S&P Global
Market Intelligence

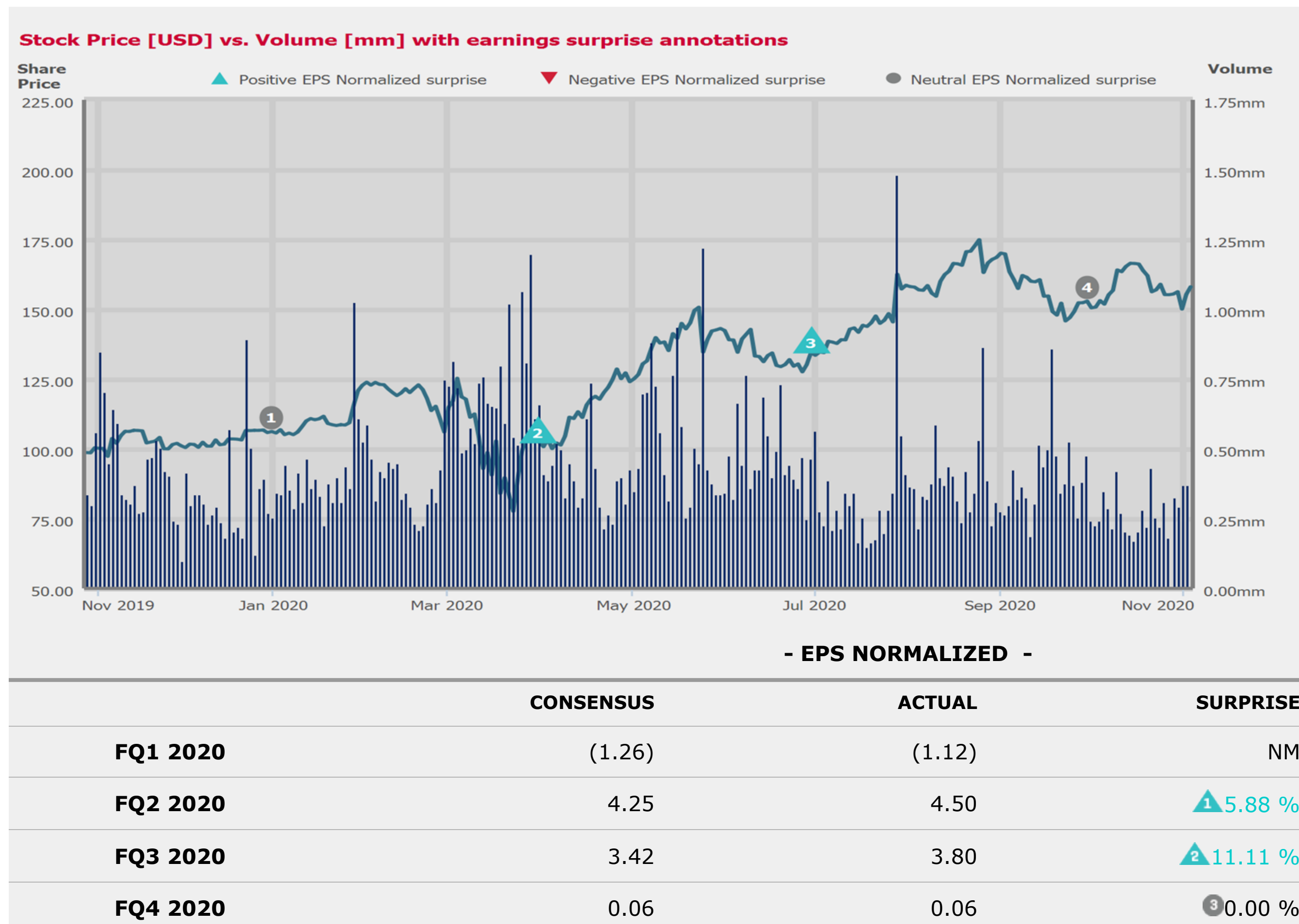
The Scotts Miracle-Gro Company
NYSE:SMG
FQ4 2020 Earnings Call Transcripts

Wednesday, November 04, 2020 2:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2020-			-FQ1 2021-	-FY 2020-			-FY 2021-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	0.06	0.06	0.00	(1.11)	7.20	7.24	▲0.56	7.76
Revenue (mm)	886.23	890.30	▲0.46	441.90	4129.25	4131.60	▲0.06	4005.25

Currency: USD
Consensus as of Nov-04-2020 1:27 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2020	(1.26)	(1.12)	NM
FQ2 2020	4.25	4.50	▲5.88 %
FQ3 2020	3.42	3.80	▲11.11 %
FQ4 2020	0.06	0.06	0.00 %

COPYRIGHT © 2020 S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved

Table of Contents

Call Participants 3
Presentation 4
Question and Answer 11

COPYRIGHT © 2020 S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved

Call Participants

EXECUTIVES

Christopher J. Hagedorn
GM & Senior VP

James D. King
Chief Communications Officer, Executive VP & President of The Scotts Miracle-Gro Foundation

James S. Hagedorn
CEO & Chairman of the Board

Josh Peoples

Michael C. Lukemire
President & COO

Thomas Randal Coleman
Executive VP & CFO

ANALYSTS

Alexander Rocco Maroccia
Joh. Berenberg, Gossler & Co. KG, Research Division

Eric Bosshard
Cleveland Research Company

Jon Robert Andersen
William Blair & Company L.L.C., Research Division

Joseph Nicholas Altobello
Raymond James & Associates, Inc., Research Division

Sarah Stuart Clark
JPMorgan Chase & Co, Research Division

William Bates Chappell
Truist Securities, Inc., Research Division

William Michael Reuter
BofA Merrill Lynch, Research Division

Copyright © 2020 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

Presentation

Operator

Good day, and welcome to The Scotts Miracle-Gro Company's Fourth Quarter Earnings Conference Call. At this time, I would like to turn the call over to James King. Please go ahead.

James D. King
Chief Communications Officer, Executive VP & President of The Scotts Miracle-Gro Foundation

Thank you, operator. Good morning, everyone, and welcome to The Scotts Miracle-Gro Fourth Quarter Conference Call. We're going to modify the structure of the call this morning, so let me set your expectations. I'm here today with Jim Hagedorn, our CEO; Randy Coleman, our CFO; as well as President and Chief Operator, Mike Lukemire; Chief Marketing Officer, Josh Peoples; and Hawthorne General Manager, Chris Hagedorn.

We've got a lot to cover this morning. Randy will go through the numbers and provide some clarity around the guidance we outlined in this morning's press release. Then Jim, Josh and Chris will share their thoughts, mostly about the opportunity we see going forward in fiscal '21. At that point, we'll open the call for your questions. I respectfully ask that all of you participate in the Q&A, ask one question and one follow-up. I'm glad to set up time later today or tomorrow for anyone who has additional questions.

I want to remind everyone that we will be making forward-looking statements this morning, so our actual results could differ materially due to a variety of risk factors. Those risks are highlighted in our press release this morning and explained more extensively in our Form 10-K, which is filed with the Securities and Exchange Commission. I also want to remind you that this call is being recorded. An archived version of the call will be made available on our website, investor.scotts.com.

With that, let's get going, and I'll now turn things over to Jim Hagedorn for some opening remarks. Jim?

James S. Hagedorn
CEO & Chairman of the Board

Thanks, Jim, and good morning, everyone. As you saw in our release, we capped off our record-setting 2020 results with a strong finish across the board in the fourth quarter. For both the quarter and the full year, we saw growth in every category of both the U.S. Consumer business and Hawthorne. We also announced this morning our plans to increase our existing 25% financial stake in Bonnie Plants through a 50-50 joint venture with its current owner, Alabama Farmers Co-op. I don't want this news to get lost in the headlines around our financial performance for 2020 and our guidance for next year. We see live goods as an essential part of our long-term strategy, and having a more significant stake in Bonnie is the right place to start. I'll elaborate on this point later in my remarks.

I know most of you want to focus today on our outlook for fiscal '21. Frankly, that's our focus as well and where I want to spend most of my time. Our EPS guidance, which projects 10% to 16% growth in 2021 demonstrates we're in a good place entering the year. We're going to handle things a little different this morning, so that my comments have some better context. I'm going to turn the call over to Randy now. He'll walk through a few highlights for 2020 and then provide some of the details for our fiscal '21 outlook. Then I'll come back and share the remainder of my time with some of my colleagues, so you have a better sense of our vision for the business as we enter fiscal '21.

