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SMG - Q2 2014 The Scotts Miracle-Gro Company Earnings Conference Call

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OVERVIEW:

SMG reported 2Q14 adjusted net income of \$136.7m or \$2.17 per share. Expects 2014 adjusted EPS to be \$3.05-3.20.



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PRESENTATION

Operator

Good day and welcome to The Scotts Miracle-Gro earnings conference call. Today's call is being recorded. At this time, I would like to turn the conference over to Jim King. Please go ahead, sir.

Jim King - *The Scotts Miracle-Gro Company - SVP IR & Corporate Affairs, Chief Communications Officer*

Thanks, Carrie, and good afternoon, everyone. Welcome to our second-quarter call for fiscal 2014.

With me here in Ohio are Jim Hagedorn, our Chairman and CEO; Barry Sanders, our President and Chief Operating Officer; Randy Coleman, our recently named CFO; and several other members of the management team.

We appreciate everybody adjusting their schedule for today's call. You might recall that we've released Q2 earnings after the market for the last few years now. The National Hardware Show is held right after this event and several members of our team are leaving to attend that. So we appreciate your flexibility.

Given the hour, we are going to try to keep our comments concise today. When we get to the Q&A session, I would ask that you have just one question and one brief follow-up. I've got follow-up calls scheduled with many of you well into the evening and will be available tomorrow, as well, to answer your questions if we don't get to them in the time allotted to this call.



So with that, let's get to the business at hand. As always, I want to remind you that our comments today will contain forward-looking statements, and so our actual results could differ materially from what we have discussed. We encourage investors to familiarize themselves with our risk factors that can impact our business. Those can be found in our Form 10-K, which is filed with the SEC.

Finally, as a reminder, this call is being recorded and an archived version of the call will be made available on the investor relations section of our website, investor.scotts.com.

With that, let me turn the call over to Jim Hagedorn to get us started.

Jim Hagedorn - *The Scotts Miracle-Gro Company - Chairman, CEO*

Thanks, Jim. Good morning, everyone.

I'm going to be brief with my comments and keep things at a pretty high level. Then I will turn it over to both Barry and Randy to get the details to you guys.

As you can see from the press release, we had a great result in the second quarter as our retail partners in the United States took an aggressive stance in getting ready for the season and our European business got off to a great start. Gross margins exceeded our expectations and we continue to do a good job of managing expenses.

I normally don't like to talk about the consensus, but the fact that our Q2 results were nearly \$0.20 better than what Wall Street expected might cause some of you to be tempted to take your numbers higher. Not so fast. There is no doubt that our retailers were in better shape entering the season than I can recall in a long time. However, consumers were understandably slow to get out of the gate, due to an extremely long and harsh winter.

As most of you know, there was snow in much of the midwest and northeast all the way through the second week of April. So for us to have negative POS in March after last year's record poor weather is the last thing I ever would have predicted, but that's what happened. On a real-time basis through yesterday, POS is still slightly down to last year, after including the impact of acquisitions.

The good news is now that the weather has broken, the consumer has been engaged. Our retail partners are also still engaged. So while there are some tweaks to our forecasted P&L, we feel like we have good control of the business. Our adjusted EPS guidance of \$3.05 to \$3.20 remains our best estimate to where we will finish the year.

I'm going to let my colleagues focus on the results and our outlook for the year. I want to spend my time updating you on the steps we've taken to position the organization for some of the long-term opportunities we outlined in December. I also want to update you on where we stand in relation to our commitment to focus on shareholder-friendly actions.

When we met with you back in December, the theme of our analyst day event was pretty straightforward. Given the current environment, we will continue to plan for growth in the existing consumer portfolio of 1% to 2%. We will supplement that growth with acquisitions like TOMCAT, and we also see incremental growth opportunities in areas like urban gardening, indoor gardening, and organic products. We also continue to see nice opportunities in Scotts LawnService.

In addition to properly stewarding our existing brands, we also have to properly invest in these higher-growing businesses. The goal is to make these investments without impacting the P&L. To do that, our leadership team has been developing a plan to redeploy assets and resources in an effort that we will likely be going through for the balance of the year.

We know we're going to take some charges this year to make that happen. This quarter, we took a \$4 million restructuring charge related to some of those changes. By the end of the year, we expect that number to increase to about \$20 million. Because of the approach we are taking, we consider this a one-time initiative and we're excluding those charges from our adjusted EPS.

The steps we have taken so far are to begin that process of both streamlining and strengthening the leadership ranks of the organization. I believe we've greatly improved our probability for success as a result.

Following the departure of Jim Lyski in late January, we gave some expanded duties to Michael Lukemire. We have now taken Mike's role one step further as he has been tasked with overseeing the entire North American business. Mike came here about 15 years ago to run our Marysville manufacturing facility. He eventually ran supply chain, oversaw our R&D, our IT department, and eventually was named President of our South region in Palm Beach.

His new role is one that I have had myself and I am confident that he's well prepared. Mike does what I would expect from a leader. He immerses himself in the business, he understands the key issues, and then he works with his people to help them succeed.

When he first moved into sales, he visited practically every store in his region, met with almost every associate, and quickly had a firm grasp on this side of the business. So I have enormous confidence that Mike will run North America in a way that allows us to be more efficient, more consumer focused, more responsive to our retail partners, and therefore more profitable and predictable.

The other benefit of giving Mike this expanded role is it allows Barry to change his role as well. Since he has taken over his chief operator, Barry has done an outstanding job improving our processes, our visibility into the business, and alignment around what needs to be done. Our ability to overdeliver on our numbers last year, despite the extremely slow start, was a testament to the groundwork that Barry had laid.

While Mike will report to Barry, the structure now allows Barry to spend significantly more time working on all of the emerging channels. Our urban, indoor, organic, biotech, and services business will report to Barry. So will strategic planning, M&A, and international.

There are two other structural changes we made in the quarter that deserve your attention. The first is in Scotts LawnService. Mark Wilhemi is a name that most of you probably don't know, but he has been the head of operations at LawnService for seven years and has a 40-year track record at Scotts. Mark has been an unsung hero in this business, but has played an enormous role in the successful turnaround of Scotts LawnService.

A month ago, we named Mark President of this business. At the same time, we moved Jim Gimeson from our Miracle-Gro business to SLS. Jim has a proven history in leading field-based organizations as well. His move to SLS gives us long-term stability and a natural succession plan as Mark prepares for retirement.

I want to provide some context about the changes at SLS. I want to stress that nothing at SLS is broken, and you have been hearing me praise that team for years. In fact, we made these changes because we are so confident in the future potential of this business that we wanted to make sure we have the right leadership for the long term.

New products, new services, and acquisitions are all on the horizon for this business. The leadership changes we made in SLS, I believe, will increase the probability that we execute the vision of this business in a way that enhances shareholder value.

The other obvious change we have made is by naming Randy CFO. As many of you know, Randy was a candidate for the job when we made the decision to go outside and hire Larry. That decision was never about Randy. Given the direction we're heading, my entire team, as well as the Board, believe we needed someone in this role who liked to get his hands dirty and who already had a deep understanding of the business.

As we have evolved over the past year, we realized that we had created a structure that resulted in a corporate CFO, Larry, and an operating CFO, Randy. It became clear that this was not a sustainable path, especially as we are looking to get leaner and redeploy assets.

So we made a change. And if there is someone in the organization who likes to get his hands dirty, it's Randy, so much so that we will not back-fill his previous role, because he will bring a lot of that responsibility with him to the CFO's office.

Many of you have met Randy in the past and I know he's looking forward to getting engaged with our shareholders. He is a good addition to my team and our shareholders should be pleased. As I think you'll hear from him, Randy and I are aligned about what we need to do to manage for growth and create the type of long-term shareholder value that I believe is achievable.

