMC. In comparison, we had only one month from DMC last year, and organic revenue growth was 6% and reflects widespread increases across the Pet segment was benefited from the shift in timing of orders into Q1. With more difficult comps later in the year, we would expect our Pet organic growth to be less robust than it was in our first quarter.

Pet segment operating income increased \$7 million, or 28%, compared to the prior year. Pet operating margin increased 50 basis points to 11%. The operating margin benefited from a favorable mix of sales during the quarter versus the prior year, as well as higher profitability from DMC, which had depressed margins a year ago due to the impact of purchase price accounting adjustments.

The impact from these gains more than offset the unfavorable margin impact from the company's recent acquisition of Segrest and the increased spending on facility, as we transitioned several dog and cat businesses to a new location. Those activities are expected to continue in the future quarters.

Moving to Garden. For the quarter, Garden segment sales increased 4%, or \$4 million, to \$115 million. Higher sales of other manufacturers' products as well as increased grass seed and wild bird feed revenues, contributed to the sales increase. The first quarter of last year included \$5 million in revenue from the holiday decor business we exited in January of 2016.

Garden's operating income improved to \$3 million from a loss of \$3 million in the first quarter of last year, and the operating margin was 2.3%. The improvements in both operating profit and margin were due in part to the sale of the distribution facility as well as additional volume leveraging fixed operational costs and lower input costs.

Moving back to our consolidated results, other expense doubled to a \$1 million, reflecting our interest in partnerships to drive future growth. We expect expenses to be slightly higher in this line item in the fiscal year at our normal run rate. Net interest expense decreased from \$22 million to \$7 million. The \$15 million decrease was due primarily to the absence of a \$14 million in incremental interest expense we incurred in the first quarter of the prior fiscal year, in conjunction with the refinancing of our fixed rate debt.

Our net income for the quarter was \$8 million and diluted earnings per share were \$0.15, compared to a loss of \$9 million, or \$0.18, in the first quarter of 2016. Adjusted earnings per share was \$0.12, compared to \$0.01 in Q1 of fiscal 2016.

Turning to our balance sheet and cash flow statement. For the quarter, cash flow used by operations increased approximately \$13 million from the first quarter a year ago. CapEx was \$13 million versus \$5 million in the first quarter of 2016. The increase was predominantly driven by investments in expanding and consolidating our facilities.

Depreciation and amortization for the quarter was \$10 million, up from \$9 million a year ago. The primary driver of the increase was the new businesses we acquired. Our total debt decreased to \$395 million from \$436 million a year earlier. So, we made an acquisition for \$60 million just a few months ago, and yet, our debt level is still down \$41 million year-over-year and our leverage ratio was 2.1, compared to 2.9 a year ago. We also had \$329 million of availability on our credit line as of the end of the quarter.

During the quarter, we did not repurchase any of our outstanding stock and approximately \$35 million remains available under the board approved stock repurchase program.

Now, I'll turn it back over to George.

George C. Roeth

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

Thank you, Howard. So to summarize, we're off to a good start in the fiscal year. We're driving share and consumption gains. We are successfully integrating our acquisitions, and we're on track executing our strategic initiatives.

So with that said, operator, can you please open the line for questions?

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from Bill Chappell of SunTrust. Please proceed with your question.

William B. Chappell

Analyst, SunTrust Robinson Humphrey, Inc.

Thanks.

Q

George C. Roeth

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

Hi, Bill.

A

William B. Chappell

Analyst, SunTrust Robinson Humphrey, Inc.

Hey, how are you? Just starting off on figures, maybe you can give us a little more color now on kind of the revenue run rate, or if we should look at this is kind of a normal quarter, I don't know if there's much seasonality, or kind of also what you think in terms of impact on margins going forward?

Q

George C. Roeth

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

There's not a lot of seasonality on the business. We don't have a full quarter, but I'll tell you during the integration, the sales have been as to expectations. So, it's doing quite nicely and we expect it to be roughly around the company margins in Pet going forward.

A

William B. Chappell

Analyst, SunTrust Robinson Humphrey, Inc.