Thomas Randal Coleman
Executive VP & CFO

Thanks, Jim, and hello, everyone. As you know, we essentially prereleased our 2020 results that you expect, and we said we expected to finish at about $7.25 per share for the year. Given our prior detailed communications earlier this year, I won't be walking through the specifics of the P&L at this time as I normally do, however, I do want to share a few thoughts and highlight some key points.

Copyright © 2020 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

Starting with sales, I've never seen growth in my 22 years here like we had in Q4. In the Consumer business, POS growth was 38% in the quarter. And as Jim said, the growth was everywhere. The other thing that was happening though is that retailers were working to rebuild depleted inventory levels, and that was what drove the 90% growth in shipments. We ended the year with retail inventory about 15% higher than a year ago, but also with customers continuing to buy aggressively into October and planning for a big early spring.

Full year sales in U.S. Consumer increased 24%, driven by POS growth of a similar number. Gardening is the big driver, we did go 45% increase in consumer purchases of branded soils and 30% plant food. Insect control products were up 51%, weed control was up 16%, grafting 31% and lawn fertilizer 11%.

At Hawthorn, the story was pretty much the same as it has been. Chris is going to share some of the details in a few minutes, so I won't go into them right now. But I will tell you that September was our largest sales month ever for Hawthorn. And it was encouraging to see that Hawthorne translated higher-than-expected growth for the year into higher-than-expected profitability rates, too.

On the gross margin line, Hawthorne improved 240 basis points due to fixed cost leverage, favorable brand mix and pricing. The segment margin for Hawthorne improved about 300 basis points to 11% for the full year. This was ahead of our initial expectations, and more importantly, keeps us on track for a segment margin goal of 15% in the next few years. By the way, the U.S. Consumer business posted an 80 basis point improvement in gross margin rate for a lot of the same reasons that drove the Hawthorne rate higher. You'll notice though that the company-wide rate is up only 50 basis points. That's due to the faster growth at Hawthorne, where the overall gross margin rate is approximately 10 percentage points lower than the corporate average. Nevertheless, we are extremely pleased with what we saw.

SG&A was up 47% in the quarter and 26% for the full year. The biggest driver was variable compensation, which was approximately $80 million higher than a year ago, but SG&A also increased due to media, marketing, selling, long-term comp and charitable giving. Interest expense benefited from lower debt levels and lower interest rates, which is $5 million lower in Q4 and $22 million lower for the full year. And we finished the year with leverage at 2.5x average net debt-to-EBITDA. This is about a full turn lower than our target leverage and 2 turns lower than the maximum permitted under our debt covenants.

So we enter 2021 with tremendous flexibility to invest in the business while also returning more cash to shareholders.

Turning to cash flow for just a moment. You may recall that I said after Q3 that free cash flow would come in around $400 million for the year because we wanted to build inventory. Instead, product was going out the door as soon as we build it because retailers were looking to replenish their own depleted stock. So our free cash flow came in about $100 million higher at $495 million, meaning we still have work to do in terms of building inventory next year. I'm glad to answer any question you have about Q4 or our full year results, but I doubt there are many surprises in what we announced today. So I want to provide some detail for our '21 guidance and set the stage for Jim to explain our outlook from a more strategic perspective.

We have always prided ourselves of being transparent with shareholders. So let me just start there. We expect to see enormous sales growth in Q1 from both major segments that will have growth rates similar to Q4 and probably even higher. We will also likely be pacing well above our full year target through Q2 given Hawthorne's momentum and U.S. retailer plans for a big spring. However, our visibility is much less clear after Q2 for obvious reasons.

In addition, our Q3 and Q4 comps are huge. For example, second half growth for Hawthorne in fiscal 2020 was 69%; and from May through September, our POS comp in the U.S. Consumer business was 43%. As you'll hear from Jim and Josh Peoples, we believe full year growth in the U.S. Consumer business is still possible even with that reality. I'll let them explain why. But if we simply hold the U.S. Consumer number flat and Hawthorne grows at 20%, we would expect to earn roughly $8.40 per share. If the U.S. business were to decline by 5 points and Hawthorne grew to 15%, earnings would be roughly $8 a share, which would still be a double-digit increase versus 2020.

Copyright © 2020 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

We currently see gross margins declining roughly 50 basis points which is different from what I indicated on our most recent public comments about 2 months ago. As we have finalized our plans for the year, however, it became clear that we need to further increase our investment in warehousing for both businesses to get inventory levels to where we want them. And like other companies, we're starting to see the potential in the recent weeks for more commodity pressure, especially from resin. Note the total company rate decline assumes about flat rates in both businesses, but a negative impact from segment mix, consistent with what happened in 2020 with Hawthorne's dramatic sales growth.

And know also that we are hedged on our key commodities, urea, fuel and resin at about a 65% level, similar to our normal historic approach. SG&A will likely decline 6% to 11%. Our guidance assumes variable compensation will be about $80 million level for the year, with some of those dollars being offset by a higher level of planned investments in marketing and our direct-to-consumer efforts.

Free cash flow, defined as operating cash flow minus capital expenditures, is expected to be about $325 million. We expect a step-up of CapEx in fiscal '21 to roughly $100 million and perhaps more. And I would expect working capital to be a use of cash during the year as we work to get inventory levels back to where we want them.

Finally, we will be paying much larger bonuses based on 2020 results, and this creates another cash headwind in 2021. As you've heard from several other companies, this is a tough environment to provide guidance. Our preference is to continue providing a range of what we see as likely outcomes, but it's not easy. In fact, you can argue that 2021 could be even more volatile than 2020. So the range to our guidance range for EPS is wider this year to reflect this uncertainty and also the fact that earnings base is much higher versus this year.

I'll remind everyone that we had adjusted EPS at $4.47 in 2019. The low end of our fiscal 2021 range would suggest a roughly 80% increase in earnings and $800 million of free cash flow over a 2-year period. In fact, since the start of Project Focus in December 2015, total shareholder return has increased approximately 160%, we've generated over $1.5 billion of cumulative free cash flow.

Regarding our Bonnie announcement, we are not yet including ranges from this transaction in our guidance, but we will update you once the deal is closed. The additional investment and the nature of our JV will result in different P&L geographies than we used in the past, and we'll provide clarity on this when the time comes. You will hear throughout the balance of the call from Jim and members of the operating team that we're striving to do even better. If that proves to be true, we'll change our guidance. But at this point, trying to estimate the timing and impact of the global events on our business is impossible. Regardless, even if our current P&L estimates prove accurate, it will be another year of record results for our shareholders. So with that, Jim, back to you.

James S. Hagedorn
CEO & Chairman of the Board

Thanks, Randy. Before I expand on Randy's comment, I want to provide some of my own thoughts about why I believe our business is so well positioned right now. And it goes well beyond COVID-19 and the way it changed consumer behavior. During our second quarter call, I told you about a saying that hangs above my office store, something I've learned from my dad. Luck is where preparation and opportunity meet. Five years ago, we began a transformation of this company through an effort we called Project Focus. We divested businesses we didn't believe could drive shareholder value. We invested in new categories that had a higher growth rate with brands like Tomcat and Bonnie Plants. We also invested in an entirely new business with the creation of Hawthorne. We just crossed the $1 billion sales threshold with Hawthorne and have begun to exceed the financial targets we set in our business plan when we started down this path. It has quickly become a business that is critical to our future. The benefit of Project Focus that too often gets overlooked, however, is what we did to improve our core U.S. Consumer segment.

We dedicated ourselves to ensuring our brands remained relevant in a rapidly evolving marketplace. Without those efforts, the results this year would not have been possible. We changed our approach to R&D, which quickly led in rapid succession to the introduction of our most successful new product launches ever. Miracle-Gro Performance Organics, Scotts Turf Builder Triple Action and Ortho GroundClear. All of

Copyright © 2020 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

them were new product home runs. We began overhauling our approach to marketing. Spending behind our brands has increased 40% over the past 2 years. We also brought new agency partners to the table to help us reimagine our relationship with consumers.

