SMG reported 1Q16 sales of $246m and GAAP loss of $81m, or $1.32 per share. Expects 2016 sales growth to be 4-5% and adjusted EPS to be $3.75-3.95.
Good day, everyone, and welcome to the 2016 first-quarter earnings conference call. Today’s conference is being recorded. At this time, I’d like to turn the conference over to Mr. Jim King. Please go ahead, sir.

Jim King - Scotts Miracle-Gro Company - SVP, Chief Communications Officer

Thanks, Shannon. Good morning, everyone, and welcome to the Scotts Miracle-Gro first-quarter conference call. With me this morning in Marysville, Ohio, is our Chairman and CEO Jim Hagedorn and our CFO Randy Coleman. Joining by phone from the West Coast is Mike Lukemire, our Chief Operating Officer.

In a moment, Jim and Randy will share some prepared remarks. Afterward, we will open the call for your questions. In the interest of time, we ask that you keep to one question and to one follow-up. I’ve already scheduled time with many of you later in the day to fill in any gaps that we have, and anybody else who wants to set up some Q&A time can call me directly at 937-578-5622.

One bit of housekeeping before we start. I wanted to let everybody know that Randy and I will be presenting at the Raymond James conference in Orlando on March 9. We also have set aside a day and a half for one-on-one meetings at this event. The presentation itself will be webcast, and so we’ll provide more details when we get closer to the date. With that, let’s move on to today’s call.

As always, we expect to make forward-looking statements this morning. So I want to caution everyone that our actual results could differ materially from what we say. Investors should familiarize themselves with the full range of risk factors that could impact our results. Those are filed on our Form 10-K, which is filed with the Securities and Exchange Commission.

I also want to remind everyone that today’s call is being recorded, and an archived version of the call will be available on our website. With that, let’s get things started, and I’ll turn things over to Jim Hagedorn.

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

Thanks, Jim. Good morning, everyone. Just before we get going, we’ve got some money on the table here. So I’m getting over a pretty wicked cold, so I asked Randy if he would lead the Q&A. So don’t direct questions to me; direct them at Mike and Randy.
Nobody believes me here that I could actually take a backseat role during the Q&A, but we're going to prove them wrong, right? I will split the money with you guys. (laughter)

Randy Coleman - Scotts Miracle-Gro Company - CFO

It's on the table, by the way. Hey, listen: a bet is a bet, man. (laughter)

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

Anyhow, so just heads up. The first quarter usually doesn't make a lot of headlines for us, and I want to be careful I don't overstate things this morning, because Q1 results are less than 10% of our full-year results. But clearly, the quarter was strong, putting us on good footing as we get ready for the season.

But more than just our Q1 results, I'm most encouraged when I step back and look at the big picture. Not only are we poised to have another solid year in 2016, but we're taking the right steps to position this business for the long term.

In terms of our 2016 outlook, the team is excited about the prospects for the season. Weather has been favorable so far, and the days are already getting longer, so spring is right around the corner. And as I'll explain in a bit, the macro-economy continues to be our friend, and our retail partners are clearly committed to their category -- our category and our brands -- as they prepare for the spring.

In terms of the long-term outlook, whether it has been our Board, our associates, our retail partners, our vendors, or many of you listening today, the feedback we've been getting regarding Project Focus has been extremely positive. We're convinced it's the right plan at the right time, and we are executing against it with energy and enthusiasm.

As you saw from the press release, we took the next step in executing Project Focus with our minority investment in Bonnie Plants. I'll elaborate on Bonnie later and tell you why I think it offers us such great potential. I'll also fill you in on the status of some of the other strategic initiatives that are underway.

For now, let me spend a few minutes talking about the results we announced this morning. I'll let Randy cover the P&L. I want to start with consumer purchases, up 14%, with double-digit increases at each of our major retail partners.

You will recall that our lawn business -- that is grass seed and fertilizer -- was down 8% in 2015. Once the fall lawn care season broke, we saw a high level of consumer and retailer engagement. Consumer purchases were up 13%, with most of that activity occurring earlier in the quarter when consumers were still actively engaged.

But it wasn't just lawn care that did well. Soils were up 12%, mulch up 8%, outdoor insect up 12%, indoor insect up 10%, Roundup was up a solid 7%, and our rodent business, which is the TOMCAT brand, was up 38% in the quarter.

Unlike the rest of our portfolio, Q1 is a critical time for TOMCAT. Since we acquired this business two years ago, consumer purchases are up more than 50%. Our Dead Mouse Theatre advertising campaign has caught the attention of both consumers and the advertising industry, as we continue to receive more awards and recognition for the effectiveness of this unusual campaign.

At Hawthorne Gardening, we are aided by the acquisition of General Hydroponics, which we made last April. Beyond the impact of the acquired growth, GH sales in Q1 on a pro forma basis were up 40%. So this business continues to exceed our initial expectations. And Europe had a solid quarter too.
All of this led to a 14% increase in sales within the Global Consumer segment. And our gross margin rate on a Company-wide basis was up almost 600 basis points. Yes, it’s early and the numbers are kind of small, but this is a great way to start the year. Clearly we are well-positioned as the season starts to unfold.

Let me transition to talk about the macro-environment for a moment, as well as our 2016 plans. I appreciate that our shares have been pretty volatile lately, but so was the overall market. But I want to repeat some of the same comments I made during our Q1 call last year.

In short, the macro economy is our friend right now. For us, oil is a tailwind. We had already assumed about $10 million benefit from fuel savings this year, and that number probably has some upside these days, both in terms of cost of goods, but on the top line as well.