And so, that brings me to my final point, which is an update on our thoughts on uses of cash. Nothing has changed. But we are getting closer to the time frame we announced previously regarding returning cash to shareholders.

Our operating cash flow guidance for the year was \$275 million. Our leverage ratio right now is 1.8 times and we have expressed a willingness to take our pro forma leverage as high as 2.5 times by the end of the fiscal year. When I exclude capital projects, the TOMCAT acquisition, the shares we have repurchased throughout the year, and the recurring dividend, that leaves us with roughly \$125 million to \$150 million, or about \$2.50 per share, available to us if the year comes together as planned.

Later this summer, most likely in August, we'll make a decision about returning cash to shareholders. I want to stress that we have not made a final decision. If the results in May or June throw a wrench in our numbers this year, we'd probably re-evaluate how aggressively we attack this.

This business has historically generated a lot of cash. Deploying that cash with discipline, combining it with reasonable assumptions for the core business, as well as having confidence in the emerging businesses puts us in a great position to drive long-term shareholder value.

As I have said at the outset, I am pleased with the overall picture that is taking shape here. We are taking a reasonable approach to the existing portfolio. We are investing for the upside where we believe it exists. We are focused on emerging areas that we believe has strong growth potential, and we're using our capital structure in order to meet near-term and long-term needs of the business, while also sending cash to shareholders. So in my view, we're executing well against all the things that are in our control.

I know you want to learn more about the second-quarter results and our view of the rest of the year, so at this point, let's switch gears. I am going to turn things over to Barry to talk about the state of the business, and then Randy will look at the numbers. Barry.

Barry Sanders - *The Scotts Miracle-Gro Company - President, COO*

Thanks, Jim, and hello, everyone.

I agree with what Jim said. Our Q2 results were extremely strong and our retail partners have been supportive in both the US and in Europe. If you exclude the Easter weekend, we have had a series of weeks in which consumer purchases were well above \$100 million, and we had solid momentum as we enter the peak weeks of the gardening season in May.

In the US, we have seen increased consumer purchases of lawn fertilizer, grass seed, spreaders, and mulch. We have seen slight declines in plant food and soil, and we have seen a larger decline in controls where the weather delay has been the most pronounced and where we've also seen aggressive retail price points. Overall, POS year to date through yesterday is slightly down.

As you might expect, consumer purchases in our North region have been the slowest to take off, but all of our markets are now in full swing. Across the board, the level of support we have seen from our retail partners is outstanding. Some channels have done better than others, but they have all been highly engaged. More importantly, they have remained committed despite the fact the weather has caused us to have a late break to the season.

In terms of specific product categories, we are pleased so far with the retailer support and consumer support for our new Roundup 365 product. The product not only kills weeds, but provides a residual benefit for a year. This means the consumer can apply just once a season and not have to deal with the problem until next year.

In our gardening business, we have seen a strong start to our Gro-ables product line. For those of you who are unaware, the product is a compostable pod about two inches long. It contains soil, plant food, and seed, such as a tomato, green beans, or a variety of other herbs and vegetables. All a consumer has to do is stick the pot into the ground, water it, and then wait for it to grow.

This product is still in its infancy stages and is a classic case of investing for the long term. If margin were the sole test for Gro-ables, it would have never been launched. But with a long-term vision of selling tens of millions of units a year and with the expectation that this product will be an entry point for new consumers, we are bullish what Gro-ables can mean for the category and over the long term.

So far this year, we have had almost a 50% sellthrough nationwide entering May. This is not only -- this not only has proven to be a great impulse buy at retail, but has been very strong online as well. E-commerce consumers have been highly active both in making purchases and writing positive online reviews.

Our [natch] and organics tests are also going well. We have seen this segment of the soils category outperform the rest of the business, entering May. As you have heard us say repeatedly, we believe this business can be a significant one for us. This year, we are testing two different organic products under the Miracle-Gro brand and one of them will receive nationwide support next year.

Finally, in lawn fertilizer we have seen some strong results, especially in the south. In that region, our most popular product, Bonus S, is up 5% on a year-to-date basis. Recall that in two markets in Florida, we are currently testing a new formulation of Bonus S. This product has a new and better active ingredient that will result in a much better consumer outcome with a better environmental profile.

In these markets, POS of Bonus S is up double digits, on average, and retailer support remains strong. In the west, Bonus S is up 18%, bringing total Bonus S up 11%. This gives us a great deal of confidence as we prepare to launch the new Bonus S product in all the appropriate markets for 2015.

Let me move on to Europe. In our largest three markets -- France, the UK, and Germany, we have seen strong sales increases and the overall business has grown by more than 10% year to date. By category, we have grown across the board, with the exception of plant food, which is essentially flat.

It's too early to declare victory in Europe, but we are extremely pleased at the outcome so far. We still have a ways to go to get the business back to its historic levels of profitability, but we should beat our planned operating income targets this year and we will be well positioned as we prepare for the next year.

As you might expect, Scotts LawnService is trailing our expectations right now, as the weather has been a big impediment in many northern markets. While SLS has been enjoying some momentum in recent weeks, it is unclear whether they will make up the revenue weakness from Q2.

However, the business has good contingency plans in place and I'm confident they will be able to hit their profit targets for the year.

Many of you recall that a year ago, I was frequently using the phrase success equals predictability. We're in the lawn and garden business and things happen beyond our control. Like Jim, did I think there was any chance that this March could be worse than last March? Not on your life. But it was and so we now move on.

The good news is that the consumer trends we are seeing right now are positive, and just like last year, we have done some contingency planning in advance of the season in case we saw issues arise. So that phrase, success equals predictability, still applies to our team here even when outside forces get in the way of our results.

This is why I am confident that we will continue to see strong consumer response and retailer support through the rest of the season and that is why I believe the guidance range we outlined entering the season remains achievable.

To be more specific about that, let me turn the call over to Randy.



Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

Thanks, Barry, and hello, everyone.

I want to start by saying that I'm excited to be sitting here talking to you today. I appreciate the trust that Jim, my peers, and the Board placed in me, and it is a responsibility that I take seriously.

For most of my career here, I viewed the operators of our business as my clients. But today, that's changed. As the CFO, I view our shareholders as my primary clients, and I am focused on doing everything I can do to make sure we're executing a financial strategy that balances the short-term needs of the business with the ultimate goal of creating long-term value for all of our shareholders.

I want to be respectful of everyone's time, given the hour. But before I jump into the numbers, I want to spend a few minutes sharing a little bit about my background and my approach. I've been at Scotts Miracle-Gro for 15 years now. I have led the operating finance group for the last seven years and had a series of other finance leadership roles before that.

Most recently, in addition to leading operating finance, I had responsibility for leading and shaping our analytics group. You have heard us talk about our efforts to better understand the data around our business and I am glad to have been a key driver behind this effort. I can tell you that our use of data has made us a smarter and better informed Company than we were just a year or two ago.

In terms of my approach, you won't see or hear much different out of me than you did from my predecessors, especially Dave Evans, who I worked for directly during much of my career at Scotts. Dave and I saw the world in much the same way.

You will see me operate with the following five core principles. First, regarding short-term growth, we need to establish reasonable expectations. I believe we can grow, but I agree with our assessment that low single-digit growth is our near-term reality. So I don't want to spend money and sacrifice profit by chasing growth that isn't there.

Second, regarding long-term growth, we must maintain appropriate focus on the long-term potential of our business. We must balance our plans for near-term profitability with necessary investments in our brands and innovation pipeline where we can achieve our long-term upside.

Third, a sound capital structure is critical. We don't need to swing for the fences to drive shareholder value. The combination of modest levels of growth and a smart and consistent capital allocation strategy will allow us to continue to deliver solid and consistent returns to our shareholders.

