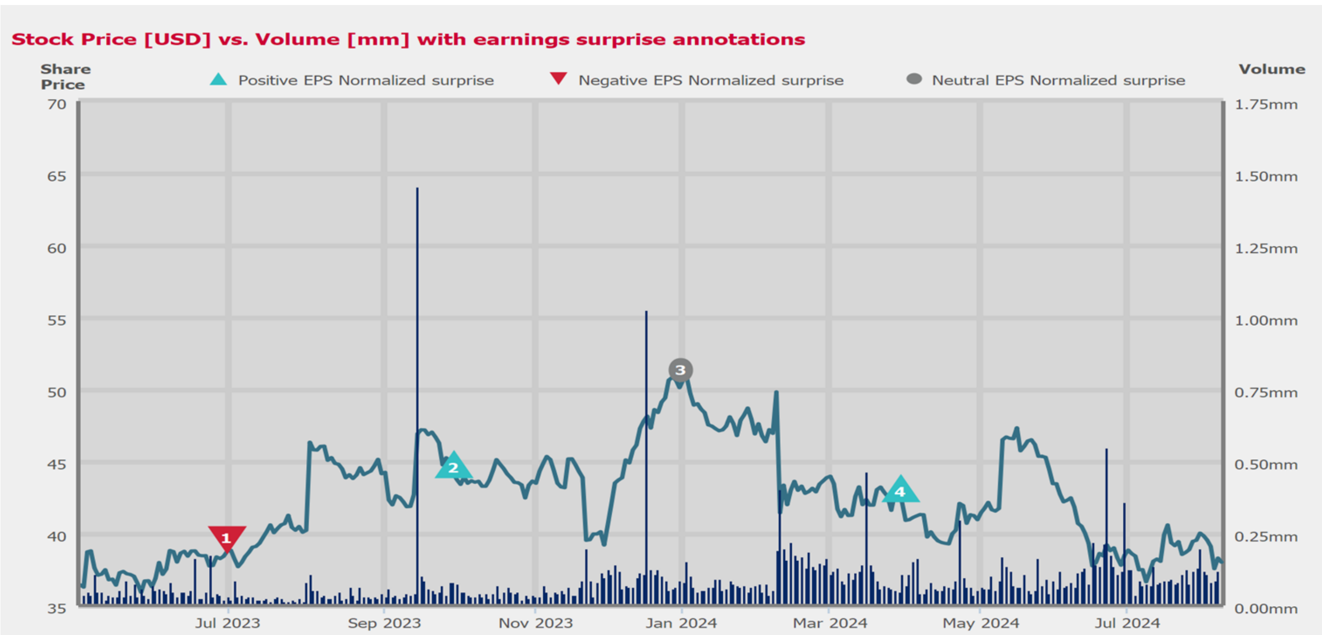
S&P Global
Market Intelligence

# Central Garden & Pet Company NasdaqGS:CENT
# FQ3 2024 Earnings Call Transcripts
## Wednesday, August 7, 2024 8:30 PM GMT
## S&P Global Market Intelligence Estimates

| | -FQ2 2024- | | | -FQ3 2024- | -FY 2024- | -FY 2025- |
|---|---|---|---|---|---|---|
| | CONSENSUS | ACTUAL | SURPRISE | CONSENSUS | CONSENSUS | CONSENSUS |
| **EPS Normalized** | 0.76 | NA | NA | 1.21 | 2.22 | NA |
| **Revenue (mm)** | 887.48 | NA | NA | 999.84 | 3244.77 | NA |

Currency: USD
Consensus as of Jul-22-2024 11:08 PM GMT




- EPS NORMALIZED -

| | CONSENSUS | ACTUAL | SURPRISE |
|---|---|---|---|
| **FQ3 2023** | 1.48 | 1.40 | (5.41 %) |
| **FQ4 2023** | 0.06 | 0.08 | 33.33 % |
| **FQ1 2024** | (0.17) | 0.01 | NM |
| **FQ2 2024** | 0.76 | 0.99 | 30.26 % |

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# Call Participants

### EXECUTIVES

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*Vice President of Investor Relations*

**John D. Walker**
*President of Garden Consumer Products*

**John Edward Hanson**
*President of Pet Consumer Products*

**Mary Beth Springer**
*Interim CEO & Lead Director*

**Nicholas Lahanas**
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### ANALYSTS

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*Truist Securities, Inc., Research Division*

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# Presentation

### Operator

Ladies and gentlemen, thank you for standing by. Welcome to Central Garden & Pet's Fiscal 2024 Third Quarter Earnings Call. My name is Robert, and I will be your conference operator for today. [Operator Instructions] As a reminder, this conference is being recorded.

I would now like to turn the call over to your host, Friederike Edelmann, Vice President, Investor Relations. Please go ahead.

### Friederike Edelmann
*Vice President of Investor Relations*

Good afternoon, everyone. Thank you for joining Central's Third Quarter Fiscal 2024 Earnings Call. With me on the call today are Beth Springer, Interim Chief Executive Officer; Niko Lahanas, Chief Financial Officer; J.D. Walker, President, Garden Consumer Products; and John Hanson, President, Pet Consumer Products. In a moment, Beth will highlight our key messages, and Niko will provide more details about our results. After the prepared remarks, J.D. and John will join us for Q&A.