History has shown that discretionary income is critical to our consumers, especially those who shop at mass retail. So gas prices below $2 a gallon should help us as well.

Last year, investors worried about currency issues, which didn’t impact us that much in 2015, and should impact us even less this year. The focus is now on China; the story is even better when comparing Scott to other CPG companies. A slowing market in China has almost zero direct impact on our business.

Another macro tailwind is that retailer support for the US, or in the US, remains extremely strong for us. The top-to-top meetings we’ve been having, many within the last two weeks, give us even more confidence that our retail partners continue to see lawn and garden as a destination category for them, and continue to see our brands as helping them drive the foot traffic that they need to be successful.

I’ve been in this business far too long to start making promises this early in the season. Weather has been a headwind in some shape or form over the last several years. So for all we know, we could be shoveling snow in May. But after factors that are beyond our control, I’m extremely optimistic of the way that the season is setting up.

As we prepare for spring, we’ve been especially focused on building inventory and starting to activate our marketing and sales plans. Randy will provide the details, but our inventory levels are deliberately higher right now as we work to get ahead of the season. Frankly, this is an area we could’ve done better in each of the past two years.

With strong early-season demand for our soil and mulch products, we found ourselves having to ship further than we had planned. While we never missed a shipment, our commitment to customer service cut into our margins. To prevent this from happening again, we’ve decided to build our inventory earlier this year, though I’ve challenged the team to improve on this area going forward.

On the marketing side, you should begin to see some of our new advertising in the weeks to come. We will have an entirely new creative approach for our lawn fertilizer and our Roundup businesses. We’ve improved our product offerings this year in our lawn fertilizer business as well.

Our weed and feed product is 40% more effective, based on new granulation technology. And that’s using the same active ingredient applied at the same levels.

In our gardening business, we are extremely well-positioned for the second full year of Nature’s Care in the marketplace. We’ve expanded our marketing approach to help consumers better understand the difference in product quality and efficacy between Nature’s Care and other competitive organic products on the market. And our sales and promotional support will be even greater.

As you heard us say at length in December, the organic space is one we’re extremely focused. We remain committed to converting the majority of our gardening business to organic. But we’ll do so without asking gardeners to sacrifice product quality or performance.

We also told you in December, we wanted to have direct interest in the live goods space, and that brings me to the investment in Bonnie Plants that we made this week. While it’s a minority investment, the deal is structured in a way that gives us a way to increase our ownership over time.
The entire team here, as well as the Bonnie team, is excited about this opportunity. Those of you who followed us for a while know that we've experimented with our own brands and live goods on several occasions, but were never able to build the momentum we wanted. This deal with Bonnie is far different. Bonnie has the leading brand in the segment of live goods that we like the most -- edible gardening -- and Bonnie has the leading share by far of the edible gardening category. So the opportunity for growth is both real and significant.

The growth rate in edible gardening has been in the mid- to high-single digits over the past five years. It's also a space that's extremely popular with Millennials. But we're convinced we can further accelerate the growth in popularity of edible gardening.

Most gardeners don't know the difference between a Big Boy, a Better Boy or a Roma tomato -- and yes, those are all real varieties of tomatoes. But our consumers would like to know which of those is best in a sandwich, in a salad or in spaghetti sauce. They want more help understanding what plants to put in the garden versus a clay pot on their patio or their balcony.

That's where we believe that our expertise in sales and marketing, coupled with Bonnie's expertise as growers, makes for a very exciting combination. We believe we can help change the conversation in gardening, and make it more accessible to more people. And we can make it fun.

There are real similarities between what we did with TOMCAT and the opportunity that exists in live goods. TOMCAT was already a great product, just like Bonnie. We applied our expertise as marketers in new and creative ways that resulted in increased demand and improved retailer support. That cycle keeps feeding on itself, which has led to the POS increases that I mentioned earlier.

As for live goods, we think we can do it the same. That's why some of our most talented marketing people will be dedicated to the Bonnie business. In addition to helping grow the Bonnie business, we believe this partnership can help us grow our own business too. Working with Bonnie, we can do a much better job of cross-promoting and cross-merchandising in retail stores.

Part of our goal is to help gardeners understand they can greatly enhance their success if they start by using the right soil, soil amendments or plant food. If we are successful, that obviously helps our Miracle-Gro business too. Listen, I can go on, but probably the best way to get the point across is to sponsor some store walks later in the season. So expect to hear from Jim King in the weeks ahead, and we'll work to get some of those put in place.

The Bonnie partnership is an important part of Project Focus, and that's why we spent so much time talking about live goods with you back in December. But as you know, there are other elements to that plan as well.

We continue to make good progress on the JV between Scotts LawnService and TruGreen. The integration plans are moving forward as we expected, and both sides are targeting a closing later this month. Obviously the goal for both businesses is to move forward with as little disruption as possible so that we can start the season with a strong customer count and execution plan.

We also continue to explore opportunities that would expand our product offering in hydroponics, getting us closer to our goal of offering a full range of products, just like we do in the core business, to consumers and retailers in this space. It might even be possible to have further news related to our hydroponics portfolio by the time we announce our Q2 results.

As for the other major elements of our plan, opportunities to improve our operations in Europe, we continue to make progress. We told you in December that we're exploring potential partnership opportunities, and those discussions continue to go well. We'll provide updates where we can, but I wouldn't expect any big news for Europe until the second half of the year.

