

Central Garden & Pet (CENT)

\$42.96 (As of 08/06/20)

Price Target (6-12 Months): **\$49.00**

Long Term: 6-12 Months

Zacks Recommendation:
Outperform

(Since: 08/06/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

1-Strong Buy

Zacks Style Scores:

VGM:C

Value: C

Growth: D

Momentum: B

Summary

Shares of Central Garden & Pet have outperformed the industry in the past three months. Much of the stock's momentum is driven by a sturdy third-quarter fiscal 2020, wherein top and bottom lines beat the Zacks Consensus Estimate and grew year over year. Results primarily benefited from strong organic growth across both segments and gains from the C&S acquisition. Margins were also robust in the quarter driven by improved overhead leverage and reduced promotional activity, mainly related to the pandemic. Management informed that fiscal fourth quarter generally attracts smaller earnings, which coupled with increased investments in the period, is likely to result in delivering a slight loss in the quarter. Nevertheless, it envisions earnings per share at or above \$1.90 for fiscal 2020, suggesting growth of nearly 18% year over year.

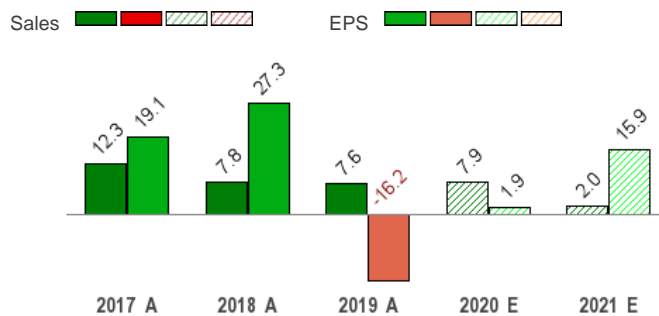
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$44.80 - \$22.48
20 Day Average Volume (sh)	76,949
Market Cap	\$2.3 B
YTD Price Change	38.3%
Beta	0.37
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Consumer Products - Discretionary
Zacks Industry Rank	Top 17% (43 out of 252)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	61.0%
Last Sales Surprise	14.5%
EPS F1 Est- 4 week change	17.8%
Expected Report Date	11/24/2020
Earnings ESP	12.5%
P/E TTM	20.9
P/E F1	26.4
PEG F1	3.7
P/S TTM	0.9

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	500 E	724 E	739 E	575 E	2,622 E
2020	483 A	703 A	833 A	549 E	2,571 E
2019	462 A	674 A	707 A	541 A	2,383 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	-\$0.08 E	\$0.85 E	\$0.93 E	\$0.18 E	\$1.89 E
2020	-\$0.08 A	\$0.78 A	\$1.32 A	\$0.11 E	\$1.63 E
2019	\$0.03 A	\$0.72 A	\$0.80 A	\$0.04 A	\$1.60 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 08/06/2020. The reports text is as of 08/07/2020.

Overview

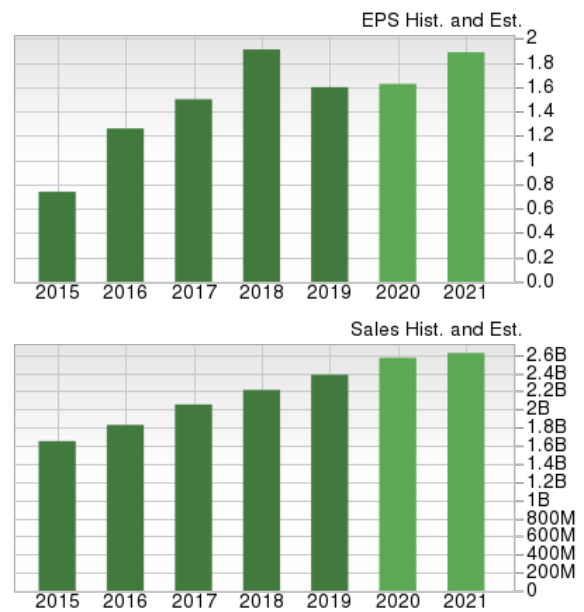
Committed to product innovation, Central Garden & Pet Co. is looking forward to strengthening its position as one of the leading companies in the U.S. pet supplies and lawn and garden supplies space. Unique packaging, point-of-sale displays, logistic capabilities and a high level of customer service are some of its key growth catalysts.