Project Focus has been about hard work and preparation, and fiscal 2020 presented us the opportunity to exploit that preparation. Not only did we do so, but we positioned ourselves for continued success. And so as we look to fiscal '21, we believe there is more work to do and more growth to capture. While we remain bullish about our strategy and our future, we are taking a prudent approach in setting expectations. I told you on our last call, I would be satisfied if we simply held on to the growth of our U.S. Consumer business and protected our margins, and that remains the case. The real question is whether we can do better than that. Specifically, do we believe the consumer business can grow in '21? And the answer is yes. Our marketers believe that. Our sales force believes that. Our direct-to-consumer team believes it, and our retail partners believe it, too. So we'll incentivize all of them to deliver that growth.

And as we demonstrated throughout 2020, we have the ability to lean into higher sales, and we'll be positioned to do so if we see they're achievable. There are legitimate reasons for the optimism. For starters, the momentum we've seen in the second half of the year has yet to slow down. We also know we left sales on the table over the last 2 quarters, probably $200 million in U.S. Consumer and Hawthorne combined, just because we couldn't keep up.

The competitive dynamic in the retail market could also be interesting. We expect our smaller national retail partners to fight hard next season to maintain the market share they gained in 2020. And we expect some of our larger retail partners to step up their promotional activity in 2021 to claw that share back. Remember, due to COVID, there was little ability by these larger accounts to drive foot traffic into their stores in March, April and the first half of May. Though we're optimistic there's no reason to guide any higher right now. Just as we did throughout 2020, we'll be as transparent as possible when we have greater clarity, and we'll adjust guidance when and if it's necessary. We're not trying to be coy. We're simply being honest. Six months ago, I never would have predicted the state of the world right now. And while we have a good line of sight for the next several months, I'm doubtful of anyone who says they can predict what the world will look like next spring and summer. That leaves an enormous gap between what is possible in '21 and what is likely.

I will tell you, we share the same macro view as many other CPG companies. We believe the U.S. economy will remain sluggish for the next several quarters, and most consumers will still be in nesting mode next year. That actually should bode well for our Consumer business. But I want to be clear about my goal for the Consumer business in fiscal '21, and this is a message targeted at our long-term shareholders. I will not define success this year based simply on whether we grow. There is a more important long-term mission here, and that's the focus. The next generation of consumers came knocking on our door in 2020, millions of them. And I'm mostly talking about millennials, the largest generation in American history who are in the midst of becoming homeowners and gardeners. The goal is not simply to enjoy their company for a short visit, but to keep them with us for the rest of their lives. So we will invest heavily to build the strongest relationship with consumers we've ever had. If we also see growth for '21, great. But if we fall back a bit and still keep most of these new consumers engaged, I can live with that, too.

How we accomplish that goal is a task that is in the hands of our new Chief Marketing Officer, Josh Peoples. Josh has been here more than 20 years. He's worked his way up from a junior marketeer to run our lawns business and to oversee the work of all the brand teams. He's one of the most thoughtful and analytical marketers we've had here during my tenure. We're lucky to have retained him this long, and I'm confident he's the right person at the right time to serve as CMO. Josh?

Josh Peoples

Good morning, everyone. As Jim just mentioned, I've been at Scotts Miracle-Gro for 20 years now in a variety of marketing roles. I believe I've got a good sense of our business and, more importantly, the needs of our consumers. The one thing I've learned for certain over the past 2 decades is that lawn and garden consumers are different than in other categories. There is an emotional element to this space that is truly unique. Gardening is a form of self-expression that can be deeply personal. Understanding how

Copyright © 2020 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

to tap into that emotion which, by the way, is different for every consumer is the most critical element between growing and standing still.

What we've all learned more recently is that we need to take a different approach if we're going to tap into that emotion and strengthen our relationship with consumers. We can't talk about ourselves and our products like we used to. Our messages have to be focused on consumers, not us. As Jim said, we had tremendous success bringing new people into the category in 2020. About 30% of participants in edible gardening were new or lapsed users. We estimate about 8 million more people participated in lawn care than in 2019. We not only believe we can keep most of these new users engaged, but bring even more people into the space. Demographics will continue to help us. Millennial homeownership will continue to swell in '21 and the years that follow. Our research indicates this group is more interested in lawn and garden activity than their parents and equally accepting of our brands. Jim mentioned the importance of innovation, I couldn't agree more. But our new product strategy has to be driven by consumer needs while being rooted in science. It's not sustainable the other way around.

All the products Jim mentioned, Performance Organics, Triple Action, GroundClear, speak to the lifestyle of the millennial consumer. They have a great environmental profile and are easy to use. They also happen to deliver outstanding results. But the most important innovation for us will be how we communicate. We were forced to throw out most of our marketing plans at the break of the 2020 season and work on the fly. We learned a lot from that experience and got smarter about what works. So we entered fiscal '21 following these 3 principles: First, to be creative lead; second, to be always on; and third, to be data-driven. As we saw this past season, none of these focus areas exist in a vacuum, they exist together.

As recently as just a few years ago, we would have taken months to produce a single TV commercial and ensure that everything was focus group tested. We also would have relied on just 15 or 20 creative assets to support the season. That's not what we're doing today. Instead, we're developing new creative approaches literally every day and creating thousands of them, not dozens, in the process. This means we are learning and changing every day. We are responding with real-time data that helps us understand what is resonating with consumers. We are putting increased investment behind what is working, and we are quickly walking away from what is not. Most importantly, quality is not being sacrificed. If anything, it's improved.

In 2021, I would expect upwards of 75% of our advertising spend to be on digital. This will allow us to be much more precise in hitting our target audience. We will be more capable of diversifying our creative to represent different audiences and their values. A millennial couple, for example, living in the same house, planting the same garden, are likely to see 2 very different approaches, each tailored to their online activity or personal interests like cooking, entertaining or home decor. And consumers in Chicago are likely to see different messages from those in San Francisco or Dallas or Boston.

The timeliness of our messaging has also improved. If the weather is looking good in a specific city, we'll lean in hard to maximize the weekend. If it's going to be rainy, we'll pull back. If a retailer has a promotional activity we want to support, we can target the exact audience most likely to respond. We know this approach works. We see it in our data and in our results. Our retail partners are seeing it, too. That's why we'll work with all of them in 2021 to drive consumer foot traffic and category growth, while also fueling online shopping.

You'll see us add to our portfolio of digitally native brands, not sold at retail like Lunarly, Knock Knock, Barkyard and Greendigs. You'll also see more focus on indoor gardening and live goods. I am confident our marketing efforts are more impactful now than at any time since I joined the company, and I am confident in our plans for the '21 season. I agree with Jim about the opportunity in 2021. We have a great opportunity to step our business for years of future growth. We're not worried about difficult comps and issues beyond our control. We're focused on the issues within our control, and I'm confident that the steps we take in '21 will benefit Scotts Miracle-Gro for years to come.

So Jim, let me turn it back to you.

James S. Hagedorn
CEO & Chairman of the Board

Copyright © 2020 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

Thanks, Josh. One last point before we turn to Hawthorne. As I've mentioned earlier, we've signed a letter of intent in recent days to acquire a 50% equity stake in Bonnie Plants. This is part of a proposed JV with Alabama Farmers Co-op. Most of you know I'm a big fan of live goods, so is Mike Lukemire. It is what drives the category. Without the plant, there is no gardening. When we announced Project Focus, I said I wanted Scotts Miracle-Gro to evolve from a gardening products company to an actual gardening company, and the best place for that to happen is in edible gardening. That makes the increased stake in Bonnie an obvious choice.

Like us, they've been at this for generations. They have the single most powerful brand in the space and an exceptional relationship with retailers, and consumers love them. Josh mentioned the emotional component of lawn and garden. Nowhere is that more evident than in this space. The shopping experience for fertilizer and growing media is pretty pedestrian and, frankly, not that inspiring, pick up a bag, put it in the car, take it home, spread it on the lawn or garden. But with edible plants, we're talking tomatoes, peppers, leafy greens, basil, rosemary and a variety of other herbs and vegetables, consumers are engaged in a far different way. The shopping experience is different, more engaging. They spend far more time at the shelf looking for the perfect plant. They become invested in the purchase process, and then they go home and they nurture a plant that is going to provide for food for their families. There's an emotional connection we can make in this category, a level of trust that is critical.