So before I turn things over to Randy, I want to touch on another recurring theme. At the risk of sounding like a broken record, I want to congratulate my team for the progress we are making. FY16 will mark the first plan that this team is solely responsible for building and then executing. The plan for this season is outstanding, and the execution so far has been equally good.

This team is also responsible for helping to architect Project Focus, and I've already stated repeatedly how I feel about that plan. I'm seriously enjoying my work, and I think every member of my team would say the same thing. But it's not just about having fun; it's about winning. We are
confident our plans will strengthen Scotts Miracle-Gro in both the near and long term, and we're confident we'll do so while driving shareholder value.

With that, let me turn things over to Randy.

Randy Coleman - Scotts Miracle-Gro Company - CFO

Thank you, Jim, and good morning, everyone. My comments will be fairly brief today, as Q1 is a pretty small quarter for us. Looking at the results in our P&L, everything is either in line with what we expected or slightly better, as was the case with the gross margin rate.

Before I go further, it’s worth reminding everyone that Q1 results are easily skewed on a percentage basis. For example, the six extra days in the quarter alone accounted for a 7% increase of sales from last year. But the dollars at play, $15 million, would be less than a half day’s worth of sales once we get to the end of the second quarter.

I would urge everyone to focus on the absolute dollar changes and not the percentages. Let me also point out that our POS growth numbers cited earlier by Jim are on an apples-to-apples basis, and were adjusted for the extra days in the quarter.

Still, I agree with Jim’s assessment that this Q1 had a different feel than most. The warm fall weather kept both consumers and retailers engaged, and we wound up having slightly better top-line results than we expected.

Sales in the quarter were $246 million, compared with $216 million last year. Setting aside the fiscal calendar impact, roughly 1/3 of the increase was due to improved unit volume, and the rest from acquisitions. Pricing had no impact, as our price increases didn’t take effect until January, as is the norm in lawn and garden.

Gross margin, up 580 basis points, is another good story, and one that could have actually been better. Lower fuel prices at the end of the quarter resulted in a mark-to-market adjustment of roughly $4 million. Obviously we don’t plan our budget for those adjustments or we wouldn’t be hedging our fuel. However, the adjustment in Q1 a year ago was $8 million, so we actually saw improved gross margins from a smaller unfavorable mark on our fuel hedges.

Improved distribution costs also provided significant boost to the gross margin rate, as did favorable product mix. That mix is not just within the core product portfolio, as we also benefited from acquired growth. As Jim said, General Hydroponics had a strong quarter, and the margin on this business is accretive during Q1. Finally, fixed cost leverage, mostly from warehousing, also helped the gross margin rate in the quarter.

Moving on to SG&A, $139 million in Q1 compares to $127 million a year ago. Higher sales, marketing and incentives expense in Scotts LawnService, SG&A from newly-acquired businesses, the timing of expenses in the US core business, as well as planned increases in areas like associate compensation, also impacted the number.

The Company-wide adjusted operating loss in the quarter was $107 million versus $106 million last year. In the Global Consumer segment, the operating loss was $63 million, a 15% improvement from $74 million last year. And SLS reported an operating profit of $500,000 compared to $1.5 million last year. Again, no real news below the operating line.

As expected, interest was up nearly $7 million to $16 million as a result of higher borrowings from acquisitions. The tax rate was 35.5%, and the share count was 61.5 million. So that gets you to an adjusted loss in the quarter from controlling interest and continuing operations of $69 million or $1.13 per share. That’s essentially flat with last year.

Currency was a non-issue for us in the quarter, and we expect it to only impact us by a couple pennies per share on a full-year basis. On a GAAP basis, the loss in Q1 was $81 million or $1.32 per share, compared with a loss of $75 million or $1.23 per share last year.
Remember: this year’s numbers will include reimbursements we received from insurance providers related to last year’s Bonus sales consumer claims. This is not a big issue in Q1, but it will become more pronounced as the year progresses. The GAAP numbers also include deal costs related to the JV with SLS and TruGreen, as well as our ongoing efforts to potentially reconfigure our European business.

Speaking of SLS, I want to remind everyone that our P&L will look much different in Q2. Assuming the SLS deal is completed during the quarter, that reporting segment will disappear. At that point, the income we receive from TruGreen, based on our 30% ownership in the business, will flow through the other income line. In addition to the movement related to SLS, we’ll have the addition of Bonnie in Q2.

But the biggest impact on the quarter will be related to our fiscal calendar. As I said earlier, because of our accounting convention, we picked up six days in Q1. This calendar reset happens every six years for us. The days added to Q1 are subtracted from Q4, so there’s no impact to the full year.

However, our quarterly splits could create some confusion, so let me provide some clarity on what to expect from here. The biggest impact from the shift will be in Q2. We’ll have the same number of these as last year, but the calendar shift means our Q2 close will be six days later than last year. That shift alone could add $75 million to $100 million to Q2 sales.

At this point, I can’t tell you the exact impact on gross margin, because it will be impacted by product mix. In terms of SG&A growth, it should track sales growth.

The third-quarter shift picks up the first weekend of July. And since those days are much lighter than the days lost at the beginning of the quarter, the calendar shift will be a negative in Q3. The shift will be an obvious headwind in Q4, since we will have six fewer days.

Let me quickly touch on the balance sheet and fill in the gaps around some of Jim’s comments. As you can see, inventory is up $76 million compared to last year, for the reasons Jim discussed. But assuming the season comes together as planned, we expect year-ending inventory to be fairly flat on a year-over-year basis, so it should be neutral to full-year working capital.

