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OVERVIEW:

Company Summary

CORPORATE PARTICIPANTS

Aimee DeLuca *The Scotts Miracle-Gro Company - SVP of IR*

Christopher J. Hagedorn *The Hawthorne Gardening Company - Division President*

James S. Hagedorn *The Scotts Miracle-Gro Company - President, CEO & Chairman of the Board*

Matthew E. Garth *The Scotts Miracle-Gro Company - Executive VP, CFO & Chief Administrative Officer*

Nate Baxter *The Scotts Miracle-Gro Company - Executive VP & COO*

Joshua Meihls *The Scotts Mircale-Gro Company - Senior Vice President of Global Sales*

CONFERENCE CALL PARTICIPANTS

Jon Robert Andersen *William Blair & Company L.L.C., Research Division - Partner & Research Analyst*

Joseph Nicholas Altobello *Raymond James & Associates, Inc., Research Division - MD & Senior Analyst*

William Andrew Carter *Stifel, Nicolaus & Company, Incorporated, Research Division - VP*

William Bates Chappell *Truist Securities, Inc., Research Division - MD*

William Michael Reuter *BofA Securities, Research Division - MD & Research Analyst*

PRESENTATION

Operator

Good morning, and welcome to the Q4 2023 Scotts Miracle-Gro Company Earnings Conference Call. (Operator Instructions) Please be advised that today's conference call is being recorded. I would now like to turn the conference over to Aimee DeLuca, Head of Investor Relations for Scotts Miracle-Gro. Please go ahead.

Aimee DeLuca - *The Scotts Miracle-Gro Company - SVP of IR*

Good morning. With me this morning are Chairman, President and CEO, Jim Hagedorn; Chief Financial and Administrative Officer, Matt Garth; Chief Operating Officer; Nate Baxter; and Chris Hagedorn, Group President of Hawthorne.

Jim and Matt will begin our discussion with some prepared remarks. The operator will then open the call to your questions. As we will be making forward-looking statements, please be aware that our actual results could differ materially from what we share today. Please refer to our Form 10-K filed with the Securities and Exchange Commission for details of the full range of risk factors that could impact our results.

For further discussion after the call, you are invited to e-mail or call me directly at (937)-578-5621 and will work to set up some time as quickly as possible. Lastly, please note that today's call is being recorded. An archived version of the call will be published on our website at investor.scotts.com.

With that, let's get going. I'll turn the call over to Jim Hagedorn to begin. Jim?

James S. Hagedorn - *The Scotts Miracle-Gro Company - President, CEO & Chairman of the Board*

Thanks, Aimee. Good morning, everyone. Today, you're going to hear how we closed out fiscal '23 and the actions we've taken to continue to move forward positively in '24. I'll remind everyone there are many factors that led to our current financial situation impacting our Consumer and Hawthorne businesses. Some were macro in nature brought on by the post-COVID economy and unfavorable weather, but many were our own doing as we pursued growth. I know this has been a lot for our stakeholders and our associates to deal with.

Our mission in fiscal '23 was to stabilize the business. This put an incredible amount of stress on our people and our operations. It required tough choices and fast actions. As a result of this work, we made legitimate and measurable progress. We generated $681 million improvement in cash flow from a year ago and paid down debt by $361 million. We cut expenses north of $200 million and have targeted another $100 million in cost savings.

We've reduced inventory by more than $450 million. And thanks to our banks, we have greater financial flexibility. We outperformed the lawn and garden category and took share in a challenging environment. As we enter fiscal '24, retail inventories are in good shape. Our relationships with our retailers have been tested and are stronger than ever. All of this contributes to what we see as a return to a more normal state of running our business.

Our progress can be tied to the strength of our brands, whose awareness and trust among consumers are at all-time highs, and our people whose resilience in these times has been outstanding. As for Hawthorne, I stated at the start of '23 that my goal was to restore it to profitability. It reached breakeven run rate at the end of Q4, generated more than $100 million in free cash flow in fiscal '23, setting the stage for profitability in '24.

On top of our achievements, we upgraded talent, the executive and senior levels with next-generation leaders who bring energy and fresh perspectives. Together, we're building momentum to improve our performance and enhance shareholder value.