And we know that connection is especially strong with millennials, which is what makes Bonnie such an important strategic fit. I believe our involvement with Bonnie over the past several years has been a benefit to both companies, and I doubt you'll hear any different from them. In fact, Mike Sutterer, one of our former operators here, is now the CEO of Bonnie. He understands our vision and our goals, and we consider him an outstanding operator. So this has the makings of being a great partnership and is critical to our long-term success. We're not going to cover too many details today because we are still several weeks from actually completing the deal, but expect to hear more from us in the quarters ahead.

I now want to switch gears and talk about Hawthorne. As I said earlier, we see double-digit growth as a real likelihood again next year. We have some good tailwinds in the near term and see the long-term outlook to be strong as well. Instead of going into the details myself, let me turn things over to Chris Hagedorn for a few minutes to share his view.

Christopher J. Hagedorn
GM & Senior VP

Hey, everyone, Chris here. I'll start by simply saying that 2020 was obviously a huge year. Crossing $1 billion mark was a big deal for the team, and I felt even better knowing that we didn't have to do anything crazy to drive that number. Honestly, I think you could add another $100 million or so to the top line this year. But our supply team was so stressed out at times that we lost some money on the table. And so we've been making investments to ensure that those stresses don't emerge again in the future. If you look at 2020, it was a great story everywhere. Within our North American Hydro business, we doubled our lighting business during the year, driven by about $100 million worth of LED lights. This was a category that didn't even exist for us 2 years ago, and it's looking like we underestimated how significant it would turn out to be.

LED sales were more than 100% higher than expected going to the year, and we're selling our fixtures as fast as we can build it right now. Consumables in North America saw 49% growth in nutrients and 64% in growing media. Geographically, we saw growth in literally every market. California, our single largest market, was up 78%, but newer markets like Michigan and Oklahoma were up 133% and 203%, respectively.

I also want to give a nod to the team because we finished the year with a second margin of 11%. I expect that number to move up again next year. We're doing a good job of striking the balance of driving growth, market share and improving our profitability. Some of you asked on the last call if we are worried about too much inventory in the channel or some degree of overcapacity. We're not seeing any signs of that right now. In fact, we expect the growth rate in the first quarter of '21 to look a lot like what we saw in Q4. There's also a good reason to be optimistic in Q2. The forecasting is a little less predictable later in the

Copyright © 2020 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

year though. And obviously, the comps that we face in the second half will be tough. But the head start we get should allow us to deliver the 15% to 20% growth that Jim referenced earlier.

The other great news for Hawthorne is what we expect from yesterday's election. Look, people are still counting votes, so I don't want to get too far ahead of myself. We expect New Jersey to approve recreational adult use of cannabis, and there's a good chance that Arizona will do the same. Going into the election, there was also good polling from South Dakota, Montana and Mississippi. On top of that, the Governors in New York and Pennsylvania have said in recent weeks that they'll look to legalization to help them make up some of the budget deficits that have been caused by COVID-related issues. Who knows what's going to happen in D.C.

We're increasingly optimistic that the federal rules will change as well, although time line there is likely to be longer. What's become clearer than ever this year is that we built some pretty special Hawthorne, it's hard not to feel good about the prospects in both the near term and the long term. I do want to be clear, guys. We've seen up and downs in this industry over the past few years. So we're not taking anything for granted. But we clearly have the best product line in the industry and the best service and supply chain, too, even with our challenges this year.

Earlier this month, we finally opened our R&D facility in British Columbia, the first of its kind in the world. When we combine what we're doing there related to Canada's cultivation with our current R&D work on hemp in the U.S., I feel confident in saying we also have the best innovation program in the industry, too. So the outlook for next year is a pretty good one for Hawthorne, and we look forward to keeping you all updated as the year comes together. With that, Jim, I'll hand it back to you.

James S. Hagedorn
CEO & Chairman of the Board

Thanks, Chris. One last thought on Hawthorne. These guys have done a tremendous job in getting the business to where we thought it could be. They've clearly established themselves as a leader in the industry, and they've shown the ability to manage complexity like the implementation this year of SAP. I want to congratulate them on how far they've come in this short period.

Before we end, I just want to say one more thing. 2020 was beyond anything we could have ever expected. And I'd be remiss if I didn't take the time to thank our associates. I want to start with our field sales force as well as our manufacturing and distribution folks. These people didn't get the luxury of working from home when COVID hit. They still went to work every day. And I'd be dishonest if I didn't acknowledge they put themselves and their families at risk for the company. We provided them with premium pay and provided bonuses and additional 401(k) contributions. That's what a good company would do, though I'm not sure we can ever really thank them enough.
I'm inspired by the things I've seen this year and humbled now to be entering my 20th year as CEO of this company. It feels a bit tried to say I've never felt better about where we stand, but it's true. We're in the midst of introducing an entirely new generation of consumers to our core business. We're enjoying continued success in a fast-growing category with Hawthorne. And our shareholders have benefited from the multiyear run that allowed us to more than double the value of this company in the 5 years since the introduction of Project Focus. We don't know exactly what fiscal '21 has in store. But the one thing I do know is that we have the right team in place to manage whatever happens. With that, let me open up the line so we can take your questions.

Copyright © 2020 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

Question and Answer

Operator

[Operator Instructions] And we'll take our first question from Joe Altobello from Raymond James.

Joseph Nicholas Altobello
Raymond James & Associates, Inc., Research Division

I just want to go back to the roughly 8 million new lawn customers that you guys added last year. The upper end of your guidance assumed you keep pretty much all 8 million this year. And maybe a question for Josh as he is the lawn, is there a way to target those 8 million customers to keep them in the category in a period when they'll likely have more competition for their time on a weekend beyond just promotions. It sounds like you guys know roughly where they live, but do you guys actually know who they are to be able to target market to them from a digital perspective?

Josh Peoples

Great question. Yes, I mean, right now, the goal continues to be to not only retain, I would say, those 8 million, but honestly trying to bring in even more as we go into 2021. A lot of the feedback we got from consumers, even though time may become more of an issue, they definitely found lawn and garden to be a passion point that they haven't really tapped into or haven't thought it was possible. So we feel really good about not only knowing where they're at, but who they are. And I think this is where it does come into working with our retail partners to continue to keep them engaged and reaching them in new and unique ways and continue to build on really what we've done here in 2020.

James S. Hagedorn
CEO & Chairman of the Board

Obviously, I'm a shareholder and say, like, I'm surprised like long tails weren't better. Joe, we had a lot of, gardening clearly was sort of leading the pack this year. And I think we've learned enough that I think we ought to be seeing the same kind of growth in turf care. And I think our products are improving. I think our -- we're going to have a lot more promotional support this year regardless of where COVID is at unless it's a complete lockdown. I think you're likely to see the retailers not being as sensitive as they were this last year. And so that there'll be, I think, a lot more cooperation and a lot less shyness about bringing people into stores. So I would be challenging the marketing group to do better in lawns than what they did and try to keep up with the gardens people.

Josh Peoples

They are challenged.

James S. Hagedorn
CEO & Chairman of the Board

[indiscernible] you're being safe.

Joseph Nicholas Altobello
Raymond James & Associates, Inc., Research Division

No, I am. And one other one for Chris, if I could. If you look at Hawthorne this year, the initial expectation was up 12% to 15%. You did 61%, so a slight over delivery, I suppose. But if you could flip that 60-plus percent growth in more context, how much of that was from the market? How much of that was market share gains and maybe what you're thinking for '21?

Christopher J. Hagedorn
GM & Senior VP

Copyright © 2020 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

Joe, good question, yes. So we -- as you heard for what we're expecting '21, we think there'll be continued sort of general market growth, and we certainly do intend to continue to take share. To kind of try to quantify the gains from this year, we think there's probably a solid 20% increase in consumer usage of cannabis, and that's largely anecdotal, but we quote from data sources that are available to us. So certainly it seems like stay-at-home orders and that kind of thing did increase the sort of high single-digit usage gains that we see typically in a normal year. And I think we attribute the rest of our growth to market share gain, largely driven by our ability to continue to deliver a relatively high service level. We certainly had our challenges this year, but our competition, I think, suffered even greater challenges. And then I got to give a lot of credit to our innovation team. We launched some really, really great products this year. Our LED light that we launched in Gavita was the single biggest product launch in SMG history, not just Hawthorne but the entire enterprise. And that I think is, definitely, we have to give a lot of credit to that for how we did this year.

Operator

We'll take our next question from Bill Chappell from Truist Securities.