Comments made during this call include forward-looking statements that are subject to risks and uncertainties. Our actual results may differ materially from what we shared today. We've described the range of risks in our SEC filings, including in our annual report on Form 10-K and undertake no obligation to publicly update these forward-looking statements.

Our press release and related materials, including the GAAP reconciliation for the non-GAAP measures discussed on this call are available at ir.central.com. All growth comparisons made are against the same period in the prior year, unless indicated otherwise. If you have further questions after the call, please don't hesitate to reach out to me.

And with that, I will now turn it over to Beth Springer. Beth?

### Mary Beth Springer
*Interim CEO & Lead Director*

Thank you, Friederike, and good afternoon, everyone. Let's begin with the 3 key messages we would like you to take away from this call. First, recognizing we had record earnings in the third quarter of 2023. We delivered solid third quarter 2024 earnings performance in a challenging environment. GAAP EPS was $1.19 and non-GAAP EPS was $1.32. Unfavorable weather negatively impacted our sales of live plants and continuing softness in durable pet products more than offset our double-digit e-commerce growth across the pet and garden categories.

Second, we further expanded gross margin. Our strategy to simplify our business and improve efficiency across our organization continues to bear fruit. Recent cost and simplicity milestones include our decision to exit the underperforming pottery business over the next fiscal year and the closing of a live plants distribution facility.

And third, we are maintaining our outlook for the fiscal year. Given the recent significant decrease in market prices for grass seed, we now anticipate a write-down of approximately $15 million to $20 million in our grass seed inventory in the fourth quarter. While we see a path to delivering our outlook, it is worth noting that we also face continued volatile weather, uncertainty about retailer inventory and the value-seeking consumer.

Longer term, we believe the consumer trends in the pet and garden industries remain attractive, and our cost and simplicity program will continue to enable us to improve profitability and generate the fuel to make thoughtful investments in our Central to Home strategy.

Finally, I want to thank all 6,700 members of Team Central for their hard work and dedication this quarter. And with that, let me hand it over to Niko, who will share with you more details. Niko?

### Nicholas Lahanas
*Senior VP & CFO*

Thank you, Beth. Good afternoon, everyone. I'll provide more details on our Q3 results, the progress on our cost and simplicity program and our outlook for the year. Now let's start with our third quarter results. Net sales were $996 million or 3% below prior year. Organic net sales also declined 3%.

Non-GAAP gross profit of $326 million was essentially in line with the prior year. Non-GAAP gross margin improved to 32.7%, driven by cost and simplicity projects, including the benefit from last year's consolidation of our cushion business with dog beds and moderating inflation.

Non-GAAP SG&A expense of $199 million was 5% above the prior year, and non-GAAP SG&A as a percentage of net sales increased by 140 basis points to 19.9%, mainly due to the TDBBS acquisition and increased expense in corporate, primarily due to higher legal costs.

Non-GAAP operating income was $127 million and non-GAAP operating margin contracted by 60 basis points to 12.8%. Net interest expense was $10 million compared to $13 million in the prior year quarter, driven by higher interest income from higher cash balances and higher interest rates.

Non-GAAP net income was $88 million compared to $94 million a year ago. We delivered GAAP EPS of $1.19 compared to $1.25 and non-GAAP EPS of $1.32 compared to $1.40. Note that the prior year EPS was adjusted for the February 2024 stock dividend. Adjusted EBITDA was $156 million compared to $166 million. Our effective tax rate was 24%, compared to 24.4% in the prior year quarter due to a larger tax benefit related to stock compensation in the current year quarter.

Let me add some details on our 2 segments, beginning with Pet. Pet segment sales increased 1% to $508 million, driven by the recent TDBBS acquisition, our professional business, dog and cat and equine. Organic net sales, excluding TDBBS, decreased 2%, primarily due to continuing declines in durable pet products across our categories, in line with softer new pet adoptions and ongoing macroeconomic pressures, impacting consumer discretionary spending. Importantly, our POS outperformed shipments.

Branded pet products once again outperformed our private label products, demonstrating the strength of our brands, and we expanded market share in flea-and-tick small animal, aquatics and wild bird.

Let me highlight just a few of our recent product and marketing innovation. Our aquatics line, Aqueon, introduced the France first app, BlueIQ for smart and easy aquarium care. Using our Coralife smart LED lights, salt water and freshwater fish keepers can now control their aquarium lights with the WiFi and Bluetooth-enabled app and will be notified when a light is on too long or it's time for a filter replacement. Our outdoor patio cushion brand, ARDEN, launched its first favorites collection together with Country Music Singer-Songwriter Alexandra Kay, the fade-resistant textiles are eco-friendly, featuring ARDEN's new earth fiber material, a blend of bamboo, viscose and polyester.

And our Equine brand, Farnam, went live with its innovative everything for the ride campaign, featuring the country music Trio, The Castellows, resulting in over 28 million impressions, achieving engagement rates well above benchmarks and driving strong conversion rates. Our e-commerce business outpaced the market, growing high single digits and representing approximately 28% of our pet sales.

Leveraging our online capabilities, we improved conversion rates, driving share growth online in several key pet categories. Pet segment operating income improved 39% to $83 million and operating margin expanded by 450 basis points to 16.4%, driven by gross margin expansion. Pet segment adjusted EBITDA was $94 million, compared to $84 million a year ago.