Matt will explain how we delivered the results for fiscal '23 within or better than the guidance we provided in August. He will also share our outlook for fiscal '24. We will focus on the final phase of Project Springboard while ensuring we protect and invest in things that differentiate us. Those are our brands, our sales force, our innovation and our supply chain.

The team has developed an operating plan for fiscal '24 that is aggressive but well thought out. Elements of the plan include: one, improving gross margin to deliver $575 million in EBITDA; two, finishing the 2-year job of achieving $1 billion in free cash flow by the close of '24; three, paying down debt by an additional $350 million or more by the end of fiscal '24; and four, getting our leverage ratio into the 4s by year-end. The risks to this plan are mostly things outside of our control, the state of the consumer and global events.

But when you look at consumers holistically, our core lawn and garden consumer is the most stable and healthy. We and our retailers believe this core consumer will show up in numbers at least to the level they did this past year. Our plan assumes flat on our existing consumer business plus incremental unit growth that we secure from share gains will drive incremental volume through more promotions, shelf space and listings that we did not have with last year with major retailers.

I'll address this in more detail shortly. I first want to talk about the leadership team that is charged with delivering the plan. The Board and I put an entirely new team in place to empower the leaders who will guide this business for years to come and create opportunities for rising executives to take on more responsibility. It starts with Nate Baxter and Matt Garth. They are the future of our operating and management team. Nate and Matt are smart, aggressive and work well with me and each other. They're experienced executives and provide what I need as real business partners.

At the close of Q4, I made the decision to accelerate the retirements of Mike Lukemire and Denise Stump, both have planned to leave in '24, but it became clear we needed to move more quickly for clarity and to set Nate and Matt up to run the business day-to-day. Nate is responsible for the operations side, and Matt has expanded responsibilities beyond the CFO role. Shifting almost all administrative functions to Matt positions him and Nate as equal partners. The power and responsibility between them is balanced. We extended the leadership changes to surround Nate and Matt with talent who could step up. We have a new Head of Human Resources and a new General Counsel.

We've also set a new direction with marketing and IT by eliminating the Chief Marketing Officer and the Chief Information Officer roles. The teams have been restructured. Marketing is led by brand VP, Ashley Bachmann and Jodi Lee. And IT is led by VPs, Emily Wahl overseeing IT infrastructure and Sayyed Nezhadi responsible for digital initiatives. They report to Nate.

In marketing, Ashley and Jodi will partner with a new creative agency to provide world-class compelling creative that inspires and motivates our consumers. They'll also work with Mediahub, a longtime partner for world-class media buying to effectively deploy our media dollars based on our priorities.

Now let's get back to the plan. Protecting the consumer franchise is paramount. It's what moves the needle, and we must invest heavily in all things that drive our lawn and garden business. Marketing and sales topped the list. In fiscal '23, we spent 25 percent more on advertising than we did in '22. Among my priorities is to further increase our advertising budget this year. We will also shift the majority of the spend into more traditional forms of media to prioritize our core consumer.

As I said, our core consumer is the healthiest within the entire consumer base. They are existing homeowners who tend to be higher earners. Their personal debt is low, and they have higher-than-average savings. We and our retailers see indications they will spend more time at home in '24 than they did in '23. And this isn't the time to chase a broader base of new consumers. As for retailers, they're focusing on foot traffic. They say lawn and garden is their biggest opportunity to drive more foot traffic.

And lawn and garden belongs to us. Together, we will drive powerful promotions and activations aimed at our core consumer. As I said, retailer inventories are in good shape. We expect retailer load to be strong. Last year, there were changes to our sales patterns as we took a short-term quarter-to-quarter approach to the year. For fiscal '24, the load will follow more historical pre-COVID patterns. Let me walk you through how we intend to grow our volume and share. We took about 1/3 of what would have been our total gross margin rate improvement from fiscal '23 and invested it back into our retailers in the form of trade and modest pricing reductions on certain SKUs to help with elasticity.