With such upsides, it boasts a wide repertoire of clients, including PetSmart, PETCO, Walmart, Home Depot and Lowe's. Further, the company actively engages in buyout activities to gain market share. In this regard, it acquired four new businesses in the last two years, including Arden and C&S.

Moving on, the company offers products to mass merchants, home improvement centers, lawn and garden nurseries, grocery stores, specialty pet stores, veterinarians' municipalities, and other individual animal buyers. It also produces both branded products and private-label products along with distributing third-party brands. With such a wide array of products in its portfolio, Central Garden & Pet operates under two segments as discussed below.

Pet Segment (58% of Fiscal 2019 total sales): This segment offers food and accessories for dogs, cats, birds, small animals, fishes, horses and livestock under brands, such as Adams, Aqueon, Avoderm, Cadet, Farnam, Four Paws, Kaytee, K&H Pet Products, Nylabone, Pinnacle, TFH, Zilla, Comfort Zone and Coralife.

Garden Segment (42% of Fiscal 2019 total sales): This segment offers both proprietary and nonproprietary grass seeds, herbicides, insecticides, pesticides, decorative outdoor lifestyle and lighting products. The segment markets its products under brands such as AMDRO, Ironite, Pennington, Sevin, Over-N-Out and The Rebels.



Reasons To Buy:

▲ **Robust Q3 Performance Aids Stock:** We note that shares of Central Garden & Pet have gained 25.2% in the past three months, outperforming the industry's 11.1% decline. Much of this stock's momentum is driven by better-than-expected third-quarter fiscal 2020 results, wherein the top and bottom lines also improved on a year-over-year basis. Results primarily benefited from strong organic growth across segments as well as gains from recent acquisitions. Notably, adjusted earnings of \$1.27 per share rose substantially from 80 cents earned in the year-ago period. Strong sales growth as well as operating-margin expansion drove the bottom line. Operating margin expanded 290 basis points to 12.6%, primarily attributed to gross-margin expansion coupled with improved overhead leverage and reduced promotional activity, mainly related to the pandemic.

Central Garden & Pet's impressive third-quarter fiscal 2020 results gained from the acquisition of C&S and robust organic sales growth across both the company's segments.

Additionally, the company has been experiencing a sturdy top-line performance. In third-quarter fiscal 2020, sales increased 18%, following hikes of 4.4%, 4.5%, 7.7% and 7.4% in the preceding four quarters. While net sales at the Pet segment grew 18% on gains from the acquisition of C&S, the metric advanced 17.9% at the Garden segment. Robust portfolio strength, gains in garden distribution, controls and fertilizers, wild-bird feed, and grass seed aided the Garden unit. Driven by strong year-to-date performance and anticipated investments in the fiscal fourth quarter, earnings per share are envisioned at or above \$1.90 for fiscal 2020. This suggests growth of nearly 18% from the year-ago quarter's earnings of \$1.61. Management expects robust business momentum witnessed in fiscal third quarter to continue ahead.

▲ **Acquisitions Playing a Key Role:** Central Garden & Pet company has been a disciplined buyer in the garden and pet areas and has concluded more than 50 acquisitions since 1992. The company through buyouts also looks to enhance manufacturing capabilities, operating synergies, or developing distribution network. In the last two years, the company has bought four new businesses including entering into the live plant and outdoor seat cushion businesses. In this regard, Central Garden & Pet acquired C&S Products in May 2019, which has been complementing its existing wild bird feed business. This buyout has been boosting the company's top line. During the third quarter of fiscal 2020, acquisitions contributed about \$10 million of sales.

Prior to this, the company acquired the remaining 55% stake at Arden Companies in February 2019. Earlier, the company bought Bell Nursery, a leading grower and distributor of live flowers and plants in March 2018, while the same year in April, it acquired General Pet Supply, a supplier of pet food and supplies.

