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# EDITED TRANSCRIPT

SMG - Q4 2014 Scotts Miracle-Gro Co Earnings Call

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## OVERVIEW:

Co. reported full-year 2014 Co.-wide sales of \$2.84b and adjusted EPS of \$3.29.  
Expects 2015 sales growth to be 4-5% and EPS to be \$3.40-3.60.



## CORPORATE PARTICIPANTS

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

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

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

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

## CONFERENCE CALL PARTICIPANTS

**Jason Gere** *KeyBanc Capital Markets - Analyst*

**Olivia Tong** *BofA Merrill Lynch - Analyst*

**Bill Chappell** *SunTrust Robinson Humphrey - Analyst*

**Connie Maneaty** *BMO Capital Markets - Analyst*

**Jon Andersen** *William Blair & Company - Analyst*

**Alice Longley** *Buckingham Research Group - Analyst*

## PRESENTATION

### Operator

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

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

Thanks, Katie. Good morning to all of you, and thanks for joining us on our Q4 conference call. With me this morning here in Marysville are Jim Hagedorn, our Chairman and CEO; Barry Sanders, our President and COO; as well as Randy Coleman, our Chief Financial Officer and several other members of the management team. Jim, Barry, and Randy will each share some prepared remarks related to our 2014 performance and our outlook for 2015. At that point we will open the call up for your questions.

We have a lot to cover this morning so we will try to be as comprehensive as possible in our prepared remarks. But in the interest of time I'd like to request that you ask only one question and one follow-up. We might not get to everything, but I've already scheduled calls with quite a few people this afternoon to cover up any loose ends.

Of course, our comments this morning will contain forward-looking statements. And so, our actual results could differ materially from what we discuss. For that reason we suggest that investors review our risk factors, which are listed in the press release this morning, and spelled out in more detail in our Form 10-K which is filed with the SEC.

Two bits of housekeeping before we begin -- Randy Coleman and I will be attending the Morgan Stanley Global Consumer and Retail Conference November 19 in New York. Please work through Morgan Stanley if anyone has an interest in scheduling one-on-one meetings. Also, that presentation we make that day will be available via webcast and available on our IR website, [investor.Scotts.com](http://investor.Scotts.com).

One final item -- in lieu of having a major analyst day event this year in New York in December like we normally do, we have scheduled a less formal affair in Boca Raton, Florida, most likely on February 19. Many of you know that that week is also the week of CAGNY's major event for the year. We are managing our schedule so that it does not interfere with the CAGNY conference. By moving the meeting to Florida we will be able to conduct



store walks at the break of the season and give you a better sense of our go-to-market approach for 2015. Obviously, more details will follow from our investor relations team in the weeks ahead. But we hope to see as many of you as possible for this event.

With that, let's move on to the news of the day, the discussion of our 2014 results and our 2015 outlook. So let me turn the call over to Jim Hagedorn to get us started.

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

Thanks, Jim. Good morning, everybody. As we began preparing for this call I spent a lot of time looking at our numbers, analyzing what they meant and thinking about what I wanted to say to all of you this morning. And what I determined was that there's two ways to look at the results. You can narrowly look at just the numbers themselves. In doing so, you see an extremely strong second half that allowed us to exceed our guidance for the second straight year. And through that lens it's a pretty good story.

Or you can look at it more broadly, at what we accomplished. And when you do that, this is what you'd see. In 2014 we called an expensive tranche of debt early in the year, allowing us to lower our overall borrowing costs. We improved our margin rate by 100 basis points for a second straight year despite unexpected distribution challenges and unfavorable product mix. We returned \$350 million to shareholders through recurring and one-time dividends as well as share repurchases. We made strategic tuck-in acquisitions that set our long-term growth objectives in four different areas of the business. We began a process but we have more to go in reviewing literally every dollar of SG&A in order to reallocate investment dollars to fund long-term growth. And we did all this while navigating a still uncertain consumer environment that continues to make growth difficult to achieve.

Over the last two years we have also generated about \$550 million of operating cash flow. And with the leverage ratio of only 2.2 times, we maintain the financial flexibility to continue funding smart investments in the business and returning cash to shareholders. More importantly, over the past two years we have developed a higher level of discipline to avoid chasing growth that isn't there. We've returned the business to a proper level of profitability. We've run the business to recognize that in the end it's cash flow and not EPS that actually drives value.

And most importantly, we have embraced the real beauty of this business. And that beauty is knowing that if we properly steward the strongest brands in lawn and garden, if we stay focused, if we know when to invest hard and when it makes more sense to pull back a bit, then we can maintain our momentum and continue to build upon the kind of returns we have delivered to our shareholders. We can further improve our return on invested capital, now 50% higher than our weighted average cost of capital, and also continue delivering high quality earnings.

So no matter whether you are an investor who looks at the world on a quarter-to-quarter basis or whether you look through a longer and more strategic lens, one thing was crystal clear as we were preparing for this call -- that the news we announced this morning is pretty darn good. The strong performance in 2014 is a testament to this team, the commitment of our retail partners, and the resilience of this category and our brands.

Those who know me also know I don't sugarcoat things. Not everything went perfectly in 2014. In addition to lousy spring weather, we were caught off guard, like a lot of people, by a tighter freight market. We suffered some competitive losses in Ortho and we continue to see pressure in the mass retail channel.

But overall the good outweighed the bad. Europe had its best year ever -- good weather, good planning, and good execution allowed them to grow the top line and they benefited on the bottom line by the effort made last year to reduce their G&A by 10%. Consumer purchases in the United States, after a slow start, were extremely strong in the second half of the year in nearly every category against double-digit comps. We continue to see solid performance in home centers, hardware, independent garden centers and clubs. And the new products we launched or tested left us highly encouraged as we begin planning for the next year.

I'm going to leave the details of the business and financials to Barry and Randy to discuss. I want to spend just a few minutes talking about a few of the things you won't see in the P&L, the things we did in 2014 to set us up for the future. There is four specific initiatives I will call out. First and most importantly, we stepped up the support of our brands. In our core US business we had the first opportunity to put our marketing skills to use behind the Tomcat acquisition we made at the beginning of the year. Our marketing team delivered an extremely creative advertising campaign



and the early indications show a nearly 30% improvement in consumer purchases of Tomcat products compared to last year. The creative approach to Tomcat was risky but it's working.