Okay. And then in terms of you alluded to or you spoke to on the call, you gained some share in Pet, but you don't expect Pet growth to be as robust on the organic side for the rest of the year. So, can you help me couple those two comments and then maybe give some more color where you've gained share in Pet?

Q

Nicholas Lahanas

SVP-Finance Operations & Management Reporting, Central Garden & Pet Co.

This is Niko, Bill. So, yeah, in looking at the consumption data via Nielsen, we gained share in a lot of categories, so dog and cat, aquatics, hard goods, small animal, avian. So, it was pretty broad-based, feel really good about that. Going forward, as we look later into the year, we're obviously lapping tougher comps. We also had a lot of promotional activity last year. We'll have promotional activity again this year. Hard to say at this stage whether it will be as successful. So, that's why we're tempering the outlook a little bit.

A

William B. Chappell

Analyst, SunTrust Robinson Humphrey, Inc.

Okay. And then just last one for me on Garden. Any idea kind of, I mean, how much of an impact the longer season? Scott's also talked about it was a pretty good fall season. What you're expecting Garden to grow and maybe what it'd end up doing and how much weather helped?

Q

J. D. Walker

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

A

For Q1, you're talking about, Bill?

William B. Chappell

Analyst, SunTrust Robinson Humphrey, Inc.

Q

Exactly?

J. D. Walker

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

A

Yes. So this is J. D. I'll speak to that. Similar to what has been reported by others, the favorable weather, the milder temperatures in the fall favorably impacted our business. So we saw strong consumption really across the board in all of our businesses, probably the strongest performers were grass and our branded controls. Our distribution of business also was very strong during the quarter. So we talked previously about our traditional lawn and garden categories versus our wild bird food categories. So our wild bird didn't fare well as well because of the milder temperatures. So, we have a little bit more of a balanced portfolio. Having said that, very strong quarter for us. We exceeded expectations and over delivered for the quarter and we feel good about that.

William B. Chappell

Analyst, SunTrust Robinson Humphrey, Inc.

Q

Sounds good. I'll turn it over. Thanks a lot.

George C. Roeth

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

A

Thanks.

Operator: Our next question comes from Brian Nagel of Oppenheimer. Please proceed with your question.

Brian Nagel

Analyst, Oppenheimer & Co., Inc.

Q

Congratulations on a nice quarter. So maybe [indiscernible] (18:28). With respect to weather, and I know that's been a topic that inspires in retail to like. So, is it fair to assume that as temperatures cooled later in your fiscal Q1, so month of December, did sales moderate or was there just more of a big shift in there to some other colder weather type products?

J. D. Walker

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

A

So, Brian, this is J. D. The first part of the quarter is when you're going to see most of the traditional – the October-November timeframe, most of the traditional lawn and garden categories, that's where they perform better. As you get into December, colder weather in certain areas as well as moving into holiday season for the retailers, that had an impact on those categories. We did see a lift during that period of time in our wild bird food business.

George C. Roeth

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

A

The only other perspective I would jump in with is, Q1 is a very small quarter in the overall Garden season.

J. D. Walker

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

It is.

A

George C. Roeth

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

And weather has a way of reverting to the mean, so there's a lot out in front of us.

A

Brian Nagel

Analyst, Oppenheimer & Co., Inc.

So as I understand that the other question is on the weather [indiscernible] (19:31). A lot of rain this year on the West Coast, it's interesting – there was a talk of flood condition – I'm sorry drought conditions for so many years and with the rain, I think that the drought may be over, close to being over. How should we think about that within the context of your Garden business, I mean not just here in Q1, but maybe as a factor going through the year?

Q

J. D. Walker

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

So, Brian, this is J. D. again. It's impossible for us to accurately predict the weather going forward. We do subscribe to the syndicated weather data. It tells us that there are going to be tough comps during parts of Q2 and stronger comps in other parts. I do believe what you said is accurate, the retailers believe it as well, and that is that favorable conditions in California and Texas for that matter should have a positive impact on the business.

