

FINAL TRANSCRIPT

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SMG - Q3 2010 The Scotts Miracle-Gro Company Earnings Conference Call

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PRESENTATION

Operator

Good morning, and welcome to Scotts Miracle-Gro Company third quarter 2010 earnings conference call. All participants are in listen-only mode. (Operator Instructions). This call is being recorded. If you have any objections, you may disconnect at this time.

I'd now like to turn today's meeting over to Mr. Jim King. Sir, you may begin.

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Jim King - *The Scotts Miracle-Gro Company - VP - IR & Corporate Communications*

Thank you. Good morning, Tracy, good morning, everyone. I want to welcome you to the Scotts Miracle-Gro third quarter conference call. With me this morning are Jim Hagedorn, our Chairman and Chief Executive Officer, Mark Baker, our Chief Operating Officer, and Dave Evans, our Chief Financial Officer. In a moment, they will begin with our prepared comments, then we'll have Q and A this morning. In the interest of time, I'd like everybody to try to refrain their questions to two per person, and if we don't cover everything during the call, we'll follow up with you in one-on-one calls later on in the day.

With that, let me remind everybody that our comments this morning will contain forward-looking statements. As such, actual results may differ materially from what we discuss here this morning. As a result, we encourage investors to look at the risk factors in our Form 10-K filed with the Securities and Exchange Commission. Any non-GAAP disclosures discussed this morning will also be released on our Investor Relations site at scotts.com.

With that, let me turn the call over this morning to Jim Hagedorn, our CEO.

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

Thanks, Jim. Good morning, everyone. We have a lot to talk about this morning. Record third quarter earnings, the continued execution of our growth strategy, as well as the inflection point we've reached in our capital structure that is allowing us to execute a significant share repurchase, as well as double our quarterly dividend. I'll update you on the state of the business and touch upon each of the key headlines. Mark and Dave will elaborate on the details of our results.

The take-away from our comments is pretty simple. We're having another solid year, and the fundamentals of our business remain strong. My focus is on the progress we're making against our long-term strategy. For our long-term shareholders, I trust the same is true. Against that focal point, everything's good. We continue to see solid organic growth. We continue to gain market share. We continue to see the benefits of innovation. We continue to see strong gross margin improvement.

Our SG&A is under control with non-revenue generating expenses in check, as we invest more heavily in areas that drive the business. Our regional model is already proving successful, and in 2011 we'll open offices in Chicago and New York. We continue the process of remaking Marysville to take more day-to-day responsibilities out of the headquarter's function and put them in the field.

Cash flow remains strong. In fact, so strong we are now in a position to return excess cash to our shareholders. And we continue to place even more focus on our core consumer business, as we evaluate our overall portfolio.

With that, let's focus on our performance. As it relates to the core business, you heard me say repeatedly that advertising matters, that innovation matters, and that feet on the street matter. All of that is true, and there are multiple examples of solid performance this season that prove that point. For example, we still expect the EZ Seed to grow by more than 200%, easily making it our best selling new product ever, and demonstrating the critical role that innovation plays in our business.

Advertising and retailer support was critical once again in our growing media business. Scotts Nature Scapes is up by 23% over last year, and Miracle-Gro Moisture Control Potting Mix increased 10%. We gained more than seven points of market share in grass seed, and nearly three points in growing media as a result of these efforts. We've also seen double-digit growth in our non-selective weed business led by Roundup, as well as our selective weed control business led by Weed-B-Gon.

In our lawn fertilizer, our market share through June has also increased, up nearly 100 basis points. Going into the year, we felt it could slip a bit after the strong gain we made last year. But the in-store support provided by our retailers and our sales force, as well as aggressive locally-focused advertising effort throughout the season prevented that from happening.

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Overall, we believe our market share in the United States improved by 190 basis points through June. That improvement was driven by three points of improvement of market share in the southeast and two points in the southwest. Remember, the goal of our regionalization efforts is to have consistent market share throughout the United States. We started off with markets like the southeast and southwest about 10 points lower than the midwest and northeast. So, we've already made great progress in closing that gap.

While we did see consumer purchase momentum slow as the season progressed, our top-line growth is still ahead of both the 2010 and the long-term expectations we communicated prior to the season. This is despite the fact that our two most cyclical segments, Global Professional and Scotts LawnService, will report close to flat sales growth for the year.

The last time we spoke, POS at our largest US retailers was up 11%, which allowed us to revise our guidance to reflect 7% to 8% sales growth for the year. In June, we adjusted those growth assumptions to 5% to 7% sales growth. We're standing by that guidance today, despite the extreme heat much of the US has endured throughout the summer.

For sure, the weather was oftentimes our foe in 2010, and clearly presented a challenge on a year-to-year basis. But we're in the lawn and garden business, and so we know weather happens. Our job is to run the business regardless of the weather. And I would say our solid organic growth this year proves that we know how to do that.

We did an outstanding job executing against those things that we could control. As Mark will tell you in more detail, our regional offices had some early successes, giving us confidence that the model is headed in the right direction. We also had a good season with our retailers, especially in DIY, hardware, and independent garden centers, all of which saw strong gains.

All in all, I feel good about the season and remain confident about the current and future state of the business, and I feel equally good about other actions we've announced today. We're at an exciting inflection point at our Company. Our business model is evolving. We continue to see solid organic growth. We are increasing our spending in both advertising and innovation, and we have increased our capital expenditures.

We are meeting all of those needs, and still have excess cash. And given the strong state of our balance sheet, we believe now is once again the time to be giving that cash back to shareholders. I've said that advertising, sales support and innovation are all critical to driving our business. But in terms of driving our relationship and value on Wall Street, two other words come to mind, focus and credibility.

Back in 2007, we strategically used our balance sheet to return \$750 million to shareholders through a combination of a one-time dividend and share repurchase. And we did so with the stated goal of growing the business 5% to 7% each year, delivering free cash flow of \$150 million to \$200 million a year, and re-establishing a leverage ratio of about two times within four years.

When we made those commitments, we could not have anticipated the challenges we faced from unprecedented swings in commodity prices, product recalls or the deep downturn in the economy. Yet even in the face of these challenges, we remained focused on driving growth and never lost sight of the commitment we made to our shareholders. And as we now approach the close of fiscal 2010, we find ourselves ahead of our plans, even with a major interruption of our business in 2008. Since 2007, we've used our cash to repay debt, and are on track to finish the year at about two times leverage. This gives us tremendous flexibility to make all of the investments I outlined a moment ago, while also contemplating bolt-on acquisitions.

However, it also allows us to take shareholder friendly actions, so let's talk about those. There are two key messages you should take away from our decision to repurchase up to \$500 million of our shares over the next four years. First, we believe Scotts Miracle-Gro is a truly unique franchise with a strong long-term growth potential. We believe the repurchase of our shares represents good value, one that we believe is often under-appreciated.