And what you will see next year in one of our flagship brands, Miracle-Gro, will also be a completely new approach. In fact, we will continue to push the envelope with all of our major brands, recognizing the need to stay relevant with today's evolving consumer.

As you will hear from Barry, we saw a real momentum from new products. Roundup 365 was a first-year success and promises to do even better going forward. Our new Bonus S fertilizer product did extremely well in Florida test markets, leaving us optimistic about a full-scale launch next year of this new and highly innovative product. And we also made our biggest strides yet in the natural and organic space. After a full year of product testing we are highly encouraged by the potential of a national launch of our Miracle-Gro's Nature Care product line next year.

Second, we made some good acquisitions, deals that fit in nicely with existing parts of the business and allow us to better execute our long-term plans. I won't go through each of them, in the interest of time, but I will call out the purchase of Fafard in Canada. The numbers on Fafard in and of themselves are pretty good. It will add about \$40 million of top line and a margin rate that's consistent with the rest of the business. But it's the diversity of Fafard that makes this a clever and compelling story. In addition to the consumer business they have in Canada, Fafard also gives us an opportunity to participate in the professional growing media business.

Most importantly, by acquiring Fafard we've become basic and what is increasingly one of the most important commodities in our business. While most of you tend to focus on inputs like urea and resin, no one really pays close attention to peat, which is suffering from a real imbalance of supply and demand and costs us nearly as much as each of the other two inputs every year.

Third, as many of you probably saw, we announced last week the formation of Hawthorne Gardening Company. Based in New York, this team will be responsible for driving our entry into the urban and indoor gardening market. They are currently managing the Whitney Farms brand as well as the AeroGrow business, which, as you saw in a press release, we are now consolidating into our financials. AeroGrow has turned out to be a tremendous investment for us, and we're expecting the Christmas season to be a big success for this product.

As we look ahead, the Hawthorne team is actively exploring opportunities to make meaningful acquisitions in the hydroponic space that would build off the success we've had with AeroGrow. Additionally, in the days ahead the Hawthorne team will likely be announcing a small acquisition of a niche organic brand.

And fourth, in addition to the acquisitions we've made this year, we've better positioned our core business for growth. During the second half of the year we analyzed every dollar we spend throughout the Corporation. As a result, we have already identified about \$40 million that can be reallocated to become more productive. The majority of that money will go to Mike Lukemire in the North American consumer business. They will have the capacities to better support our brands, continue to focus on innovation, and import talent that will make our team stronger for years to come.

While I like the investments we are making to grow, I'm not ready to change my outlook for the core business. Yes, I remain confident that our core consumer remains healthy and engaged. And yes, I remain positive about how we are executing against the things that we can control. But as I spend the time with other CEOs and when I watch another earnings season unfold, I still see no evidence of a significant improvement in consumer spending.

So going into next year we continue to manage for our consumer business to grow 1% or 2%, though I hope we can do better. When adding SLS and acquisitions to the mix, we expect 4% or 5% top-line growth next year. That is a change from the past two years but is consistent with the goal I outlined in December to return the business to a sustainable level of growth ranging from 3% to 5% per year.

And while we won't see the kind of P&L leverage in 2015 that we've seen over the past two years, that's not surprising and I'm not concerned. We expect to maintain our gross margin and what expect EPS to improve a few points more than sales growth next year. I'll leave the details to Randy to explain.



Some of you have been asking about the recent acquisitions and whether they signal a change in our plans around our uses of cash. I will preface my answer by saying that our overall philosophy remains the same -- to execute a capital allocation strategy that's focused on delivering the highest level return to our shareholders. Over the past two years that meant reinvesting about one-third of our cash in the business and returning the rest to our shareholders. We also said we would allocate about \$100 million a year to acquisitions, but that amount could be lumpy over a three to four-year period of time.

As you can see by the actions we have taken in the past six months, the M&A pipeline is pretty healthy. So if we continue to see good acquisition opportunities, then our one-third/two-thirds may shift a bit and look a little more like 50-50. But we are only going to invest in acquisitions if we believe they are an easy fit for our business and offer a better return for our shareholders than sending the money home. So if the M&A pipeline dries up or we don't like the economics of the deals, then we will return the cash. And if we have excess borrowing capacity, then we may once again do what we did two months ago and use the balance sheet to return cash as well.

Before I turn things over to Barry, I want to take a couple of minutes to talk to you about our associates. Six months ago we were way behind plan and we begin signaling that we would likely miss our top-line guidance. So to sit here this morning and talk about actually exceeding our numbers is extremely gratifying. To get to sit in my office surrounded by other senior people in the business and tell you how great we are, Wall Street applauds us, and media reports will quote me or other members of my team.

But the people in this room are not the ones that deserve the credit. We've got 8,000 people working here at the peak of the season. Our marketing, sales, and supply chain teams all rallied this year to deliver the results that we announced today. And the support teams here not only helped them get it done but also spent the year positioning us for continued success going forward. So I would be remiss if I didn't recognize them for their work. If I could, I would list them all by name. But let me just say that I am proud to have them on our team. Better yet, I'm proud to be a member of their team.

So with that, let me turn the call over to Barry.

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

Thanks, Jim. I want to elaborate just briefly on how we finished the year in each business. Then I will turn to 2015 and build upon some of what you just heard from Jim. I will cover where I think we stand coming out of line reviews with our retailers. I'll give you my overall sense of the consumer environment, and I will talk about some of the new products and programs for next year. And I will give you my overall sense of the consumer environment before I turn the call over to Randy.

Let's start with a quick wrap-up of 2014. As Jim said a few minutes ago, consumer purchases of our product at our largest retailers were down 1% on a full-year basis. But there were some solid success stories to build upon.

Let me start with lawn fertilizer. Despite an extremely slow break to the season, our lawn fertilizer business was slightly positive for the year. I consider that a pretty good result, given the circumstances. As many of you know, the fertilizer category had seen several years in a row of unit volume declines. We reversed that trend last year and then held our ground in 2014. This is a critical category for us, and we have some pretty good fertilizer innovation coming through the pipeline next year. I'll talk in more detail in a few minutes, but I was glad to see the resilience of this category in a pretty tough year.