You also see that long-term debt is up $385 million due to acquisitions, taking our leverage ratio to 2.8 times, based on a four-quarter average. When you include the $72 million associated with the Bonnie transaction, as well as the likely impact from some of the other deals that we are pursuing, total debt could increase another $250 million to $300 million this year. But it would still keep us below of our internal goal of less than 3.5 times leverage.

As we’ve stated several times now, we’re comfortable living at those levels. Once we complete the acquisitions we are pursuing, probably later this year, then our focus on uses of cash will shift toward returning it to shareholders. We’re already doing some of that, with an active repurchase program now underway. We expect to repurchase roughly $50 million of shares this quarter.

At the end of the day, all these moving parts don’t affect the real story -- that our business is doing extremely well right now. And the moving pieces have no impact on how we’re viewing our full-year guidance, which we are reaffirming again today.

We still see sales growth of 4% to 5%, and gross margin rate improvement of 125 to 175 basis points. Recall that in December, we increased the range of our expected gross margin rate improvement by 25 basis points to reflect an improved commodity outlook.

As both fuel and [resin] prices continue to improve, the potential benefit from that -- though small, given the fact that the vast majority of our costs are now locked for the year -- gives me an even higher level of confidence in this range.

As I said earlier, SG&A growth is expected to be in line with sales growth, and we are guiding to adjusted EPS of $3.75 to $3.95, compared with $3.53 last year. Operating cash flow should fall in the range of $275 million to $300 million, driven by the growth of the business and the benefit of reimbursements from insurance providers related to Bonus sales.
I'll close by reiterating Jim’s comments about preparedness for the upcoming season. Our plan for the season was as smooth as it’s been in a long time. And so far, our execution has been equally smooth. We are well-positioned going into the season, and we really like the macroeconomic landscape right now.

So I'll conclude simply by stressing my confidence in our outlook, and by telling you that I expect 2016 to be a record year for us. Let's open up the call now and we'll take your questions. Thank you.

**QUESTIONS AND ANSWERS**

**Operator**

(Operator Instructions)

Bill Chappell, SunTrust.

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

Good morning.

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

Hi, Bill.

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

You forgot to mention, and the groundhog saw his shadow, so you've got that going for you.

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

Another tailwind. (laughter)

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

I'll put it in my numbers. Randy, first question: actually, I didn't fully understand the guidance on the Bonnie business. It's $0.10 accretive, or maybe it's not. If you can help me walk through that? And assuming we're not including the transaction costs?

**Randy Coleman - Scotts Miracle-Gro Company - CFO**

Sure. So for a full-year basis, if you look out 12 months, the benefit to our P&L -- it will show up in different areas on the P&L -- would approach $0.10, but wouldn't quite get us there. But if you look at just the impact on 2016 -- because of, frankly, some deal costs, and also the timing of the deal, and that it's only happening midway through the year that impact for 2016 will only be a few pennies. It will be slightly accretive this year, but when we get to next year, it should be approaching $0.10.
Bill Chappell - SunTrust Robinson Humphrey - Analyst

Okay. And the few pennies is on top of your current guidance?

Randy Coleman - Scotts Miracle-Gro Company - CFO

Well, if you look at that deal individually, you could say yes, but I’m not sure we are that precise at this point, on Groundhog Day.

Bill Chappell - SunTrust Robinson Humphrey - Analyst

Okay, thank you. And second, as I do look out, Jim alluded to some offset on your gross margin opportunity. At this point, aren’t you largely kind of locked in on some of these -- fuel, urea, other things -- and have a pretty good outlook? And have things meaningfully changed over the last three or four months now to give you some cushion? Can you give us some more color there?

Randy Coleman - Scotts Miracle-Gro Company - CFO

Sure. Obviously, with the drop of oil over the last 45 days, it’s helped a little bit. But we’re at 95% locked on urea at this point for 2016, and we are 70% or so locked on fuel. So we are now buying some hedges going into 2017. So obviously, if the price of oil were to stick where it is, and our fuel costs would continue to benefit, we’d see some more of that later in the year. But it’s difficult to predict what’s going to happen later in the spring and summer, at this point. But obviously helpful, no question about that.

Bill Chappell - SunTrust Robinson Humphrey - Analyst

And I’m sorry, I didn’t really understand, on the gross margin this quarter, how helpful was commodities on a year-over-year basis?

Randy Coleman - Scotts Miracle-Gro Company - CFO

It was about $0.04 to $0.05 year over year.

Bill Chappell - SunTrust Robinson Humphrey - Analyst

Perfect. Thanks so much.

Randy Coleman - Scotts Miracle-Gro Company - CFO

Sure.

Operator

Jon Andersen, William Blair.

Jon Andersen - William Blair & Company - Analyst

Good morning, everybody.
Jim Hagedorn - Scotts Miracle-Gro Company - Chairman & CEO

Hi, Jon.

Jon Andersen - William Blair & Company - Analyst

I was just wondering if you could talk a little bit more about the point of sale, the 14% point of sale growth in the current quarter? And what that kind of implies about consumer engagement, how you are thinking about that potentially carrying over into the heart of the season over the next couple of quarters? Thanks.

Randy Coleman - Scotts Miracle-Gro Company - CFO

Sure. So obviously in the fall, we had terrific weather in the Midwest, Northeast, so that’s where we saw the greater strength, when you look across the country. As far as what it means for the balance of the year, I’m not sure necessarily that the strength in the fall would lead to say you can expect the same in the spring. But when you look at the broader macroeconomic factors in play and look backwards at the correlation between our results and our key factors, when you look at consumer confidence, you look at the price at the pump and you look at disposable income. Those are all favorable items for us.