A

But we've gone into seasons before anticipating strong markets and things have gone in the other direction on us, so it's difficult. What I tend to talk about is, what is controllable and what's uncontrollable. The controllable causal factors in our business going forward, distribution, secondary locations, promotional support, we feel great about all of that. If the weather is favorable, we'll capitalize on that, but that is the single biggest causal factor out of our control.

Brian Nagel

Analyst, Oppenheimer & Co., Inc.

All right. Then, the one final question, and I know this is longer-term, it's quite difficult to ask at this point. But I'm getting a lot of questions across my coverage universe on the potential for a border adjusted tax. Is that something – and again recognize kind of no entry for dog on this. But, is that something that you begin to contemplate within your discussions and maybe some initial thoughts there for your business?

Q

George C. Roeth

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

Well, it's obviously something we have to think about. First thing I'll tell you, there's a lot of unknowns, where, when, on what, from where. We do produce the majority of our production in U.S., although we do have material imports, so it's something we have to keep our eye on. The way we think about is the competition is going to face the same pressures. So if there's pricing pressure, they will face the same things and the market will likely move in lock step, and we're a very nimble company on this front. We shift our sourcing to optimize the cost and our low-cost producer program, I think I talked earlier about controls. We moved some production in-house versus

A

things that we had done with co-packers, in other cases co-packers who are in other countries which this would actually impact. So, we're confident in our ability to adapt to any situation as it unfolds.

Brian Nagel

Analyst, Oppenheimer & Co., Inc.

Q

Great. Okay. Well, thank you, and again congratulations.

George C. Roeth

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

A

Thanks.

J. D. Walker

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

A

Thank you.

Operator: Our next question comes from William Reuter of Bank of America Merrill Lynch. Please proceed with your question.

William Michael Reuter

Analyst, Bank of America Merrill Lynch

Q

Good afternoon. You guys talked a little bit about a shift in timing from the second quarter into the first quarter. Can you disclose what's the dollar value of shipments that you think shifted from the second quarter to the first would be?

George C. Roeth

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

A

We're not going to get into the puts and takes. First, I want to be clear, we didn't say it was from – necessarily from the second quarter into the first quarter and we're not going to put a dollar value on it. There's a number of things that impacted timing. One of them I talked to in my opening comments was around our investment timing around our dog and cat facilities project. Demand on that business has been quite strong. We want to execute for our customers and the change was excellence. Therefore, some of the timing hazard has been pushed out in the fiscal year. There has been some promotional shifts that impacted the business as well. So, I wouldn't long on strictly from Q2 into Q1 and we're not going to give an exact dollar number.

William Michael Reuter

Analyst, Bank of America Merrill Lynch

Q

Okay. You guys are exiting a handful of facilities this year. Do you guys have a ballpark range for what you guys might receive in proceeds? I can't remember exactly how many of them you own that you guys are exiting?

George C. Roeth

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

A

As far as the – if you're referring to the dog and cat facility transition, or the one we transitioned from, we mentioned on the opening comments that we had a \$2 million gain from the sale of a distribution facility. So, I'm not sure if you're harkening back to that or to something else?

Howard A. Machek

Senior Vice President and Chief Accounting Officer (Principal Accounting Officer), Central Garden & Pet Co.

A

We had a facility we exited last year on the Pet side and then this year was on the Garden side.

George C. Roeth

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

A

Sure. So, I mean, we are always evaluating our footprint and trying to optimize it. And just recently, we came across those as part of our optimization process. It doesn't mean there won't be any in the future, but right now, that's – don't have anything on the horizon.

William Michael Reuter

Analyst, Bank of America Merrill Lynch

Q

You mentioned it was a \$2 million gain, what were the proceeds from the sale of that facility?

George C. Roeth

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

A

Oh, I think, it might have been around \$5 million, I don't recall specifically.

William Michael Reuter

Analyst, Bank of America Merrill Lynch

Q

Okay. And then just lastly for me, in your prepared remarks, when you guys were talking about acquisitions, it sounded like maybe the pipeline was more robust, or maybe you guys were going to be more active than you had been recently. I guess, was I reading your body language correctly that it seems like there's more opportunities than maybe there had been for some time?