Second, there are a lot of things that drive value, cash flow improvement, return on invested capital, as well as steady and predictable EPS growth. The combination of solid mid-single-digit top-line growth, disciplined expense control and putting



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our cash to work through the repurchase of our shares should allow us to generate double-digit EPS growth over the next several years.

As far as the dividend is concerned, I want to leave you with this thought. We plan to have a more proactive policy of managing our dividend in the future. We will benchmark our yield against the S&P 500, as well as our consumer product peers. In doubling the current dividend, our yield will go from about 1% to about 2%.

I want to elaborate on one other point. I want to remind you that our primary focus will remain on our Global Consumer segment. As I said earlier, with the evolution of our business model, we are putting more resources against the core. As we continue an active process of managing the rest of our business portfolio, we'll have that bias in mind. Our consumer business is our heart and soul. That is who we are. That is where we will excel. Our core business offers the highest ROIC, it generates the most cash, and is the segment where our innovation can be put to work in the most productive and profitable way.

There are a lot of other moving pieces and details that are important in understanding our third quarter and year-to-date performance. Instead of shifting gears and trying to cover all these topics, I'll hand it over to Mark, and then to Dave to cover the details. Thanks for your attention.

Now, let me give the floor to my partner, Mark Baker.

Mark Baker - *The Scotts Miracle-Gro Company - COO*

Thanks, Jim. There are three basic thoughts I want to leave all of you with this morning. Number one, it's been a good season. While we've seen some ups and downs as the weather extremes impacted the business, our top-line growth in POS have been right in line with our long-term outlook. We could take this year's performance and repeat it for years and years to come. I'd take it.

Number two, our strategic initiatives are working. I'll share some details with you here in a few minutes that show the impact from localizing the business, allowing us to capture growth we have missed in the past, and that is allowing us to capture market share as well. And number three, the season isn't over. We have a lot of strong Fall programs with our partners this year, and we feel good about the opportunities to drive consumers into the stores later into the season this year, which hopefully will be evident in some of our fourth quarter and first quarter initiatives.

With that, let me share with you a look at the details. After adjusting in our fiscal calendar, sales in the consumer business are up 8% on a year-to-date basis. 100% of that growth is in unit volume. We have seen a significant level of re-engagement with the independents this year, and we've had strong programs, especially in the DIY channel, that has resulted in solid POS growth of 5%, though it has been sharply higher at our two largest retail partners. We've also seen strong international performance, with 21% gain in Canada and an 8% gain in the UK. Overall, we believe retail inventory is in good shape. Several major retailers were light this time last year, and independents were light as well last year in inventory.

Let's break apart POS, starting with the category results on a year-to-date basis. Grass seed up 10%, growing media up 9%, weed control up 11%, plant food up 5%, lawn fertilizer was flat this year, insect control was off by 3%, and wild bird food was down by 10%. Entering the Summer, we had expected this to be a robust insect year because of weather conditions. However, the fire ant business in the southeast has been nearly non-existent. It appears that the harsh winter wreaked havoc on the fire ant population.

Wild bird food is two stories. The decline is due to the commodity business. One of our largest accounts has de-emphasized the commodity business this year. However, the Scotts branded business was up 115% from last year, and we have a strong outlook for 2011.



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If you break down POS by geography, you can see several story lines unfolding. First, the southeast was up 7%, strong local focus has helped us stay in front of the consumer with relevant messages and products all year. Let me give you a few examples by market of what we've seen. Greenville up 12%, Norfolk and St. Pete both up 11%, Greensboro, North Carolina up 10%, Charlotte up 9%, Nashville up by 7%. You get the picture. Clearly, with those kinds of results, pretty obvious that we're gaining share. As Jim said, we picked up three share points in the southeast, and we think a significant opportunity remains ahead.

Let's move on. The west coast was up 6%. We've seen some really strong local successes here. Let me pause for a moment and give you a couple of examples. We told you in February that we were changing the timing of our media buy in Sacramento as part of a test. We thought we were advertising our early feed and fertilizers in a product called Halts too late in the season. We thought we could grow the business by changing the timing of our advertising, and we were right.

Here's a breakdown of Halts POS. In the nation, it was flat. California, excluding in Sacramento, was up 3%, but Sacramento through April was up 28%, and now year-to-date is up over 43%. Sacramento is the best performing D&A in the country for Halts this year, so there was a key learning here that we will try to apply to other markets going forward.

Here's one more example. A lot of you asked whether regionalization would create a lot of new SKUs. We said it would not. And most of the changes we're labeling, we use Roundup as an example in the Pacific Northwest. We said we believed in changing the label of our poison ivy product to focus on wild blackberry bush, that product would resonate with our consumers. We did not create a new product in the Northwest, we changed the label. POS of Roundup in the Pacific Northwest is up 240% over last year. This was the best performing Roundup SKU and the fastest growing region in the country any other product. So again, meeting the needs of local consumers is critical for this business.

Let me quickly look at the rest of the country with you. The southwest was up 5%. A really tough start to the season and nearly nonexistent fire ant business, we've seen solid and steady progress over the past several months.

The northeast up 6%. Once the season started, it has been fairly steady. There are a lot of independent retailers in this region as well, whose numbers are not included in our POS data. We know these retailers had a great season as well.

The midwest was only up 2%. Jim talked about weather. Well, here it is. After a great April, the weather in the midwest has been mostly miserable, cold and wet in May, record heat, as many of you know, in June and July. However, this is a strong region for Fall business. We hope to see some improvements by the end of the season.

I want to make one further point on POS. And this is once again intended to further dispel any concern about our tie to housing or the overall economy. While the economy isn't really strong anywhere, let's look at where the economic pain has been the worst. Florida, California, Nevada and Pennsylvania, all tough markets, all up over 6% year-to-date in POS. Michigan, as we pointed to last year, up 5%. Michigan has had double-digit unemployment, is the best performing state in the midwest.

I know your interest is already looking ahead to next year, so let me share with you some early thoughts. First, our line reviews with our retail partners are complete, and I am confident they will remain engaged in the category, will make strong investments that get the consumers focused on our brands. Again, in 2010 they saw their investments pay off, and I expect them to continue to invest in our brands like ours that they can rely on to drive foot traffic.

I know there was speculation last week about our private label business at Walmart for next year. At this point, it appears that Walmart may will select another partner for some of this business. As it relates to 2011 results, the impact should be fairly modest, given the timing of any changes.

Second, we have engaged in pricing discussions with our retailers, and have communicated our intent to take modest pricing next year. We will not break this out in detail, but I will tell you we are talking about low single-digit increases in selective categories. Third, by the end of the Summer our regional offices in Chicago and New York will be up and running. Unlike the



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other regions, we don't anticipate these teams to be focused on market share gains. Instead, we see them working on driving overall category growth in all channels of trade.