I know that we just saw yesterday, government came out and said it looks like a lot of consumers are putting the money in their pocket, but we haven’t seen that in the past with our particular business. I think a lot of that is because the consumer is a little more discretionary in our category. When they do have some more dollars in their pockets, they do want to engage. They want to get outside when springtime hits. So I think there’s a lot of reason to be bullish on sales looking out across the year, but I wouldn’t necessarily tie it back to what we saw in the fall.

Jon Andersen - William Blair & Company - Analyst

Okay, great. One other for me. On the Bonnie investment, can you talk a little bit about the strategic rationale for that, and what you were hoping to accomplish? Maybe some specifics of what that relationship will help you accomplish over -- I guess this is -- it will evolve over the next couple of years or few years? But more color around that would be helpful. Thanks.

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

Sure. So I’m just going to throw in on this one just a little bit. Hopefully this won’t cost me my $1. (laughter) Don’t be putting your hand close to that.

Jim King - Scotts Miracle-Gro Company - SVP, Chief Communications Officer

All right. I win.

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

No, it’s not you win. Randy has been in charge so far. This Bonnie one, it’s important -- I think the strategic rationale does matter. And to start with something really simple, is, we have felt for a long time we’d like to be more than just a lawn and garden chemical Company. I personally -- and I think the management team and the Board agree with this, and I know my family does, that we like to -- I’m a big Martha Stewart fan of what she has created. And I’m talking going back, where it’s kind of woman, kitchen, garden, family, home.

And this is a -- I would call it kind of a mega-trend. I think you can look at the food, and then that gets back to the edible side. And this is a business that my father really started a relationship with back in the day, and if you look at where that business has gone, they have done an absolutely
fabulous job. This is a company that is virtually exclusive in all the big accounts. They operate, in a lot of ways, like we do -- very much about their brand and their service model and their relationship with retail.

When I spent time this last year out in the field, especially with associates, women associates, it may be it's their favorite brand, as we were out there. Because they are out there and they're shopping a lot like you would shop for, like in a seed catalog; where it's, what can I bring home? And this goes back to the Martha Stewart comments. What can I bring home to my house and my garden? And I'm going to grow this, and it's going to be something I feed to my family. And it really is exciting to see. This is a business that two years in a row is Vendor of the Year at Depot. So these guys are not posers, they are actually serious folks when it comes to this business, and they've done a really great job expanding the brand in a dominant way, in a lot of the same retailers we are pretty strong in as well.

So that really gets back to our interest is, we want to be more than just a chemical Company. We really like this emerging trend in edibles. We've talked about it a lot, and I think it has benefited our business in a sort of tertiary way. We want to directly, and be more directly involved in that. And to have the opportunity to partner in a deal very much, I'm going to say, architected by a bunch of people at Scotts, but including Randy, that allows us to go in with the investment as we are -- and you'll see more about that. I'm not sure we are ready or willing to talk about a lot of the details of it today. But it will be announced in a -- I guess it's a K or Q, whatever -- I guess it's a K, that we will put out. It's very much a partnership with the Alabama Farmers CoOp, people who own Bonnie, that allows us to get in with a significant investment and build that over time, and really partner with them to make this business better. And I think there's a lot of work that can happen on the brand side, just on the edible side.

In addition, our ability to cross-merchandise with live goods. This we know from many years of work in live goods. We know we can improve our sales if we have the right products for sale when people are buying these live good products. We've also done absolutely a ton of work with people like Syngenta and Monsanto and our own scientists here on combinations of varieties, fertilizer sort of combos, growing media combos, that right off the bat give consumers a much better result. So if we can take the marketing, the supply chain expertise that Bonnie brings from the growing side, and then genetic work -- and I'm talking conventional genetics -- and growing protocols that can be executed in the Bonnie growing facilities, I think this is a massive home-run for us. And then assuming everything works out, we can, at our choice, increase our ownership over time. And it's real exciting for what it does for us.

And I think if we look at what we want this Company to be, this is a major part of saying, we like the live goods area. It's not just -- I think our view is that we should be in succulents also, and Bonnie allows us to do that. They share the view that the opportunity in the West Coast in some of these more drought-tolerant varieties, which is high-growth areas, is also an opportunity. So it's like 70, I think it's roughly, call it, 70 growing facilities around the United States, is what comes with this deal. It allows us to do a lot of stuff we've always wanted to do, in a lot of different areas. And we've got a really superb marketing group -- I mean senior people that are embedded already in the Alabama Farmers CoOp/Bonnie business. It's super-exciting. I don't know if I answered the question, but this does a lot for us.

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

That's helpful. One more. Just what would you say to -- there's a lot going on right now, with the JV of SLS, the reconfiguration of Europe, the JV that you just described, Jim. What would you say to those who might suggest that Scotts is just trying to do too much at once, it creates some execution risk at present, particularly given some of the streamlining you have done over the executive ranks over the last year or two? To me, this ultimately makes the business more focused and simpler, in some ways. But in the interim, can you talk a little bit about the organization's capacity to do all this and continue to execute with excellence in the core business?