In exchange, we will receive increased listings, shelf space and promotions, none of which we had last year. This will strengthen our ability to drive incremental volume growth we need to deliver our plan. And here are some early good news. We've had a great start to the fiscal year. Overall, POS is up 4 percent in units and 8 percent in dollars across all brands through the month of October. Our Fall [Lawns] campaign has yielded 3 percent plus in units with Turf Builder plus 2 at 21 percent, Bonus S up 56.5 percent; and Gardens and Controls are up 4 percent and 5 percent, respectively.

The biggest Ortho Line, Home Defense is up 19 percent, Roundup is up 12.5 percent, Miracle-Gro Potting Mix is up 9%. We're building momentum for the year ahead. As for Hawthorne, we've made progress on a range of potential solutions that should benefit shareholders and create opportunities for that business to grow. We're in active discussions to create a leading vertically integrated cannabis company. I can't share more at this time, but we will provide an update as soon as we can.

We are committed to doing what's best for Scotts Miracle-Gro, Hawthorne and the cannabis industry. In doing so, we can create opportunities for shareholders to participate in the industry's further growth and maximize the returns, hopefully, enabling all of us to look back and say it's been a good investment. I'll wrap up with this. For our associates, I know it felt like a grind, and it feels worse because we're used to winning. All of us need to stay engaged and focused on execution. This will be the year we turn the corner. To all of our stakeholders, we've stabilized the business and accomplished a lot.

Our cost outs by the end of the year will exceed $300 million. We're on track of meeting our goal of $1 billion in free cash flow over a 2-year period. And in that same time frame, we will pay down over $700 million in debt. We've repositioned our leadership team and brought new faces with diverse experience to our Board. By the end of this year, we will solve most of our challenges and significantly enhance our brand power. We're creating a tailwind that will benefit us for the next decade. Thank you. I'll turn it over to Matt.

Matthew E. Garth - *The Scotts Miracle-Gro Company - Executive VP, CFO & Chief Administrative Officer*

Thank you, Jim, and hello, everyone. As Jim noted, fiscal year 2023 generated significant change within Scotts Miracle-Gro. The immediate outcome of which is every associate is aligned to our strategy and priorities, maintaining market-defining positions and innovations, while driving operating margin recovery and increased financial flexibility. Now let's take a deeper look into our performance in '23 and the guidance we are establishing for fiscal '24.

Starting with top line results. Total company sales decreased 24 percent for the quarter, ending the year down 10 percent at $3.55 billion, which was in line with our fiscal year guidance. U.S. consumer sales declined 33 percent in the quarter as a result of the previously discussed timing of shipments between the third and fourth quarters. For the full year, pricing was nearly 5 percent higher. Total sales fell by 3 percent on lower shipment volumes and our higher margin but more weather-sensitive consumer loans business. We ended the year with POS dollars up nearly 5 percent, driven by the higher pricing.

POS units ended the year slightly lower than '23 as poor weather in September prevented the expected volume lift. That said, our fall campaign has taken hold and POS units in the month of October were up almost 5 percent. Retailer inventory levels entering fiscal '24 are healthy. At our 3 largest customers, unit inventories ended the year down about 1 percent on average and are currently down about 2 percent. The majority of our year-end retail inventory was related to new, fast-turning growing media listings and the ramp-up ahead of our fall and rodent campaigns.

At Hawthorne, sales declined 11 percent in the fourth quarter and 35 percent for the fiscal year, with both being in line with our guidance. We continue to see signs of stabilization in the industry. However, it remains too early to call an inflection point in the top line. Moving on to total company gross margin rate for the full year, the rate fell about 260 basis points to 23.7 percent with the acceleration of Project Springboard savings helping to deliver better-than-expected results.

Now let me break down the margin change for you. Pricing actions and Springboard deliverables drove nearly 600 basis points of the year-over-year improvements. Factors that I would characterize as near term unfavorable, including the impact of lower production and debt-reducing inventory of 380 basis points, higher material costs stemming from COVID era purchases of 330 bps and the onetime write-down of excess and obsolete inventory of 130 bps more than offset the gains we drove.

