

Central Garden & Pet (CENT)

\$30.71 (As of 03/19/20)

Price Target (6-12 Months): **\$33.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 01/27/20)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:D

Value: D

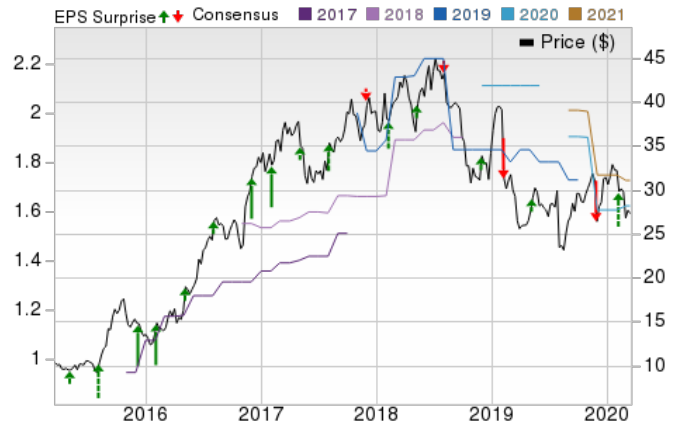
Growth: F

Momentum: C

Summary

Shares of Central Garden & Pet have risen and outpaced the industry in the past six months, courtesy its solid top line trend which was retained in first-quarter fiscal 2020. Notably, the metric rose year over year and beat the Zacks Consensus Estimate. Robust organic sales growth in the Garden and Pet segments, and contributions from the C&S and Arden acquisitions have been driving its top-line results. However, the company reported bottom line loss as compared to earnings in the prior year quarter. Further, dismal margins and higher SG&A expenses acted as deterrents. Although, management reaffirmed its fiscal 2020 earnings to be in line or slightly above fiscal 2019 reported figure of \$1.61, increased investments to drive long-term sustainable growth are likely to weigh on its fiscal 2020 bottom line.

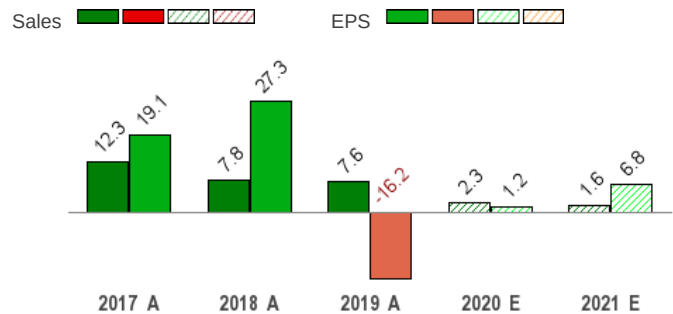
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$34.69 - \$22.40
20 Day Average Volume (sh)	107,081
Market Cap	\$1.7 B
YTD Price Change	-1.2%
Beta	0.14
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Consumer Products - Discretionary
Zacks Industry Rank	Bottom 35% (166 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	33.3%
Last Sales Surprise	2.2%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	05/04/2020
Earnings ESP	0.0%
P/E TTM	20.8
P/E F1	19.0
PEG F1	2.6
P/S TTM	0.7

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	497 E	704 E	735 E	560 E	2,479 E
2020	483 A	693 E	719 E	545 E	2,439 E
2019	462 A	674 A	707 A	541 A	2,383 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	-\$0.09 E	\$0.76 E	\$0.86 E	\$0.17 E	\$1.73 E
2020	-\$0.08 A	\$0.76 E	\$0.83 E	\$0.13 E	\$1.62 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 03/19/2020. The reports text is as of 03/20/2020.

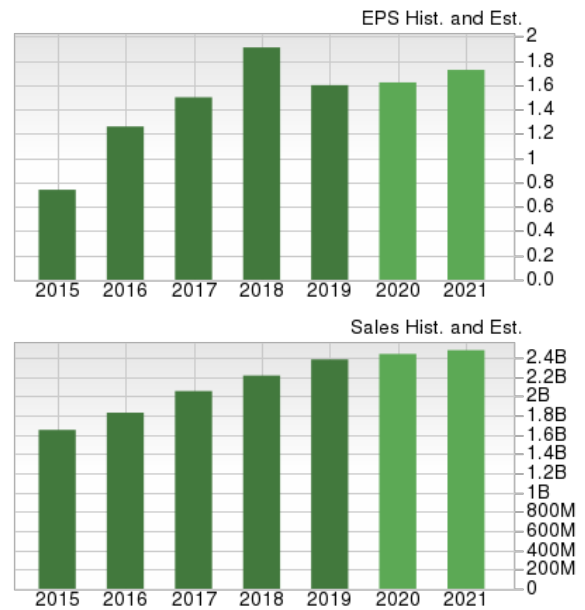
Overview

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:

▲ **Decent Top Line Performance:** Shares of Central Garden & Pet have gained 10.5% in the past six months outperforming the industry's 33.8% loss. We note that the company continues to witness decent top-line performance. During the first quarter of fiscal 2020, the metric rose 4.5% to \$482.8 million, following hikes of 7.7% and 7.4% in the preceding two quarters. The reported figure surpassed the Zacks Consensus Estimate of \$472 million. Net sales for the Pet segment increased 4% to \$354 million, driven by the acquisition of C&S. Organic sales increased 1.3%, driven by strength in dog treats and chews, aquatics, and wild bird feed categories. Further, the metric improved 5.9% to \$128.8 million at the Garden segment, aided by the acquisition of Arden. The company believes that the U.S. pet supplies market will increase in the long term due to favorable demographic and leisure trends, while gardening is one of the most popular leisure activities.

Central Garden & Pet company has been a disciplined buyer in the garden and pet areas. The company through buyouts also look to enhance manufacturing capabilities, operating synergies, or developing distribution network.

▲ **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 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.

▲ **Acquisitions Playing 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 look 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 will complement its existing wild bird feed business. 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. The company also purchased two small wholesale distributors of fish and small animals during fiscal 2018.

▲ **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.

Reasons To Sell:

- ▼ **Dismal Q1 Bottom Line:** Despite reporting narrower-than-expected loss, first-quarter adjusted loss was 8 cents per share against earnings of 3 cents in the year-ago period. Notably, higher cost of goods sold, and occupancy and SG&A expenses affected the bottom line. Further, the company's exit from the fashion-oriented pottery product line along with the exit of a major retailer from the live fish business as well as fire in one of its pet bedding facilities acted as deterrents. Although, management reaffirmed its fiscal 2020 earnings to be in line or slightly above fiscal 2019 reported figure of \$1.61, increased investments to drive long-term sustainable growth are likely to weigh on its fiscal 2020 bottom line.
- ▼ **Soft Margins Remain a Woe:** Gross margin contracted 100 basis points to 27.2% in first-quarter fiscal 2020 due to a decline in volumes in certain categories as well as unfavorable mix in product sales. Further, operating income was \$2.1 million, down roughly five folds from the prior-year quarter, while operating margin contracted 180 basis points to 0.4%. The downside was led by a dismal gross margin coupled with a rise in corporate and third-party related costs. The company also witnessed soft operating margins in its two segments during the said quarter. Notably, operating margin at the pet segment contracted 20 basis points to 8.5% owing to headwinds related to supply constraints in the aquatics business persisted. Also, operating margin contracted 270 basis points to 6.5% in the garden segment due to the company's exit from the pottery category and the addition of Arden to its portfolio.
- ▼ **Rising SG&A Expenses May Hurt Profit:** Central Garden & Pet is grappling with rising costs. Any deleverage in SG&A expenses has a direct bearing on the company's profitability. We note that SG&A costs have increased 7.7% in first-quarter fiscal 2020, following hikes of 6.9%, 6.5%, 1.8% and 9.8% in the fourth, third, second and first quarters of fiscal 2019, respectively. Persistence of such a dismal trend may hurt the company's profitability in the future. SG&A expenses increased \$43.9 million, or 8.6% to \$551.9 million in fiscal 2019 from \$508.0 million in fiscal 2018. The rise in SG&A expenses was due to recent buyouts and increased corporate costs, stemming from rise in variable compensation costs and elevated third-party costs.
- ▼ **Seasonality of Garden Segment:** Gardening is generally limited to the period between spring to summer, which makes the garden business highly seasonal in nature. A major part of the sales occurs during the second and third fiscal quarters. Failure to perform during the season is likely to have a significant impact on the company's yearly financials. In fiscal 2019, approximately 69% of Garden segment's net sales and 58% of total net sales occurred during the second and third quarters.
- ▼ **Tough competition:** The company 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. 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.

The company's exit from the fashion-oriented pottery product line along with the exit of a major retailer from the live fish business hurt its first-quarter bottom line. High SG&A trend is a concern.