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

I don't want to blow smoke up, but it's a really good question, and it's a lot of the same questions that we're asking ourselves. I've got to say, I don't think the risk is that high, but it's a very fair question. And start with the whittle-down team, which is something we spend a lot of time. So I think as the business has become easier and more predictable for us to manage, we have more time to deal with talent and planning forward. We do talk a lot about just how much easier the business is to run. With all due respect to people who have left the business, it's one of the things that, I think if you were embedded in our business, what you would say is, this is a very functional team at the moment.
And it’s not just at the management level, I think it’s at the Board level as well. We have a team that is liking to work together. I think we are very much focused on what we have to do. I don’t know, maybe -- I wasn’t going to say -- maybe the best operator I have ever worked with is Lukemire. So it makes it really easy for us. As we’ve eliminated the barriers between the operating team and the corporate team, we’re doing different things to support each other now. So Mike’s very much involved in the day to day running of the business. We are very much involved in getting him the stuff that we have said we’re going to do. I got this command sergeant-major twenty-something-year delta operator, who runs our soft team, and I think as we’ve -- that’s what we call it, so it’s our special operations group.

What it is, is strategic planning -- it’s our M&A work, and that’s our internal consultancy. And I think we have talked about that before, is that, as we skinned the team down, we probably had less positions available for good people. And some of those good people, we didn’t want to get rid of. And we basically committed to ourselves that if we could take those people, re-purpose them into a sort of internal consultancy -- and let me just explain what that means. Which is that if we’re going to run our team skinner, certainly at some times, we’re going to run out of bandwidth, okay? So what if we, instead of hiring outside consultants, we basically take some of those people, put them on the soft team, and we use them to augment where we’re running out of bandwidth? And I will tell you, within Hawthorne, within my son’s group, Chris’s group, very much active. All these M&A deals have been operating with a lot of soft support, in addition to the business operators.

So what do I think? I think I’ve got a really good team. I think I’ve got a Board that is very focused on what we’re doing and is supportive. I’ll just talk about the retailer community. I mean, we’ve had a bunch of these top-to-tops -- we got another big one today, I don’t think I’ve seen the retailers this focused. A lot of these big retailers, it’s pretty much new management teams on the merchant side; really good. If you always look at your old friends and say, ah, but they were so good, and like -- but seriously, these merchant teams right now, they’ve got their act together and they’ve got serious-looking eyes. They are working with us to say, we want good plans and drive the business.

And when we sit down and we talk on these top-to-tops about what we’re not doing that we probably should be -- even this late -- as soon as they get back to wherever their headquarters are, and they have listened to us and we have listened to them. All of a sudden, you’re hearing plans change and improvements being made in a much faster way than, I think, I’ve seen since I’ve been here -- and that’s a while. So I think these things are very reasonable -- we got a new phone system around here, so it’s ringing and I don’t know what it means.

But the bottom line is, there was a part of our script today that I left off that is, like, things are going so well, it’s got to be like we are jinxed or something -- something bad is going to happen. But that kind of goes to what you were saying, I think that so far, the year is coming together, the operating side of the business is pretty much -- I’m not going to say on autopilot, because it’s not quite like that. But Mike is on top of this business, and the sales and marketing side are doing their thing, and lots of work happening on the supply chain for now, in the future to make things better, good pipeline of new products coming out of R&D. It’s just one of those things, you look at everything and say: it feels pretty good.

And on the deal front, there is a lot of work to do. I think that on the Clayton Dubilier side, very pleased with how those things are going. Start with both the management teams on our side and their side are, I think, getting along and looking forward to working together. I think they have validated the benefit of the combination, which means now it’s execution time. So I think that actually everybody is believing in the numbers. That is really good. Just had a team come back from Europe; very positive. Now, every one of these deals has its own distinct operating group behind it. This is one of those things where everybody is not sharing here, so that everybody has a dedicated team to get on this. I’m hopeful Europe can go faster than what we were saying in the script, but I think we are being probably realistic.

And on the hydro deals, just a ton of work happening there. We are leaving here today to go to have a Board meeting at the General Hydroponics facility in Santa Rosa, over the next three days. So we’re putting a ton of effort on not only executing our plan, but getting these things. And part of what we get, which goes to your question -- I’m sorry it’s so long, but it’s actually a super-important question. I give up the $1 fine. (laughter) But part of what we get with the deals that we’re talking about and you will hear more about in the future, is really elite management in the hydroponics space that will hopefully come along with these deals, and that will very much empower our hydroponic efforts. So I feel actually really good about it, that part of what we are buying is not just business, but it’s very much a lead operator in the space, and these are impressive people.

That’s part of what we’re trying to show the Board in the next couple of days, is that this is a $1 billion-plus category, just on the supply side that we are playing in. And the people who are the elite folks that are making decent money and that we are talking to right now, they are serious
people. They don’t look like us. They don’t look like Ohio gray-haired old, short – they are like tattooed-up, with black-rimmed caps and stuff like that. But they are really interesting business people, and making good money. So I think these are very much their welcome to our community, and it’s an exciting time. I don’t think we’re going to screw it up, but it’s a good thing to be careful of. And I agree with you. I agree it’s something we should be careful of; I also agree it’s important for the future.

Jon Andersen - William Blair & Company - Analyst

Thanks for all the color.

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

Yes.

Operator

Jim Barrett, CL King & Associates.

Jim Barrett - CL King & Associates - Analyst

Good morning, everyone.

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

Hi, Jim.

Jim Barrett - CL King & Associates - Analyst

Randy, on Bonnie, how quickly would you expect Scotts’ R&D efforts to be manifested in Bonnie’s product lines?