William Bates Chappell
Truist Securities, Inc., Research Division

Going back to Hawthorne, I mean, just trying to understand, similar question. How tough the comps really are and how much visibility you had? I mean, Chris, I think you said you felt like you left $100 million on the table. I think by now you've had some kind of, correct me if I'm wrong, idea of how states progress once they legalize medicinal and then recreational and then revenue starts to come in. And so is it really that tough of a comp? I mean I understand March when there was kind of a surge was, but help me understand how the year really progressed, especially the back half when you have these states coming on and you [indiscernible], as you said, $100 million on the table.

James S. Hagedorn
CEO & Chairman of the Board

Yes. Let me throw some spin on this, Bill. I think this is the year where honestly, and I think we've been hinting pretty hard core in the recorded portion of the script, the sort of difference between kind of what we hope, and I think based on like our knowledge of business both Consumer will do and Hawthorne will do and live goods will do versus what we're kind of committing to within the range. This drives a, I think, diversity was used somewhere in the script, I think maybe by Randy, of sort of views of what we think is like could happen, what like we want to happen. And so those numbers, the operating numbers are like quite a bit different, to be honest, to -- we just don't believe we can commit to that.

So I would ask everybody on the call to sort of bear with us on this. I think we can't say it more clearly that we're trying to be safe here that -- and I know we're going to have more conversations with you guys about this. But I think sort of up until when, at least on the Consumer side, there's consumer takeaway, so call it next spring, I think you're going to continue to see -- I don't know what Randy used, the adjective he used...

Thomas Randal Coleman
Executive VP & CFO

Enormous.

James S. Hagedorn
CEO & Chairman of the Board

Gigantic or enormous, so enormous, sort of what looked a lot like the sort of growth rate we saw in Q4 and Q1. Q2 probably won't be quite as ginormous as that, but it will be pretty big numbers. And I think that will put pressure on you guys to sort of think we're saying back in our, this whole believability factor. But the hints we're trying to lay allow you guys to sort of connect dots. And so when you say to Chris, how come you don't think you can do better than that, it's a pretty hard one to answer because we do think we

Copyright © 2020 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

can do better than that. We're just not committing to it on either the Consumer business or the Hawthorne business.

But -- so it's a very -- I mean Chris can answer the question, I'm not quite sure how. But he can sort of try and talk everybody down and talk himself down. But remember, Mike's operating plans are different than what we're talking about, but they're included in sort of the expectations of, if we're trying to drive this thing as saying Consumer could be down 5%, Hawthorne could be up 15%, and we're still burst $8, okay? And then you sort of take it from there and it leverages up pretty fast. And so we had a Board meeting yesterday where we, I think, put the best sort of the budget and incentive goals for next year. I think not too hard, but they're lucrative if really good things happen, and they're fair if we're kind of at the bottom end of the range and nothing terrible happens. But I do think that that's kind of what we're dealing with. When you say please defend your low number, it's kind of hard to do. It's just saying nobody knows and nobody expected a sort of 60-plus percent growth in a single year. And so -- I don't know, Chris, how you try and ask the question.

Christopher J. Hagedorn
GM & Senior VP

All right. All that said, look, realistically, internally, yes, I'm definitely driving the team towards a more aggressive number than we had inside the building. Like Jim said, look, the back half of this past year that we just finished was unlike anything, I think, anybody in our business has ever seen before. So the idea that we're going to be able to match that is a challenge for sure. Now the remarks that we had up at the top of the call, those were prerecorded earlier this week. So now we know what happened in the election, we know how citizens voted on cannabis issues, and they voted extremely favorably across the board. And we do expect to see incremental business as a result of what happened in states like New Jersey and Arizona and others. That being said, these changes aren't going to happen overnight. What we've seen is there's typically a 12- to 18-month lag from when a state legalizes until there's any meaningful increase in business for us. So I wouldn't expect a significant amount of business as a result of those votes in this fiscal year. That looks like it will be probably more of a 2022 uptick for us.

James S. Hagedorn
CEO & Chairman of the Board

We have been doing it for a lot, as we were looking and trying to analyze like lighting sales, and I might be off by a little bit, but you can correct me, Chris. But our high-pressure sodium lights say, HPS likes to kind of be the traditional lights that get hot and all that, I think they were up like 50%. Clearly, we had a blow away success with the innovation on LEDs. And we're trying to say where did they go? And so I think that in states that are legalizing, you're seeing build-outs occur, which I think are kind of in advance in the marketplace. And I think that's healthy for us. I think you've heard me mention and I'm gigantic fan of Senator Sweeney in New Jersey, who sort of led that process. I don't think he legislatively could get Jersey done and he just kind of threw his hands up. And this is -- the guy is like an iron worker, okay? So big union guy, one of the few guys with a mouth louder than mine. And he has a real vision for New York or New Jersey being an important center of excellence in cultivation and the Garden State means something to him. So I do think you're likely to see build-out occur because -- again, if we look at where these lights are going, and you say certain people are just improving the lights and go with LEDs, but there's a good bit of build-out occurring in there. And I think that build-out occurs in advance of the market, as you'd expect. There's one thing that you might add to that is when we look at our sales of lights this year. So everybody knows California is about half of our sales and light had a tremendous year. But we overindexed the California versus the rest of the country and California being an established market. The fact that we are able to overindex indicates to me that there's a lot of renovation and replacement going on, which is really a positive for the long run, too.

William Bates Chappell
Truist Securities, Inc., Research Division

One, I'll try to be quicker on the second one. But looking at your U.S. Consumer guidance, and Randy help me if I'm -- I think I'm doing this math right, I mean at the low end of your guidance, say it's down 5% in 2021, still assumes that it would be -- the revenue would be up 17%, 18% versus 2019 levels. So can

Copyright © 2020 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

you maybe help us bridge that is, I assume, like 5 points over a 2-year period of price and 12 points is volume. And so it's kind of -- assuming you get a normalize it was a 6% growth for the category over a 2-year period. Is that the right way to look at it?

Thomas Randal Coleman
Executive VP & CFO

Let me try to bridge it by quarter and then first half, second half, Bill. So first quarter, like we said, it's going to be tremendous. It's going to have growth rates for the entire company, but U.S. included it will look a lot all like what we saw in Q4. Still a lot of confidence in Q2 and retailers will be building, and we expect consumers to be continually engaged, and we expect POS rates to continue like we've seen in Q4. What we expect to see in Q1, we expect that to roll through Q2. At that point, our assumption beyond that point is that to get to a minus 5% or to a nearer number for the U.S. That would assume that we're down about 1/3 or half of what we gained in the second half of 2020 on a POS basis and really beginner basis that you can argue that's really conservative because we think people are going to be continuing to work from home, I don't expect people to go back 5 days a week. And I think people who have new engagement category will continue to be because they have enjoyed it and they continue to want to capitalize investments they made this year. So the time will tell -- for us to try to speculate what's going to be going on in the world and the economy and how that applies to the U.S. lawn and garden, that's real, really challenging. But that's the assumption that we've made, and we want to be transparent about what the math looks like to get to that kind of guidance. So hopefully, that helps you, Bill.

Operator

We'll take our next question from William Reuter from Bank of America.

William Michael Reuter
BofA Merrill Lynch, Research Division

Great numbers. Two questions for me. The first is you're going to be doing $800 million of free cash flow over a 2-year period. I guess what are your plans with regard to that cash flow and your leverage continues to go lower as your results have gotten better and better. I guess, what are your plans in terms of leverage targets at this point?

James S. Hagedorn
CEO & Chairman of the Board

Randy and I think, have partnered real well on this issue. So I'll start and hand it over to Randy. This is one of the areas where I think we are completely in agreement. And as we prep for the call, we sort of figured this would come up. I think at the moment, we're pretty happy with our leverage where it's at. It gives us a lot of options. And I think I want to spend some time understanding the election results, to be honest. And what's happening with corporate tax rates, dividend, personal income tax rates, which in this company, matters, I think, to our shareholders. And I think we were very much prepared to special dividend, a lot of money out if we felt that taxes were going up to the people who own this company and that is our entire shareholder base. And we definitely have a more active M&A pipe than we did probably 2 years ago, nothing crazy. But if you look at the Bonnie deal, we haven't really talked about it, but it's pretty accretive. And I'm going to say, relatively neutral to sort of leverage. So this is one where we're actually doing a deal, and it's really hardly moving leverage and on the EPS line it's accretive. So I think we feel good about that. I think we're looking really hard and spending a lot of time with the Board on the sort of evolving cannabis and hemp marketplace and how we place that there I think live goods continues to be an interest for us. But we do have a commitment to our shareholders to be shareholder friendly, and we absolutely intend to do that. And what happened in 2020 has been really good. I mean we did not expect to end this year at 2.5x. And I have to ask Randy, but I think if you sort of look at our numbers for like year-end, I think we're talking -- I think the projections internally are down like 2.0 or something like that. So we've got a lot of flexibility. We are committed to shareholder-friendly and we're committed to investments in the business, but we're not doing in any rush at this point to act anyway sort of quickly.