George C. Roeth

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

A

I will say that M&A is going to be a key growth lever for us and we'll continue to be active in the market. We bought three properties – three significant properties in the last 18 months. We hope to at least continue that pace. And as we look out and have been putting diligence again building the pipeline, we feel the pipeline is as strong as it's ever been.

William Michael Reuter

Analyst, Bank of America Merrill Lynch

Q

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

Operator: [Operator Instructions] Our next question comes from Bill Baker of GARP Research. Please proceed with your question.

William Wendell Baker

Founder & Portfolio Manager, GARP Research Corporation

Q

Hi, thanks. It was a fantastic quarter. I'm trying to understand the organic growth that was really excellent on the Pet side, and you do a nice job of breaking out Segrest. And knowing what I think I know about DMC, is that a very – are these very low sales months for DMC, because if I'm trying to adjust for that, I'm not sure I can get to a similar organic growth number unless I assume DMC doesn't really saw many dog beds in November and

December? And could you just also just tell us where, what pieces of Pet might have been stronger than the 6% organic growth and which might have been lower, highlight one or two areas if you haven't already?

Nicholas Lahanas

SVP-Finance Operations & Management Reporting, Central Garden & Pet Co.

A

Sure. This is Niko, Bill. As far as DMC goes, we have the October, November, December timeframe is a strong sales timeframe for that business. So, there is some seasonality in that business and that's what was strongest. As far as Pet strength, the dog and cat category was very strong, particularly the treats category, treats and toys. I'll tell you our small animal, avian category did extremely well in Q1, and then aquatics was also good. Underperformers would be our reptile category where we continue to retrench there.

William Wendell Baker

Founder & Portfolio Manager, GARP Research Corporation

Q

Okay. Thanks. Is there anything you did in small avian that might have led to that good growth or was it just the market?

Nicholas Lahanas

SVP-Finance Operations & Management Reporting, Central Garden & Pet Co.

A

No, I think we've got excellent operators in that business. They do a tremendous job every quarter. I'll tell you that our small animal bedding project is doing extremely well. That product is well received by both the customer and the consumer. So we are aggressively going after that market, and it's just a function of having great operators, to be honest with you.

William Wendell Baker

Founder & Portfolio Manager, GARP Research Corporation

Q

Great. Thanks, Niko. This was a super quarter. So, thanks. Keep up the good work.

Nicholas Lahanas

SVP-Finance Operations & Management Reporting, Central Garden & Pet Co.

A

Thank you.

George C. Roeth

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

A

Thanks, Bill.

Operator: Our next question comes from Kevin Ziets with Citi. Please proceed with your question.

Kevin L. Ziets

Analyst, Citigroup Global Markets, Inc.

Q

Hi. Thanks for taking my questions. Just quickly on commodities, I guess I've heard your competitor and others talk about a spike in urea costs, I know you picked up some private label in the fertilizer space. And I was just wondering if you could talk about your outlook for the year and how you're managing through that?

J. D. Walker

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

A

Kevin, it's J. D. here. I will comment on that. Typically, that's not something we make comments on or divulge any information there. I did hear the same comment from our competitor. In terms of commodities, it affects three of our businesses, our wild bird business, our fertilizer business and our grass business. And what we've seen having been in these markets, in these categories for a long time is quarter-to-quarter, year-to-year we see some fluctuations in those. There were some slightly favorable commodity impact from last year. However, I've said on prior calls, I wouldn't take that necessarily as a headwind or a tailwind for us, because typically we work pretty closer with our customers. Our customers are tracking these costs as well. So usually, there's a pass-through to the customer in retail price and ultimately to the consumer.

Kevin L. Ziets

Analyst, Citigroup Global Markets, Inc.

Q

Okay, great. And then, did you reiterate the CapEx guidance? I think last quarter you had said \$40 million to \$45 million.

George C. Roeth

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

A

We're not changing that guidance at this point as well.

Kevin L. Ziets

Analyst, Citigroup Global Markets, Inc.