Randy Coleman - Scotts Miracle-Gro Company - CFO

Well, ASAP. But I think initially, we’re really focused on the marketing side more than anything, and how to bring consumers together. And I think the only thing I would add to what Jim outlined earlier, related to the whole deal is -- the battle or the war in the store -- I think we have a much more prevalent position now. And instead of us working against Bonnie, not that, that would always happen, but there’s now reason for us to collaborate together. Also work with retail store operations, and I think just make it a better deal within the store, not just for the consumer but for the people that work there whether they are from Scotts or Bonnie or one of our major retailers.

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

But Barrett, I think it’s pretty much happening already. The teams have been working together for months. The Alabama Farmers Coop is a great company, the Bonnie business is something everybody should be really proud of. But our ability to get ahead of them with their board meeting and their meeting of membership – which is a little bit why we’re still being a little bit tight on information is that we just don’t want to screw the relationship up, and it’s important. But the teams have been working together for months already.
Jim Barrett - CL King & Associates - Analyst

Sounds good. And do you envision, looking out a few years, the investment will be paying a dividend back to Scotts?

Randy Coleman - Scotts Miracle-Gro Company - CFO

Definitely. From a cash flow basis, it's immediately accretive. Like I said earlier, approaching $0.10 of EPS accretion next year. And that's really just looking at the existing business, not the tertiary benefits it brings to Miracle-Gro and our other brands that we already sell. Which I expect, we should see a logical lift in those areas as well, just through cross-merchandising and cross-branding in the stores.

Jim Barrett - CL King & Associates - Analyst

Good. And then finally, were there other bidders who were looking to invest in Bonnie? And Jim, could you tell us more broadly, in the hydro space, are you starting to see more competition for deals in that space?

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

I think Bonnie has been very much eyeballing us for some years. And I think they have been looking to try to raise some capital for a while. I don't think that's a surprise, at least on the Southeast banking world, because I think they've been. But I think everybody -- it does seem to me that, whether it's our relationship with SCI, what's happening in Europe, Bonnie, the recent changes to our Monsanto deal -- all this stuff is like 10 years in the making. So I do think that this is one that -- it has taken a long time, but I think it's very positive for both Companies.

I think what Bonnie discovered is, it's harder -- it's kind of a funky, weird business. And I don't think they were looking to sell it right now; I think they were looking to try to raise some capital. And it really fit together well with what we were trying to achieve. And especially Randy's, I think, view that we don't have to go in as the majority owner, and that we can do this over time. And I think everybody was pretty chilled with that. So I want to thank Randy for being willing to go in a minority way. I think that really broke the logjam with how to structure a deal. And then we had great partnerships on both our M&A group and on their side, that was really collaborative, working together.

In regard to hydro, yes there is more competition, I would say. What's clear is that a lot of the people in the space understand success that is a consolidation. I think that a lot of people say: what you want to be when you grow up? I think a lot of people think that as hydro becomes a little more acceptable, that somebody is going to try and consolidate the space. People don't view that as a big negative, they view that as something that should happen, as this business matures. And if you view this as a version of lawn and garden, we're absolutely core. We've got capital, we've got management systems, we are not trying to overpower.

I think if you look at deal structure, our willingness to do alternative structures, whether it's the LawnService deal, things that we are looking at doing in Europe, hydro, Bonnie -- this is one where we're not putting our egos first. We are basically saying: look, combination make sense -- let's figure it out. And we're doing that. And I think what that means then is that we've got capital, people know who we are, I think we're not trying to run it as a bunch of old guys out of Ohio. That's really happening through our Hydroponics entity that operates through Chris's group, Hawthorne. And we're saying: we want you all to stay.

I think that does give us -- if you look at all those combinations, a lot of this -- remember, we're playing in fertilizer and growing media. We believe controls are important, hydroponic systems, and both durable and consumables -- that these are important. These are all things we know how to do. Not saying we are perfect and know their space, but when it comes to fertilizer and growing media, this is stuff we have expertise that is deep, and like generations deep. And I'd say, world-class.

So nobody else, I think, can put all these combinations together. So I do think that while there is competition, if you look at the entire combination -- especially if you were saying: I'd like to partner or sell my baby to someone else, you want to be a responsible person who knows what they are
doing and can see it through. And I'm going to say, I've told you guys this before, I feel very blessed that I have a management team, a Board of Directors, and an investor community that actually is willing to let us invest in the space.

So that all comes together. I think we're in good shape. Listen, we could -- I'm not sure any deal is better than 50/50, any time. But I think we've got good deal flow on the elite side. We're not talking about companies that lose money, we are talking about very profitable businesses. And we have good combinations going forward. Can they get screwed up? Yes. Could we lose stuff to competitors? Yes. Are we cognizant of that? Yes. Do I think that's going to happen? I don't know. Actually, I feel very comfortable with deal flow right now. Thank you Jim.

Jim Barrett - CL King & Associates - Analyst
Okay, sounds good, Jim. Thank you both very much.

Randy Coleman - Scotts Miracle-Gro Company - CFO
Thanks.

Eric Bosshard, Cleveland Research Company.

Eric Bosshard - Cleveland Research Company - Analyst
You commented earlier that you felt like the season was set up very positively. Curious what specifically you would say is different this year? The last couple of years, growth in the category, I know, has been influenced by weather. But what is different this season that makes you more optimistic than prior seasons?

Randy Coleman - Scotts Miracle-Gro Company - CFO
Hi, Luke, do you want to address that particular question? Then Jim and I can fill in the blanks if we need to.

Mike Lukemire - Scotts Miracle-Gro Company - COO
I think the retailer engagement, I think the new products, I think the economy -- those are all factors. And certainly the good start to the weather. But every retailer we have talked to is engaged in the category and wanting to do more, so there is more promotional activity. And then we're also coming off of the Midwest and Northeast being down, the Southwest kind of being down. And I think the opportunity and ready for a good season, and the El Nino effect.