Moving down the income statement. SG&A was managed tightly across the year, with savings driven by Springboard actions aimed at creating efficiencies within the organization. We continue to maintain investments in our future through strengthening our brands, our sales force and our innovation pipeline. For the fiscal year, SG&A came in 10 percent lower than last year at 15.5 percent of sales and in line with our guidance. Operating income for fiscal '23 ended the year at $292 million or 8.2 percent of net sales with accelerated Springboard savings delivering improvements over our guidance of 7 percent to 7.5 percent. Adjusted EBITDA was $447 million.

Looking below the operating line, the higher interest rate environment has driven a significant increase in interest expense which ended the year roughly $60 million higher. SMG average borrowing rates increased 180 basis points in fiscal 2023, and we will see another 80 basis point increase in 2024. As is typical, our free cash flow generation was weighted to the back half of the year, so debt paydown largely occurred in the fourth quarter. There were several discrete items in our effective tax rate in the fourth quarter that drove the full year rate to 36.6 percent, which was well above our expectations.

In short, we had valuation allowances against our deferred tax assets in certain jurisdictions that meant credits could not be used in the current period. All told, fourth quarter adjusted earnings, which exclude impairment, restructuring and other nonrecurring items were a loss of $2.77 per share versus a $2.04 loss per share last year. Full year EPS was $1.21. Note, this result includes the onetime impacts of $0.25 related to the U.S. consumer inventory write-down from the third quarter.

Now moving on to free cash flow and the balance sheet. We continue to deliver significant improvements with positive free cash flow of nearly $440 million, of which over $500 million was generated in Q4. Versus prior year, free cash flow improved $681 million, driven primarily by lowering inventories and other working capital improvements. Inventories fell by over $450 million year-over-year, and we anticipate a further $275 million decline in fiscal '24. With this cash flow, we are able to maintain our quarterly dividend and drive debt lower by $361 million. Liquidity is strong with nearly $1.2 billion in debt capacity as of the end of the fiscal year.

Additionally, we announced today the closing on a new accounts receivable sale agreement with JPMorgan that replaces and upsizes our prior facility. The timing of the closing crossed quarter ends and created a dip in our cash flow. If we had this program in place at year-end, cash from operations would have been $50 million higher in fiscal '23. Note that the discounted cost associated with the AR sales will be reflected in the other income and expense line within operating earnings and is expected to be around $20 million.

We ended the year with leverage at 6.57x adjusted EBITDA versus a covenant maximum of 7.75x. Recall that adjusted EBITDA for the leverage calculation includes $39 million of allowable increases to reported adjusted EBITDA for nonrecurring E&O and warehouse closure costs that occurred in the third quarter.

Now let's turn to our outlook for fiscal '24. In establishing guidance for the full year, our primary objectives remain generating strong EBITDA and free cash flow. Our operating plan is aggressive, and reflects strong engagement with our retail partners to yield high single-digit growth for the U.S. consumer business.

Factors beyond our control may impact consumer takeaway and yield a lower growth trajectory for the year. An improvement in gross margin, combined with tight control of SG&A is expected to result in an operating income of 10.5 percent to 11 percent of sales. Below the operating line, interest expense will be essentially flat year-over-year as borrowing costs on average are expected to be higher and debt paydown will take place in the fourth quarter as is typical.

And lastly, our ETR will be between 29 percent and 30 percent and share count will grow by 1.5 million shares. From a net leverage perspective, we now see the second quarter of 2024 as the most acute period in the outlook based on the phasing of seasonal working capital. Note that we have proper headroom to manage any outside swings within our covenant requirements. To sum up, the fundamental advantages of our iconic brands, our supply chain and innovation capabilities as well as our talented associates support our 3 near-term priorities: Margin recovery, the balance of $1 billion in free cash flow and a solution for Hawthorne's future beyond SMG.

We are focused on executing with precision. We have a determined path forward and I'm confident that our trajectory is improving and that we can return to delivering outsized shareholder returns.

With that, I'll turn the call back to the operator so we can answer your questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Jon Andersen with William Blair.

Jon Robert Andersen - *William Blair & Company L.L.C., Research Division - Partner & Research Analyst*

I was wondering if you could talk a little bit more about the assumptions underlying your 2024 growth outlook for the U.S. consumer business. Matt just commented that the baseline assumption is high single-digit growth coming off of a couple of years where we've been kind of in reverse. What are some of the underlying assumptions there around point-of-sale growth, volume, price because it sounds like you're investing in price in 2024 and what needs to happen in order to kind of hit that target?