Overall, our growing media operations also had a solid year, good but not great. Soils had a slight decline of 3%, but that was offset by a 13% increase in our mulch business. I don't think we've ever had a year in which mulch did not grow by double digits, and our expectations for next year is that the growth will be even better. As we have shared in the past, mulch creates some headwinds for us on the margin line, as mulch has lower margins than the rest of the portfolio. But it's a critical category for our consumers and our retail partners. We continue to work to improve the margin structure, but we are extremely happy with the support and the growth we continue to see in the mulch category.



In our controls business Roundup was down 1%, but we are extremely pleased with the launch of Roundup 365. This is a product that offers year-long weed control and exceeded our first-year expectations for sales. And 60% of the 365 sales were incremental to our weed control business. Retailer support for the product remains extremely strong

And we expect another good year in 2015.

The one area of concern was in Ortho, which was down by about 10%. We talked about this on our last call, and there was really no material change on a year-to-date basis here. Essentially, our competitors got aggressive on pricing and benefited from good product placement in the store as well. By midyear we had begun to stem the impact, but we are not happy with the result here. For obvious reasons I'm not going to share the details of our plans for Ortho next year, but I will share the headlines. We are planning an aggressive response, and we're looking to recapture the share we lost in the category as quickly as possible.

Two other quick items in North America -- first, our animal repellent business had a strong year, and we not only gained market share in this space but we drove category growth as well. We continue to see this as a nice incremental opportunity with long-term upside.

Second, I'm really pleased by what we are seeing with Tomcat. We quickly and successfully integrated this business into our organization. And, as Jim said, we've taken an extremely creative approach with our advertising. Tomcat had strong shelf presence when we bought it, but we believe the support were putting behind it will take this brand to a new level. In Q4 consumer purchases of Tomcat products were up 19%. If you look at the overall fall season, our entire rodent portfolio is up 22% through October including a 28% increase in Tomcat.

The news in our international business was good across the board as we had record results on both the top and bottom line. The business benefited from an early and strong start to the season and maintained its momentum all year. The top-line performance was bolstered by the restructuring effort we undertook the year before as we saw quick bottom-line payback on the changes we instituted. In fact, every line of the international P&L showed improvement.

While Jim thanked all of our associates for the quarter, I want to take a moment to focus on this team in particular. They've had a tough ride for the last several years but have remained focused and committed to improving. Their performance this year was outstanding and I want to thank the leadership and the team for getting the job done.

Finally, let me move into Scotts LawnService. There's really a tale of two seasons. In the back half of the fiscal year they did fine and their 5% growth in Q4 has them back on the right trajectory. However, unlike the DIY business, service has a tougher time making up ground after a slower start to the season. Once the first fertilizer application for a homeowner gets pushed back, then the rest of them generally get pushed back as well. As a result, we have known for several months that SLS would miss their original targets and we have been sharing that with you since the middle of the year. So while the numbers may not be great due to the late spring, the overall direction of SLS remains strong.

I'm not going to spend any more time than that talking about 2014. If you have more questions we will take them up during Q&A. Instead, I'll tell you how I feel really good about our plans for 2015, especially in the North America business. Our team had good line reviews with the retailers over the past few months. Whether retailers had positive or negative results in 2014, all of them are building aggressive plans for next year. I'm encouraged by the programs we are working on with our retailers, and I'm confident we'll see nice growth as a result.

In terms of the consumer, let me build upon what Jim said. Those consumers shopping in the destination channels like home center, hardware, and garden centers remain highly engaged. But the consumer in mass retail remains challenged. However, the retailers themselves remain committed to this category and supportive of our brands and are building good programs for next year. Part of what all of our retailers are continuing -- are counting on is our innovation pipeline.

So there are three specific things I want to call out on the new product front for 2015. First, all year we talked about the strong consumer response to our improved Bonus S weed-and-feed product in our Florida test markets. Next year we are introducing this product throughout all of the relevant markets in the South and expect the strong response to continue. This is the most effective Bonus S product we have ever produced, and its weed control capabilities are far better than the old product. In addition, the environmental profile of this product is better as well.



Second, also under the Scotts brand we would be launching a new deck-cleaning product that will be co-branded with OxiClean. This partnership is a couple of years old and the product that we've developed is far better than anything you will see on the market. Unlike most competitors, the Scotts OxiClean deck cleaner will not harm your grass or plants, which is an extremely important selling point to the consumers who take on this task themselves. We've got good support for the product in 2015 and we expect to gain steam as this product rolls out.

And third, we are excited about the natural launch of Miracle-Gro's Nature Care. Organic products are part of nearly all consumer categories and they especially make sense in our space. You will recall that the test market Nature's Care in ten markets this year, and the response was very encouraging. Retailers are extremely supportive and our launch will be made stronger by good in-store product placement and a national advertising program.

Speaking of advertising, as always, we will have a lot of new creative for next year. We'll show you all of that when we meet in person in February. As Jim said, a lot of the reallocation of spending will go to North America business next year. And a fair amount of those funds will be used to better support our brands with these new campaigns.

In the interest of time I want to wrap things up. But before I do, I want to reiterate some of what you've heard from Jim. The last two years have been a great journey for us, and we have accomplished nearly everything we set out to do. But the most important part of what we've done is to better position ourselves for the future. We are not reaching for the stars next year in terms of growth, but we do believe that the tide is beginning to turn for this category. Our consumer remains highly engaged and our retailers do as well. So I like where we are now and look forward to sharing our success with you over the course of the next year.

With that, I'll turn it over to Randy.

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

Thanks, Barry. And hello again to everyone. As Jim said at the outset, all of us are encouraged by the results announced this morning. We feel good about our business as we begin to execute our plans for fiscal 2015. I know most of you are more interested in our outlook for 2015 than a detailed review of the fourth-quarter results so I'm not going to spend too much time going through the details of the P&L. Frankly, not much has changed over the past 90 days, and the results we announced today are very much in line with where I thought we would be exiting the third quarter. The primary exception is our gain on investment in the AeroGrow business, which I will discuss in a minute.

The one highlight I want to focus on during the quarter was sales growth in the global consumer segment. Sales increased 5% to \$355 million as we saw solid performance in both the US and international businesses. As Jim said, we are managing the segment assuming 1% to 2% organic growth next year. But the momentum we've had in the back half of this year is certainly encouraging.