We expect consumable pet products to continue to grow but sustained pressure on durables through this fiscal year. We anticipate household penetration and buy rates will be fairly stable. Longer term, we expect that consumer trends, including premiumization and humanization, pet health and wellness and growing share of e-commerce and a shift to younger generations will support pet industry growth.

Switching now to Garden. Garden segment sales were $488 million or 6% below the prior year. Organic net sales declined 4%. Recall that the independent garden channel distribution business we sold last fiscal year represented approximately 5% of our garden sales. This year, the cold and wet weather in April and May, followed by record heat in June, negatively impacted sales across almost all garden categories, particularly the sell-through of our live plants, more than offsetting sales growth in grass seed.

Non-GAAP Garden segment operating income was $74 million compared to $88 million a year ago. Non-GAAP Garden segment operating margin declined to 15.1% due to lower sales in live plants, one of our key businesses. Garden segment adjusted EBITDA was $85 million, compared to $99 million in the prior year.

Household penetration and buy rate have remained essentially in line with the prior year and well above 2019 levels, demonstrating consumers are staying engaged in the garden category. While boomers historically comprise 50% of the category spend, that is beginning to shift to younger cohorts, supporting future growth. However, foot traffic in our largest home center customers was below prior year and the pre-COVID baseline.

Our targeted investments in consumer insights, branding and digital capabilities supported our growth, particularly online. We increased return on ad spend and drove conversion, resulting in share gains and double-digit e-commerce growth across categories and retailers and e-commerce sales now represent 7% of total Garden sales.

Turning now to the balance sheet and cash flows. Our balance sheet remains strong, and our team stayed focused on decreasing inventories, in particular, on the garden side, with total inventories now $81 million lower despite the added inventory from TDBBS. Cash and cash equivalents at the end of the third quarter were $570 million, compared to $333 million a year ago. Net cash provided by operations was $286 million for the quarter compared to $325 million.

This quarter, we invested $14 million of CapEx, mostly in the maintenance and productivity initiatives in our dog and cat business, small animal, grass and wild bird. Total debt of $1.2 billion was in line with the prior year. Our gross leverage ratio was 3x at the end of the quarter, compared to 3.1x a year ago. We had no borrowings under our credit facility at the end of the third quarter. Depreciation and amortization for the quarter was $23 million compared to $22 million.

We continue to make progress on our journey to reduce cost and simplify our business. The savings generated from strategic projects across procurement, manufacturing, logistics, portfolio optimization and administrative costs are allowing us to create the capacity to invest and offset sustained cost increases. As part of our ongoing network optimization, we closed the manufacturing facility in California and moved the remaining production of our organic fertilizer called Alaska Fish to our garden manufacturing facility in Missouri.

Our next-gen plant science center operates research farms and facilities across the country with a focus on developing new and innovative grass seed and controls products. We recently announced the opening of a new research location in Texas, which will reduce our reliance on third-party testing as well as consolidate our current grass seed breeding farms in Oregon. In line with rightsizing our logistics footprint and simplifying our work processes and fulfillment strategy, we closed the live goods distribution center.

The consolidation of 4 Garden distribution locations across Georgia, Alabama and Virginia, into a new fulfillment center is well underway, and we recently started shipping out of the new Georgia based facility. We expect the new center to improve in-season on-time service and support future growth in the Southeast region. Optimizing our portfolio and shifting to higher-margin businesses, we started winding down our underperforming pottery business, including taking out the remaining inventory, which was held in 7 locations across the country.

As a result of our cost and simplicity projects, we incurred an $11 million of onetime costs in the quarter, largely related to the pottery exit, including $8.6 million in cost of goods sold and $2.5 million in SG&A, the majority of which was noncash. Our 6,700 members of Team Central have rallied behind our multiyear cost and simplicity program, and we will continue to provide quarterly updates on our progress.

The pipeline of projects to leverage our scale and deploy our capabilities across our 2 segments remain strong. As in the past, we believe there will be plenty of opportunity to reduce cost ahead of us.

And last but not least, turning to our fiscal '24 outlook. We are maintaining our outlook for the fiscal year of non-GAAP EPS of $2 or better despite several challenges. Due to a recent significant decrease in market prices for grass seed, based on our current analysis, we anticipate a write-down of approximately $15 million to $20 million in our grass seed inventory in the fourth quarter.

While we are confident in our ability to meet our fiscal goals, we must acknowledge the ongoing risks and uncertainties, including continued volatile weather, uncertainty around retailer inventory levels and a consumer base that is increasingly focused on value. Additionally, we assume moderating inflation, softer consumption in a number of categories, lower foot traffic in key home center customers and an environment of macro and geopolitical volatility. Looking ahead, we continue to believe in the competitive strength of Central, our Central to Home strategy and the positive long-term consumer trends, enabling growth in our 2 industries.

Thanks to our financial position, coupled with the amount available on our credit facility, we remain on the lookout for growth and margin accretive acquisition targets in Pet and Garden that can add scale to our businesses enable us to enter adjacent categories or ad capabilities, for example, in digital and e-commerce. As always, our outlook excludes the impact of any restructuring activities undertaken during the fourth quarter, including any projects under the cost and simplicity program.

And with that, let me turn it back to Beth for a final comment. Beth?