Operator

Copyright © 2020 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

We'll now take our next question from Eric Bosshard from Cleveland Research.

Eric Bosshard
Cleveland Research Company

On the Bonnie business, I'm just curious for a little bit more color. For the last 20 years, you have been somewhat aggressive about trying different things and different adjacencies, but never really done anything in live goods. And so I'm curious if there's something changed in the dynamics of that business or the opportunity to make money in that business? And especially interested in the thinking on that relative to the bigger runway that you have in the cannabis business, just sort of how you -- what changed in the thinking to get you to want to get in the live goods business?

James S. Hagedorn
CEO & Chairman of the Board

All right. Well, I don't think anything actually. I think we've been trying live goods, Miracle-Gro plants and stuff like that. And I call it modest success in that. I think if we look at sort of the whole Project Focus approach to the business that we took, I don't know, whoever was saying 5 years ago, it was some businesses that we thought were not long-term beneficial to us. And look for businesses that had higher growth rates, remember, at that time, and due -- a lot of stuff has changed since then, to be honest, which is that I think we were looking at 0 2 on the core at the time. And that's not a crazy number now, but it's clearly, we believe, better than 0 to 2, but we wanted businesses that could grow faster than that. And I think we did view lots with particularly herbs and veggies, as a business that could grow some multiple of 0 2, and that's been true. And so that's really why we hooked up with them with AFC, Alabama Farmers Co-op and Bonnie to sort of begin with. And the reason that we were at the 25% level with them was because that's as far as it let us go, okay. We've had other discussions with other opportunities, and I think liked the Bonnie opportunity better.

When AFC assets and Mike Sutterer assets, could he go over there to sort of upgrade their management team, we were very encouraging about that. I think if you looked and said, what would Randy has been critical of, I think it would be sort of a lot of processes within Bonnie that I think he thought could be better. And that's because we were kind of with them, understood the business, but as a kind of minority partner. I think Mike agrees with those things, and he's done a lot of that. So I think as we looked at the business, and remember, the -- this is -- will become more clear, but it's an average earnings over the past 3 years, that there was a big enough increase this year that we kind of wanted to go more quickly. We had a right to go to 51%, but they had the right to say no and buy us back out. And we ended up, I think, very happily at this sort of 50-50 place, which we're actually super comfortable with. But -- and so when you look at the profitability of that business today versus before Sutterer was there, big difference. So a much more attractive business today than it was, growth rates that continue to exceed our core consumer business and this idea that we want to be a gardening business. And so if you have not been aware of our interest in live goods, I guess, we haven't been clear enough.

So -- and we don't -- I don't view it as an exclusive decision where it's binary, like decide on like consumer, veggie, edible, live goods or within the Hawthorne business. The -- we've clearly been spending beaucoup dollars building our Hawthorne franchise, and they've done a really nice job integrating that all those pieces. You're not a part of the Board. But I would say the Board is very encouraging of continuing to look for opportunities, and with kind of fair pricing, to continue to invest in that business. So I think that this is where Randy and I play. Mike and Chris and the rest of the group advocate for deals, and it's Randy and I got relieved and our finance committee and the Board, that's run by my sister, my twin, to sort of look at those and evaluate them based on kind of lots of things, but shareholder-friendly leverage, what we think the opportunity is long term. And I think we're positive about both of them. And I think if you read something from that, I would say, continued investment in live goods, continued investment in the Hawthorne business and continued shareholder-friendly reaction and very pleased with the result of the election, at least in regard to the senate and stability of sort of taxation at least in the near term. [indiscernible]

Thomas Randal Coleman
Executive VP & CFO

Copyright © 2020 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

I only just dropped into say, but I guess what I'd add is they've been really good partners for the last 4 years. The quality of team there is top-notch, and we've enjoyed working with them, and I'm optimistic going forward that we're going to make it even better. So it's been really good partnership...

James S. Hagedorn
CEO & Chairman of the Board

Look, just a quickie and it's maybe redundant. Randy was one of the more tough guys to get on board with our live goods approach. And you might talk about why that so and what's changed?

Thomas Randal Coleman
Executive VP & CFO

Well, on a relative profit basis, Bonnie has a class of live goods and when we look at operating margins, that still is below what we see in our U.S. business and below our corporate average. So this year, they've been a beneficiary of the grading that we have as well, but their profitability rate is actually higher now than our corporate average. A lot of optimism that they're going to have a good 2021 despite Scotts will. And I think we're making the right kind of changes to maintain that kind of profitability rate. So at that point, it's easier to get on board and then I think the price we're paying to is fair and that it is based on 3-year average. And if we wait another year, we have much higher check to write. So I think that was the right time like you said.

Operator

We will take our next question from Jon Anderson from William Blair.

Jon Robert Andersen
William Blair & Company L.L.C., Research Division

Most of my questions have been answered actually. I guess, one thing that keeps my interest. Jim, you mentioned a competitive dynamic at retail in 2021. Could you just talk a little bit more about what you expect there by channels or with respect to some of your major customers? And I know that pricing at retailer -- price at retail is up, but promo is down. To what extent did that impact you or benefit you? Or was that truly just a kind of a retail phenomenon and how you expect that to kind of play out in 2021?

James S. Hagedorn
CEO & Chairman of the Board

You're going to get me in a kind of a trouble with that. Actually, I think it's a really good question that I'd like to answer. We've talked about how the large footprint format of some of our larger customers actually was when this whole thing of essentiality and the risk of COVID and nobody wanted to get anybody sick, and they're worried about their own associates, that there was a lot of kind of head in the sand during the peak of the season. And so what happened was you saw a lot are relatively smaller retailers, Tractor Supply, Ace, Costco, who really got your head down and were relatively less to frame because I think there was less criticism based on their format of bringing people into the stores. And so I think early season, you saw just a sort of beaucoup share gain with our sort of next year down below Depot and Lowes. I think that once sort of June happened, you saw, I think, and we have a lot of conversations, great ones with guys I consider friends, both at Depot and Lowes to sort of reconnect to the market. And if you look at sort of the second half of the season, they really started to actually work pretty well and take advantage of the marketplace.

But a lot of credit goes to those smaller retailers who just did really innovative work along with our sort of sales and marketing teams to drive that business. And so they deserve a lot of credit, and they're going to look to defend their share. In addition, the number we threw out of sort of $200 million roughly sales between Hawthorne and sort of the core consumer business, I think there was a lot of out of stock and lot of stock just in consumer products world where people wanted to buy the stuff and nobody wants to do that again. So everybody is also saying, we got to be in stock, and you're seeing that sort of drive our manufacturing processes right now, retailers are buying heavily. But I think there's much less fear of investing in the marketplace. And therefore, I think you're going to see a very active sort of promotional

Copyright © 2020 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

schedule as people try to say, actually, this worked out pretty well for us. And I think you're going to see that small customers, large customers, the whole thing. The -- and I want to mention Walmart just for sake, I think they did a fantastic job this year. And they've done a really nice job of head down in the marketplace and working alongside of us, just like our other retailers have. But they deserve a complement because it's been a while since we said they were leading in the space too and they were. Now if you get to pricing, this is one area, where because of the relative lack of promotion, I think most of that benefit went to the retailers, to be honest. I mean we got a little bit of pricing last year. But I think our view is retails were probably up about 10% because of the lack of promotions, especially sort of these big heavy Black Friday events. I think what we learned is consumers on a unit basis were relatively insensitive to it.