Fourth, I believe in frequent and transparent communication. You will see Jim King and me out on the road a lot to meet with our investors. I want to make sure our shareholders understand the path that we are on. Just as importantly, I want to make sure that we understand how our decisions will resonate with our investors before we make them.

And fifth, I will be a hands-on CFO as I believe this is the only way to accomplish the first four principles I outlined. I am a roll-up-your-sleeves kind of guy and, like my boss, I am a straight shooter. I'm not a micromanager, but I do want to understand the details and the nuances of our business.

I have been here long enough to have a good head start in the CFO role and I am fortunate to be surrounded by exceptionally smart and experienced people who I know are dedicated to helping me succeed. Importantly, Jim Hagedorn and I are aligned on these five principles, and this alignment was crucial to both Jim and me when we talked about me moving into this role. Ultimately, my success, Jim's success, the Company's success, and increasing shareholder value are all linked together.

So, enough about me. Let's talk about the business. I'm going to run through the numbers quickly, then I want to share some thoughts about our outlook for the year.

Let's start with the topline where we had a solid 7% improvement in the quarter. That gives us a 6% increase through the first half of the year. The entire increase was driven by our global consumer segment, which was up 9% in the quarter and 7% year to date. Within this segment, we saw a

9% quarterly increase in the US, driven by the acquisition of TOMCAT, some pricing decisions we made entering the year, and, finally, strong sell-in getting the retailers ready for the season.

The increase outside the US was 5%, or 3% when you exclude the impact of foreign exchange. The season in Europe got off to a strong and early start, especially in the UK, where good weather contributed to a 6% year-to-date sales increase versus year ago, excluding FX.

Scotts LawnService was down 12% in the quarter. This business had a tough start in many parts of the country, due to the same weather challenges faced in our US consumer business, but the team is focused on making up ground quickly and remains bullish on the year.

Corporate and other was down by 50% in the quarter. Recall that sales in this line are related to a supply agreement linked to the sale of our professional business from a couple of years ago. This is effectively a zero margin business for us, so our margin rate improved slightly as our sales here declined.

One point I want to make sure you understand, all these numbers exclude our wild bird food business. As most of you probably have read, we sold the business in a series of transactions over the past two months, but we had budgeted for about \$35 million in sales from this business. Exclusion of these numbers will not affect our earnings guidance as this business generated little profit.

Within the next few weeks, we will file a separate 8-K that will show five years of data excluding the wild bird food business. The 10-Q filing will also contain quarterly information for the past two years. This should help you adjust your models, but if you have any questions, please give Jim King a call.

Moving to gross margin, I'm really pleased with the improvement we are seeing here. We have been saying for two years that we are focused on driving this rate higher and we continue to see traction from our efforts. The rate improved 270 basis points in the quarter, and we are now 290 basis points better year to date.

The big drivers of the rate improvement in the quarter and year to date were product cost-out initiatives launched in the second half of last year, targeted price in our US business, and increased sales volume associated with the strong early-season sell-in, which drove favorable product mix and improved leverage on our fixed costs.

We continue to do a good job with SG&A, as well. The 3% increase is in line with the guidance we provided. Most of the increase is related to higher planned advertising expense for the full year, which we have talked about numerous times in the past. Companywide reported operating income in the quarter was \$217 million, compared with \$172 million a year ago. Year to date, we are at \$127 million versus \$80 million a year ago.

By segment, global consumer operating income was up 23% in the quarter and 35% year to date. For SLS, the operating loss increased \$3 million in the quarter to \$20 million and remained flat on a year-to-date basis.

Interest expense was nearly \$6 million lower, both for the quarter and year to date, due to lower average interest rate and lower borrowings.

And on the bottom line, adjusted net income was \$136.7 million, or \$2.17 per share, for the quarter, compared with \$99.3 million, or \$1.59 per share, a year ago. Year to date, adjusted net income was up 130% to \$71.1 million, or \$1.13 per share.

I want to point out that the numbers in the quarter exclude \$6 million of costs categorized as impairment, restructuring, and other. As Jim said, \$4 million of that is related to severance costs.

With that said, let me now transition into an update on our guidance. As Jim already pointed out, we are reaffirming our original earnings guidance for the year. Given the poor early weather and slower than expected POS, we ended Q2 with retail inventory levels that were higher than we planned. This situation has corrected itself since the end of March and retail inventory levels today are only slightly higher than a year ago.



As in most years, the period between now and Memorial Day and into early June will be crucial to our topline results. We expect to do better on the gross margin line than our original guidance of a 100 basis-point improvement. However, we will see a lot of pressure on the rate in the back half of the year, due to the volume shift between Q2 and Q3 and the related fixed-cost absorption; higher freight rates in early Q3, especially April; and unfavorable product mix.

As Jim also said earlier, we are moving swiftly to begin executing a plan to shift some G&A dollars around the organization. Executing this project is going to result in approximately \$15 million of additional restructuring costs spread out for the balance of the year, and we will exclude these costs from our adjusted earnings. Excluding restructuring, SG&A will likely be in the original 2% to 3% range provided, but it could swing a bit, depending on our results on variable comp.

We entered the year saying interest expense would be \$5 million to \$7 million lower. We will probably do a bit better than that.

So far this year, we have repurchased 1.1 million shares of SMG, including almost 900,000 in the second quarter. But given the timing of those purchases, they won't impact our EPS numbers until next year.

So pulling it all together, we still expect adjusted EPS of \$3.05 to \$3.20 per share.

Overall, I share my colleagues' enthusiasm for the strong start, as well as our confidence for the second half. Just as importantly, I am pleased with our early planning efforts for next year, and I'm glad to see us taking aggressive steps to [set] the business for even longer-term success.

With that, let me wrap things up and turn the call over to you. So Operator, at this point, let's open up the call to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Josh Borstein, Longbow Research.

Josh Borstein - Longbow Research - Analyst

Thanks for taking my questions here. Just on the guidance, you reiterated it. I am just curious. Has anything changed, gotten either better or worse or offset by other parts of the business that's different from when you originally provided guidance?

Randy Coleman - The Scotts Miracle-Gro Company - EVP, CFO

Sure, Josh. We have really confirmed our \$3.05 to \$3.20 earnings guidance for the bottom line. When you think about the pieces of the P&L, we do feel there was a little bit of pressure on the topline, but at this point, we are not willing to call that number down, given how much POS is still ahead of us.

On the gross margin line, we think we will do better than our original guidance of 100 basis points, but until we see how the topline plays out, we're reluctant to be too specific on what that might mean. And as I pointed out on SG&A, we right now would stick to the original range, but that could vary a bit, depending on how the year plays out, again, depending on the topline and how incentives might line up (multiple speakers)

Jim Hagedorn - The Scotts Miracle-Gro Company - Chairman, CEO

I would just throw in there that I think the things we control, we are doing better than budget on pretty much everything we can control.



The part that we can't control is the topline, and so I think that the only thing I would add to what Randy said is that I think we're pretty agnostic to the topline. The topline, we're going to do the best we can, and I know the sales group is out there really pushing and executing, and the weekends we have seen recently have been good.

So that being said, I think that the one thing that we are less in control of is the topline, but I think we're pretty relaxed about it and don't feel particularly exposed, and I think that's the important part.

Josh Borstein - *Longbow Research - Analyst*

Okay, great. I appreciate that. And then just one follow-up, looking at 3Q, what things should we keep in mind from a modeling standpoint with respect to weather comps or other one-off incidents? Thank you.

Jim Hagedorn - *The Scotts Miracle-Gro Company - Chairman, CEO*

I'm not sure -- . This is just a repeat of what I say every year, which is the thing that I would watch is look out the window. That is what is going to drive ultimately what matters, which is if we're going to exceed guidance, it's going to be because we have got good weekends, and that is pretty much what I would say.