▲ **Financial Status:** Central Garden's cash and cash equivalents at the end of third-quarter fiscal 2020 was \$495.3 million, which rose 49.4% sequentially and is sufficient to fund its short-term obligations of \$31.7 million (includes current lease liabilities and current portion of long-term debt). As of Jun 27, 2020, the company's long-term debt (including operating lease liabilities) of \$765.4 million inched up 0.1% sequentially. However, its debt-to-capitalization of 0.42 shows a decline from 0.45 at the end of fiscal second quarter. Also, the company's times interest earned ratio of 4.2 as of Jun 27, 2020 has increased from 3.6 as of Mar 28. The times-interest-earned ratio is very important for some companies, as it measures a company's ability to meet its debt obligations based on its current income.

▲ **Healthy Commercial Relationship:** Being the leading producer of garden and pet supplies products in the U.S. with a diversified portfolio of brands has aided Central Garden & Pet in developing healthy commercial relationships with giant retailers such as PetSmart, PETCO, Walmart, Home Depot and Lowe's. We believe this provides the company significant opportunity to drive growth. Walmart, the company's largest customer, accounted about. Sales to Walmart represented approximately 28%, 29% and 31%, sales to Lowe's represented about 22%, 21% and 21%, and sales to Home Depot represented roughly 29%, 27% and 20% of Garden segment's net sales in fiscal 2019, 2018 and 2017, respectively.

Walmart, the company's largest customer, accounted about 16% of total company net sales in each of the fiscal years 2019, 2018 and 2017. Home Depot, the second largest customer, reflected approximately 12%, 11% and 8% of our total company net sales in fiscal 2019, 2018 and 2017, respectively. Moreover, other prominent customers include Lowe's, Costco and PetSmart, and together with Walmart and Home Depot, represented for approximately 49% of net sales in fiscal 2019, 48% in fiscal 2018 and 44% in fiscal 2017.

▲ **A Complete Metamorphosis:** Central Garden & Pet's effective inventory management is helping it to optimize merchandise levels in accordance with sales trends and is also facilitating in optimum utilization of its working capital. Further, the company intends to evolve into an integrated, multi-brand company by restructuring and reorganizing operating units and consolidating facilities. The company is steadily making strides in advancing its digital capabilities to focus on e-commerce and optimizing supply chain. The company is also expanding its data analytics capability to improve and accelerate business insight. Management revealed plans to lower cost of goods sold and administrative spending by 1-2% annually via cost-containment efforts.

Risks

- **Valuation Looks Stretched:** Considering price-to-earnings (P/E) ratio, Central Garden & Pet looks pretty overvalued when compared with the industry and the S&P 500. The stock has a trailing 12-month P/E ratio of 27.9, which is above the median level of 19.86 and in line with the high level, scaled in the past year. On the contrary, the trailing 12-month P/E ratio is 22 for the industry and 23.71 for the S&P 500. Given these factors, we believe that the stock is quite stretched from the P/E aspect.
- **Higher SG&A in Q3:** Although margins were robust in third-quarter fiscal 2020, the company's SG&A expense increased 5% year over year in the quarter. Various factors such as increased variable-compensation accruals and logistics costs along with inorganic spend from the C&S acquisition and PPE costs led to this increase in SG&A. Higher SG&A expense remains a deterrent to the company's profits.
- **Soft Q4 View:** Management informed that the fiscal fourth quarter generally attracts smaller earnings, which coupled with increased investments in the period, is likely to result in delivering a slight loss in fourth-quarter fiscal 2020. Central Garden & Pet delivered adjusted earnings of 4 cents in the same quarter a year ago.
- **Tough competition:** Central Garden & Pet operates in highly-competitive markets. It faces intense competition from regional and national firms on grounds of price, product quality, number of products offered, brand awareness and customer service. The company's growth and success depend on its ability to offer high-quality distinguished products at a competitive price.