James S. Hagedorn - *The Scotts Miracle-Gro Company - President, CEO & Chairman of the Board*

Okay. So the volume growth across the business is flat, okay? So that's -- if you look at and it's -- I would put it as a big question. When I put risk out there, I think what I said is global events and the consumer shows up. I think, Jon, you kind of hit it right, which is we've been losing altitude. I told our lawns people if you can just stop the descent and gain a little altitude, that's a heroic move. But if you look at footsteps, and I think these are kind of average numbers that I'm hearing from sales decline at DIY retail. It was called about 12 percent, 13 percent is what I think we are viewing as kind of an average across the board. So I think what we're saying is that stays the same. Now what's different that's positive -- this is sort of positive back to we maintain altitude.

Okay. Retailers are very focused on Lawn and Garden as a category. I think that and kind of cleaning, I don't know, there's a couple of other kind of not super expensive categories that retailers are saying, that's where they're going to be putting all their efforts. So there's a ton of work happening at the retail level to drive consumers into the store for the spring. I view that as a positive. I personally have a hard time with all the data, and I think I'm pretty current on it. But this issue of elasticity within the lawn and the seed category, I think is real.

Now it's hard when somebody shows you here's sales, here's pricing. But within that, you have weather and a lot of other factors, a consumer that's apprehensive. So I'm not sure I believe anything that people are telling me, but I think directionally, elasticity is an issue. We have adjusted pricing on seed and ferts, and we're seeing really good results since we did that. So again, I put this as a positive in order to sort of argue that we think we can level this thing. If that's a big victory. I don't want to hand it over yet.

In addition, the focus that we're going to put on it, we made a change in marketing. We spend a lot of time on our consumers who they are, where is the power. And our core consumer is the healthiest consumer out there. These are generally college educated, homeowners, they've got more savings. They got more money. I think everybody's sort of excess savings from COVID is expiring. And I think we and the retailers are looking at data that says people will spend more time at home, doing home projects.

I think that's a positive for us. I don't know if I'm missing anything on level in the core business, and that's where we start. And again, after a 13 percent reduction in footsteps in the front door out of many of our major retailers, okay? Then it goes to why you think it can grow. And we not only knew we had this elasticity, but we understand the pressure retailers are under to bring people into Lawn and Garden. And some of them challenged us to sort of contribute to the cost. And at a time where we're trying to rebuild our margins, I was not exactly open-minded to that, when the sales force and Mike Lukemire came to me on this.

And it's like in exchange for what. The performance of our business, and this is a real complement to our sales force. They have been in a very challenging year, maybe a couple of years, our sales force and our ability to execute in the store and what that builds in the relationships is very powerful. And so when the retailers are saying, we need sort of contributions to help with this cause in exchange we'll give you listings you don't have, promotions that we gave to other people will go to you. And we size that out, it's worth doing. Now we traded about 1/3 of what would have been acceleration of margin improvement for this.

But I personally think very much worth it. And that gets you --to the entire gain is in listings we didn't have before, priced out at volumes that were with other people the year before, promotions that didn't go to us went to other people, priced at exactly what they were at last year. And that's how we got to these numbers. I think that if we had a big debate and we could have it if other people want to talk about it because I would say, gross margin and our revenue numbers are probably the ones that are most interesting as we've been prepping for this call. We feel, and I think Nate and Josh who are here feel very confident in. Josh, you want to talk about it.

Joshua Meihls - *The Scotts Mircale-Gro Company - Senior Vice President of Global Sales*

No. I think you said it well, Jim. T growth is built on 3 foundational pillars of what we would say, it's incremental listings, it's incremental promotions and then incremental merchandising space within the stores and then that elasticity factor that's the smallest part of it. So when we look at it in the early results, the team has a ton of confidence in it and our retailer partners are doing the same. They're forecasting the growth as well.