**Mary Beth Springer**
*Interim CEO & Lead Director*

Thank you, Niko. I would like to provide an update on CEO succession. As you know, our Board of Directors has been working to identify our next Chief Executive Officer. We have shared on prior calls that we've been pleased with our progress, and we are now in the final stages of our work. We expect to make an announcement soon, which could be as early as the end of our current fiscal year and certainly before our Q4 earnings release.

We'd now like to open the line for questions.

# Question and Answer

**Operator**

[Operator Instructions] Our first question comes from Brad Thomas with KeyBanc Capital Markets.

**Bradley Bingham Thomas**
*KeyBanc Capital Markets Inc., Research Division*

A couple of questions, if I could. First, I wanted to start off with the Garden segment, and I know we're coming off of the most important quarter in the year for the segment. And so going forward, a little less important seasonally. But I guess just as we reflect on the last few months, I was hoping you could talk a little bit more about the underlying trends versus the impact of weather versus the impact of pricing? And just how you're thinking about the overall health of the category as we look out to next year?

**John D. Walker**
*President of Garden Consumer Products*

Brad, it's J.D. Thanks for the question. I'll take that. First of all, it was a bit of a challenging quarter, which Niko referenced in his script. The consumption for the quarter heading into the quarter, we were encouraged most of the season still in front of us. We had had a pretty decent first 6 months of the year, including in our live goods business was up 17% for the first 6 months of the year. As you know, that's a business that is largely dependent on third quarter. That's when most of the consumption takes place. And then really across all of our businesses, that's true. But we were most profoundly impacted by our live goods business in Q3, unfavorable weather there.

I think Niko said it well, wet and cold weather in April and the first part of May and then followed by intense heat through the month of June. So just taking live goods alone, up 17% for the first 6 months of the year, Q3, down 6%, and that's when most of the consumption takes place. The month of May, which is the peak month for that business down 13%. And that's something that we just couldn't recover from. If you don't sell the goods there, you have high scrap rates.

And really, if we separate live goods from the rest of the business, the rest of the business, the underlying metrics for the business were quite healthy. Consumption wasn't bad at all, and our financials would have been -- ex live goods would have been strong, solid, I should say. So year-over-year, it was -- the comparison doesn't look great, but it's really driven by one of our businesses. And that's a seasonal business that weather is hard to predict. So it's to draw long-term conclusions from that, I'd say that that's a challenge to do.

I think that we're working on some of the underlying fundamentals there. We're still encouraged about the future. There's a lot to feel good about. Niko referenced cost and simplicity initiatives. We're making great progress in that. A number of different facilities that we are optimizing right now, optimizing our footprint, gaining more efficiencies. We've gained share and share in a couple of our categories, including grass and outdoor insecticides, e-commerce is growing nicely. Household penetration is stabilizing, younger cohorts are entering our categories.

So to answer your question, we feel good about the overall dynamics of the business. We have one business that clearly underperformed for the quarter, and that affected our entire lawn and garden business.

**Bradley Bingham Thomas**
*KeyBanc Capital Markets Inc., Research Division*

That's very helpful, J.D. Niko, I was hoping you could talk a little bit about the margin opportunity looking forward as we reflect on this current year with 1 quarter left, Central has done a very good job of supporting margins in a difficult environment. Could you talk a little bit more about what opportunity you have ahead of you? And maybe in broad strokes, what the puts and takes maybe as you look out to fiscal 2025, again, knowing that you haven't given formal guidance yet, but just so we think about things in broad strokes?

**Nicholas Lahanas**
*Senior VP & CFO*

Yes. Sure, Brad. It's going to be more of the same really. We have our cost and simplicity initiatives ahead of us. We've got a nice pipeline of initiatives that we plan on executing well into '25 and beyond. There's also portfolio optimization that you're going to see. This last quarter, we announced the wind down of the pottery business. That business was underperforming both from a top line as well as a margin standpoint. So we're going to be pretty ruthless in terms of looking at the portfolio as well as cost out projects that we can continue to do.

I would say too that just to pile on to what J.D. said, the live goods business was just devastating to Garden and even the company. And you look at margins would have expanded both garden and total company had that business just somewhat underperformed. It, in fact, contracted by 1,200 basis points, which is really tough to overcome.

But getting back to your question, yes, we have every intention of continuing this journey on taking cost out, becoming more simple, focusing in on higher margin businesses. So I think it's just going to be more of the same. We'll obviously give a lot more color in late November when we lay out our guide and our plans for '25, we're kind of in the middle of putting those together. But I would say more of the same. It's a big push for the company.

**John D. Walker**
*President of Garden Consumer Products*

And Niko, I'd say that we're still in the early innings of the cost and simplicity initiative, right? And we still have a lot of runway still in front of us.

**Nicholas Lahanas**
*Senior VP & CFO*

We really do. We really do. And getting back to that example out in Covington, the warehouse we did there. We took out 4 warehouses, consolidated into that. Plus we had some ancillary other sort of surge warehouses that we're able to close down. And then when you do a big project like that, it has a domino effect where it opens up space in other areas, too, that we can leverage. So a lot more to come there. And I think it's one of the benefits of growing through acquisition where you have a little bit of a longer runway in terms of really integrating and optimizing businesses.

**Operator**

Our next question comes from Bill Chappell with Truist Securities.