Last Earnings Report

Central Garden Q1 Loss Narrower-Than-Estimated

Central Garden reported first-quarter fiscal 2020 results, wherein adjusted loss per share was narrower than the Zacks Consensus Estimate, while sales also surpassed the consensus mark. Further, net sales improved on a year-over-year basis.

Per management, the company's exit from the fashion-oriented pottery product line along with the exit of a major retailer from the live fish business and fire in one of its pet bedding facilities affected quarterly results.

Quarter Ending **12/2019**

Report Date	Feb 05, 2020
Sales Surprise	2.23%
EPS Surprise	33.33%
Quarterly EPS	-0.08
Annual EPS (TTM)	1.48

Delving Deeper

The company reported adjusted loss of 8 cents per share against earnings of 3 cents in the year-ago period. However, the reported figure was narrower than the Zacks Consensus Estimate of a loss of 12 cents. Notably, higher cost of goods sold and occupancy (up nearly 6%), and SG&A expenses (up 7.7%) affected the bottom line.

The California-based company reported net sales of \$482.8 million, beating the Zacks Consensus Estimate of \$472 million. Further, the metric rose 4.5% from the year-ago period, driven by acquisitions of Arden and C&S. Meanwhile, organic sales remained flat in the quarter under review owing to unfavorable timing of customer purchases along with the aforementioned exit from pottery business and the impact of a fire at its pet bedding facility.

Gross profit increased 0.8% to \$131.3 million, whereas gross margin contracted 100 basis points to 27.2%. Gross margin contraction can be attributable to a decline in volumes in certain categories as well as unfavorable mix in product sales.

Operating income was \$2.1 million, down roughly five folds from the prior-year quarter, while operating margin contracted 180 basis points to 0.4%. This downside was led by a dismal gross margin coupled with a rise in corporate and third-party-related costs.

Segment in Detail

Net sales at the Pet segment advanced 4% year over year to \$354 million, driven by the acquisition of C&S. Organic sales increased 1.3%, driven by strength in dog treats and chews, aquatics and wild bird feed categories. This was partly offset by sluggish sales in lower bedding due to fire at one of the company's facilities, as well as weak live fish sales.

The segment's operating income grew 1.6% year over year to \$30.2 million, backed by the C&S acquisition. Meanwhile, operating margin contracted 20 basis points to 8.5% as headwinds related to supply constraints in the aquatics business persisted during the quarter.

At the Garden segment, net sales advanced 5.9% year over year to \$128.8 million, driven by the acquisition of Arden. Organic sales decreased 4.4% due to the company's exit from the fashion decor pottery product line. Also, lower sales in grass seed and controls businesses acted as deterrents.

The segment reported an operating loss of \$8.3 million, wider than a loss of \$4.6 million in the year-ago quarter. Also, operating margin contracted 270 basis points to 6.5%. The metrics declined due to the company's exit from the pottery category and the addition of Arden to its portfolio.

Financial Details

Central Garden & Pet ended the quarter with cash and cash equivalents of \$445.8 million and total debt of \$693.3 million compared with \$478.7 million and \$692.4 million, respectively, in the prior-year period. Shareholders' equity at the end of the quarter was \$973.1 million, excluding non-controlling interest of \$48,000.

Cash used in operating activities was \$18 million in the reported quarter. Moreover, the company bought back shares worth \$22.1 million during the fiscal first quarter. As of Dec 28, 2019, it had \$100 million remaining under its share repurchase program. Additionally, it has 600,000 shares remaining under the Board's equity dilution authorization.

Net interest expenses increased to \$8.6 million in the reported quarter, up from \$8.1 million in the prior-year period. Management incurred capital expenditure of \$10 million in the quarter under review. For fiscal 2020, capital expenditure is expected to be \$40-\$45 million.

Guidance

Management still anticipates fiscal 2020 earnings to be in line or slightly above \$1.61 reported in fiscal 2019. Increased investments to drive long-term sustainable growth are likely to weigh on the company's fiscal 2020 bottom line.

Valuation

Central Garden & Pet Company shares are down 1.2% in the year-to-date period and 9.7% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Consumer Discretionary sector are down 36.4% and 33.7% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are down 38.4% and 27%, respectively.

The S&P 500 index is down 24.9% in the year-to-date period and 16.3% in the past year.

The stock is currently trading at 18.387X forward 12-month earnings, which compares to 11.49X for the Zacks sub-industry, 14.1X for the Zacks sector and 14.3X 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 18.77X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$33 price target reflects 19.75X F12M earnings.