And that doesn't mean we should be raising our prices and taking advantage of it. But I think it is a data point that says how valuable and you guys have heard me talk about these Black Fridays. I generally think they're almost always poorly planned. We miss weather a lot. A lot of our marketing approach deals with that in a much more sensitive level. But you do have to question the whole sort of Black Friday -- I assume it is priced 75% of our promotional dollars are going to like a couple of weekends. And so we're working through this with our retailers. But our benefit was less than the retailer benefits, but I think their costs were up significantly as they dealt with sort of hygiene and safety issues in the store. And so I think a lot of that money was spent just in their operations trying to stay open. But I do think it's worthy of real conversation as we go forward as to what does promotion mean in this space, what does pricing mean in this space. And the selling, the amount of loss just as an example, does that make a lot of sense. And so I think there's a lot of work still to do on this issue. And Mike and his team are, I think, very engaged with a lot of people who are very much personal friends of ours on trying to understand this. And I've had some of those discussions with senior management as well. So where are all those? I don't know. I hope that they don't all get amnesia. Get back into the same world to like give product away, steal share from each other in '21 and not remember the lessons we learned in '20, which I think really are fundamental. But again, if anybody you remember, it's a little bit like look at the election results, I think there's a lot of lessons learned here. You just wonder if 6 months from now, everybody is going to go back to the corners and just do the same whole craft that they've always done. But I think there's real reason here to reflect on what does it all mean.

Thomas Randal Coleman
Executive VP & CFO

Jon, I'll give you a little perspective on what pricing means for us over the last few years and thinking about next year and year after. But if you recall, in '18, we didn't take pricing. So in '19, we did a 2-year catch-up. Going into 2020, we thought our price would be about 75 basis points that actually turned out to be higher because we did pull back some promotional money like retailers we ended up spending that against media marketing. So we've had it necessarily drop to the bottom line, but we invested back in the business. But the actual pricing ended up higher than 75 basis points just to good mix and that area where we didn't take pricing those products sold especially low. So we were able to realize over 1% by the time we got to the end of the year on just an invoice sales basis. So going into 2021, we're certainly not in a similar place, but I quantify on a total company basis at about 75 basis points. And again, that could flex up a little bit up or down depending on how the year unfolds. But we're really comfortable with that and that -- we take pricing almost every year. We try not to get too far ahead of things, and we try to think long-term about our pricing and making sure that it's reasonable. So '21 about 75 basis points, and that will cover commodity costs, which have started to increase a little bit over the last couple of months. I think more important to us when we think about gross margin more broadly, that we are seeing necessary investments in warehousing and distribution just to keep up with the volume and the labor costs as well. There's some pressure there. So 2 months ago, we would have thought we'd see gross margin rates closer to flat versus down 50 basis points, but definitely going to take price change in 2022 as well and continue that multiyear continual pricing efforts that we've talked about.

Jon Robert Andersen
William Blair & Company L.L.C., Research Division

Copyright © 2020 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

That's really helpful. Just one quick follow-up. In Hawthorne, a couple of years ago, you were very aggressive, I believe, from a pricing perspective. And it was, I think, part of the strategy to consolidate market share, et cetera, shore up customer relationships, other things. I think you, correct me if I'm wrong, maybe eased off on that a little bit. In the last year, 1.5 years, what should we expect from Hawthorne on pricing? Are we more kind of a steady-state mode like U.S. Consumer or any changes to expect there?

Thomas Randal Coleman
Executive VP & CFO

So to quantify, we will be taking pricing for Hawthorne again and it's probably not as high in '21 is what we did in '20. But I think in addition, it's just a little bit of pricing, and we're clearly not trying to be greedy by any means, but just be rational about it. But we've also greatly simplified the way we get a business with our retailers and we structured new trade programs and rebates and so on, that's much more rational. When you think about how we combine all these businesses that we bought over a 3- or 4-year period, and they were all going to business differently in different programs. So now we streamlined that, simplified it, made our business much easier to deal with. And I think there'll be a lot of benefits from that simplification as well. But we're thinking about Hawthorne similar to the U.S. and that we expect to take pricing in those 2 years, but definitely don't want to get too far ahead of ourselves. And Chris, I don't know if you want to add anything to that?

Christopher J. Hagedorn
GM & Senior VP

Yes, Randy. No, I think you covered it pretty well. We have taken pricing at the start of the year. As Randy said, we're really looking at when we talk about is pricing and trading program. And like he said, revising and simplifying and rationalizing those trade programs, make it a lot easier for us to deal, a lot easier for retailers to understand where they're at with us. We expect to see some pretty significant benefits from that as we go through the year.

James S. Hagedorn
CEO & Chairman of the Board

I guess have one kind of warning out to the team, and I know Luke carries around us on his shoulders a lot. There's quite a few products on both sides, Consumer and within Hawthorne, where we're completely oversold even today. And I think that one of the things we have to be really careful of is to sort of -- because we know what we've done in the Consumer side, which is this whole idea of one thing to the customer. I think we did a lot as we saw the U.S. Consumer business, this goes back 15, 20 years ago, and we built a bunch of companies into one easy-to-do business, to some extent, powerhouse. I think Hawthorne is down that track. This is a year where I think -- and we're not alone. I mean there's a lot of people who have products did so well during COVID time. But it is not unfair to say that we couldn't fulfill probably $0.25 billion of business, and that does make it hard to look someone in the eye and say, "I want pricing." We've got to be a better partner than that. And I don't think anybody takes it too personally, which kind of surprises me a little bit to be honest because I would, and I do. I don't know, Mike, your view on kind of the acceptability of sort of having a pricing discussion right now where we couldn't satisfy demand.

Michael C. Lukemire
President & COO

Well, that's a difficult conversation. If you're building infrastructure to support the business, I think that's what you do with the retailer and you both try to win because everybody is trying to increase infrastructure on direct-to-consumer and have delivery to stores. And so -- but if you're not servicing -- for me, that's very personal. I don't like not servicing. So I was here when we were really then back 25 years ago. So -- and we built a great supply chain, and it's time to go to the next level. So you're going to see some capital and some expenditure that is to build that next capability.

James S. Hagedorn
CEO & Chairman of the Board

Copyright © 2020 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

Yes. I mean this is a little bit of a [add on] in regards to this conversation. Mike took this stuff really personally this year, and so is Randy. I mean I think Randy's issue was that while the numbers were great, we had a real difficult time keeping up with the budget inside of it. And I think it's going to involve us, trying to really make some improvements to our systems and how we think about budgeting and on Mike side it was the supply chain. I mean -- let me tell you, this company was entirely functional during what I view is a pretty significant national emergency and it could have been for us. And so this is not saying itself being here. It was saying, what is it that bother people a lot was our inability to keep up with the growth from us or a budgeting point of view, and we view this as a credibility issue to our Board, to ourselves, to you guys. And Mike's view that got sort of sour and sour toward the end of the summer is that this is unacceptable that we can't deliver. And so I guess I want to throw that out in regard to pricing that we've got some work to do to make it. If we can build a business where we are an absolutely perfect supplier, vendor, partner, whatever you want to call it, to a retailer -- and you make it easier to do business, people don't have a beat with that, okay. If you aren't delivering product, that's a way harder conversation. And it's worth noting of how difficult the last sort of 2 or 3 months have been for Mike as he has focused most of his time like back in the day of kind of dedicating himself to improving our supply chain and our sort of ability to consume our -- to get our deals done with when somebody asked something, give it to them 100% of the time in full, in the time line they want. But we're still out of stock on products that are important to the future.

Thomas Randal Coleman
Executive VP & CFO

This is Randy. Yes. Let me just make one more point. I'm not sure we've been absolutely clear enough. We're all building a lot more inventory than what we need to be flat in the U.S. and similarly to be up 15% or 20% at Hawthorne. So there will be a point in the spring where we need to evaluate what the second half of the year looks like, but we're not building inventory to meet the numbers we've talked about in guidance because we need to do better and we need to get ahead of things and we're actively working on that to make that happen. There will be a point of where we need to evaluate, but it's not on November 4th.

Operator

We'll take our next question from Alex Maroccia from Berenberg.

Alexander Rocco Maroccia
Joh. Berenberg, Gossler & Co. KG, Research Division

Can you explain the cannabis market opportunity in Jersey and Arizona, and how it compares to other states that have well-established medical user bases already?