**William Bates Chappell**
*Truist Securities, Inc., Research Division*

Just following up on Garden and maybe you can help us parse through exactly what's going through on grass seed. And I say that -- I think you have a write-off -- and more, I guess, specifically, Scott's talked about on their call that in lawns, they gained 700 basis points of market share, but they're going to do some heavy discounting because there was a glut of grass seed in the fourth quarter. And so I'm just trying to understand, it seems like -- you said excluding live goods, everything was fine. But according to at least your largest competitor, you're getting trans and the grass seed business looks terrible. So any clarification there would be helpful.

**John D. Walker**
*President of Garden Consumer Products*

Trans is a strong term, Bill. And I'd say that they called out not to speak about the competition too much. But I think they call that strength in their lawns, which is a few different categories in grass seed, I don't believe that they called out any particular strength there. We believe -- we know that we took share in grass seed. Grass seed has performed well for us.

But let me explain a little bit about some of the market dynamics, what's happened over the last few years. We've seen some wild fluctuations in supply and demand over the last few years. And I'll speak to kind of from 2021 to 2024. First of all, at the beginning of that period, there was a drought that had a pretty significant impact on the harvest, so supply was low going into the pandemic, then we saw unprecedented demand for grass seed during the pandemic and consequently, rapid cost inflation as a result of that.

And some of our varieties like turf-type tall Fescue, K31, Bermuda, Perennial Ryegrass, all of those saw significant increases. Some of those doubled in cost and which is versus historical standards really unusual, really unprecedented. And the higher cost led farmers to start planting more acreage for grass seed. And then in the post-pandemic period, what we've seen is over the last 1.5 years or so, higher retail costs have forced the consumers to think otherwise. So we've seen demand soften. We've seen unit declines, and that's exacerbated the situation.

As we see this year's harvest coming in, we're coming off record prices a year ago that we paid. This year's harvest coming in with a solid crop. Supply chain is heavy everywhere, not just in our barns, but across every manufacturer that we're aware of, all retailers, and it's not just a domestic issue, it's international as well. So we're seeing heavy inventories Therefore, prices have dropped significantly. And I'm talking about really this is new news in the last month or so, we've seen significant price drop, and that's what we're reacting to here.

**Nicholas Lahanas**
*Senior VP & CFO*

And we have to take a look at the net realizable value of that inventory, and that's really the reason the driving force behind the write-down.

**William Bates Chappell**
*Truist Securities, Inc., Research Division*

And I have another question on pet, but just to clarify, like does the grass seed go bad? Or you're just choosing to burn it up to take some supply out of the market?

**John D. Walker**
*President of Garden Consumer Products*

Our grass seed can go bad over time if it sits too long, the germination rate will drop on grass seed. That's not so much of the case here. What we're doing here is marking to market, right? The market has dropped. So therefore, we have to lower the cost of our inventory.

**William Bates Chappell**
*Truist Securities, Inc., Research Division*

Got it. Got it. I understand. And then on pet, just kind of trying to understand both from the consumable and durable side, like how the category performed versus your expectations this year? And whether you see kind of the light at the end of the tunnel in terms of as we move into '25 kind of returning to a growth category as it's been historically.

**John Edward Hanson**
*President of Pet Consumer Products*

Bill, I can comment on that. This is John. I would say drillable have been a bit softer than what we had planned as we entered the year. Now keep in mind that 80% of our business is consumables and 20% is durables. And we're growing consumables, I think mid-single digits and durables continue to decline, I think, low double digits.

So Niko talked about softening pet ownership, macroeconomic environment. We're also seeing low-priced imports coming in via the e-com channel. We can't really measure that in terms of we don't have good syndicated data, but we know it's having an impact, right? And we're staying really close to it. Long term, we see these categories growing low to mid-single digits, for sure. But short term, this durable headwind, we just got to stay close to it and work our way through it as we've been.

**Nicholas Lahanas**
*Senior VP & CFO*

Yes. And I think that's right what John said is spot on. And we're seeing, again, on top of the category somewhat softening, because you're seeing adoption rates that are down and also the penetration down, particularly in dog, cat has remained a little more stable. We have seen some low-cost competitors coming in from Asia and really taking some share, both via Amazon, but also some of the other online Asian competitors.

And so we have to figure out what that's doing to the category, is the category actually up and just losing share to some of the Asian competitors or is the category still down. But some work to do there. I think what you're going to see in the future is obviously a portfolio that's more skewed towards consumables. And I think that's where we need to be.

**John Edward Hanson**
*President of Pet Consumer Products*

Yes. And just to add on that, our e-com business, as Niko said, is very healthy. We gained share. It's 28% of our pet business now. We're going to continue to lean into that channel. That is the fastest-growing channel. And pet specialty remains a bit soft. We're managing through that as well.

**Operator**

Our next question comes from Jim Chartier with Monness, Crespi & Hardt.

**James Andrew Chartier**

*Monness, Crespi, Hardt & Co., Inc., Research Division*

Excluding the write-down in fourth quarter, can you just talk about some of the other margin dynamics maybe that we should consider?