In fact, the company's lawn and garden products compete against national and regional products and private label products produced by various suppliers. The company turf and forage grass seed products, fertilizers, pesticides and combination products compete primarily against products marketed by The Scotts Miracle-Gro Company ("Scotts"). Additionally, Spectrum Brands is a strong competitor in yard and household insecticides. The company's branded pet products compete against national and regional branded products and private label products produced by various suppliers. The company's largest competitors in the product categories are Spectrum Brands and Hartz Mountain. The segment's sales and logistics operations compete with Animal Supply Co., Phillips Pet Food & Supplies and a number of smaller local and regional distributors.

Last Earnings Report

Central Garden & Pet Beats Q3 Earnings & Sales

Central Garden & Pet reported better-than-expected results in third-quarter fiscal 2020, wherein both top and bottom lines improved on a year-over-year basis. Results primarily benefited from strong organic growth across segments as well as gains from recent acquisitions.

The company reported adjusted earnings of \$1.27 per share, substantially higher than 80 cents reported in the year-ago period. Moreover, the figure surpassed the Zacks Consensus Estimate of 81 cents.

The California-based company reported net sales of \$833.5 million, beating the Zacks Consensus Estimate of \$720.6 million. Further, the top line improved 18% from the year-ago period on organic gains in the Garden and Pet segments as well as contribution from the C&S acquisition. Total organic sales grew 16.5%.

Gross profit increased 19.5% to \$262.1 million, with gross margin expansion of 40 basis points (bps) to 31.4%.

Operating income was \$104.6 million, up 51.8% from the prior-year quarter, while operating margin expanded 290 bps to 12.6%. Operating margin growth was primarily attributed to gross margin expansion coupled with improved overhead leverage and reduced promotional activity, mainly related to the pandemic. SG&A expenses of \$157.4 million rose nearly 5% from the prior-year quarter.

Segment in Detail

Net sales at the **Pet** segment grew 18% year over year to \$413.3 million, driven by the acquisition of C&S. Organic sales increased 15%, driven by strength in dog treats and chews, pet distribution, small animal food and supplies, and animal health categories. This was partly offset by weak live fish sales due to the exit of a major retailer in this category during fiscal 2019 as well as shipment and supply restrictions for live animals due to the COVID-19 outbreak.

The segment's operating income grew 44.8% year over year to \$50.8 million, backed by the C&S acquisition and organic sales growth. Operating margin expanded 230 basis points to 12.3%, while organic operating margin was up 220 bps to 12.2%.

At the **Garden** segment, net sales advanced 17.9% year over year to \$420.2 million, driven by robust portfolio strength, with gains in garden distribution, controls and fertilizers, wild bird feed, and grass seed. Organic sales for the segment improved 17.9%. The segment reported an operating income of \$77.8 million, up 46.5% from \$53.1 million in the year-ago quarter. Also, operating margin expanded 360 basis points to 18.5%.

Financial Details

Central Garden & Pet ended the quarter with cash and cash equivalents of \$495.3 million and total debt of \$694 million compared with \$445.6 million and \$693.1 million, respectively, in the prior-year period. Shareholders' equity at the end of the quarter was \$1,059.4 million, excluding non-controlling interest.

Cash provided by operations during the quarter was \$181.6 million compared with \$172.1 million a year ago, driven by EBITDA gains, offset by changes in working capital mostly associated with robust demand trends in the reported quarter. Net interest expenses increased to \$11.5 million in the reported quarter, up from \$8.5 million in the prior-year period.

Moreover, the company bought back shares worth \$5.1 million during the fiscal third quarter. As of Jun 27, it had \$100 million remaining under its share repurchase program. Additionally, it has 600,000 shares remaining under the board's equity dilution authorization.

Outlook

Driven by strong year-to-date performance and anticipated investments in the fiscal fourth quarter, the company projects earnings per share at or above \$1.90 for fiscal 2020. This suggests growth of nearly 18% from the year-ago quarter's earnings of \$1.61. However, the company informed that the fiscal fourth quarter generally attracts smaller earnings, which coupled with increased investments in the period, is likely to result in delivering a slight loss in fourth-quarter fiscal 2020.

Additionally, the company expects to provide its refreshed long-term strategy, called the Vision2025, at a virtual Investor Day to be held in conjunction with its fiscal 2020 earnings release in late November 2020.