That is the one factor that -- so that if we are comfortable with the consensus, then -- or with the guidance, I guess, is the words, then variations on the theme will come out of topline growth, and that's a matter of looking out the window. I don't think there's much more cosmic shit that will happen, excuse my French.

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

Looking ahead at the months coming up, our biggest POS month of the year typically is April, but this April we expect to be a little bit unusual. But after that, May is the second biggest, June is the third biggest, and then March will be the fourth, so there is a lot of POS still ahead of us. So we are still optimistic and bullish, but realizing the weather has to come together and there's six big weekends between now and mid-June.

Josh Borstein - *Longbow Research - Analyst*

Terrific. I appreciate it. Thanks and good luck on the rest of the year.

Operator

Olivia Tong, Bank of America Merrill Lynch.

Olivia Tong - *BofA Merrill Lynch - Analyst*

First question is just around the second-half guidance. It looks like if you are sticking with your original EPS outlook that you are looking for a pretty decent-sized deceleration in EPS in the back half. So I realize that a lot of the year is still in front of you, but what would get you towards the top end of that range or potentially beat that range relative to the bottom end or getting in that range? Thanks.

Jim Hagedorn - *The Scotts Miracle-Gro Company - Chairman, CEO*

I am sorry you're wasting a question on that. I will say the same thing, and I know Barry was whispering while you were talking, weather. Weather would get us over the top of the range.



Barry Sanders - *The Scotts Miracle-Gro Company - President, COO*

Yes, we have seen -- this is Barry -- the south is in pretty good shape, the west is in pretty good shape. This is the latest spring we've ever seen relative to the midwest and the northeast, and so what Randy said is if we had a string of six, seven great weeks across the midwest and northeast, that could push our numbers. But what we are not counting on is that happening. So we are planning for the worst and we are comfortable with where we are at. But if we had better weather, it could push it to the other end.

Jim King - *The Scotts Miracle-Gro Company - SVP IR & Corporate Affairs, Chief Communications Officer*

Olivia, is that it?

Olivia Tong - *BofA Merrill Lynch - Analyst*

I'm sorry; I put myself on mute. But just on gross margin, clearly this is the best gross margin you have had in a couple of years. But if you're -- even with presumably you are going above 100 basis points, as you said, but even then, you're probably looking for a fairly material deceleration in the second half. So first, where were the overages in gross margin relative to your expectations in Q2, and other than raw materials, what could potentially trip you up in the second half?

Jim Hagedorn - *The Scotts Miracle-Gro Company - Chairman, CEO*

When you think about where we are year to date -- that's probably a little bit easier to explain, there's three big drivers why we're up almost, call it, 300 basis points.

So pricing in our US business is roughly a third. Costout from product changes that haven't decreased the quality of our products, but just improved our profit, is worth about a third. And then, a combination of favorable product mix and absorption from higher sales is about the other third.

So that last third will more or less reverse itself in the second half of the year. We will continue to see the pricing impact, and on the costouts, while we will continue to see benefits, it won't be quite as dramatic in the second half as what we saw in the first because last year's second half, we had ramped up when we were starting to already see some of those benefits.

The other factor that I referenced earlier was freight rates, which not even specific necessarily to our business, but just with the weather being so bad across the country in March, there was a lot of pent-up demand for freight in early April. And especially around our growing medium business and our mulch business, we saw some freight rate impacts that hit us most immediately in the last 30 days. We will still see a little bit of that in Q2.

So all those headwinds will contribute to why we think -- we know we won't be up as high in the second half as we were in the first half, but given that, we still think we're going to finish higher than 100 basis points for the full year.

Olivia Tong - *BofA Merrill Lynch - Analyst*

Got it, thanks. And then, just lastly, can you call out maybe the growth disparity in a couple of regions, maybe compare and contrast how you did in the west versus the northeast and midwest?

Barry Sanders - *The Scotts Miracle-Gro Company - President, COO*

Olivia, the question was business results, how we did?



Jim Hagedorn - *The Scotts Miracle-Gro Company - Chairman, CEO*

Basically the growth we are seeing in the south and the west, compared to the north right now.

Olivia Tong - *BofA Merrill Lynch - Analyst*

Exactly.

Barry Sanders - *The Scotts Miracle-Gro Company - President, COO*

Sure. I think basically the south is flat; call it down 1%, 2%. The west is down 2% and what we call our north region, which is the midwest and the northeast combined, is down about 5.5%. So, it's down a little -- the north and midwest is down a little more than double what the south and the west are.

Olivia Tong - *BofA Merrill Lynch - Analyst*

Got it, okay, and that's year-to-date numbers?

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

Yes.

Olivia Tong - *BofA Merrill Lynch - Analyst*

Okay, okay. So that's still quite a bit below where -- and this is -- so this is inclusive of April, as well?

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

Those are numbers through April, but excluding TOMCAT.

Olivia Tong - *BofA Merrill Lynch - Analyst*

Understood.

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

(multiple speakers) if we were to put in TOMCAT, it would be closer to flat on a year-to-date basis.

Olivia Tong - *BofA Merrill Lynch - Analyst*

Got it, versus your plus 1% to 3% outlook? So it's flat versus your plus 1% to 3% full-year outlook?



Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

Sorry, Olivia, can you restate that one more time?

Olivia Tong - *BofA Merrill Lynch - Analyst*

Sure, so right now, the way that you are trending year-to-date through April is about flat, and that on a like-for-like basis compares to your plus 1% to 3% topline outlook.

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

Yes, that is right. (multiple speakers) outlook Companywide including our European business, which is going bonkers right now.

Jim Hagedorn - *The Scotts Miracle-Gro Company - Chairman, CEO*

Olivia, just to make sure I am clarifying, we are talking -- the numbers we're talking are sellthrough, not our sell-in numbers, correct?

Olivia Tong - *BofA Merrill Lynch - Analyst*

Right, right.

Jim Hagedorn - *The Scotts Miracle-Gro Company - Chairman, CEO*

Okay.

Olivia Tong - *BofA Merrill Lynch - Analyst*

Okay, thank you, and Randy, congratulations on your new role.

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

Thanks, Olivia.

Operator

Joe Altobello, Oppenheimer.

Joe Altobello - *Oppenheimer & Co. - Analyst*

I guess in terms of the base period, could you remind us what kind of comps you are facing and -- or did face in April, and then in May and June versus last year, because as I recall, it was pretty volatile from month to month last year. So I am just trying to put your guidance into context, that's all.



Jim Hagedorn - *The Scotts Miracle-Gro Company - Chairman, CEO*

For reference, whether it be April, May, or essentially every month over the balance of the year, we are essentially facing double-digit comps almost every single month.

So if you recall, we started out last year, in March we were down 30%-ish and climbed out of that. So we are seeing something, to a large degree, that is similar to last year and expecting a lot of that to come together for us in May and into June, which are two of our three biggest POS months.

Joe Altobello - *Oppenheimer & Co. - Analyst*

Okay, so even on a double-digit base period, comp in April, you were still up on POS?

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

No. We were down about 3% at the end of March, and at the end of April, still down about 3%.

Joe Altobello - *Oppenheimer & Co. - Analyst*

Yes, I am sorry. Just for the month of April, you were up year over year.

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

No.

Joe Altobello - *Oppenheimer & Co. - Analyst*

Okay, sorry, got it now.

And in terms of the advertising, obviously you guys are coming off of a pullback last year and expect that to have to be up a little bit this year. Can you talk about market share, because I think last year you held market shares flat despite the fact that advertising was down a little bit? So I would imagine, given the increase in spending this year, you would hope to get a little bit of an uptick in market shares? Thanks.