James S. Hagedorn - *The Scotts Miracle-Gro Company - President, CEO & Chairman of the Board*

But we all, as we prep for this call, said, what's the big risk is consumers don't show. I don't know how big that risk is coming forward. I think that a lot of people are writing about how people have spent sort of their COVID excess savings and where that's at, people will be traveling a little less and spending more time at home. We think that's true, and we think there was a significant reduction in footsteps last year. Do we think it's going to get worse? Look, this is probably where there are some really great people who could say, yes, it could be worse. And we're not saying there's no risk, but we're saying that we think it's a thoughtful approach to volume.

Matthew E. Garth - *The Scotts Miracle-Gro Company - Executive VP, CFO & Chief Administrative Officer*

Yes, starting off with POS being flat, assumptions there and then going, absolutely where Josh went into, drives that high single-digit movement in top line. The broader question, which Jim brought up, that honestly, I think we're going to leave to you, which is to dimension what that downside could be beyond flat POS because the other components of this, what we are driving out, as you move through the rest of the financial statements in terms of margin accretion driven through cost-outs, improvements on the operating side, more intelligence in how we're going to market, which

Nate can talk about here shortly. Everything that we are doing is around those 3 items that we have on the table, reestablishing higher margins to drive EBITDA, the balance of $1 billion in free cash flow and a strategic solution for Hawthorne. That all starts with the top line. And so to have this level of insight, confidence and connection with our retail partners who allowed us to work with them on these improvements is a good start to the year.

Jon Robert Andersen - *William Blair & Company L.L.C., Research Division - Partner & Research Analyst*

Sure. That's helpful. One quick follow-up. The EBIT or operating income kind of outlook that you gave for '24. It was a little -- at least on my end little muddled. Did you mention 10.5 percent to 11 percent? And if that's right, that would suggest, I guess, 250 kind of 300 or close to 300 basis point level of improvement in operating margin in '24. Could you help dimension that a little bit across gross margin and SG&A ratio?

Matthew E. Garth - *The Scotts Miracle-Gro Company - Executive VP, CFO & Chief Administrative Officer*

Thank you, Jon. I appreciate the question because I was going to drive it to there at some point. So you're right. When you back into it, gross margin will be north of 250 bps. I think what we have talked about on getting there previously has been driven through Project Springboard, additional savings that will come through higher volumes that we are expecting with these additional listings. And by the way, just working through our over-inventoried position and getting back to a more normal production rate in the second half of the year. All of that will accrue to margin.

When you move down into SG&A, what we had said previously, the long-term modeling for the company should be between 15 percent and 16 percent. For 2024, what we're telling you is to be between 14.5 percent and 15 percent. We will be narrower on SG&A in 2024. That doesn't necessarily mean dollars down in the important areas. We are repositioning dollars into marketing, into the sales force and into innovation. That is the net result of all the activities we are driving to focus on those 3 areas.

Operator

And our next question comes from Eric Bosshard with Cleveland Research.

And our next question then comes from Bill Chappell with Truist Securities.

William Bates Chappell - *Truist Securities, Inc., Research Division - MD*

Just following up a little bit on Jon's question and not to be too sceptical, but I mean, this time last year, I think you had pretty much the same tone in terms of the retailers were engaged. This is going to be a great year, and we don't see a lot of risk to the issue, our consumers love the category, we're going to have expansion. And within 6 months, we were blaming global warming, among other reasons for the thing. So is there any new data set? Is there any new information you have? Or is it just a view that, hey, this time last year, the consumer really wasn't back to kind of 2019 levels. Now we feel we're back to 2019 until it's more forecastable?

James S. Hagedorn - *The Scotts Miracle-Gro Company - President, CEO & Chairman of the Board*

You've like been eating your (expletive) wheaties. I'd start by we live in a world and there's consumers and retailers. As much as we sort of felt like heels last year, here's the thing. Volume was up like 4.5 points, okay? Did we achieve what we wanted to in Lawns that was the whole thing. No. So I would say where we fell down was on Lawns. I do think global warming, by the way, is part of that. But when we talk to retailers about last year, you know what they say, I know you guys think it sucks. Lawn and Garden was ace for us, and we thought you guys did great. So I'd start by saying, Bill, like, yes, this is just continued in the slog.