Fourth, Jim mentioned that our efforts to remake Marysville will continue. We continue to believe that we can keep non-revenue generating G&A roughly flat again next year to get further leverage out of the P&L.

And fifth, we're confident that our long-term growth expectations of 4% to 6% of the top line are appropriate entering next year. I don't see us deviating from that outlook. So, all in all, I agree with Jim about our solid performance in 2010, and the outlook as we prepare for next year.

Now, let me turn the call over to Dave to share financial details.

Dave Evans - *The Scotts Miracle-Gro Company - CFO*

Thanks Mark, and good morning, everyone. As you can probably tell from Jim and Mark's comments, we're feeling positive about the business with a lot to talk about.

Our third quarter financial results were strong, and when combined with the first half, give us confidence on delivering within our full-year guidance of \$3.25 to \$3.35 per share. These results represent about 25% growth versus prior year, and well over 50% growth over the prior two years, doubling our dividend and initiating a share repurchase program, reflecting our long-term confidence in delivering strong and consistent cash flows, while continuing to increase investments in the sustained growth of the business. And we're bullish on the prospects for the future, the upcoming Fall season, 2011 and beyond.

I want to touch on each of these topics, but let me start with the quarter's results. Remember, similar to our discussion at the end of Q2, we experienced a shift in the 2010 calendar that, because of our high seasonality, influences year-over-year quarterly comparisons. This year's third quarter had the same number of days as the prior year, but gained one week in July while losing one week in April.

And when we talk about the fourth quarter, remember there will be five fewer days in the fourth quarter fiscal 2010 than fiscal 2009. We shipped \$38 million in those same five days last year. So, on a reported basis, net sales for the Company were up 1% in the third quarter and 8% year-to-date. After normalizing for the calendar shift, consolidated sales increased 5% for the quarter and 7% year-to-date. Changes in foreign exchange rates had a negligible effect on sales for the quarter, but contributed 1% to the year-to-date growth rate.

For Global Consumer, third quarter sales were up 5% on a normalized basis, with increases of 5% from the US and 8% internationally. Changes in foreign currency had a negligible effect for the quarter. Mark already provided color on the growth within Global Consumer by brand and region, so I'll move straight to Global Pro which reported sales growth of 3% for the quarter and 4% on a normalized basis, both of which were net of changes in currency, which reduced growth by 4%.

We saw good fundamentals in the Pro business this quarter, with a unit volume growth of 19%, offset by a 12% decline in selling prices. The decline in selling prices was driven by lower year-over-year material costs, and as evidenced by 190 basis point improvement in gross margin rates within Pro, the team did an excellent job successfully navigating within this environment. Scotts LawnService also contributed to third quarter growth, and we saw improvement in almost every key metric, including customer count and retention, strong leading indicators of future growth.

Sales for the quarter were up 3% on a reported basis, and 4% on a normalized basis. This is the first quarter we've seen top line growth in the segment, since the second quarter of 2009.



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Moving on to gross margin, reported rates improved 210 basis points in the quarter. The improvement was 180 basis points after adjusting for non-recurring costs associated with product recall and registration matters. All business segments reported some gross margin rate accretion, primarily from lower input costs and cost productivity improvements, partially offset by increased freight costs.

SG&A was down nearly \$9 million, at 4% for the quarter. We continue to see the benefits of carefully managing overhead expenses, and redirecting spend toward revenue enhancing activities like advertising, selling and marketing. Lower variable compensation expense was the primary contributor to the reduction in SG&A this quarter. And finally, as expected, interest expense declined, primarily as a result of lower year-over-year borrowings, with average daily debt down \$190 million on a year-to-date basis. All in all, we finished Q3 with adjusted earnings of \$2.61 per share, 11% higher than last year, and another strong quarter.

Let me briefly touch on balance sheet highlights. We saw a decline of \$82 million to accounts receivable, despite the growth in sales. FX contributed \$15 million to the decline. The balance was primarily a result of the front-loaded nature of the quarter's sales. Recall that April POS was tremendously strong, driving sales early in the quarter which were substantially turned to cash prior to the end of the quarter.

Inventories were down \$86 million. Currency contributed \$7 million to the decline. The balance was accounted for by the elimination of Smith & Hawken inventories, and lower year-over-year material costs, partially offset by a small increase in units.

Total debt net of cash declined \$360 million, reflecting our strong earnings and working capital improvements. Our debt to EBITDA leverage ratio declined to 2.1 times at the end of the quarter, ahead of plan.

So as we look ahead to the fourth quarter and full year results, I wanted to provide some updated direction. We are still guiding to full-year consolidated sales growth of 5% to 7%, with Global Consumer driving this growth. While consolidated year-to-date sales were up 7% after adjusting for the calendar shift, retailer inventories were seasonably high at the end of the third quarter. As a result, we are expecting sales to trend to the midpoint of the range by the end of the fiscal year, as retailer inventories are reduced through the fourth quarter.

Our adjusted gross margin rate was up 50 basis points through the third quarter. We expect this rate to continue to improve in the fourth quarter, primarily in the Pro business where the margin pressures from last year have lessened as commodity costs have stabilized. As a result, full-year margin rates should improve an additional 20 to 30 basis points over the year-to-date rate.

SG&A is also on track, up 2.6% so far this year. We expect the full year to be about the same. Rest assured that we'll accomplish this as we said we would, increasing our rate of spend in areas that enhance revenue, while keeping everything else as close to flat as possible.

No surprises with interest expense. It should be \$50 million or even slightly less for the full year. We do see some upward pressure on our effective tax rate. We now expect a full-year rate of around 37%.

This increase of 110 basis points over last year is principally the result of three factors. First, the newly passed Medicare law will contribute to approximately half of the increase. Second, states are reacting to ballooning budget deficits by raising corporate taxes. And finally, Congress has not yet renewed the R&D tax credit. Combined, these three will increase our rate in 2010.

Pulling it all together, results in full-year adjusted earnings guidance of \$3.25 to \$3.35 per share. As you know, today we reported \$3.71 per share through June. This means that despite a number of puts and takes, our loss in Q4 will be approximately the same as last year. In addition, we're reaffirming our estimate for free cash flow. We'll generate no less than \$200 million this year, while also increasing our capital expenditures to about \$80 million.



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And consistent with our third quarter, leverage should finish the year around two times EBITDA. As a result, we're able to double our quarterly dividend to \$0.25 per share, starting with the September payment. This will bring our dividend yield more in line with best-in-class CPG companies in the S&P 500 average.

We're also launching a four-year \$500 million share repurchase program. This will be part of a long-term sustained strategy to return cash to shareholders, all while continuing to invest in the long term health and growth opportunities of the Company. We will do this within the context of maintaining a strong balance sheet with near investment grade credit ratings, and leverage generally in the range of 2 to 2.5 times.