Quarter Ending **06/2020**

Report Date	Aug 05, 2020
Sales Surprise	14.54%
EPS Surprise	60.98%
Quarterly EPS	1.32
Annual EPS (TTM)	2.06

Valuation

Central Garden & Pet Company shares are up 38.3% in the year-to-date period and 79.8% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Consumer Discretionary sector are down 7% and 3.9%, respectively, in the year-to-date period. Over the past year, the Zacks sub-industry is down 3.1% but the sector is up 4.8%.

The S&P 500 index is up 4% in the year-to-date period and 14.3% in the past year.

The stock is currently trading at 24.87X forward 12-month earnings, which compares to 15.42X for the Zacks sub-industry, 33.99X for the Zacks sector and 22.84X for the S&P 500 index.

Over the past five years, the stock has traded as high as 26.29X and as low as 12.2X, with a 5-year median of 19.37X. Our Outperform recommendation indicates that the stock will perform better than the market. Our \$49 price target reflects 28.37X forward 12-month earnings.

The table below shows summary valuation data for CENT

Valuation Multiples - CENT					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	24.87	15.42	33.99	22.84
	5-Year High	26.29	26.7	33.99	22.84
	5-Year Low	12.2	10.31	16.12	15.25
	5-Year Median	19.37	17.49	19.84	17.55
P/S F12M	Current	0.94	1.16	2.39	3.66
	5-Year High	1.05	1.22	2.95	3.66
	5-Year Low	0.3	0.57	1.68	2.53
	5-Year Median	0.75	0.92	2.5	3.04
EV/EBITDA TTM	Current	12.24	9.1	10.79	12.98
	5-Year High	14.99	23.03	17.81	12.98
	5-Year Low	6.87	5.43	8.34	8.24
	5-Year Median	10.12	12.03	12.24	10.89

As of 08/06/2020

Industry Analysis Zacks Industry Rank: Top 17% (43 out of 252)



Top Peers

Company (Ticker)	Rec	Rank
Aphria Inc. (APHA)	Outperform	3
Spectrum Brands Holdings Inc. (SPB)	Outperform	1
Chewy Inc. (CHWY)	Neutral	3
General Mills, Inc. (GIS)	Neutral	3
Hengan International Group Co., Ltd. Unsponsored ADR (HEGIY)	Neutral	3
Prestige Consumer Healthcare Inc. (PBH)	Neutral	3
The J. M. Smucker Company (SJM)	Neutral	4
Party City Holdco Inc. (PRTY)	Underperform	5