As many of you recall, the slow start to the season didn't just impact the core consumer business. Scotts LawnService got off to a slow start as well. We entered the year expecting that business to grow 4% to 6%. While they fell short of that goal with 2% growth for the full year, 5% growth they reported in the fourth quarter was also encouraging and reflects the continued catch up on customer account and production as the year progressed. On a full-year basis, finishing with company-wide sales growth of 2% at \$2.84 billion was a really good story for us, given the weather we saw in March and April.

Moving on to gross margin, entering the year we expected to be up about 100 basis points and that's exactly where we ended. You may recall the gross margin rate was up 290 basis points for the first half, but significant mix and distribution pressures in Q3 offset many of the gains we saw throughout the year. For the fourth quarter the gross margin rate improved 90 basis points versus year ago, similar to our full-year result.

There's not much to cover in SG&A. The number came in similar to our guidance, up 3% for the year. You will notice that SG&A was up 11% in the quarter. There were three items that really drove this -- timing of US marketing costs, the startup costs associated with the Hawthorne Gardening Company, and the cost associated with closing the Fafard and Solus transactions.



To anticipate a couple of your questions, media spending was relatively flat at \$144 million although marketing spend was higher due to new packaging as we rebranded our Miracle-Gro line this year as well as startup marketing cost related to the Hawthorne business unit. Variable compensation was up slightly for the year but not enough to really move the needle.

The one line on the P&L that we rarely spend time discussing is other income, but it definitely merits discussion this quarter. The \$6.2 million of other income in Q4 includes a \$3.3 million gain on our investment in AeroGrow International, which we consolidated in Q4. You might recall that we purchased a minority stake in this business last year with the flexibility to own up to 80% of it over time. In addition, we realized a slightly lower one-time benefit in the third quarter related to the increased value of the warrants issued when we meet our initial investment. Although these were separate one-time non-cash benefits, our continued support of AeroGrow is important to our long-term growth strategy. That is why we included these in our adjusted operating results. That said, I believe the more realistic operating baseline EPS for 2014 is actually \$3.23 and not \$3.29 per share.

Moving on, we had told you earlier in the year that we expected slightly better results in interest expense and the effective tax rate than our original guidance indicated back in December. Our result on both of these lines was pretty much spot on with that revised guidance. The balance sheet also is consistent with what we had anticipated. The increase in receivables is consistent with sales growth and the quality of the receivables remains extremely strong.

Also, you might recall that we had originally expected year-end inventory to be improved from last year, but adjusted that downward after the slow start to the season. The increase in inventory is in line with that revised forecast, and the good news is that we expect an improvement here for 2015.

You will also note that long-term debt is more than \$200 million higher than last year. We said entering the year that we were willing to use debt to fund growth in the business and also return cash to shareholders. But our current leverage ratio of 2.2 times on a rolling four-quarter basis is exactly in line with our capital structure strategy and continues to leave us with more than enough flexibility to meet the needs of the business.

Before I set the stage for 2015, I want to reiterate what you heard from both Jim and Barry. We have good momentum in the business right now, and we are encouraged by what we saw coming out of line reviews with our retailers. We also have some meaningful new products coming to the market next year.

All that played a role as we thought about the guidance we're providing for 2015. Before I walk you through our outlook, I want to provide some context about what these numbers represent.

In my first call with all of you in May, I said I believed in honest and straightforward communication. So as it relates to our 2015 outlook, let me say this. We have not built a lot of wiggle room between our guidance and our internal plans. The high end of our EPS range is consistent with our internal bonus plans. In fact, if we get the high end of the EPS range, the management is scheduled to be paid almost to the penny the same amount it earned in 2014. In other words, our first line of defense in delivering on our commitment to shareholders in 2015 will be our own pay.

So here's how we see next year coming together. On the top line, our outlook of 4% to 5% growth assumes 3% growth from the acquisitions that Jim mentioned earlier and 1% to 2% growth from the current portfolio. As all of you know, we have had back-to-back years in which we started slowly due to weather. I would like to believe that we are overdue for a good spring but I'm a finance guy and not a weatherman. So I'm not building any assumptions about favorable weather into our plan. Understand, though, that any top-line growth in the core business will be almost entirely based on unit volume. We are taking a charge related to higher distribution costs but no other net price increases are baked into our plans as increases for certain product lines are being offset by targeted price reductions and also promotional increases for other SKUs.

And so that brings me to gross margin. For 2015 we are looking at gross margin rate as being flat. Commodities will be up slightly, probably less than \$10 million, and that pressure will be offset by our other cost-out initiatives. Right now, we still think distribution costs will be a headwind. But the surcharges we are passing along will offset that pressure. We currently have about two-thirds of our commodities locked for 2015, and we are on pace to be 75% locked by the end of the calendar year.



I know many of you are interested in how declining oil prices will impact us. But we don't see a significant tailwind since almost 70% of our fuel is locked for 2015, and the correlation between oil prices and our commodity basket is historically not very strong.

On a percentage basis SG&A should increase slightly less than sales, in the range of 3% to 4%. As we discussed in the previous quarter, the SG&A reductions identified going into next year will be reinvested in additional brand support as well as long-term growth initiatives like Hawthorne, LawnService, and Naturals R&D. Below EBITDA, interest will be about \$5 million higher as rate savings in the first quarter will be more than offset by higher borrowing levels during the year. The tax rate should return to a more normal historical level of about 36%. And we are modeling for share count to be flat to down about 750,000 shares, depending on the level of repurchase activity during the year.

That translates into EPS guidance in the range of \$3.40 to \$3.60 per-share, the midpoint being about 8% higher than 2014, once adjusted for the impact of the AeroGrow gain. Normally, I would expect to see a greater amount of leverage out of the P&L than we are guiding for next year, so let me explain. While both the Fafard and Action Pest acquisitions are slightly accretive next year, the acquisition of Solus will be negative in year one. We purchased this business out of bankruptcy in the UK, and we believe it will be a good long-term asset. For only \$1 million we acquired a business that will contribute about \$30 million in revenue.

But at that cost we also inherited a few problems. As we've begun the integration process, we now believe Solus represents the headwind of \$0.03 to \$0.05 per share in 2015. By no means is that insurmountable, but it does offset the year one benefits from the two other deals. Beginning in 2016, we see substantial upside to all three of these transactions. Each fits nicely into different portions of our existing portfolio and represent compelling investment cases over the long run. The purpose of this explanation is to make clear that literally all the earnings growth next year is coming from the core business.