**Nicholas Lahanas**
*Senior VP & CFO*

Yes. I mean, I'll just start from the beginning. If you look at on a non-GAAP basis year-to-date through Q3, a year ago, we were at $2. This year, we're at $2.31. So we feel really great about the business. We feel like we've put together 3 solid quarters. We had this come up with grass seed, and we have to deal with it. It gets back to the net realizable value of that inventory. We have to do the right thing. I would add to that, what J.D. had mentioned, we had a very, very challenging year in live goods. So we sort of have those 2 businesses that are out there that are a little bit of a drag.

Overall, though, if I reflect back on Q3, our Garden sales were actually up double digits. So -- or excuse me, our grass seed sales were up double digits. So we actually had a pretty good quarter in grass in Q3. And then across the business, the margins still continue to expand, really due to 2 forces. One is our cost and simplicity program and then also moderating inflation. And those 2 things are contributing to some really nice margin expansion.

**James Andrew Chartier**
*Monness, Crespi, Hardt & Co., Inc., Research Division*

Okay. And then you talked about some new innovations coming to market and then some marketing. I guess how do you feel about kind of the innovation pipeline coming into next year? And how are you thinking about advertising spend? And what are you doing to kind of drive the business?

**Nicholas Lahanas**
*Senior VP & CFO*

I mean, I'll give some overarching comments, and I'll kick it over to J.D. and John, I think you can never have enough innovation and great ideas. So that's an area where we feel like we can really improve and there is an effort to improve on that to bring new fresh ideas to the market. It's great for the consumer and great for the retailer. We're pretty pleased with where we are, but we feel like we can do a lot better.

And I think on top of that, not only do we want those to come organically, but they're going to come through M&A as well by bringing new DNA into the company, new thought partners, fresh ideas. So those are the areas that we really want to go after. And then we want to go after areas where we have a right to win.

So as we mentioned earlier, we really want to be in consumables on the pet side. On the garden side, we want to also be in consumables, we're divesting pottery. So I think we can get better. We've got a long ways to go, but I think we've made some really nice progress. And I'll kick it over to John and J.D. to give any details.

**John Edward Hanson**
*President of Pet Consumer Products*

Yes. Just to jump in on pet, Niko hit the nail on the head, right? Our focus really is pet consumables. We continue to build our capability and innovation and insights. And I think you can never have enough, but our pipeline certainly hasn't improved, and we feel good about it as we head into fiscal '25. On the marketing side, we've really pivoted to digital. And the investment behind that, the capability that we've built behind that is really improved. And I think you see it showing up in our market shares on e-com, and we'll continue to do that.

**John D. Walker**
*President of Garden Consumer Products*

Yes. And then similar story on the garden side as well, Jim. The -- we feel good about the innovation pipeline. It's building nicely. We've made nice progress over the last couple of years. We still have a ways to go. We're in the process right now of landing our 2025 listings with our customers, finalizing line review results from the past several months, and we feel good about where we are. I think we'll see nice growth in our branded portfolio for next year.

I don't want to show too many of my cards right now, but I do think that we'll see SKU store combinations, total distribution points grow for next year. So we're encouraged by that. And I think that speaks to a building innovation pipeline. Similar to John, our marketing tactics will be focused more on lower funnel type conversion type tactics. And I think that that's appropriate to this type of a business environment where the consumer is seeking value.

**Operator**

Our next question is from Bob Labick with CJS Securities.

**Unknown Analyst**

This is Will on for Bob. Maybe you can add some color to the components necessary for a return to revenue for Garden going forward?

**John D. Walker**
*President of Garden Consumer Products*

Will, can you give me a little more color on that question?

**Unknown Analyst**

Did you -- can you talk more about the components necessary for a return to revenue for garden going forward? I know you're talking about the innovation pipeline? And then maybe you can talk about...

**John D. Walker**
*President of Garden Consumer Products*

You mean growth?

**Unknown Analyst**

Yes, growth.

**John D. Walker**
*President of Garden Consumer Products*

I think it largely speaks to what I was just addressing. Some of that is new distribution, which we are working on right now, finalizing line review results. I think we'll see nice gains in distribution. Of course, in a seasonal business, weather would be nice. It's tough to plan on. So we think about -- Will, we think about the controllable causal factors, things like distribution, things like our investment and lower funnel marketing activities, execution at retail. We feel good about all of those things. What we need also is some participation from mother nature in the weather standpoint. And if we get that next year, then I feel very good about this business getting back on profile from a revenue standpoint.

**Nicholas Lahanas**
*Senior VP & CFO*

We actually came out with some new packaging this year in our controls business that was extremely successful, both online and in brick-and-mortar. And then the other thing I would add to J.D.'s point as far as controls go, the weather actually has cooperated, it's hot and wet, which brings all the bugs out. And so we've had a very nice control year so far. And largely, in many ways, driven by the packaging as well as very good weather for bugs.

**Operator**

Our next question comes from Brian McNamara with Canaccord Genuity.

**Brian Christopher McNamara**
*Canaccord Genuity Corp., Research Division*

Most of our questions have already been answered, but I'd like a little more clarity on the pet durables. I think last quarter, you said they were still double digits but kind of improved sequentially. I think you said that they were down low double digits this time. Is that -- I'm assuming that's a further improvement. It just seems like it's been a long grind here.