Barry Sanders - *The Scotts Miracle-Gro Company - President, COO*

Market share, Joe, is about the same story this year. What we're seeing is when the markets are accelerating, we have seen good news in fertilizers and mulch and so forth. Where we have seen a little slippage is in the control products, but that business really hasn't started yet.

And so, overall, I think we're roughly flat, and -- but one of the things we have done this year is we have not pulled back our advertising like we did last year. So we have gone ahead and stayed consistent with the investment that we said we were going to make this year in advertising.

Joe Altobello - *Oppenheimer & Co. - Analyst*

Okay, great, thanks, Barry.



Operator

Bill Chappell, SunTrust.

Bill Chappell - *SunTrust Robinson Humphrey - Analyst*

I am going to just ask a question to clarify this one more time. Through March, it was down 3%. April was flat to down 3%, and May, we need it to be up mid-single digits or higher for May/June to get to your numbers? Is that the right way to look at it?

Barry Sanders - *The Scotts Miracle-Gro Company - President, COO*

Yes, Bill.

Bill Chappell - *SunTrust Robinson Humphrey - Analyst*

Okay, thank you. Sorry. And then, second, just on the (multiple speakers)

Jim Hagedorn - *The Scotts Miracle-Gro Company - Chairman, CEO*

I just want to be clear. This is why I'm relatively chilled. We have good control of the bottom line of the business. What you just said is to get to our topline, the original topline budget, that is what we would need, okay? That's not the case to get to our earnings guidance, okay?

Bill Chappell - *SunTrust Robinson Humphrey - Analyst*

Correct, correct. I just want to make sure I got all the numbers -- I'm looking at it the right way.

And then, in terms of the non-margin items, what are you expecting now for interest expense and for share count for the full year to get to those EPS numbers?

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

Share count will be roughly similar to our original guidance. On interest, we'll be a bit better, so call it a few million dollars.

Bill Chappell - *SunTrust Robinson Humphrey - Analyst*

Okay, and then my last one, Europe, why is Europe on fire? I know this has been a struggle over the past, let's say, decade of good years and bad years. I would think that the season is still early over there as it is here. So can you maybe help me understand that, too?

Jim Hagedorn - *The Scotts Miracle-Gro Company - Chairman, CEO*

Pretty simple. Good weather, excellent expense control. The European business last year not only suffered crap weather, but went through a pretty dramatic change, particularly in France, of effectively eliminating one-half of the sales force. So we had two sales forces, one for, call it, the independent or the mass merchant, and then one for DIY. And we basically said that doesn't make sense.

So, we went through a lot of changes to enhance the profitability of the business, and now they have gotten good weather as well. So I think it's really come together, and we are -- I can speak for all of us in the senior management team. We're all really happy with where the European team



is right now, and they got a tailwind at their back with the weather. And I think an important part of the season is they are in right now. So, they continue to do really well, and it's great for them. I wish we had the weather that they are having here.

Bill Chappell - *SunTrust Robinson Humphrey - Analyst*

Got it. All right, I'll turn it over.

Operator

Connie Maneaty, BMO Capital Markets.

Connie Maneaty - *BMO Capital Markets - Analyst*

I have a question on the third-quarter gross margin. Last year's margin went up 350 basis points, so it's pretty clear that there is a real tough comp there. But if retail inventories are equal to last year or just slightly above, and you've got your biggest POS months ahead of you, do you have an unusual amount of inventory yourselves or -- just help me understand the pieces there, especially with regards to absorption?

Barry Sanders - *The Scotts Miracle-Gro Company - President, COO*

When we ended March, our retail inventories were up 16% in our largest customers versus year ago. So we were working collaboratively with our customers. We were all ready to go. Operationally, we were as sound as I can ever recall.

Now, April POS wasn't what we had expected. We continued to see bad weather and falling snow, et cetera, so April wasn't what we had expected and it wasn't as good as last year, either. But we have been able to work through with POS to the point now retail inventories, as we sit here today, are only slightly higher than where they were a year ago. So for the rest of the year, here on out, shipments and POS should more or less be in line and you won't see these aberrations and flips from quarter to quarter.

Unidentified Company Representative

That's speaking about our retail inventory.

Connie Maneaty - *BMO Capital Markets - Analyst*

So how does that mean, though, that shipments in POS are going to be in line? Why does that suggest absorption pressure, or did I misunderstand you?

Barry Sanders - *The Scotts Miracle-Gro Company - President, COO*

The fact that we had shipped in \$70 million more than last year, approximately, in our US business through March, we gained a lot of absorption through our P&L, just fixed-cost absorption in the month of March. And then, as we ship lots in April and that inventory works itself through the stores, we lost that absorption in our P&L, so more or less it was just timing one month to the next.

Connie Maneaty - *BMO Capital Markets - Analyst*

Okay, so it's an April issue. Got it.



Barry Sanders - *The Scotts Miracle-Gro Company - President, COO*

Yes, first of April.

Jim Hagedorn - *The Scotts Miracle-Gro Company - Chairman, CEO*

But I think that what people shouldn't do is overreact to what we have said. I think we continue to believe that for the full year, we will be better than what we have said, okay? Just not the level we are through the first half.

Barry Sanders - *The Scotts Miracle-Gro Company - President, COO*

Yes.

Connie Maneaty - *BMO Capital Markets - Analyst*

Yes, okay, I got that. Could I ask, the outlook for urea pricing, I think, is starting to look quite favorable for next year. Have you started locking in yet or what is your view on that?

Barry Sanders - *The Scotts Miracle-Gro Company - President, COO*

At this point, we've purchased about 15% or 20% of our expected quantities required for next year, and we have the same outlook you do looking forward, thinking that the price should potentially drop as we work ourselves into May and June. So at this point, we are not out aggressively buying, but waiting a little bit to see (multiple speakers)

Jim Hagedorn - *The Scotts Miracle-Gro Company - Chairman, CEO*

This has been something we actually spent a lot of time talking about today, which is our outlook is favorable. I think other than a little bit of a blip up, like last couple weeks, I think we generally feel that the environment for urea purchases is pretty favorable. Personally, I would hedge harder on this. I think -- Barry is shaking his head.

I think there is people there who believe urea could go down -- over the summer down to as low as \$250 and that's holding people up. I personally -- if we're sub-\$300, I'm encouraging people, so this is an internal debate that continues.

But the bottom line is whatever the number is, whether it's \$290 or \$250 or anything in between or anything below \$300, it's pretty favorable to our strategic plan and where we think we are as far as standards that have been set for next year. So it's all -- that's good news for us.

Connie Maneaty - *BMO Capital Markets - Analyst*

That's all I had. Thanks.

Operator

Jason Gere, KeyBanc.



Jason Gere - *KeyBanc Capital Markets - Analyst*

I have just two questions. So the first one, maybe if you could talk a little bit about the competitive environment, and obviously you are saying from now until probably early June is when you really got to get the consumer activity going at this point. So are you seeing anything from your competitors are getting maybe a little -- maybe they don't have the same scale that you have to still hit their bottom-line numbers, but obviously the topline needs to drive. So are you seeing anything unique coming in on the competitive side that as we get further, and if POS is not improving as well as they need to, that it might get a little bit more promotional? I am just wondering if you're seeing anything out of context.

Jim Hagedorn - *The Scotts Miracle-Gro Company - Chairman, CEO*

Look, there is a lot in that question. First, I think we feel pretty good about our relationships with our major retailers, and by the way, the independent channel is doing really well, also.

When seasons don't perform and people start focusing on closing inventory, I would say we really want to focus in on our stuff, not on inventory problems they have, okay?

So, I think that can always drive discontinuities that are irritating as hell. I am not suggesting that's going to happen, but I think when weather is poor and people start shifting focus on what's my ending inventory going to be as a retailer, we want them to be thinking about us, okay?