So when you exclude the one-time benefit from AeroGrow and look at the business on apples-to-apples basis, returning organic sales guidance of 1% to 2% into high single-digit improvement in EPS. And I do find that kind of leverage in the P&L to be a good result.

So let's move on. In terms of working capital for next year we would expect inventory to be better and no material changes in either receivables or payables. Operating cash flow for 2014 was roughly \$240 million and I would expect this number to be between \$275 million and \$300 million next year. Right now, I have no reason to believe that our leverage will move outside of our targeted range of two to 2 1/2 times.

Jim mentioned that the M&A pipeline is pretty active right now. While there is nothing on the horizon that would take us out of that range, we are willing to go higher than that temporarily if there's an opportunity that's in the best interest of our shareholders.

So the outlook for 2015 is pretty straightforward. As Jim King mentioned at the outset, we are not planning on having an analyst meeting in this December. As we thought about it, we determined having store walks at the break of the season made more sense to us. But as many of you know, Jim King and I have been busy traveling over the past three months as I've tried to meet as many of our shareholders as possible. However, there are plenty of our shareholders that I still have not had a chance to sit down and meet. So we will be out on the road again sharing our plans before the end of the calendar year. I look forward to meeting more of you face to face.

And with that, I will turn the call back over to the operator to take your questions. Thank you.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Jason Gere with KeyBanc.

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**Jason Gere** - *KeyBanc Capital Markets - Analyst*

I guess the first question -- I know you've said in the past that if you grew 3% to 5% you get some good overhead leverage. So can you just talk to maybe -- I know you've gone through a lot of the details here, but a little bit more specifically what you would need to see to get more of the leverage coming through next year, because it seems with the sales guidance, 1% to 2% on the core, it seems a little bit conservative. But I'm just wondering how that would translate upside on sales, maybe to the SG&A. That's the first question.

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

Sure. So Jason, we spent quite a lot of time over the summer on what we call project growth internally. So we've identified about \$40 million of SG&A spending across the business including Europe. And those savings are being redirected into the business in long-term growth initiatives for next year -- areas like LawnService and areas like Hawthorne, where we have big long-term plans for our urban and indoor business, and areas like Naturals, where we think there's a lot of long-term growth.

So at this point we are not planning to take any of those savings and drop them to the bottom line, which admittedly is much different than the plan that we've executed over 2013 and 2014. But that's what you'll see in 2015. Again, if we do get higher sales growth, which I think would be largely dependent on weather, beyond the guidance we're providing, you would see on a rate basis better leverage. But for now I'm real comfortable with the guidance that we are providing.

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**Jason Gere** - *KeyBanc Capital Markets - Analyst*

Okay. And just as a follow-up with that, you guys have been very diligent with taking out the structural cost there. So in what inning do you think you might be in terms of rebalancing the SG&A and, again, how you are allocating to some of the strategic spending or eventually falling to the bottom line?

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

So we've made a lot of progress over the last two years, but we think that there's continued progress to be made. We will continue to work on project growth and we think we are halfway through that initiative. When I think about it beyond SG&A I think there's a lot of long-term savings that we can drive from our supply chain and the distribution network, warehousing, freight, et cetera. So it may be less people dependent than what we've done over the last couple years and more thoughtful and more supply chain strategy driven. But we think there's still a lot of savings going forward.

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**Jason Gere** - *KeyBanc Capital Markets - Analyst*

Okay. And then just as a quick follow-up is just can you talk a little bit more about international? Obviously, you've had a pretty good year this year. But can you just talk about the international opportunity in terms of markets, the expansion plans out there? Obviously, it's a smaller piece of the story. People tend to focus on the North American consumer. But I was just wondering if you could maybe talk about the next three-to-five-year kind of outlook on that business. Thank you.

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

Sure. Jason, this is Barry Sanders. The business had a good year. Some of that was weather driven, some of that was the team did a good job in the marketing programs they put out. And then, quite frankly, they've gone through the same cost exercise. So I think we've got our cost structure in place.



And so, what I would say is we call it international, but the business primarily is the UK and France. And both of those markets are doing well, and I think we should treat those businesses like they are core opportunities, just like they -- similarly position that we have in the US. So going forward, I think there's geographic opportunities. We have a new leader in Germany; we were very pleased with what he's done this year. We have low market share so I think there's upside there. Our Australian business reports into international. We also have a new leader there. We are extremely pleased with the way that business is performing. So both of those have opportunities to grow.

And then there's other markets that we can look at. And just like we are evaluating here tuck-in acquisitions, we will evaluate the European market the same way and say: is there small products tuck-in acquisitions we can make or is there geographic opportunities that we have to expand and invest some money? So, I think that's relatively it, relative to international.

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**Operator**

(Operator Instructions) Olivia Tong with Bank of America.

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**Olivia Tong** - BofA Merrill Lynch - Analyst

I just wanted to talk about you alluding to mass retail's sluggishness a couple of times because we've heard from quite a few companies through this reporting season about the US backdrop perking up. So just kind of curious why you think it hasn't necessarily shown up in your categories. Or is it just a matter of timing or something else that's driving that?

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

I think it's a matter of timing. And quite frankly, I just think we are lagging a bit relative to spring. But what I would tell you, Olivia, is they're pacing right on track with everybody else in the fall, and we're very pleased with the results. And I think looking into next year they are positive and I think they have good programs going into 2015. So, I would expect them to catch up pretty rapidly.

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**Olivia Tong** - BofA Merrill Lynch - Analyst

Got it. And then on the commodities I know you mentioned that you've locked quite a bit of oil already, so maybe not capitalizing on the recent decline in crude prices. But is it possible to lock in more now for future use, or has that ship sailed and commodities are what they are for 2015 and it's hard to lock initially for 2016 at this point?

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

Olivia, this is Randy again. Typically, we stay at a point where we are about 70% locked for any one month. But at this point we are going up to 80% to 85% for 2015. In fact, we are also looking at 2016 to get ahead. So with that, it carries some mark-to-market risk during the year, but we think in the long-term that's the right economic decision, given current fuel prices.

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**Olivia Tong** - BofA Merrill Lynch - Analyst

Got it. And then just on some of the additions and changes that you've made to the business, first with the pest control service business, is that still primarily in test mode or do you feel like you now have the groundwork in place for a much larger expansion of that?