We expect to start slow with the share repurchase, and accelerate momentum over the four-year period, with a plan that I would categorize as a blend of both programmatic and opportunistic tactics. And we will always preserve the ability to suspend the program at any time if circumstances warrant. Both the increased dividend and share repurchase demonstrate our continued confidence in the consistent and strong cash flows generated by the business.

In closing, I want to reiterate our collective confidence in the future of our Company. We're in a unique position at a unique time in our history. We've never been stronger from a brand perspective, market share perspective, innovation perspective and financial perspective.

With that, I'd like to turn the call back over to the operator for questions. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Jeff Zekauskas with JPMorgan. Your line is open, sir. Go ahead.

Jeff Zekauskas - JPMorgan - Analyst

Thanks very much. Good morning.

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

Hard name to say, I guess.

Jeff Zekauskas - JPMorgan - Analyst

Yes. With practice, it gets easier. In terms of your share repurchase, your shares outstanding have moved up a little bit over the past year and a half. So, if you were to buyback order of magnitude 10 million shares over the next four years, what do you think the net reduction in your share count would be?

Dave Evans - The Scotts Miracle-Gro Company - CFO

Jeff, what I would say is that each and every year, if you look at our history, disregarding the price volatility we had over the last couple years that changed the trend a bit, in general, we're increasing our share count a million to a million and a half shares a year from equity grants and equity exercises. For 2011, I would expect that the shares we repurchase, which remember are going to be on a weighted average basis, will fairly neutralize that increase in share count from equity grants and exercises. Once you get beyond 2011 then, when we start seeing the full-year impact of share repurchases, we should see some slight



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reduction in our share count on a year-over-year basis. I think 10 million shares sounds like a lot. But over the four-year period, maybe we see a \$2 million to \$3 million reduction in share count over the four-year period.

Jeff Zekauskas - JPMorgan - Analyst

Dollar or share count?

Dave Evans - The Scotts Miracle-Gro Company - CFO

Share count.

Jeff Zekauskas - JPMorgan - Analyst

And then for my follow-up, since you forecasted your share repurchase over a multi-year period of time, do you have a sense of your capital expenditures over the same period? You're going to move up to about \$80 million this year. Over the next three or four years, what's the general shape of your capital expenditures as best as you can say?

Dave Evans - The Scotts Miracle-Gro Company - CFO

Well, what you've seen over the last couple of years is a progressive increase. If you go back two to three years ago, we were spending \$55 million to \$60 million. Last year was north of \$70 million. This year's going to most likely touch \$80 million. And I think what I'd tell you is we have a pretty strong and robust pipeline of capital expenditure opportunities within the heart of the business, which have historically given us above average returns.

I would see that over this period of time of four years, we're going to continue to increase that CapEx, and probably over the cycle, we'll average closer to 3% of our top line. So, you could see a spike in any one year of \$10 million to \$20 million if we bring something significant online. It's probably going to start to touch the \$90 million neighborhood, and possibly higher in the fairly near future.

Jeff Zekauskas - JPMorgan - Analyst

Okay, thank you very much.

Mark Baker - The Scotts Miracle-Gro Company - COO

I just want to add while we're on the subject, that my demands on the operating team is IRRs north of 20% on capital investments. So, I think what we're seeing is that we have quite a nice queue of internal projects that are high return and, from our view, low risk compared to buying somebody else's problems. So, we've got a nice group of our own stuff we can do, which we think is a higher return and safer.

Jeff Zekauskas - JPMorgan - Analyst

Okay, thank you very much.

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Mark Baker - *The Scotts Miracle-Gro Company - COO*

You bet.

Operator

Our next question comes from Sam Yake with BGB Securities. Your line is open. Go ahead.

Sam Yake - *BGB Securities - Analyst*

Yes, thanks for taking my question. You guys are doing a really terrific job.

Mark Baker - *The Scotts Miracle-Gro Company - COO*

Thanks. Thank you.

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

I'm glad we put you second then.

Sam Yake - *BGB Securities - Analyst*

I was just wondering if there's anything further you can add on your thoughts about possibly retaining or possibly selling the Global Pro and the SLS businesses.

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

Well, maybe I'll start with SLS, and the SLS business is a business that continues to do better than we thought, given the difficult time for people who would have it done for them, meaning it costs about 10 times more to do it for me than if they do it themselves. This year, we're actually seeing customer count improve, which is something we haven't seen for a bit, and we're seeing record profits. So, it's a business that I think as Mark and myself and the rest of the team talk, we argue about is it consumer business, i.e., is it core or not? In regard to our Professional business, I would say that's an argument we're beyond, is that, is it a core business or not, to us. I think it's a good business. I'm not sure that we are the best owner necessarily, of that business. So, it is a business that we are very carefully looking at, where it should be or not into our portfolio. And I would say, consist with that, that we, from time to time, evaluate the opportunities from our non-consumer business and product lines, and we are exploring our strategic alternatives in regard to that business.

Sam Yake - *BGB Securities - Analyst*

Okay, thank you. And I had one other question. It was amazing to me you had such a great year with the EZ Seed, and I think you had made some previous comments that it didn't cannibalize your current grass seed sales all that much. Could you offer some thoughts on how much of the \$75 million plus in EZ Seed sales cannibalized other sales versus you actually grew the grass seed market?



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Dave Evans - *The Scotts Miracle-Gro Company - CFO*

The great story on EZ Seed, I don't think we've found the top on that either. We started with it last year, call it \$20 million. This year, call it \$65 million to \$75 million. So once again, speaks to innovation. I think the number one thing that's important, is it's brought a lot of new people to the category that had left the grass seed category. But certainly there's probably a 5% cannibalization, or something to that magnitude. I think what's messy in the numbers, there wasn't particularly a great grass seed season in a lot of the markets as well, so it wasn't as clear that there was huge cannibalization on that number. As much as 50 in some categories, but I think the difference is, again, we're selling a value-added product with high degree of success that our grass seed business overall grew, so it helped the category. There might be some cannibalization --

Mark Baker - *The Scotts Miracle-Gro Company - COO*

Yes. I would add as well, that it's accretive both to our top-line growth, but also to our gross margin rate growth, as we're seeing some healthy mix improvements in our portfolio this year. Some of which are being driven by this EZ Seed launch, and it's not just in the US. We're seeing similar launch in Canada and the UK that are having some very strong effects in those non-US geographies as well.

Sam Yake - *BGB Securities - Analyst*

Okay, thanks so much.

Operator

Our next question comes from Alice Longley with Buckingham Research. Your line is open.

Alice Longley - *Buckingham Research Group - Analyst*

Hi, good morning. I got cut off, so I hope I don't ask a question you've already answered. But losing some business in Walmart, will that take maybe a point off sales next year? What's the magnitude of that hit?

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

Only because this is one of those ones that actually, I got some sort of burn over. The issue of our private label business, I want to deal with right up front, which is that I like the business, I think strategically, it's good for us. Retaining that business, if it was possible to have retained it, would have been -- what I'm saying is the effect on the profit line of not taking that business is small.