So we've got great tabs, really good programs, a lot of advertising dollars still ahead, both with us and with our retail partners, and we feel okay about that.

If somebody were to say who's impressing you, I would say [Speck] continues to be -- I think they have the benefit of going through a bankruptcy, but I think they knew who they are, and this is on the pesticide area. So, this is a group of people who I think have competitive pricing, the ability to market. They're making us better.

And so, this is an area that within our Ortho business group, I think they really got to raise the game, and I think everything I know about where Mike is headed with that business, both in the brand support, sales, programs, marketing, there's a lot of pressure to really up the game. But so, impressed with -- I would say on the competitive front, that's what I would say. And I'm not saying they are whooping our ass, but I would say they are legit competitors and respect them.

Jason Gere - *KeyBanc Capital Markets - Analyst*

But within the guidance, I guess I should talk about the gross margins and the tough -- the comparisons to last year. Are you building in, maybe, any shift of dollars from some of the pure advertising to a little bit more in-store promotions that -- just to make sure that when consumers do buy, obviously they are buying you guys. It just seems to be that right now you're waiting on the weather to be -- to work, and then the consumer will come. But I think everybody is looking at the same kind of dynamics, that POS is not as strong as right now. So just wondering if you've built that in there, that may be (multiple speakers)

Jim Hagedorn - *The Scotts Miracle-Gro Company - Chairman, CEO*

It's a good question and I can answer that. Within Mike's P&L, without affecting what he owes Barry and Randy and myself, he has room built in. And I know Mike is every day working promotional support across all the brands, given the year.

So without decreasing the advertising, Mike has money, what we would call here walking around money, to make things happen. He continues to exploit that. Any comment, Mike, on that?

Mike Lukemire - *The Scotts Miracle-Gro Company - EVP North American Business Unit*

No, I think we will respond to the competitive pressures, but it won't be additional funding. It will be funding that we redeploy within our control.

Jason Gere - *KeyBanc Capital Markets - Analyst*

Okay (multiple speakers)

Mike Lukemire - *The Scotts Miracle-Gro Company - EVP North American Business Unit*

I think the good news here is when you think about our category, the whole category through March was down probably mid-single digits, where controls was down double digits. So we typically -- when the category's growing, that's when we tend to take share. When it's declining, we lose. So I think as we look forward, there is more reason for optimism there in that particular controls category also.

Jason Gere - *KeyBanc Capital Markets - Analyst*

Okay. And then the other question, just it's more of a longer-term question, so I know that maybe it was two years ago, Jim, you were talking about trying to get those operating margins back to the 2010 level. And clearly, we have seen how you guys have progressed really well. So, I guess once you get to that level, what type of sales growth do you need to see going beyond that to get more operating leverage in the model?

Right now, the 1% to 3% this year seems like it might be doable. It might not. It depends on how the weather plays out. But I'm just wondering that once you get back to that margin that you got in 2010 that you've talked about, to go beyond that to get more upside, what do you need to see?

Jim Hagedorn - *The Scotts Miracle-Gro Company - Chairman, CEO*

I know what I would say. I'm looking to see what my partners, how they react to it. Slightly more growth than that. I think that would be extremely useful to us on utilization of our assets. So I think absorption, lots and lots of good things happen. So I think that we are definitely on track or ahead of track on margin, okay?

Jason Gere - *KeyBanc Capital Markets - Analyst*

Okay.

Jim Hagedorn - *The Scotts Miracle-Gro Company - Chairman, CEO*

A lot of -- I just was pausing and thinking carefully about my words. A lot of the work we are doing here is to basically, without promising you guys more growth, improve the probability that we get growth that is above that 1% to 2%, which is what we based our strategic plan on.

And I think that means by stewarding the brands properly; by spending the amount of money, not like crazy money like for us would have been a couple years ago, but money that we've talked to you guys about as far as advertising or marketing to sales ratio, relative to what we have told you and what other consumer marketers have done.

So that we believe if we run the business properly, we steward the brands properly, we invest in innovation, which we have got a pipeline that's starting to look interesting, and we maintain the margins that we've talked about, okay, which is the subject of the question, if we can do that, it's growth that will make this and turn us -- go ahead, Barry, you can --



Barry Sanders - *The Scotts Miracle-Gro Company - President, COO*

So without overpromising on the core business, we have talked about that we believe that there is adjacencies that we can acquire into. We are looking at new businesses. We're stewarding our existing business right, and we think Scotts LawnService is a tremendous growth opportunity for us.

And so, while we've been promising low single digits, we think we can get it up into the mid-single digits. And Jason, I think the thing that is important is it's not only that. It's we're taking a view of total shareholder return, so a combination of getting that growth up 100 to 200 basis points, plus the shareholder-friendly actions that Jim has talked about earlier, that we can get total shareholder return on a consistent basis in the 15%, 16%, 17% and being able to consistently deploy that to our shareholders and be predictable, like we talked about earlier to them, on a long-term basis.

Jason Gere - *KeyBanc Capital Markets - Analyst*

Okay, that makes sense. And the last housekeeping and just how much did TOMCAT contribute to the quarter? In terms of the 9% that you had in consumer, can you break out price, volume, and TOMCAT, the acquisition? Then I promise I will leave.

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

On a year-to-date basis, we can tell you that the sales of that business are approximately \$20 million and the bottom-line impact would be about \$0.03.

Jason Gere - *KeyBanc Capital Markets - Analyst*

Right, but in the quarter, of the 9% growth how much did -- just for modeling purposes, because obviously you'll still have it as an acquisition until it anniversaries. So did it -- was it 3% of the 9% and was price 2% or 3%? I'm just trying to figure out how much underlying volumes were just in the second quarter.

Barry Sanders - *The Scotts Miracle-Gro Company - President, COO*

What was it, \$13 million in the quarter?

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

\$13 million.

Barry Sanders - *The Scotts Miracle-Gro Company - President, COO*

\$13 million of sales in the quarter, so \$0.02.

Jason Gere - *KeyBanc Capital Markets - Analyst*

Is TOMCAT?



Barry Sanders - *The Scotts Miracle-Gro Company - President, COO*

TOMCAT.

Jason Gere - *KeyBanc Capital Markets - Analyst*

Okay, okay, great. I will pass it on to the next person.

Operator

Jeff Zekauskas, JPMorgan.

Jeff Zekauskas - *JPMorgan Securities Inc. - Analyst*

Jim, I think three years ago you were interviewed in the Wall Street Journal and you talked about the medical marijuana market as being interesting, and you know since then, marijuana has been legalized in Colorado and there are initiatives in other states. Does Scotts care about this market or does it not care about this market?

Jim Hagedorn - *The Scotts Miracle-Gro Company - Chairman, CEO*

Cares.

Jeff Zekauskas - *JPMorgan Securities Inc. - Analyst*

Okay, what have you got?

Jim Hagedorn - *The Scotts Miracle-Gro Company - Chairman, CEO*

Look, I think that with AeroGarden was really the beginning of work in hydroponics, and I think broadly if you look at the west coast business in particular, it's unique compared to the organic and natural business on the east coast is different than when you go, I'm going to say, Denver west. There, I think it's a very interesting and dynamic market where I personally think it is the biggest change I have seen in lawn and garden.

And it's not just what I would call high-value agriculture. I think that the business is interesting in a bunch of ways. Number one, I think it's younger. I think it's -- we've been talking about this, and part of it is just directionally. It's younger, it's more independent, it's more natural and organic. It's less brand focused.

And I think that if you look at this business, just the entire dynamic, which is not just that part of the business that you mentioned, it's -- just in general, it's much more like what you are seeing in beverages, I think. Whether it's the Coca-Cola business where it is more fruit drinks, energy drinks, teas, et cetera, waters, but not the main brand. I think if you look in the beer business, in particular, it is much more of the craft beers.