The table below shows summary valuation data for CENT

Valuation Multiples - CENT					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	18.38	11.49	14.1	14.3
	5-Year High	26.29	27	23.23	19.34
	5-Year Low	12.2	10.37	14.1	14.3
	5-Year Median	18.77	20.01	19.88	17.42
P/S F12M	Current	0.69	0.44	1.54	2.6
	5-Year High	1.05	1.19	3.19	3.43
	5-Year Low	0.27	0.44	1.54	2.54
	5-Year Median	0.72	0.9	2.53	3
EV/EBITDA TTM	Current	10.39	6.35	8.51	8.92
	5-Year High	14.99	22.69	17.59	12.88
	5-Year Low	6.47	6.17	8.29	8.31
	5-Year Median	9.78	12.36	12.28	10.78

As of 03/19/2020

Industry Analysis Zacks Industry Rank: Bottom 35% (166 out of 254)



Top Peers

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

Industry Comparison Industry: Consumer Products - Discretionary				Industry Peers		
	CENT Neutral	X Industry	S&P 500	CHWY Neutral	GIS Neutral	SPB Neutral
VGM Score	D	-	-	D	B	C
Market Cap	1.70 B	109.46 M	16.45 B	12.92 B	32.54 B	1.24 B
# of Analysts	4	3	13	6	8	3
Dividend Yield	0.00%	0.00%	2.67%	0.00%	3.65%	6.21%
Value Score	D	-	-	D	C	C
Cash/Price	0.30	0.08	0.06	0.01	0.02	0.07
EV/EBITDA	9.38	7.34	10.36	NA	13.51	9.24
PEG Ratio	2.48	1.01	1.49	NA	2.27	0.47
Price/Book (P/B)	1.75	1.00	2.16	NA	4.14	0.85
Price/Cash Flow (P/CF)	11.90	2.78	8.92	NA	12.59	2.71
P/E (F1)	17.83	12.00	13.12	NA	15.86	7.47
Price/Sales (P/S)	0.71	0.35	1.72	NA	1.94	0.33
Earnings Yield	5.28%	8.22%	7.54%	-1.39%	6.30%	13.38%
Debt/Equity	0.79	0.60	0.70	-0.52	1.47	1.58
Cash Flow (\$/share)	2.58	1.16	7.01	NA	4.26	9.99
Growth Score	F	-	-	C	C	D
Hist. EPS Growth (3-5 yrs)	24.06%	6.80%	10.85%	NA	2.82%	NA
Proj. EPS Growth (F1/F0)	1.41%	3.33%	4.90%	24.23%	5.12%	26.69%
Curr. Cash Flow Growth	-4.06%	1.74%	6.03%	NA	5.47%	64.31%
Hist. Cash Flow Growth (3-5 yrs)	21.71%	12.05%	8.55%	NA	1.32%	16.24%
Current Ratio	3.84	1.42	1.23	0.56	0.64	1.42
Debt/Capital	44.13%	44.13%	42.57%	NA	59.59%	61.20%
Net Margin	3.60%	-0.39%	11.57%	NA	12.68%	14.35%
Return on Equity	8.60%	6.99%	16.74%	NA	26.40%	8.25%
Sales/Assets	1.16	1.16	0.54	NA	0.55	0.72
Proj. Sales Growth (F1/F0)	2.36%	1.83%	3.13%	26.53%	2.13%	1.30%
Momentum Score	C	-	-	B	A	A
Daily Price Chg	5.06%	2.22%	1.03%	5.09%	-7.05%	11.04%
1 Week Price Chg	-1.30%	-12.95%	-11.01%	-7.03%	-2.36%	-18.43%
4 Week Price Chg	4.63%	-26.35%	-33.45%	10.88%	-0.83%	-55.12%
12 Week Price Chg	-2.75%	-26.97%	-30.67%	10.20%	2.40%	-57.43%
52 Week Price Chg	9.72%	-56.97%	-23.69%	NA	7.27%	-52.04%
20 Day Average Volume	107,081	22,448	3,981,936	3,567,218	7,735,384	738,393
(F1) EPS Est 1 week change	0.00%	0.00%	-0.01%	0.00%	2.77%	0.00%
(F1) EPS Est 4 week change	0.00%	0.00%	-0.85%	0.00%	2.44%	0.00%
(F1) EPS Est 12 week change	1.09%	-2.29%	-1.70%	-1.51%	1.94%	-0.28%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	-0.88%	1.13%	0.40%	-2.80%

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	D
Growth Score	F
Momentum Score	C
VGM Score	D

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.

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