**John Edward Hanson**
*President of Pet Consumer Products*

Yes. It has been a long, you're right. I would agree with that. As Niko said, softening pet ownership, the macroeconomic headwinds and products coming in from imports coming in from Asia via e-com. That last one has really gotten on our radar over this last quarter, and we're trying to really quantify the impact relative to the category in our business. The category still remains soft. I wouldn't call it an improvement from quarter-to-quarter. I'd probably call it kind of a stabilization from quarter-to-quarter. And we're just going to stay really close to it, manage it appropriately. But yes, it's been a long burn here for sure.

**Nicholas Lahanas**
*Senior VP & CFO*

And there's also more commoditization going on with durables. They become brand is less important for the most part, and there's a lot of commoditization going on and a little bit of a race to the bottom. So it's not something that we're eager to participate in, which, again, is why we're going to probably focus on more consumables, where we can build brand and really connect with our customers and consumers.

**John Edward Hanson**
*President of Pet Consumer Products*

Yes. And just to build on that, we are -- like I said before, 80-20 consumable to durable -- and Niko is right, a lot of durable categories are heavily private label. Categories that have been or are being commoditized a bit. Yes.

**Brian Christopher McNamara**
*Canaccord Genuity Corp., Research Division*

All right. Great. And then secondly, I mean, we've heard a whole host of consumer companies talking about the consumer weakening. A lot of companies actually saying July has been a really weak month. I'm curious what you're seeing there. And then just relative to -- you throw that into kind of maybe the struggles we're seeing in pet ownership from maybe a cyclical standpoint? Like I mean we have the humanization trend all that stuff that's kind of supportive, but it feels like those old reliable kind of structural trends are weakening there. So how should we think about that maybe a potential weakening macro environment?

**Nicholas Lahanas**
*Senior VP & CFO*

Yes. I mean I would say that we are seeing value-seeking behavior by the consumer. We see that in our business. The good news is, in many of our categories, we have good, better, best. So we will see the consumer just buying good as opposed to the more premium product that we have in the category. So we are somewhat covered off there, which is great.

On the pet side, our largest customer is Costco, which I would submit is a real big value play. People go there for value. That's why the pack sizes are bigger. We do very well there. And so I think in many ways, we sort of hit the sweet spot of that value-seeking behavior, but we also need to get better and recognize that, that's an ongoing trend.

I would say, overall, what we're seeing on the pet side is really the boomers are kind of a wildcard. You're seeing some of their pets as they pass away, they're not re-upping with new pets. And I think that's been probably the biggest area of weakness. On the positive side, we're seeing Gen Z and millennials really get into the category as well as on the garden side, we're seeing a younger cohort come into these hobbies and categories. So that bodes well for the future. I think we were going through a little bit of a rough patch, and it should sort itself out soon, and we can get more back into a more normalized sort of growth type of trajectory.

**Operator**

Our next question is from Shovana Chowdhury with JPMorgan.

**Shovana Nafiz Chowdhury**
*JPMorgan Chase & Co, Research Division*

I have a couple of questions. On the -- with the cash of like about $570 million on your balance sheet, can you give us more details on what you're seeing in the market in terms of M&A? And I think you mentioned you're also looking M&A into digital and e-commerce. If you could please add a little bit more color?

**Nicholas Lahanas**
*Senior VP & CFO*

Sure. Yes, we've -- we're very proud of our cash balance. We feel like it makes us a very good buyer. We can get to speed to close much quicker because we've got that amount of cash. And again, we're looking in the garden and pet categories. My bias right now is to lean more into pet given the fact that we did the 4 Garden acquisitions back in 2021 and then more importantly, pet consumables. So those are the areas we're looking at.

I would say, overall, right now, the climate is a little bit slower on the M&A front. I think the reason is a lot of the businesses that have been bought by sponsors, where a lot of the sponsors sort of overpaid. They paid higher multiples. They're a little remiss to come out and try to sell because multiples have come down. And so I think they're taking a little bit more of a wait-and-see attitude at the moment.

So we aren't seeing quite as many deals as we did, call it, 2, 3 years ago. But that's going to be our primary use of cash right now is M&A. Secondarily, we want to invest in the business, and that's through as well as digital capabilities. And also on the M&A front, we do look at digital and e-com type of acquisitions and capabilities, because we see that as the fastest growing channel right now in both pet and garden. And it's an area where we frankly do need to get better up our game and really set us up for lots of success in the future.

**Shovana Nafiz Chowdhury**
*JPMorgan Chase & Co, Research Division*

Another quick question. In your commentary, you mentioned in the pets, the POS outperform shipments. So does that mean -- was there any retailer inventory pressures? Or is inventory in a good shape exiting the quarter? If you could add more color...

**John Edward Hanson**
*President of Pet Consumer Products*

Yes. This is John. I can take that one. Our pet retail inventory has been in a good position throughout the year. That doesn't change the fact that across the industry, there is a focus to tighten inventory. So are we going to see some customers being a little more successful and having new programs against it? Absolutely. As we continue to want to tighten inventory on our end as well. But I think our inventory position is in good shape. You do see -- also do see some changes quarter-to-quarter, and that might be very well what we're seeing right here. But we also feel good that POS is outpacing ships.

**Nicholas Lahanas**
*Senior VP & CFO*

On the pet side, we don't have a lot of overhang in the market right now at retail. We feel really good about our inventories.