And I think there is a craft element to the lawn and garden of that is extremely active on the west coast and really exciting. And it's an area of the business that we are -- what have we got? I would say we've got the best brands in the business, but they are less important for this sort of people we are talking about out there, which is -- this is a part of the business that -- I could go on for a long time on it.

As the world went to crap 2007, 2008, 2009, the business of DIY and Scotts did okay. The people who frequent Lowe's and Depot, they didn't lose their houses, most of them. They had above-average earnings. They have gray hair. They like spending time in gardening. And if you had to hang on to a constituency, the group of people we hung on when things got tough, our core consumer, did pretty well, considering.



The question is, is there a lot of growth in that going forward? And we believe there is growth and that's -- I'm going to say a little bit. And that's the core of the business that Mike runs.

The part of the business which is craft, hydroponic, service, all the things that are now direct reporting to Barry are really different than that. It's like a different world. And it's not a world that we totally get yet. Because we tend to be the DIY big box. That's -- we represent that. But it's a little bit like the Republicans. Can you win an election here without young people, without women, without Hispanics, without gays? I think the answer is you can't.

And for us to get the kind of growth that we believe is achievable, we want to invest in those areas where we get a much better -- not a much better, where we get the growth that we think is available, the crafty part of the business. This would be -- and I don't think we're different than the beer people. I think if you look at Miller Coors, where is their growth? It is in their Blue Moon and their craft labels.

And we are going to develop, and it reports directly to Barry, our craft lawn and garden business where our main brands are less important and there is a level of authenticity and energy and youth, and non-core is pretty important to driving that business.

And so, if you look at the things we talk about that directly to Barry, you got Mike running the core, which I think we have very cautious sort of -- and that doesn't mean negative because I think we all believe that if we do the right things and we take this mission we are on right now, we will get better growth than we are telling you, we think. We are just not going to promise it and we are not going to base our forecast on that.

But we believe if we do the right things, we can do a couple percent better than that. And that difference between our forecast -- our strategic plan numbers and if we can do a couple percent better, the output from that, economically, is huge.

So it's really good if we can do it, and probably half the benefit that we get through this project is going to go to the core. Plus you get core branded, adjacent acquisitions, that will go into Mike's business as well. And if you look at our M&A dollars, about one-third of it will be toward hydroponic-y businesses, craft businesses, about one-third of it will go to service, and about one-third of it will go to Mike's business. And that is -- this becomes Barry's mission and I am really excited about it and very enthusiastic. Long answer, but it's --

Jeff Zekauskas - JPMorgan Securities Inc. - Analyst

That's a good answer.

Jim Hagedorn - The Scotts Miracle-Gro Company - Chairman, CEO

-- where we think there is above-average growth rates.

Jeff Zekauskas - JPMorgan Securities Inc. - Analyst

Okay, and for my second question, when I read your raw material slides, there is always a focus on diesel fuel. I forget. Why do you use so much diesel fuel?

Barry Sanders - The Scotts Miracle-Gro Company - President, COO

It's our Scotts LawnService business with the trucks that we use to deliver the service.

Jeff Zekauskas - JPMorgan Securities Inc. - Analyst

Okay, okay, thank you very much.



Operator

Eric Bosshard, Cleveland Research Company.

Eric Bosshard - *Cleveland Research Company - Analyst*

Two questions. First of all, it sounds like you have got levers to pull on the margin line that, as you said, make you agnostic about sales. Can you just talk about what is playing out differently than when you started the year or what you are doing differently in regards to the margin performance for the year that gives you confidence on the earnings number, regardless issue of the sales?

Jim Hagedorn - *The Scotts Miracle-Gro Company - Chairman, CEO*

I will let the pros answer. I start with underpromise and overdeliver, so we don't get ourselves in a bind, number one. Two, I think the things that we control we're actually doing a pretty good job on.

And as far as negative in there, I think really the big one right now is just -- is freight. I think we believe that there is competitive pressures largely due to fracking in a lot of areas that we care about that are -- meaning that a trucker can get a couple hundred dollars more by delivering freight -- fracking crap and picking up our stuff.

So, where we have our freight contracts in place, we are doing pretty well. Where we are buying on the spot market, it's just a little more competitive than we would like to see, which is a little bit below standard, and I think that's the only significant negative that we see and that's not huge. But it just means that we just wouldn't have expected to be negative on freight at this point.

Barry Sanders - *The Scotts Miracle-Gro Company - President, COO*

And a couple of the upsides are the product costout and management of commodities, that's gone better than we would have expected.

I referenced earlier about being operationally sound, but typically at this point of the year, we look back and there's a couple of hiccups that we point out and we kick ourselves about. At this point, there is really fundamentally -- we're trying to scratch our heads, trying to come up with something to beat people up about.

Jim Hagedorn - *The Scotts Miracle-Gro Company - Chairman, CEO*

Now you probably jinxed us.

Barry Sanders - *The Scotts Miracle-Gro Company - President, COO*

No, I'm just saying, aside from the freight issue, which you could argue is (multiple speakers)

Jim Hagedorn - *The Scotts Miracle-Gro Company - Chairman, CEO*

Eric, what I would say is this has been a journey for us. I think where we are headed with the business and the way we are talking about, which is very consistent -- there is no changes, really, as we've been talking about this shareholder friendly, what we talked about for the last couple of investor conferences. We are executing it and we're pretty well down the path.



I think the lack of major hiccups, I think, says that where we are in the journey is a pretty well-controlled business, in spite of the fact that I would say the weather has been a negative. Obviously, it's been negative for us. But Barry and his team have done a really super job of getting it to the point where it's no drama on the business side.

And as we look forward to where we are going, it's to take that control of the business, now apply ourselves to saying what can we do to take a relatively low business and, without swinging for the fences, add 1% or 2% more, and that is really nice for us financially within the core, add some acquisitions to that, and then focus on these areas, continue to get Europe where we want to be, this whole craft/hydroponics space, natural, organic, urban, and then our service business.

And we think that we can do this in a pretty low drama way. And so, I think where we are in the journey, coming out of economic crisis globally and relative to other consumer companies, is I am really pleased with where we are right now, and I am really pleased with how the team is doing, so I am pretty chilled. It's just everything right now is okay, except I would say minor issues, and the biggest thing is weather.

Eric Bosshard - *Cleveland Research Company - Analyst*

That's helpful. The second question I wanted to ask, I understand the north and the midwest numbers being down. I think you said 5.5% year to date in terms of sellthrough. The south and the west being down a couple of points, can you give some thought or explanation around that? It seems like the weather has been okay there and you have some new products there. Can you just frame how we should be thinking about the south and the west declines year to date as well?

Jim Hagedorn - *The Scotts Miracle-Gro Company - Chairman, CEO*

You want to take it?

Mike Lukemire - *The Scotts Miracle-Gro Company - EVP North American Business Unit*

Texas --

Jim Hagedorn - *The Scotts Miracle-Gro Company - Chairman, CEO*

That is Lukemire talking.

Mike Lukemire - *The Scotts Miracle-Gro Company - EVP North American Business Unit*

Yes, this is Mike. Texas has been a little bit of struggle because of drought, and that's been slower. And then, the transition zone for the south, that's actually recovering. They were actually up this weekend. And so, and Florida has actually been up a couple of percentage points, as well.

But I would say Texas, California has had some drought issues. It's a little slower. And then, the transition zone in the south.

Jim Hagedorn - *The Scotts Miracle-Gro Company - Chairman, CEO*

Transition zone, Eric, means the mid-Atlantic states were slow to start.

Mike Lukemire - *The Scotts Miracle-Gro Company - EVP North American Business Unit*

Right.