Alice Longley - *Buckingham Research Group - Analyst*

Okay.

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

So, the top line effect, I actually don't know what it was. Somebody else can throw that out. But the bottom line effect was minimal, and so, we've had a great year. Walmart is committed to our branded business, and we have, I think, excellent programs in the queue for next year in regard to our branded fertilizer programs. So, I feel very good about that. I do like the private label

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business, largely because we have one truck coming in, we can deliver everything together, it's more efficient for them. There's a lot of benefit to it.

But if you're going to get down to auctioning off the business for low value, it's a business that we don't need. And you guys have heard me say, it's easy for us to go down, it's not easy for other people to come up to us. And so, I view it as okay business, I like it. It's efficient for us, and I think it's efficient for the retailers. But the retailers can make the choices they want, and there's a price below which we're not going to do it.

Alice Longley - *Buckingham Research Group - Analyst*

Great. Okay. And then my other question is about your plans for increasing support going ahead. Can you tell us what we should assume for your marketing ratio? Will it be intensified in fiscal 2011 or not? And also, your sales force, the people you put in your stores, could you give us an update on what those plans are and whether that kind of spending will be intensified?

Barry Sanders - *The Scotts Miracle-Gro Company - EVP - North American Business*

Hi, Alice, this is Barry Sanders. We will continue to invest in improving our A to S ratio. We've said on an ongoing basis, we'd like to get that number up to in the 6% to 6.5% range next year. We will continue to invest and make incremental investments into media. Now, from our regionalization standpoint, each region is looking at DMA by DMA what kind of support they need, and they're optimizing that spend. And we're right in the middle of that. But going forward, I think what Dave has said is we're going to hold our G&A flat, we're going to invest in sales, marketing, and R&D, and you should see our overall SG&A grow at about half the rate of our sales and that'll all be in marketing sales and innovation.

Alice Longley - *Buckingham Research Group - Analyst*

And the compensation ratios will be flat next year? Those aren't going up or down?

Dave Evans - *The Scotts Miracle-Gro Company - CFO*

That's right. So, what that means, Alice, is over the four-year plan period, we're committed to growing our aggregate SG&A at half the rate of sales growth. So, we're going to earn the privilege of investing more strongly on things like media and like selling and like R&D by getting more productivity out of the non-productive G&A. So, that is our long term plan and our goal.

Alice Longley - *Buckingham Research Group - Analyst*

And so the selling is ratio part of the expenditures that will be intensifying?

Dave Evans - *The Scotts Miracle-Gro Company - CFO*

I think selling is one of the areas we view as core competitive advantage, and one that we like to continue to strengthen.

Alice Longley - *Buckingham Research Group - Analyst*

Excellent. My final question is independents POS, as well as you know at independents, what has that been year-to-date?

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Barry Sanders - *The Scotts Miracle-Gro Company - EVP - North American Business*

Alice, we don't get the POS is from the independents. We think overall they had a good year. The folks that we do see their numbers, they were at equivalent to where we were at or better in some cases on the hardware guys and at some of the bigger independents.

Alice Longley - *Buckingham Research Group - Analyst*

Meaning your POS, you think is up in line with your POS at your three largest customers?

Barry Sanders - *The Scotts Miracle-Gro Company - EVP - North American Business*

Correct.

Dave Evans - *The Scotts Miracle-Gro Company - CFO*

At least, I would say.

Barry Sanders - *The Scotts Miracle-Gro Company - EVP - North American Business*

At least.

Alice Longley - *Buckingham Research Group - Analyst*

I thought they were growing faster this year, but, anyway.

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

Well, I think what we said was that the independents, hardware and DIY had good years.

Alice Longley - *Buckingham Research Group - Analyst*

Okay. Thank you.

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

Yes.

Operator

Our next question comes from Bill Chappell with SunTrust. Your line is open.

Mike Swartz - *SunTrust Robinson Humphrey - Analyst*

Hello, good morning. This is Mike Swartz filling in for Bill.

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

Hello, Mike.

Mike Swartz - *SunTrust Robinson Humphrey - Analyst*

Just looking at the gross margin improvement on the quarter, how much of the improvement would you attribute to favorable mix versus lower costs versus regionalization savings? Just trying to get a feel for how much of this is sustainable going forward.

Barry Sanders - *The Scotts Miracle-Gro Company - EVP - North American Business*

Well, I have not broken out each of those pieces parts, but I would be -- I would tell you that the ability to maintain pricing in a falling commodity environment this past year is probably the single largest driver. The second then would be mix, which is, I would say, partially attributable to our innovation investments. I think third then, is going to be the continued productivity improvements in our supply chain. So, if you look forward, and your question is really what's sustainable over the long term, I'd take you back to what we said back in February at our annual investor conference, where we talked about over a four-year period trying to drive the 200 basis point improvement in gross margin rate. So, I'm optimistic, and I think we have good plans next year to take another step in that path. So, that's to tell you that we believe that there are sustainable improvements that we can drive through cost productivity and through innovation and mix, and that's what our target is for next year. And we're well on our way.

Mike Swartz - *SunTrust Robinson Humphrey - Analyst*

Okay, great. And then one final question. Taking a step back and looking at the overall lawn and garden season, and I know that the season isn't completely over, how would you characterize it? I know early season was stronger than some of the trends you saw in May and June, but how do you feel the overall season went? And looking forward to next year, is this a very difficult comp, looking at the 2011 season?

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

Actually, it's a bunch of questions within one right there, good dude, but I'd start by saying, I think what Mark said was just that would we take this year every year? To me, the answer is yes. It was a good solid year. I think we went through a period there in April where it was euphoria around here, and then I'm going to say we've been working harder than we thought we were going to for the latter half of the lawn and garden season. But, that being said, I think we saw solid share gains, we saw good organic unit growth, because remember, there was effectively zero pricing in there. So, our growth is unit volume growth. We saw a good mix, especially with new products that came out that were innovative. And so, overall, I would say any time where you have just unbridled euphoria and that -- you come back to reality, it was a little bit of a bang on the head. But that being said, it was good year.

And I think you have to look at our peers, if that is such a thing, but the other players in lawn and garden, and you'll see that -- I don't think they had the year we did. So, I feel pretty good about it, and I feel that if you look at us compared to other consumer market companies, I think we're also a really good performer for anybody in consumer goods. So, I'm happy about it.

Mark Baker - *The Scotts Miracle-Gro Company - COO*

I'd just add to that Jim, that probably the number of really good weeks of weather were probably relatively small, and yet, I think it shows the nimbleness of our regional players. It wasn't very good January, February, early part of March in any of these



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Southern markets where we just had to move the business and react to it, what was available to us and get it back. And I think that goes to the operating model and our ability to go after the business when it is available. So, it was a good year, but it wasn't necessarily one that I'd put down as a great weather year for our business.