And then on Hawthorne, why -- can you give us a little bit of detail why you structured at the way you did as opposed to just building out that particular piece of that business? I know you guys have been talking about it for some time but just some incremental detail on why you structured it the way that you did.



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

So first we will take Pest. Olivia, I would say Pest is more -- this is scaling the test. It's no longer in test because I think we've acquired a very nice business, now it's a matter of scaling it and making sure that we get that right and that we can roll it out across the market. So I would say we have moved beyond test. And this is the first acquisition we will make. We will make sure that we get that right once again, though, before we go and get a lot more scale.

On Hawthorne, I would say we have tried some of those things here in Marysville. I think we have a fabulous business, but I would say our business here is focused on big-box suburban consumer with a 5,000 to 7,000-square foot lawn. The nature of this business is it's a different consumer, it's different channels. It's indoor, it's urban. It tends to skew younger. And so rather than dilute the efforts here that is going very well, we felt that it was better to have a different team that would be focused on a different consumer. It's a smaller business that could get lost in the shuffle here, and make sure that they are focused on the brands that Jim talked about and make sure that they are developing the business. So, we just felt it was better to separate it and have a different unit than trying to get it done here in Marysville.

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

Olivia, this is Randy again. I would add, when we think about Hawthorne we think about it similar to the beer business where you have the big national players that have their own craft beer. It's businesses that are somewhat separate and different marketing teams, different structures. So that's really how we're thinking about it from a structural perspective.

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

I've been trying to let Barry do the Q&A here. We used to say in the Air Force know the enemy, know yourself. I think that's the answer, Olivia, is know the enemy, know yourself. And -- but doing it outside of this building where I think we view anything less than \$10 million as like a waste of time is completely inconsistent with what we are trying to build there. And doing it in a more urban setting in New York I think we also view -- and it is a younger, different team than the kind of folks we tend to collect here.

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**Olivia Tong** - *BofA Merrill Lynch - Analyst*

Got it. Thank you very much.

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**Operator**

Bill Chappell with SunTrust.

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**Bill Chappell** - *SunTrust Robinson Humphrey - Analyst*

Can you talk a little bit just on the Ortho business? I think by now at least you are going through the listing process with the retailers or maybe already through. So do you have some confidence that you will get the increased listings and that things can improve there? And maybe give me a little color on how you take back that share.

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

Well, I'd say it's two focuses, Bill. First is, we are confident with what we've done with the retailers -- so the listings and the promotions and the plans we have in place. So we are happy with the plan. But the real test will be when the rubber meets the road, is next spring when the consumer

goes into the retailer. We are confident that what we've done with the entire program be highly competitive in the consumer's eyes and that we will get that share back not only through what we've done with the retailer but the consumer executing the plan that we have in place.

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**Bill Chappell** - *SunTrust Robinson Humphrey - Analyst*

Got it. And then with regards to Hawthorne, just trying to understand what are the growth prospects for that business. Are there any big players that are -- have similar size that are already there? And does it make sense for Hawthorne to have an M&A strategy to build it out?

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

Yes.

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**Bill Chappell** - *SunTrust Robinson Humphrey - Analyst*

That's all I have, then. Thanks.

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

No, listen, I think that it's a very exciting business opportunity that reports directly to Barry. And I'm very pleased with it. I think that management and the work and the M&A process is something that I -- and I know Randy as well -- take a lot of interest in, and making sure it goes well and we don't shoot ourselves in the foot. I think that some of these deals tend to be a little bit unusual, like the AeroGrow deal. But that's one where, if you were to speak to, I think, those folks, they would say it is gone exactly the way -- we've really been able to add value.

We have not only been able to add capital but I think, whether it's the supply chain, R&D, marketing ideas, just a lot -- it's the kind of thing where you say that's the real first foot in the door. And I think it has gone really well. Otherwise, we wouldn't be writing it up. So I feel good about it. But M&A is a major part of what's going to happen there, and it's a major focus for the management team here.

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

I would say, the one part of your question, is there a big acquisition out there in the space -- there's no big ones. It will be a series of smaller ones. And to date some of the focus that we have had is exactly what Jim said, which is more of a private equity partnership focus where we make an investment. We are investing in people that have either good products, good brands. We give them the advantage that we have of scale and capability, but we let that team run it independent of this business. And that's working very well for us.

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**Bill Chappell** - *SunTrust Robinson Humphrey - Analyst*

Got it. And with at least the last one, Randy, maybe help me understand AeroGrow both in the quarter and going in the guidance for next year. So was that the consolidated earnings for the full year in this quarter? And is it treated above the operating income line going into next year or is it still going to be below the line?

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

No. We consolidated it in the fourth quarter and the results were immaterial for the quarter. The biggest quarter is the one coming up, so Q1 or October through December, preparing for the holiday season. That will essentially be a tell on how that business performs for the full year. But we will consolidate it going forward. So results will be entirely included in our P&L. But because we still only own about a third of that business,



two-thirds of the earnings will be sent back to the other shareholders below the line. So for 2015 we are expecting sales to be in the range of \$20 million and earnings to be relatively zero, net of what we give back to the shareholders.

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**Bill Chappell** - *SunTrust Robinson Humphrey - Analyst*

The other income line won't have anything from it?

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

No, no longer.

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**Bill Chappell** - *SunTrust Robinson Humphrey - Analyst*

Okay, great. Thanks so much.

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**Operator**

(Operator Instructions) Connie Maneaty with BMO Capital Markets.

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**Connie Maneaty** - *BMO Capital Markets - Analyst*

I have a couple of housekeeping questions, one for Barry. When you are giving your sales increases, were those for the full year or the quarter? And was the data POS or your sales growth?

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

The data was POS, not our sales. And the number, I believe, was for the full year.

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**Connie Maneaty** - *BMO Capital Markets - Analyst*

Okay, fine. On the rollout of the new Bonus S in the Southeast, first of all what percentage of fertilizer sales does the Southeast represent? How important a new product do you think it is and where is the price break relative to regular Bonus S?

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

Let me just -- as they are preparing their data, Connie, Bonus S for the Southeast is every month the most single important product they have. Okay? So for the Southeast region Bonus S is the product that -- not the only one but it's the most important 12 months a year.

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

Yes; Bonus S -- and this is not a geographic split, Connie. But Bonus S is 10% of our overall fertilizer sales.