Jim Hagedorn - Scotts Miracle-Gro Company - Chairman & CEO
Listen, I think that -- so I've thrown like $20 on the table, so I've more than accepted my loss here. (laughter) I think it's also a little bit our attitude. We are acting extremely competitive right now. I think if you look at the TOMCAT business, I think we are the number one, at least in our class of trade, I think we're the number one rodenticide by market share now. And that was not the case. And we're dealing with serious people in that space, with Decon and Victor, et cetera. So these are people who are not hobos in the space.

But Mike and the team, and the brand team, have just done a really good job of saying: we are going to win here. I think we made significant advances last year by correcting price issues on the Ortho side, going after spec. Those days aren't over. So I think that -- we talked in my script,
which, maybe you all didn't know what you were -- is that we are going to be throwing out there, on the organic sides, performance claims that are going to say: yes, we'll check this out, how this other stuff works compared to ours. So I think part of what you are seeing, Eric, is a much more competitive mindset as the business performs, much more willingness to step out and talk much more aggressively about our product, and leave nobody any space.

And I think that retailers like that. I think there is a Jeb Bush issue here, which is, I'm not sure what is happening there, and a guy -- but I think people like people think they can win. And it's weird to see. But I do think that by acting aggressive and attacking and defending ourselves, I think these large retailers, they want somebody to drop the business. And we've got -- again, this gets back to, we've got the money to put it into our marketing campaigns. Because a lot of that money that we took out of the business, we put into driving marketing and sales programs. And Mike has been -- and both Carbonara and Lukemire have been super-aggressive in putting sales programs together with the big retailers, to make sure that our products are the ones on the shelf, in the right position, both on and off shelf, at the time we need to.

So the whole program has come together pretty well. I agree with Randy that weather was probably the biggest single driver for the fall. But that said, that's pretty good news for us. We've had, it feels to me like, four crappy springs in a row. I just figure the odds can't be like that forever. It's a pretty nice thing when you say the biggest single thing that seems to affect our business is weather. And I think -- listen, you've been with us a long time; I think you know that. So I think we figure, if we get a fair shake on weather, we've got all the programs in place, we are driving pretty hard, we're adding new categories, we're making our products work better -- it can't be bad. So that, I think, does make us feel good about it.

Eric Bosshard - Cleveland Research Company - Analyst

One follow-up, as you look at SG&A spending relative to what you just ran through -- bunch of incremental investments and efforts to be more aggressive, be on the offense, to grow the business -- what does that do within SG&A growth this year? How much of that do you fund on your own? And if we remove all the moving parts within SG&A, is what I'm really trying to figure out, the underlying SG&A investment, and what the growth of that looks like?

Randy Coleman - Scotts Miracle-Gro Company - CFO

Sure. Eric, if you just looked at the quarter, our SG&A was higher than last year, even a little bit higher than sales growth. And I think a big part of that was really related to our Scotts LawnService business, where last year, we had an okay year, but the incentive payouts for that team were really kind of abysmal. This year, that business actually outperformed everything else, and that team received the best payouts.

So the year-over-year impact on incentives for LawnService was a fairly sizable number. As well as the selling campaign we did in the fall to drive up our customer count for next spring. That cost was front-loaded, so we saw the expense in this quarter. We won't see the benefit of that until next year. So that's why there is a little bit of disconnect between the sales growth in SLS and the bottom-line growth. But it really makes you feel good going into the spring. And our customer count is up 4% or 5%, which is a really nice place to be. And aside from that, a lot of it is timing. Some of it is compensation-related, et cetera. That impact from General Hydroponics year over year played into that. But at this point, we would expect SG&A to again be in line with sales growth for the full year.

And then thinking about promotions that Jim had referenced, a lot of that, we just factor into pricing -- so trade programs and pricing. So you don't see those fall into our SG&A spend. It really falls through on our top line, and it's netted into sales.

Eric Bosshard - Cleveland Research Company - Analyst
Okay, thank you.
Hi, good morning. This is Christina on for Joe. I was just wondering if you could talk about the impact of weather on the West Coast this year? I know they’ve had a lot higher rainfall versus last year’s drought conditions. And then also just the $15 million in extra sales — was that all in Global Consumer, or did any of that benefit SLS?

Sure. The $15 million we referenced, it’s really Global Consumer. So LawnService, when you get towards the end of the quarter, there’s not a lot going on. So it’s the Global Consumer issue. And then as far as weather in California, again Q1 is pretty small. We do have a pretty favorable outlook going into the spring. So we haven’t seen those results in California to date, but looking forward, we’re feeling pretty good about it. And if you recall, last year, there were floods in Texas in May. So once we get to late spring, we feel like we should have a pretty favorable comp there. And again, when it comes to weather, like Jim said, we’ve had four difficult springs in a row. We feel like if we just get fairly decent weather, it should set up pretty nice for us.

Great. Thank you so much.

Thank you.

It appears we have no further questions at this time. We will turn the conference back over to Mr. King for any additional or closing comments.

Okay, thanks, Janet. For the record, my $1 bet has yielded a $20 return, so that makes me a pretty good investor. (laughter) Other than that, we’re done this morning. If you’ve got any other follow-up that you need from me, I’m at 937-578-5622. Otherwise, we will either see you on the road or talk to you in early May. Thanks. Have a great day.

That does conclude today’s teleconference. Thank you all for your participation.
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