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

Just to editorialize a little bit, just for grins, I would say that it tells you that this is not a business for folks who don't like a roller coaster rides. Mark's right. The beginning of the season was pretty squirrely. If you looked at what happened to the business and to our sales for the year in April, it was huge increase. If you look at some of those regions.

I mean, Mark's done an excellent job of getting out -- and Barry and the whole team on the operating side -- of getting out in the field. He went out to the Southwest, he didn't like what he saw, he made some changes, and that region, a single region, but it's a region we need, that region had significant, I think right now it's probably the number one region in the country. And that all occurred after what would we would normally think is the peak of the season. So, this is not a business for the faint of heart. And I think that those of you who are shareholders ought to feel good about your management team, and I feel good about my partners here, that we can operate a business that's not static. The lawn and garden business is not a static business. I'm done.

Operator

Would you like to go to your next question?

Jim King - *The Scotts Miracle-Gro Company - VP - IR & Corporate Communications*

Okay.

Operator

It's from Jim Barrett, CL King. Your line is open.

Jim Barrett - *CL King & Associates - Analyst*

Good morning, everyone.

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

Hello, Jim.

Jim Barrett - *CL King & Associates - Analyst*

Jim, given the strong resilience the brands have had with the consumer during the downturn, the value added to the retailers, has the Board or Management considered taking more than modest price increases in selected categories next year? It would seem as if you have some latent pricing power that continues not to be realized.

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

Everybody would say, no, don't take the bait. Let me start by saying, we know we have some cost increases coming our way. And for sure we're not going to let that effect our margin. We're, I think, taking some modest pricing. I think Mark has said is that those discussions are mostly complete. We still have some open discussions to have.

I think what's different, I would say, is that back in the heyday where there was just a huge amount of retailer power, and this is not a criticism or any sort of ding at our retail partners, they are hugely important to us, and largely responsible for working together with us to drive this business. And so, I want to thank them all. A lot of them have said, do what you want to do, and so, this drives the issue back to us to saying, we're a consumer business. This is not a -- it's not about us and the retailer, it's about consumers. And so, I think as an economic issue, it's a supply and demand deal, and we ought to get what we can get for our products. That being said, we're operating at a time of historic consumer weakness and so it just puts more pressure on us to not make a mistake here. And I do want to say that everything we talk about with the retailers depends on how the consumer behaves. And if the consumer is not up for pricing, then we'll do what we have to do to get back in line.

So, I don't think we're afraid to be alone on pricing, especially where we see cost increases coming down the road. On the other hand, if the consumer is not willing to pay that price, and we see differentials get to a point where we're not comfortable, we'll make adjustments in season if we have to. So, I think we're trying to be responsible. We're trying to act as leaders here. If we can get pricing, we'd like it, and we think we have good reason for it. Remember, we're talking very significant increases in our advertising, very significant increases in our innovation efforts, very significant increases in our sustainability efforts. And as we do these things, more feet on the street, we think it's important to driving value of the business, and we need to pay for those things. It's a matter of jet fuel. But again, at the end of the day, it comes down to consumer, and we are keenly aware that it's about driving sales. And so we'll see what happens there, but we're not afraid to go alone on this.

Jim Barrett - *CL King & Associates - Analyst*

Okay. Thanks, Jim.

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

You're welcome.

Operator

Our next question comes from Eric Bosshard with Cleveland Research Company. Your line is open.

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

I can't even believe we're letting you ask a question, dude.

Eric Bosshard - *Cleveland Research Company - Analyst*

I appreciate that.

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

Just kidding.



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Eric Bosshard - Cleveland Research Company - Analyst

Two things I'd love to understand. First of all, I think you commented that inventories were a little heavy at retail to end of quarter. Can you just expand on why they are heavy and how that works out from here?

Mark Baker - The Scotts Miracle-Gro Company - COO

Eric, it's Mark, and Barry can finish it out. Inventories that we believe might have been just compared to the last year a little bit higher. But you've got retailers, in particular, our big ones, running solid increases, very significant increases, so we don't feel like the inventories are out of proportion necessarily to sales, but they're higher than last year. As you wind through the season, we may make an adjustments based on calendar cut-offs, how much we actually ship in, in the fourth quarter. But we feel pretty good about the landing spot for the retailers are, and then their commitment for where they're going to go into what we call our fourth quarter and the beginning of our first quarter in terms of their commitments to promotions for the fall. So, you might see slightly higher inventories as we get into the fourth quarter, but we feel that they're in the right place. Barry?

Barry Sanders - The Scotts Miracle-Gro Company - EVP - North American Business

Yes. Coming out of the spring, we're in good shape. The summer has slowed down a little bit, and we'll net that out in the fourth quarter and end up where the retailers want to end up by the end of September.

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

But, from my point of view, as we have spent weeks getting ready for this call, while we would say inventories are higher than last year, we all agreed at the time, things have changed. We did not feel inventory was out of line. So, we feel like inventory levels are okay, just higher than last year, that's all.

Eric Bosshard - Cleveland Research Company - Analyst

And then secondly, you gained seven points of share last year and two points of share this year. When you gain share you generally gain versus private label. When you look at the Walmart, the slight loss of business at Walmart on private label, can you just expand a little bit on your thoughts of is this one off, does this mean that private label competition is going to become more meaningful at Lowe's and or perhaps at Home Depot? How do you think the story plays out from here?

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

I'm glad you asked that question. First, our branded program for Walmart as I understand it for 2011 is awesome. So, we'll start with that. And the loss of that business on a margin basis is -- I'm going to call it insignificant. The decision by Lowe's, which I think I read in your report, so I'm making the assumption it's true, but that they've stepped back from the Pennington brand, is a rational one because it looks like it's been sitting around to me.

So, I'm just talking about somebody who walks the stores, I think they're probably better off with Stay-Green than they were with the Pennington Select. I think that's the brand that they were using. So, I think that they could have called me earlier and asked my advice. I would have told them that a year ago. Our program is super solid with Home Depot. I think they're very happy with how that program is working.

Your report says that our multi-year program with them comes to an end next year. This is not to say we lose it, but it's to say they have an opportunity to talk to us about the program at the time that the contract is over, and I think we expect that. So,

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there's no surprise there. Just in regard to private label, a private label program is important to retailer margins. We know that. This is one of the reasons that we are cool with the whole gig. Without private label, retailer margins don't look as good as what they need and want. And so, we have made it our mission to help them have a robust program.

And I think when they do, they generally are more excited is about their entire lawn and garden program, plus their branded business, and tend to get more aggressive in driving their branded business when they know their private label program is solid. So, we don't have an issue with retailers being successful with private label. We know it's important to them, and therefore, it's important to us. We think we can make it more efficient for them. I think the decision that Lowe's made was totally rational and as far as I know, we have a solid program with Home Depot that there's an opportunity to discuss it again after next year. And we have always expected that. So, that's my view on it. I don't know if Mark and Barry feel differently.