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**Connie Maneaty** - *BMO Capital Markets - Analyst*

Okay. And --



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

And I would tell you that that business has been declining for a number of years and that we expect that to be decent growth for that business next year.

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**Connie Maneaty** - *BMO Capital Markets - Analyst*

And what's the pricing like?

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

Pricing is the same as the regular (multiple speakers).

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

Yes; it's going to be consistent with what we've had. We did not take a price increase for the product.

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**Connie Maneaty** - *BMO Capital Markets - Analyst*

So is it higher margin for you or equal margin, just better for consumer?

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

Equal margin.

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

Equal margin, significantly better performance for the consumer.

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**Connie Maneaty** - *BMO Capital Markets - Analyst*

Okay. What did you find out about Solus that you didn't know before you made the acquisition? And how could it be so dilutive?

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

We worked through this deal in fits and starts. A couple times we thought about walking away. Ultimately, the business went into bankruptcy when we decided that we weren't going to invest a lot of money up front. We eventually bought it out of bankruptcy plus some working capital and inventory that we are liquidating right now. But effectively we paid \$1 million for a few brands that will add about \$30 million to top-line for next year.

So what happened to -- in all honesty, we didn't do the diligence and the integration plan as well as we could have. It wasn't complete from start to finish. And once we owned it and really dug and deeply we realized there's some things here that we need to invest upfront, whether it's warehousing, perhaps some people, and some other areas. So again, it's unfortunate because we feel really good about the other acquisitions that we've done, and this one, it is going to take us a year or two to dig out of. But once we do, we still think it adds a lot of scale benefits to the UK. The team there is really excited. In the long run and going forward we just need to make sure that we don't have a similar situation like this one.



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

I'll throw in mine only because I think everybody in the Company knows my view. It's a lesson in how not to do things. And the opportunity when you say pretty much you can have it for free, I think, was pretty compelling and caused people not to be as careful as they are going to be, going forward, or there's going to be major problems with me.

It's just -- it creates a hole that we hadn't planned on in our budget. I think everybody has struggled through it and it's fine. But it was not a big win that we can all be happy with. And there's going to be corrections going forward to make sure that little deals like this do not become big problems.

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**Connie Maneaty** - *BMO Capital Markets - Analyst*

Can you just tell me what's in the product line, what kind of products is it?

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

There's a series of different, so it's everything from water supplies to --

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

Long-handled tools.

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

Really nice tools that in the long run we could expand beyond the UK into Continental Europe, or we think we could even import them into the US and sell them perhaps even through our big-box retailers. So there's a sourcing capability from Asia, too, that we didn't have in the past. And that was a big aspect of why we wanted (multiple speakers)

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

But, Connie, I would say tools and birding. And birding, unlike nasty commodities in the United States, which is a much more difficult market, I think, birding in the UK is a pretty rational market. And so the big areas here are tools and birding. There's a bunch of offshore-sourced stuff that goes into that. And these have good market share over there.

It just was a, I'm going to say, improperly done deal, I think largely because it was attractive. But I think it's an interesting bunch of categories that we actually like. We just didn't plan on having to do a lot of work to get it back up to speed.

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**Connie Maneaty** - *BMO Capital Markets - Analyst*

Okay. Thank you very much.

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**Operator**

Jon Andersen with William Blair.

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**Jon Andersen** - *William Blair & Company - Analyst*

My question is around pricing and long-term margin expectations. The way that you have portrayed 2015, there will not be pricing. So the first question is, why no pricing? I thought pricing every year to some degree was a part of your new model. And is this just a one-year interruption or something that you are revisiting? And then with respect to your long-term margin aspirations, is the mid-teen level something that you still see as achievable? And what kind of timeframe are you thinking about? Thanks.

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

Long-term we believe operating income in the 15% range is definitely part we want to be. Gross margin rates getting close to 40% again. So no, we are not taking the year off on pricing, necessarily, although I'll explain the context for 2015. But beyond 2015 into 2016 and 2017 we expect pricing to be an important part of how we run our business. And not to get greedy by any means, but an important way to make sure we have, as Jim likes to say, the jet fuel to run the business and that margin accretion is important.

But for 2015, in particular, we are taking price increases in a couple categories where there was either commodity pressures or, based on our analytics, we felt like there was pricing opportunity, where we are also rolling prices back in a couple of other categories where we've either lost share or we felt like there was a sweet spot where if you get to a magic price point the consumer takeaway is a lot better and the overall value created by reducing the prices little bit makes more sense.

So we are taking no net pricing, net of increases and decreases, in 2015. But we are taking increases where we thought it was appropriate. So I'd say 2015 is a little bit of an aberration versus our long-term plan, for sure.

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**Jon Andersen** - *William Blair & Company - Analyst*

Okay, that's helpful. If I could have one follow-up on the mulch business, I think it was a little over a year ago you talked about enhancements you are making to the supply chain there to improve the margin structure of that business, which you have indicated is well below the corporate average. Where are you or how far along are you in that process? And is there more to come in that area? Thanks.

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

Yes. We are going to continue to invest capital in our mulch business to drive manufacturing productivity. We have seen that even in 2014 although the net margin results don't bear that out. But it's a tale of two worlds in that, while our manufacturing productivity has improved, it was really distribution headwinds this year that we didn't see coming at the start of the year, in April and May and even into June, that really brought our margins back to the same starting point.

So our gross margins are still in the low teens. And if we can get those gross margins into the high teens, because there's less investment below gross margin, we will get the operating margin for the mulch business equivalent to the Company average. And at that point we will feel really good about that being a solid part of the portfolio. So there's still work to be done and we're going to continue doing that work.

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**Jon Andersen** - *William Blair & Company - Analyst*

Thanks a lot.

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**Operator**

Alice Longley with Buckingham Research.



**Alice Longley** - *Buckingham Research Group - Analyst*

My question is on store traffic. Can you comment on your discussions with the home center, big-box retailers and what they are saying about the store traffic? I know that's not important to you right now, but when we get into the spring and store traffic is improving because of some of the macro changes that are happening in the economy, what is the history of that converting to better store traffic for lawn and garden, weather being neutral?

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

I'll violate my rule here and take a little bit of that. Good morning, Alice. Look, I think that I continue to be -- confused, i.e., is probably not the right word because you actually think I mean that, but not really understanding the numbers over time since 2007/2008. I think there's so many variables that have gone into retail and point of sale movement.