Christopher J. Hagedorn
GM & Senior VP

I can explain what we know of it. There's a lot of regulation obviously yet to be written in those states. So it's a little premature, I think, to give our opinion on the morning that we saw that those went positively. That being said, if you look at even just the sort of opportunity size, particularly in New Jersey I think significant -- we expect those guys, particularly with New York and Pennsylvania not having responded yet. Number one, I do expect that New Jersey is going to be a trigger for those guys because so long particularly with the COVID budget holes that both those and all states have frankly, but those 2 as well, that they're going to let New Jersey kind of take their cannabis money. So it's an easy subway ride across the -- under the river from Manhattan into New Jersey as well easing over from Philly into the New Jersey. I think we'll see a lot of tax money flowing across that border there. Like -- much like you saw -- you see with a lot of states that have border states that don't have lottery. Our conversations that Jim referenced earlier with Senator Sweeney are encouraging in New Jersey.

They make us think that there'll be a rationally regulated tax rationally tax marketplace there that should be pretty business permissive. So we think there's significant opportunity there. And that's a marketplace that we've been building up our service and sales operations in anticipation of. Arizona, we think will be -- it's not quite as significant an opportunity just kind of in terms of absolute numbers. But again, that's

Copyright © 2020 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

a state that's been slowly developing in a positive way forward. We already have a good presence there. Our sales team is on the ground and well established relationships with the large cultivators there and retailers. So we feel good about both states. I think New Jersey is more exciting, not only for its potential, but the way we think it's been driving the rest of the market.

James S. Hagedorn
CEO & Chairman of the Board

But I do view that market, which is an Connecticut, New York, New Jersey, Pennsylvania, just relative to the kind of West who are extremely positive.

Christopher J. Hagedorn
GM & Senior VP

We've talked about in the past, the research that we've done and the [indiscernible] and we'll see how it actually plays out as the northeast canvas consumers that make higher per capita consumption area in the California. So we should expect it -- and you're talking about when you combine those states a similar number of individuals, about 40 million people. So it should be a market like California for us obviously factor into 3 different states. One thing to expect just because we talked about it at something we need to note is California is by far our largest state, still around half of our total business is just California. We expect California to deemphasize as the Northeast comes online. A lot of the product that is grown in California, we believe is to service the illicit market in the tri-state area. So as those states increasingly have their own kind of domestic and stable legal markets, we expect the business to kind of flow across the country for us and for business in those states to replace some of the business that we do in California now.

Alexander Rocco Maroccia
Joh. Berenberg, Gossler & Co. KG, Research Division

Got it. That makes sense. And then as a follow-up, can you explain the current retail environment in Hawthorne. Because I know that one of the retailers have been aggressive in recent months from an acquisition standpoint. So how should we think about industry consolidation and its impact on relationships?

Christopher J. Hagedorn
GM & Senior VP

Yes. There is definitely industry consolidation. I assume the retailer you're referencing is GrowGeneration. They have been aggressive for sure. And I think it's probably worth acknowledging the fact that they announced 2 days ago that they had acquired a retail chain out of Northern California called The GrowBiz. The GrowBiz is one of the larger retail chains in California and the country, and they've been a consistently very loyal Hawthorne customer. Now we expect the positive relationship to continue. We have a good strong relationship with GrowGeneration. They're our largest retail customer. They've been aggressive and working with large and aggressive retailers is something that's pretty even our DNA at ScottsMiracle-Gro. So watching them grow. They've brought in former Home Depot executives as advisers to them. I think it's clear what their objective is and it's one that we're familiar with being partners too. So we don't expect any negativity from that. We've got a good strong relationship with GrowGen and their executive team. They've been a great partner to us.

Operator

And we'll take our last question from Carla Casella from JPMorgan.

Sarah Stuart Clark
JPMorgan Chase & Co, Research Division

This is Sarah Clark on for Carla Casella. And apologies if you addressed some of this, we had to hop on late. But on working capital, how do you see that normalizing coming out of COVID? It looks like you've been managing your inventory and also seeing an increase in payable days. How do you expect that to look going into next year?

Copyright © 2020 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

Thomas Randal Coleman
Executive VP & CFO

Sure. This is Randy. I'll take this one. So working capital, let me start with inventory. At the end of September of '20, if things were ideal we would have probably had about another $100 million of inventory versus where we finished the year. But like I've mentioned in our scripted remarks, seems we could buy product or manufacture products depending on the business we're talking about, it was more or less being shipped out the door. So that will be a drag on free cash flow next year. But when you think about what inventory look like at the end of Q1 and even Q2, I'd expect it to be significantly higher than that as we finish those quarters just as we're trying to build ahead of demand that we're trying to meet now and where we expect demand to be at the back half of the year. And like I said, there will be an inflection point at some point in the spring when we need to decide how things look. But we'll be looking at things just like you do.

As far as payables, payables were up and receivables were up a lot as well. And the fourth quarter was good, sales were so high. Trying to forecast that out for what it looks like for 12 months from now, I don't think we can do that actively because it's going to depend on again so many factors and what consumer demand looks like and how all that rolls out and whether we need to continue to build. Even in addition to working capital and let me talk about SG&A little bit. We pulled a lot of projects into Q4 that would have been phased more typically in Q1 and Q2. Really trying to get ahead of things and we'll get to third and fourth quarter next year, if things go as well as we hope internally, our SG&A could be even higher because we'll keep our foot on the gas and we'll keep investing. But there's a lot of flexibility there, too. So if we need to slow things down, we have all the flexibility. So it's going to be interesting. I can't answer your question perfectly because there's just so much uncertainty right now, but that's the way we're thinking about.

Sarah Stuart Clark
JPMorgan Chase & Co, Research Division

No, that was extremely helpful. And then our last question, you talked a little bit about M&A. How have you seen valuations change pre-COVID versus now? And that's all from us. Congrats on the third quarter.

Thomas Randal Coleman
Executive VP & CFO

Sure. So on the M&A side, the multiple we're paying on the Bonnie deal was prenegotiated from 4 years ago. So it's 8x trailing 3 years EBITDA. And so not a lot going on there that would change based on current marketplace. As far as the other deals that we're pursuing right now, I would say that hasn't changed a whole lot, and I don't think it's necessarily driven upward or downward based on what's happening in the world around COVID. But there are a few things in the pipeline we're looking at, it's still very early. We can't begin to commit to right now, but when a company uses the cash beyond the Bonnie deal, there will be things that we talk about probably in the next quarter or the quarter after that. So stay tuned.

Operator

And that does conclude our question-and-answer session. And I would like to turn the call back over to Jim King for any additional or closing remarks.

James D. King
Chief Communications Officer, Executive VP & President of The Scotts Miracle-Gro Foundation

Thank you. For those people who have additional follow-ups, if you want to call out office directly, you can reach me at (937) 578-5622. Right now, we are tentatively scheduled for our Q1 results to be released on January 27. We have no kind of active IR plans between now and then. So put it on your calendar, and we hope to talk to you then. Thanks for participating today, everybody, and have a great day.

Operator
And that does conclude today's call. Thank you for your participation. You may now disconnect.

Copyright © 2020 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

Copyright © 2020 by S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved.

These materials have been prepared solely for information purposes based upon information generally available to the public and from sources believed to be reliable. No content (including index data, ratings, credit-related analyses and data, research, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of S&P Global Market Intelligence or its affiliates (collectively, S&P Global). The Content shall not be used for any unlawful or unauthorized purposes. S&P Global and any third-party providers, (collectively S&P Global Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Global Parties are not responsible for any errors or omissions, regardless of the cause, for the results obtained from the use of the Content. THE CONTENT IS PROVIDED ON "AS IS" BASIS. S&P GLOBAL PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Global Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages. S&P Global Market Intelligence's opinions, quotes and credit-related and other analyses are statements of opinion as of the date they are expressed and not statements of fact or recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P Global Market Intelligence may provide index data. Direct investment in an index is not possible. Exposure to an asset class represented by an index is available through investable instruments based on that index. S&P Global Market Intelligence assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P Global Market Intelligence does not act as a fiduciary or an investment advisor except where registered as such. S&P Global keeps certain activities of its divisions separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain divisions of S&P Global may have information that is not available to other S&P Global divisions. S&P Global has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P Global may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P Global reserves the right to disseminate its opinions and analyses. S&P Global's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription), and may be distributed through other means, including via S&P Global publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.
© 2020 S&P Global Market Intelligence.

Copyright © 2020 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.