Barry Sanders - *The Scotts Miracle-Gro Company - EVP - North American Business*

Eric, I think in the line review process, there's puts and takes every year. We think once again this year will be -- there's some takes, but there's a lot of puts as well to us and we think we'll have some net gains this year going forward. So, I think overall that'll play out in our favor. But I do think the thing to focus on is, when we talk about our spending on innovation, on the consumer and so forth, our focus, our market shares are fine, and we think we'll gain share again next year, but our real focus is not on trying to maintain our gross share, it's trying to grow the category. And we think, when you look at the penetration of this category, you look at the innovation we're bringing out, you look at the investment in marketing, our real focus is kicking the category growth up hundreds of basis points, not necessarily trading a few minor basis points of share here and there on private label. So, overall our net is up, and we're going to focus on growing the category next year.

Eric Bosshard - *Cleveland Research Company - Analyst*

Very good, thank you.

Jim King - *The Scotts Miracle-Gro Company - VP - IR & Corporate Communications*

Tracy, do we have any other questions?

Operator

Yes, our next question is from Olivia Tong with Bank of America Merrill Lynch. Go ahead. Your line is open.

Olivia Tong - *BofA Merrill Lynch - Analyst*

Thanks. Just quickly, first on margins, gross margin sounds like you took your outlook down just by a little bit. Is that primarily raw materials, or is there any change in your expectations for mix or productivity or promotional environment?

Dave Evans - *The Scotts Miracle-Gro Company - CFO*

Hello, Olivia. I'd say it's a little bit of all the above. I think back the last time we spoke, we said up to 100 basis points, and that was up from 50, which is where we were in our previous guidance. To me, it feels like it's going to land somewhere in the middle of those two. It's just the way the season has played out with the mix of products, both by customer, by product and by geography. We've seen some movement.



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Olivia Tong - BofA Merrill Lynch - Analyst

Is there anything that -- is there any one particular category that was a little bit more surprising than the other?

Dave Evans - The Scotts Miracle-Gro Company - CFO

Well, I'd say that they're all up. So, we're really pleased with every one of our business segments seeing accretion this year over last year. So, it's been nothing but good news and one we hope to continue through next year.

Olivia Tong - BofA Merrill Lynch - Analyst

Okay. And then just two other questions. First, on -- from this point forward on dividends, should we assume that dividends should probably grow more or less in line with EPS growth? And then on advertising, you had mentioned a target longer term of 6% to 6.5%. What was the spending level this quarter, and where do you think A&S will round out to for the year and what timing on a 6%, 6.5%?

Dave Evans - The Scotts Miracle-Gro Company - CFO

Olivia, we're building long-term plans. We're really focused on long-term changes. Our advertising is closer to 5% now than 6%, and I would say over this planning horizon, the assumptions we build in, we try to get to 6% or 6.5% would be our goal. I would just add one more. So, this year we've seen growth in our media. I expect for full year we'll see about 14% growth in our full year media spend on a consolidated basis.

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

So my view of, since we just came out of a long and positive board meeting, the dividend is one of those things that, except for extraordinary things, and you saw that with some companies in the financial crisis that canceled dividends, I think it's extraordinary thing to stop a dividend. We believed as we looked at it, that a 1% return on the dividend was below our peer group of consumer companies, and not really where we wanted to be, and that it should be higher. Taking it to 2%, without making any commitments, it's a little bit of a journey. As we look at our peer group and the S&P, I think there is possibly an opportunity to raise it, but that's something that we'll have to look at over time and talk about with the Board, but it's clearly was part of our discussions. In regard to the repurchase, this gets back to saying, look, how do we use our of excess cash? Especially where when we get to a -- call it a leverage ratio of call it below 2.5 times, so call it two times. The really doesn't matter what, but it's at a point where it's well within what we consider our sweet spot and gives us a lot of opportunities.

I think we want to grow our business. And so, you're seeing us raise our innovation efforts, you're seeing us raise our capital investments with -- we've preserved the ability to do acquisitions that are strategic, they fit into exactly what we're doing. You run them through the same sales force. What I'd call bolt on acquisitions. We know our weighted average cost of capital, call it 9%, something like that. And our view is if we can't earn more than our cost of capital with our excess cash, we should send it home. And I think that -- so in regard to our earnings, if we don't have a good use for that money, and our leverage is low, I think our plan going forward would be to send it home. And I think that's what companies should actually do with it.

So, that's where we're at. But for now, I think coming from no repurchase to \$500 million over four years and doubling the dividend, I think it's really good progress going forward, and it depends on what we see going forward. But I think as a method of just looking at it, we ought to be able to earn more than our cost of capital on the money, and if we can't, we send it home. And this is not a bad thing. We're really focusing on the core, and we've got about as much growth, I think, internally as we can handle. And so this is a very nice time to be working at the Scotts Company.



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Olivia Tong - BofA Merrill Lynch - Analyst

Got it, thanks much.

Operator

Our next question is from Patrick Trucchio from BMO Capital Markets. Go ahead, your line is open.

Patrick Trucchio - BMO Capital Markets - Analyst

Hi. Good morning. First, could you tell us what the gross margin outlook for next year would be based on where commodity costs are now and then how commodity costs are expected to flow through next year?

Dave Evans - The Scotts Miracle-Gro Company - CFO

Yes. So, what we're not doing on this call is giving discrete guidance for next year. I'd fall back to the longer term guidance that we provided last February. And again, in February, I think we hinted that the 200 basis point improvement could actually -- we were hoping to be more aggressive in even front loading some of that improvement. We do see cost increases, next year so we know commodities like fuel are up. We know byproducts of fuel, like resins for bags and bottles are going to be up. So, we're trying to manage that.

We're actively out locking ahead, as we've done in prior years, to manage that in conjunction with the price discussions we're having with our retailers. So, I think I tried to answer the question earlier which is I feel confident next year we're going to continue to see some growth. But the growth is really more focused on our cost productivity improvements from things like our regional supply chain and from mix improvements driven through innovation. And I think as we get on our November call, we can start to become more and more discrete about specific guidance for next fiscal year.

Mark Baker - The Scotts Miracle-Gro Company - COO

But I do think that in regard to the overall P&L, that I think it was in Mark's script, that we're looking for -- because part of what we did at this last board meeting was set expectations. The budgeting process is not done for next year, and so we'll know more about margin as we go forward and I think typically, whether it's November or when we do the visit with our investors in New York, we talk more about where we feel about the 2011 budget and going forward. But that being said, I think we presented and the Board has set expectations of call it roughly mid-single-digit top line growth and double-digit earnings growth as what the expectations are of what the budget process will result in. And so -- and we view that as a multi-year commitment as we go forward. So this is -- I think we're in a good place, and margins, all things being equal, shouldn't hurt us.