But here's what we do know. Everywhere, when weather is good -- so that if you looked at how bad the business was in the first half of the season, the weather turns around and we had just a really nice kind of relatively cool summer and allowed us to make up about a boatload of time. And so when you -- and you look at our freight negativity, particularly in the growing media business, which occurs the second half of May, it's largely because store volume went bananas. Okay? And I was having this discussion yesterday with one of our retailers is that we were doing what we had to do to keep people in stock. But it was that crazy and really ran down inventories on our mulch side and involved a lot of freight.

So I think -- and while you can say have been doing a lot of good things in Europe, Europe had good weather. You know? And so, I think this is a lesson that -- you maybe the analysts that's been around with us for the longest. I don't view that as -- it's not a negative. (Laughter) I think what it means is that the most important single thing to our business is weather.

And so, I think when people are buying lawn and garden products, lawn and garden is the most important department in the channel. And they continue to -- and I know this to be the case -- they continue to be able to harvest good returns from lawn and garden customers that are in the home centers. So it's pretty much a win-win. But I think it's very much weather-related although, again, I would say in my discussions with senior management everybody is concerned in this country about growth rates. And how do we get above low single digit growth rates? And I can't leave last night without saying I am hopeful that Washington will start to focus on things that drive economic activity in this country. But I think weather and maybe a little bit of benefit from DC would be useful.

**Alice Longley** - *Buckingham Research Group - Analyst*

So store traffic is up on improved interest in buying other things in home centers and lawn and garden. That doesn't necessarily spill over to better home and garden?

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

Alice, I would say specific to foot traffic I would say there's three elements we're working on with the retailers. One is foot traffic. The other is transactions, and then market basket size. so for our category, specifically in home centers, lawn and garden is the destination category in the spring. And so, increases in foot traffic is probably and most likely driven by our category. So if we do see increased foot traffic next spring, which is the intent, you will see better lawn and garden sales. We also track how that converts to transactions, and so we are measuring that. And then we are doing a much better job of partnering within that transaction, what are they buying? So to make sure that we are selling them and appropriate market basket and the complementary items.

And some of the promotions you've even seen us do in the last couple years is buy this and then buy the next thing that goes along with that. So our promotional efforts are driving market basket. And then we are also saying, how do we drive attachments and drive the project?



And so, long-winded, the answer is, if foot traffic is up, that is a fantastic thing for lawn and garden next spring.

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**Alice Longley** - *Buckingham Research Group - Analyst*

Okay. And a separate question is, how do you -- was mix -- I think you said mix was negative this year in terms of its impact on gross margin because of the growth in mulch. Is that likely to be the case as well in fiscal 2015?

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

Yes; it will be a contributor to why we are guiding to flat margin rates. We will see -- again, pricing will be effectively neutral. Our commodities will be up a little bit. We will have more supply chain savings, and then we will see a headwind from continued growth in mulch (multiple speakers).

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

Alice, I don't know the answers completely to mulch. It has become a super important commodity within the value opportunity for consumers. On these Black Friday events it's just a ton of value for what turns your home -- for \$20 you get a ton of value.

We are in, I'm going to say, deep discussions with our retailers on how to make it a great value but without it impacting our margins as much as it is. And part of that work we are doing but part of it is how to we deal with retailers so that we are staging inventory better, we have less need to rush freight around all over the country to try to keep people in stock.

So there's a lot of planning on saying everybody has got to watch pricing on this product because it's a tremendous value. And we've got to look for inefficiencies in the system because I don't see the value proposition going away. It's just too powerful. But we are in discussions with everybody that's involved in the supply chain here and interface with the consumer to provide a great value but find ways to make it less margin dilutive for everybody.

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**Alice Longley** - *Buckingham Research Group - Analyst*

And when you said distribution costs were a pressure in fiscal 2015, that was because you had to rush out a lot of mulch fast, I guess. And wouldn't you be able to plan better now for fiscal 2015? Or why did you say distribution expenses will again be a pressure in fiscal 2015?

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

I don't think we said that. I think we said we continue to -- so the answer to the first part is yes. We would like not to repeat that stuff and therefore a lot of work is [doing] to avoid that.

The second part is, on the gross margin front I think what Randy is saying is we expect mulch to be at the high-end of all the products we sell as far as the sales growth. So that to itself is not completely useful.

I also want to just throw out there, and it's worth saying at the end of the call, that we are not planning on great weather. If weather is good, that's good for us. Okay? We are looking, because this is a year where we are planning to harvest less off the P&L, we're trying to build some conservatism into our numbers. And therefore some of the stuff is not going to fall right to the bottom line. We are just -- we are trying to build some space in this for us so that -- again, Alice, the most important thing I ever learned from you is don't overpromise. We're trying not to do that. And so when you say, well, how come if, like if you don't make as many mistakes, I think if we have good weather we make fewer mistakes, we'll make more money.

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

Alice, I would add specific to the comments on distribution, like Jim said, we will do a better job of planning specifically for mulch and some of growing media. But what Randy did say was we expect upward pressure on freight costs. And it's not just relative to Scotts; I think it's the entire industry. As I talk to other vendors in other categories, both availability of trucking as well as cost of trucking, everybody is seeing issues. And you're having to plan for just having the trucks and the trucks are costing a bit more these days. So, I think part of what we have to look at is to be a little bit more flexible with our retailers so that as freight does go up that we can manage that with them, whether it's figuring out how to get it there or freight surcharges that we will have to pass along.

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**Alice Longley** - *Buckingham Research Group - Analyst*

Okay, super. Thanks and congratulations on a good year overall.

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

Thank you.

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

Thank you, Alice.

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**Operator**

That concludes our question and answer session. At this time I'd like to turn the conference back over to Mr. King for any additional or closing remarks.

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

All right. Thanks, Katie. Thanks, everybody, again for joining us. Again, just a quick reminder -- we will be at the Morgan Stanley conference on November 19. That will be webcast. And for those of you who joined us late, we will be sponsoring an analyst day event in Boca Raton on February 19, and we will be giving out more information about that event in the weeks ahead.

If anybody has got follow-up calls, feel free to give me a call directly. You can reach me at 937-578-5622. Otherwise, thanks to everybody and have a great day.

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**Operator**

That concludes today's conference. We appreciate your participation.

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