Q

Okay, great. And then just thinking about the new products that you highlighted, the sort of less water needed products. I guess how do you think about those being situated in an environment or maybe we're in a less drought focused?

J. D. Walker

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

A

So, Kevin, it's J. D. again. I'll comment on that. Maybe this year, the focus isn't as much on drought, but from time to time, that's usually the biggest concern, particularly around grass seed. So, whether it's this year or next year, we think that it's the claim to go after and it's more sustainable, which – in the consumer's eye it's the right thing to do. We launched a number of new products this year. We're expanding our AMDRO Quick Kill that we talked about on previous calls, a new launch of an enhanced PENNINGTON SMART SEED this year. And that's the one that helps the lawn establish quicker and uses less water. We're also launching PENNINGTON Ultragreen fertilizers with that additive that holds the nutrients in the ground longer, so better results from that. We're also relaunching with two major customers a private label line. So we feel very good about the new products that we're bringing to the market this year and the new distribution that's resulting from that.

Kevin L. Ziets

Analyst, Citigroup Global Markets, Inc.

Q

Okay, great. And then, do you think with the heightened innovation that we should expect advertising to be higher this year or at least marketing expenses?

J. D. Walker

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

A

George, do you want to comment on?

George C. Roeth

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

A

I'll just say as a company-wide, I would say marketing spending's up nominally. That's an area we'll be investing more in over time. Right now, our new products we're supporting were supporting well, particularly in our PENNINGTON grass seed line. Another case is the economics of the business are a little bit more challenging, for example, doing in like TV advertising, so we did more economical demand creation around digital activities, search engine optimization, for example, which we're investing significantly behind. So you will see our marketing spending up. You'll see it up in the absolute. I would say it's up nominally as a percent of sales and you'll see that grow over time as our consumer insights grow, as our idea generation grows, and as we invest even more around new products.

J. D. Walker

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

A

And then, George, I would add to that that in addition to our marketing spend, it's trade spending that we're investing with our customers in secondary locations and the store being very promotional. Kevin, we believe we had fantastic products and our goal is to drive five of those products with the customers, so you will see increased spend there as well.

George C. Roeth

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

A

And I think about Central, as you can see our demand creations show up in a lot of different lines. So, on some businesses, it's been selling expense, so we get feet on the street selling to cattlemen, for example, on life science businesses. In other cases, it's digital and you'll see some of that in classical marketing. In other bases, we're more off the shelf and you'll see more around trade promotion spending to drive trial in-store. And so, you'll see it's in number of areas, not just one.

Kevin L. Ziets

Analyst, Citigroup Global Markets, Inc.

Q

That's really helpful. And then I guess lastly maybe moving away from the stores, if you could talk about your positioning with e-commerce pure plays, particularly I guess in the Pet space?

George C. Roeth

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

A

Yes. We have a fantastic business digitally, I'm very proud of it, it's growing very nicely. We continue to partner with the number of e-commerce partners, and it's performing quite well. We think it's a great area for us to grow.

Kevin L. Ziets

Analyst, Citigroup Global Markets, Inc.

Q

Do you think your share is similar I guess in e-commerce platforms as it is in bricks and mortar, or is there more opportunity to grow there?

George C. Roeth

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

A

And so, it's a difficult question to answer. And in fact, I don't know the answer to that right now how our share compares. If I look at total retail and I look at e-commerce as a percent of total retail, I would say that, yes, we certainly have opportunity to grow, to reach those comps. But yes, we are very, very excited about e-commerce.

Kevin L. Ziets

Analyst, Citigroup Global Markets, Inc.

Okay. Thank you, guys. Good luck this year.

Q

George C. Roeth

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

Thank you, Kevin.

A

Operator: [Operator Instructions] If there are no further questions at this time, I would like to turn the call over to George Roeth for closing remarks.

George C. Roeth

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

I just want to simply thank everybody for being on the call today. And we're looking forward to a terrific 2017 for Central Garden & Pet. So, thanks, everybody.

Operator: This concludes today's conference. Thank you for your participation. You may disconnect your lines at this time.

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