Patrick Trucchio - BMO Capital Markets - Analyst

Okay. And if our model is right here, as we look at your outlook for the full year, it implies a fourth quarter increase in SG&A compared to sales of about 200 basis points. Could you outline what the components are of that increase?

Dave Evans - The Scotts Miracle-Gro Company - CFO

Not sure what your model is showing, Patrick, but in my script what I said was I would expect our full year growth in G&A to be very consistent with our year-to-date June growth in SG&A. Now, as a ratio, it is going to go up because our sales for the fourth quarter are actually going to be, because of this calendar shift, we're going to actually see most likely a decline in year-over-year

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sales. But at this point in year, I wouldn't expect -- so the rate as a percentage of sales will go up, but the full year, I would expect to approximate our year-to-date growth in G&A in total of about 2.6%.

Patrick Trucchio - *BMO Capital Markets - Analyst*

Okay. And then, just lastly, do you have the normalized quarterly EPS figures that would be adjusted for the calendar shifts in 2010, just so we have comparisons for next year?

Dave Evans - *The Scotts Miracle-Gro Company - CFO*

So, next year, I don't think you're going to have to worry about that any more. That it will probably be five to six years from now when we'll talk about that. Because, now next year, the calendar will shift one day. So, we're going to have good comparative year-over-year quarters again next year. And we will again until 2015.

Patrick Trucchio - *BMO Capital Markets - Analyst*

Okay. Great, thanks so much.

Jim King - *The Scotts Miracle-Gro Company - VP - IR & Corporate Communications*

Tracy, I think in the interest of time I think we have time for another question two are at the most, so just whoever is next.

Operator

Our next question is from Jon Andersen with William Blair. Go ahead. Your line is open.

Jon Andersen - *William Blair & Company - Analyst*

Good morning. I just have one quick question. Dave, I was wondering if you could comment a little bit on your refinancing plans, expectations going forward and what that might do to your average cost of debt? Thanks.

Dave Evans - *The Scotts Miracle-Gro Company - CFO*

Sure. Well, Jon, as you're aware, our credit facility today expires in February of 2012. We have a fantastic facility. We're borrowing at LIBOR plus 100 basis points. So on one hand, we'd like to keep that facility in place as long as we can. On the other hand, we're balancing risk and uncertainty in making a decision on when the optimal time is to begin refinancing that. I would tell that you that we'll likely start the discussions at the end of the calendar year, or the beginning of next calendar year and we'll be trying to secure a new facility some time in the first half of next year.

What we'll also do is continue down the path, as we started last January, of diversifying our sources of debt and the tenors of our debt. So, what I would hope is that at the end of this process, there really is no end, but a year from now we're going to have debt that could have maturities of eight to 10 years out, six to eight years out and four to five years out, which will be good. Right now, the bank market continues to improve on an incremental basis, and I think we are viewed as a very positive credit within the market. So, this is going to be a good process we're going to go through, and I think the outcome is likely to be marginally better than what we thought when we spoke last February. There's really three things that are going to drive our interest up next year, but it will go up less than what we thought seven months ago. First, we'll have the full year effect of the \$200 million in bonds we issued this past winter. So, that'll be an increase.

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But the benefits are going to be -- I'm sorry, the second is increase is going to be with the new facility. We're not going to enjoy the same spread that we have on our current facility, but I would tell that you the spreads have gotten marginally better from what we thought in February. And the third is, that LIBOR rates, we're not making these up, we're just looking at the forward rates in the market. Those LIBOR rates have come down marginally as well over the last seven months. So I think directionally next year, we're probably looking at an interest expense that could be \$15 million higher than this year. So, if this year is \$50 million or slightly lower, next year is probably going to be around \$65 million, or slightly lower. And what you're going to see when you go through this model is that's probably going to nick our operating margin growth by a couple hundred basis points. So, if our operating margins, using our guidance, are in the teens, you'll see this one year blip in interest depress that by a couple hundred basis points.

Jon Andersen - *William Blair & Company - Analyst*

Thank you.

Operator

Our next question is from Doug Lane with Jefferies & Company. Go ahead. Your line is open.

Doug Lane - *Jefferies & Co. - Analyst*

Yes, hi, good morning, everybody.

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

Hello.

Doug Lane - *Jefferies & Co. - Analyst*

Just wondered if could you talk a little bit about innovation, give us an update maybe on how the snap test is going and any other sort of innovation that's close to fruition that we might see in 2011?

Mark Baker - *The Scotts Miracle-Gro Company - COO*

2011 is going to be a year where we've introduced a few things this year, regionalization and so you're not going to see any big innovations until 2012. When it comes in to 2012, I think we actually showed you a couple of those last year when we were at the analyst conference. We will continue to test the cartridge spreader this year and roll it out regionally while we learn some things, and then have a full rollout of those in 2012. We have some new actives that we're currently working on registrations and working with the EPA and the states on in getting those registered that we're very excited about that we'll have on an exclusive basis. We have a new soil that's rolling out that's going to -- right now we're calling it expandable soil that's going to be a great new innovation for consumers, a much lighter soil. We'll be able to expand volumetrically. So, 2011 is a little lower year. 2012 we're actually looking at, Doug, and saying we have so much innovation coming that we're actually thinking the about maybe pushing some of that out into 2013.

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

I just want to step back. Because you can look at that as a two-edge sword. Regionalization is a big deal. We will be 100% regionalized, if that's a word, next year in 2011. We've got our Chicago office coming up on line, we've got our New York office

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coming up on line. This is a huge amount of work. We have taken our guy who was running our international business, Claude Lopez, Claude is now our International Head of Sales so we have a French guy, who I like very much, by the way, who is our head of sales, so we're moving a lot of the work into the field. This is a huge year of change for us in how we go to business, and I would say it is usually innovative. So, a lot of people talk about getting close to the consumer.

We're doing it. It involves a huge amount of work. It requires Mark and the operating folks to be out in the field all the time. So, the planes get a good use when we're in season. So, while it's in the a huge product year, Snap was one of those things where I ask people if we could please test it out. I'm glad we, did and we learned a lot about how to bring that product to market and how people view value. So, we've learned a lot and we're going to continue to test it.

People who bought that product liked it very much. And so we know it's innovative. We know it's particularly innovative for people who are light or non-users, and there's a lot of people like that out there. So, we've got an excellent pipeline, although I'm going to say 2011 is going to be largely completing the rollout of our regionalization efforts.

Doug Lane - *Jefferies & Co. - Analyst*

Okay. That's helpful. Thanks.

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

You bet.

Jim King - *The Scotts Miracle-Gro Company - VP - IR & Corporate Communications*

Tracy, I think we have run through the queue. If not and there's people who still have questions who we haven't gotten to, you call me directly later in the day. 937-578-5622. Otherwise, thanks for your time today, and we'll talk to you the again at our fourth quarter conference call. Thanks, have a great day.

Operator

That does conclude today's conference. Thank you for participating. You may disconnect at this time.

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