**John D. Walker**
*President of Garden Consumer Products*

And I think on the garden side, it's in aggregate, we exited the quarter with inventories up mid-single digits. And -- but that, of course, is -- that's in aggregate. If you look at it more on a category basis, I said earlier that our grass inventory and most companies grass inventories on the high side. So it's lumpy. But having said that, in aggregate, we're not in a bad position at all. With the season still ahead of us, so we still have a fall season, we should be able to burn through some of that inventory and be in a good position in advance of the season next year.

**Shovana Nafiz Chowdhury**
*JPMorgan Chase & Co, Research Division*

One last question, if I may. Given that, if I'm not mistaken, this is the third year in a row that you have had bad luck with weather and of course, it's uncontrollable. So given that the Garden segment, fiscal third quarter is the biggest business for live plants. Are you thinking of any other businesses or anything else you might be looking into, to somehow offset, let's say, the live business in future fiscal years should there be another bad luck with weather?

**Nicholas Lahanas**
*Senior VP & CFO*

Yes. We are always looking at that. In fact, that's why when I spoke a little bit earlier about M&A, we were probably a little more biased on the pet side, because that has much less seasonality to it and can help offset some of the lumpiness that we see on the garden side. So that's the reason for pivoting a little bit more over to pet.

**Operator**

Our next question comes from William Reuter with Bank of America.

**William Michael Reuter**
*BofA Securities, Research Division*

When you were responding about M&A being one of the larger uses of cash, you mentioned there's fewer opportunities out there. Are there opportunities out there almost entirely tuck-ins? Or could there be larger M&A opportunities?

**Nicholas Lahanas**
*Senior VP & CFO*

Yes. I mean all of the above, the larger ones obviously take longer to do. They're a little bit harder to do. So we're really looking at both. We have a two-pronged approach in terms of M&A. We have a team actually is dedicated to the larger deals. And then we have also another team that's focused on the bolt-ons and the tuck-ins. So we're looking at both.

**William Michael Reuter**
*BofA Securities, Research Division*

Got it. And then you moved out of this California facility. You also have this 4 DC consolidation into 1. Are there any facilities that are going to be up for sale that have meaningful value that are going to change the complexion of your balance sheet?

**Nicholas Lahanas**
*Senior VP & CFO*

No. I mean not materially. We have a lot of cash already. So it's not going to. And then anything, obviously, that we would sell, we would non-GAAP that. So we're really not in the real estate business. So yes, I don't see anything that's of any sort of magnitude.

**William Michael Reuter**
*BofA Securities, Research Division*

Okay. And then in response to one of the earlier questions on the call, I think you mentioned 1,200 basis points. I think that was the margin for the live good component of the lawn and garden business?

**Nicholas Lahanas**
*Senior VP & CFO*

Yes, that was the contraction of live goods.

**William Michael Reuter**
*BofA Securities, Research Division*

Which is like 17% of the quarter typically. Is that right?

**Nicholas Lahanas**
*Senior VP & CFO*

Not tracking on how much of the quarter is. I was only speaking to the live goods business vis-a-vis the prior year, how much the margins had contracted. I just was trying to give an order of magnitude on the degree to which it had gone down and why it affected not only garden, but the whole company.

**William Michael Reuter**
*BofA Securities, Research Division*

Have you shared how much live goods typically is in your third quarter before?

**Nicholas Lahanas**
*Senior VP & CFO*

No. We don't call out the BUs that specifically in a quarter. I would say that we said this pretty consistently. Live goods is very Q3 specific. So it is doing a massively disproportionate amount of its volume in that quarter. So it's a very important quarter.

**Operator**

Our next question comes from Carla Casella with JPMorgan.

**Carla Marie Casella Hodulik**
*JPMorgan Chase & Co, Research Division*

You've already taken some questions on the subject. But on -- in terms of international freight, shipping, kind of what you're seeing there and just wondering what you're seeing there in terms of costs? And then do you have any goods that at this point are exposed to tariffs or could be exposed if we get a more robust tariff regime?

**Nicholas Lahanas**
*Senior VP & CFO*

Yes. We haven't been impacted too much by ocean freight. It's fairly stable. We're less than like 8% of our goods are coming in from Asia. We still would have some exposure to tariffs, but it's probably a lot lower than what it was during the first Trump regime, if I'm going to go there when the tariffs were first put in place. So yes, it's not going to have a huge impact, but it will have an impact.

**Carla Marie Casella Hodulik**
*JPMorgan Chase & Co, Research Division*

And can you say when it first happened in the last regime, how -- what were the best mitigants? Was it -- how much of it would you say you would have -- you had to do in pricing or move production? And what are the best opportunities now to mitigate these cycles?

**Nicholas Lahanas**
*Senior VP & CFO*

Yes, it was like a 3-pronged approach where we started looking for other places to source the goods. So other countries in Asia, I think a lot of folks were doing that. In many cases, we had some of our vendors in Asia assume some of the risks. So they would give us a break on price to help offset the tariff. And then third was flat out pricing, which is a little bit more blunt where you just go out and take a price increase because of the tariff.

**Friederike Edelmann**
*Vice President of Investor Relations*

This was our last question. Thank you, everyone, for joining our call today. The IR team is available to answer any additional questions you may have. Turning it back to Rob now.

**Operator**
This concludes today's conference. You may disconnect your lines at this time, and we thank you for your participation.