Eric Bosshard - *Cleveland Research Company - Analyst*

Okay. And then, one last one, if I can. The \$15 million of charges for SG&A out, that creates no benefit this year, but creates benefit next year. Can you just size the magnitude and the timing of the benefit related to those efforts?

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

Eric, the right way to think about that is it's essentially a redeployment of SG&A. So we will not see necessarily immediate benefit in our P&L in 2015 by taking that out.

But what we're going to do is relocate, redeploy, reallocate some resources across our P&L, largely to prosecute the ideas that -- and the plans we have, as Jim was referencing earlier, about urban, indoor, lawn service, and just growing the category in a lot of different ways.

So, while there will be the \$15 million charge this year that we'll exclude, next year we're not expecting to see necessarily a pickup from that, at least a direct pickup within SG&A.

Eric Bosshard - *Cleveland Research Company - Analyst*

Okay, thank you very much.

Jim Hagedorn - *The Scotts Miracle-Gro Company - Chairman, CEO*

(multiple speakers) what I have asked people to do is this is not a way of taking expense out and building the P&L. This is saying, look, guys, let's run the business -- the benefit of the team we have in place right now, which is a, I'm going to say, very combat-oriented group of people who have been through the wars with me, it's not driving money to the bottom line.

It's basically saying to run the business properly, what do we need to do differently than what we are doing today? If we're going to steward the brands properly, how would you redeploy that money without putting money to the bottom line? With the idea that if we start doing more and more of the right things and fewer and fewer of the things that you would say, I don't know, I don't know if that's worth it.

Without swinging for the fences, there is nothing huge here, about half of that money goes back to effectively brand support within the core, within Mike's business, and about half of that going to these growth opportunities.

And so, we believe it's all part of what I would say is improving the probability that we can do better than what we said. That's how I would describe it to you.

Eric Bosshard - *Cleveland Research Company - Analyst*

Okay, thank you.

Operator

Jon Andersen, William Blair.

Jon Andersen - *William Blair & Company - Analyst*

Most of my questions have been answered. Just one on use of cash. Jim, I know you mentioned that you are evaluating that through August. Last year, you took a dividend [up] 35%. I think the yield now is closer to other CPG companies at about 3%. So as you evaluate returning more cash to shareholders, is it more likely to come in a different form, i.e., not increasing the regular dividend as much as maybe a special or more aggressive share buyback? Thanks.

Jim Hagedorn - *The Scotts Miracle-Gro Company - Chairman, CEO*

Yes. We just had a Board meeting last week. We spent a lot of time on this one. I think we believe that we've got a pretty good valuation going at this point.

So I think for sure it would be one of the two of continued share repurchases or special. We'd like to get to the point, and this is part of our planning, that you are seeing small but regular increases in the recurring dividend over the years.

But we are trying to balance that by saying we don't want to get in a position where we'd ever have to reduce that. So we would like to be in a position to say small, but regular, increases in the regular recurring dividend with the excess cash, and this is one of the things, get back to the pro forma 2.5 times leverage, and look at our cash flow, minus CapEx, minus acquisitions, with the two-thirds/one-third, meaning two-thirds going home, one-third staying for use in the Company on average over the plan.

So I think at this point, we are probably pretty highly focused on a special at the end of the fiscal year or very early in the first Scotts fiscal-year quarter, but end it. So, I think we are seeing that, that we would make a decision on that probably in August, and then execute that sometime before the end of the calendar year.

Jon Andersen - *William Blair & Company - Analyst*

Thanks for the color on that, and congratulations, Randy.

Operator

Jim Barrett, CL King & Associates.

Jim Barrett - *CL King & Associates - Analyst*

Jim, can you talk a little bit about Roundup 365? It would appear to be more proprietary. To what degree will it cannibalize the existing line, as opposed to gaining share? What is the objective in that area?

Jim Hagedorn - *The Scotts Miracle-Gro Company - Chairman, CEO*

The objective is to run them both and be successful with them both. This is something we are spending a lot of time on. I think we feel okay about it, actually.

Barry Sanders - *The Scotts Miracle-Gro Company - President, COO*

I think, Jim, first of all, from a price point standpoint, it's higher, but the consumer is getting more value. And so, this is a product that the consumer wants. It feeds -- it meets a specific need of that consumer, and we are seeing a little bit of cannibalization, but quite frankly, it's better than what we thought it would be.



So overall from a category standpoint, the tough thing to read right now is, like we said, the weed category is down, so it hasn't hit it yet. But what we are seeing relative to mix and what we expected, that the advertising is working. The consumer gets it and it's driving -- it will drive the overall category growth.

Jim Barrett - *CL King & Associates - Analyst*

That makes sense. So Barry, thanks for the answer.

Operator

Alice Longley, Buckingham Research.

Alice Longley - *Buckingham Research Group - Analyst*

I'm still having trouble with the numbers. Can you tell us what POS was for you in the US alone for the March quarter, for April, and for May to date? And also, could you tell us if those numbers include or exclude TOMCAT and the wild bird food? Thanks.

Barry Sanders - *The Scotts Miracle-Gro Company - President, COO*

I think the easiest way to talk about this, Alice, is with TOMCAT excluded. So, for the quarter -- I don't have that handy, but I could tell you year to date, March, we were down 3%, excluding TOMCAT.

Alice Longley - *Buckingham Research Group - Analyst*

We know year-to-date. We are looking just for the March quarter.

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

Alice, we will have to follow up with you later to give you the details quarter by quarter. We have been much more focused on where we are year to date rolling into April and the outlook beyond that, so I would rather just follow up with you off-line and have the real numbers.

Alice Longley - *Buckingham Research Group - Analyst*

Okay. And then, can you give us April and May to date because supposedly May has gotten better?

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

Right, so April year to date, we are still down about 3%, if you exclude TOMCAT. May, we're just starting, and looking forward, again, we have double-digit comps May, June, July, August, September, and to get back to the original guidance, we would need to be up, call it, 5%, 6%, 7% over the balance of the year to get back to that original guidance, which we don't need to do to hit our earnings guidance.

Alice Longley - *Buckingham Research Group - Analyst*

Okay, I'll get the numbers off-line, but also in those numbers you just gave me, what about wild bird food?



Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

(multiple speakers). Yes, all these numbers exclude bird food, also.

Alice Longley - *Buckingham Research Group - Analyst*

They exclude that? Okay. Thank you.

And then, I had a question about your comment about share buybacks. You said you bought back 1.7 million to date, 900,000 in the second quarter, but somehow that won't help you until next year. Why is that?

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

So we've bought back year to date about \$60 million. There may be some more in Q3, just because we have a 10b5-1 and there is a purchasing grid depending on the day and the price what we buy.

The reason why it won't have an effect until next year is essentially because of the options that are granted and the buybacks, more or less, net out. We will see a slight improvement probably in share count next year, but it's not really significant enough to talk about at this point.

Unidentified Company Representative

The number is 1.2 million, not 1.7 million, correct?

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

Yes, it is 1.2 million.

Alice Longley - *Buckingham Research Group - Analyst*

Okay, okay, thank you very much (multiple speakers)

Operator

That does conclude the question-and-answer session. At this time, I would like to turn the call back over to Mr. King for any additional or closing remarks.

Jim King - *The Scotts Miracle-Gro Company - SVP IR & Corporate Affairs, Chief Communications Officer*

Thank you, Carrie. If there are still follow-up questions that we haven't gotten to, feel free to give me a call directly, 937-578-5622.

Separately, we're going to be at two different conferences coming up here shortly in both mid-May and mid-June, so you will see press releases regarding those presentations. Otherwise, we will talk to you again in early August when we issue our third-quarter results. Thanks for joining us. Have a great day.

Operator

Once again, ladies and gentlemen, that does conclude today's conference. Thank you for your participation.

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