Industry Comparison Industry: Consumer Products - Discretionary				Industry Peers		
	CENT	X Industry	S&P 500	CHWY	GIS	SPB
Zacks Recommendation (Long Term)	Outperform	-	-	Neutral	Neutral	Outperform
Zacks Rank (Short Term)	1	-	-	3	3	1
VGM Score	C	-	-	C	B	D
Market Cap	2.35 B	173.82 M	23.20 B	22.78 B	39.14 B	2.44 B
# of Analysts	3	3	14	7	8	3
Dividend Yield	0.00%	0.00%	1.78%	0.00%	3.05%	2.96%
Value Score	C	-	-	F	B	C
Cash/Price	0.17	0.09	0.07	0.01	0.04	0.20
EV/EBITDA	12.91	8.82	13.21	-102.93	13.22	12.58
PEG Ratio	3.67	1.78	2.94	NA	2.43	0.97
Price/Book (P/B)	2.21	1.76	3.12	NA	4.69	1.76
Price/Cash Flow (P/CF)	16.65	9.78	12.27	NA	13.98	5.67
P/E (F1)	26.36	22.45	21.69	NA	18.21	15.80
Price/Sales (P/S)	0.92	0.80	2.48	4.25	2.22	0.64
Earnings Yield	3.79%	4.33%	4.39%	-0.79%	5.48%	6.33%
Debt/Equity	0.72	0.53	0.77	-0.58	1.31	1.93
Cash Flow (\$/share)	2.58	0.72	6.94	-0.55	4.59	9.99
Growth Score	D	-	-	A	A	D
Hist. EPS Growth (3-5 yrs)	18.21%	0.86%	10.46%	NA	3.19%	NA
Proj. EPS Growth (F1/F0)	1.67%	6.87%	-6.80%	-54.19%	-2.39%	25.41%
Curr. Cash Flow Growth	-4.06%	-4.06%	5.39%	-5.57%	9.11%	64.31%
Hist. Cash Flow Growth (3-5 yrs)	21.71%	13.95%	8.55%	NA	3.48%	16.24%
Current Ratio	3.81	1.44	1.33	0.61	0.68	2.08
Debt/Capital	41.92%	41.92%	44.50%	NA	56.69%	65.90%
Net Margin	4.28%	-1.53%	10.13%	-5.05%	12.37%	-1.86%
Return on Equity	11.16%	1.26%	14.39%	NA	27.66%	11.34%
Sales/Assets	1.19	0.96	0.51	5.75	0.58	0.74
Proj. Sales Growth (F1/F0)	7.87%	0.00%	-1.51%	37.26%	-2.85%	0.37%
Momentum Score	B	-	-	F	F	D
Daily Price Chg	6.95%	0.00%	-0.04%	-3.54%	-0.37%	0.48%
1 Week Price Chg	3.70%	0.00%	0.14%	14.21%	-1.49%	11.88%
4 Week Price Chg	20.64%	3.32%	7.78%	9.28%	2.61%	26.64%
12 Week Price Chg	24.16%	9.31%	17.48%	37.42%	3.17%	50.72%
52 Week Price Chg	79.90%	-15.66%	0.68%	67.13%	18.81%	11.49%
20 Day Average Volume	76,949	76,949	2,057,775	4,025,290	3,426,220	403,974
(F1) EPS Est 1 week change	17.77%	0.00%	0.00%	0.00%	0.00%	23.54%
(F1) EPS Est 4 week change	17.77%	0.00%	1.36%	0.00%	-0.42%	23.96%
(F1) EPS Est 12 week change	17.77%	1.60%	1.57%	-22.27%	1.99%	21.72%
(Q1) EPS Est Mthly Chg	3.23%	0.00%	0.54%	0.00%	-0.49%	49.04%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	C
Growth Score	D
Momentum Score	B
VGM Score	C

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

Disclosures

This report contains independent commentary to be used for informational purposes only. The analysts contributing to this report do not hold any shares of this stock. The analysts contributing to this report do not serve on the board of the company that issued this stock. The EPS and revenue forecasts are the Zacks Consensus estimates, unless indicated otherwise on the reports first page. Additionally, the analysts contributing to this report certify that the views expressed herein accurately reflect the analysts personal views as to the subject securities and issuers. ZIR certifies that no part of the analysts compensation was, is, or will be, directly or indirectly, related to the specific recommendation or views expressed by the analyst in the report.

Additional information on the securities mentioned in this report is available upon request. This report is based on data obtained from sources we believe to be reliable, but is not guaranteed as to accuracy and does not purport to be complete. Any opinions expressed herein are subject to change.

ZIR is not an investment advisor and the report should not be construed as advice designed to meet the particular investment needs of any investor. Prior to making any investment decision, you are advised to consult with your broker, investment advisor, or other appropriate tax or financial professional to determine the suitability of any investment. This report and others like it are published regularly and not in response to episodic market activity or events affecting the securities industry.

This report is not to be construed as an offer or the solicitation of an offer to buy or sell the securities herein mentioned. ZIR or its officers, employees or customers may have a position long or short in the securities mentioned and buy or sell the securities from time to time. ZIR is not a broker-dealer. ZIR may enter into arms-length agreements with broker-dealers to provide this research to their clients. Zacks and its staff are not involved in investment banking activities for the stock issuer covered in this report.

ZIR uses the following rating system for the securities it covers. **Outperform-** ZIR expects that the subject company will outperform the broader U.S. equities markets over the next six to twelve months. **Neutral-** ZIR expects that the company will perform in line with the broader U.S. equities markets over the next six to twelve months. **Underperform-** ZIR expects the company will underperform the broader U.S. equities markets over the next six to twelve months.

No part of this report can be reprinted, republished or transmitted electronically without the prior written authorization of ZIR.