I think that -- do I have data on that? I'd start by saying we had data on. It was a pretty good year for us where we didn't solve their issues is Lawns and it matters. But I look at the year and say maybe I should just feel bad. But we accomplished an awful lot under a ton of pressure. And did we make the revenue numbers? Not exactly. I think we did pretty much everywhere except lawns, and it's a big business.

We're saying flat. The approach on marketing -- the selection of a new sort of global agency for Scotts. And the focus on a much larger relationship at the creative level, a world-class creative team on an agency that I just -- we just haven't signed the paperwork. So that's -- Matt's probably involved in like...

Matthew E. Garth - *The Scotts Miracle-Gro Company - Executive VP, CFO & Chief Administrative Officer*

No, no. I'm not slowing that down.

James S. Hagedorn - *The Scotts Miracle-Gro Company - President, CEO & Chairman of the Board*

So I think that's going to really help us. A lot of the changes we made were a result of the fall. And I don't know about you, but in the spring, I saw a lot of commercials on that early spring campaign we did.

And where the weather was good in Texas and Florida, the results were phenomenal, okay? Now the weather in the Northeast at that time was not great, and we really saw like hardly any POS. And there's a bunch of learnings there. But what it says is the advertising, combined with the promotion, when the weather is right, was really good. Weather was a factor in there. And I'm not blaming the weather. I tried to tell everybody here when we talk about what went wrong with lawns, let's start with looking in the mirror as the #1 thing.

So we're going to look -- we look at our core consumer, and we've been chasing sort of the young, up and coming, about to be a homeowner pretty hard and the dispersion of our money into that when it gets into social media. You look at the table here and they were all maybe a little bit older than that group. None of us saw anything. And that was one of the reasons we made a change at the marketing level, okay? The approach going forward is going to be much more intense, creative focused on our core consumer and back to basics on spend. And our back to basics on spend, there's nothing new here is -- and this is kind of March Madness time is, traditional media, news and sports and not losing it as we chase people who are more challenged buying a home today than they have ever been based on interest rates and sort of lack of inventory in the market.

And I think the data we have on that we can share with you for sure. And our retailers can, if you follow the same people because this is something that we all are committed to. But you can basically throw us -- you can throw shade at us, we deserve it. But I would say that the year was we accomplished a lot. And on the sales line, it's not bad. Weather was a factor. We are a factor. I think there were promotional glitches at the retail level that probably didn't help the Lawn business. But I think we've got a really good plan for the year. And I don't think we're expecting a lot. Flat on a business that is down at this point, call it, 30 percent from the previous 2 years before. So I don't think we're really swinging for the fence here. I think this is back to basics, back to stuff we know. I don't know, Nate, anything you want to add?

Nate Baxter - *The Scotts Miracle-Gro Company - Executive VP & COO*

Yes. Yes, absolutely. So pleasure to be able to talk to all of you. So Bill, I think I would ask the question, what are we doing differently from last year? And Jim highlighted on the media side and the creative side, that's a big change for us. I think the other thing is, we've got more tools in our toolkit today. We've been building up our insights and data analytics team. So one of the things we're leaning heavily into. And I'll give you an example of weather, right? It's really a case of results, not excuses. There's no doubt, it's a factor, but you're not going to hear us talk about it as an excuse.

What we're trying to do is get smarter and use some of our predictive modeling and machine learning to help us make adjustments. We proved that in the fall. We had a terrible heat dome over the U.S. in the early fall, and you saw the results in POS. We were able to adjust some of our media and targeting based on some of those models. So I don't want to rely too heavily on that, but we've fundamentally changed our operation, whether you're talking about how we're going to target marketing. And I'll reinforce what Jim said is focusing on our core consumer. As we've tried to manage this transition to digital, it's been tough, and I think we lost sight of who has the dollars to spend today. So that's a big change.

And then on the supply chain side, we haven't talked a lot about it, but we've done a ton of optimization, and I think that will just help us on the back end from a margin perspective. So we're trying to work smarter than we have in the past. And I'll just close with -- yes, it's an aggressive plan, but it's the same thing I told the team internally yesterday. It assumes the consumer shows up in exactly the same way they did in '23. We're not assuming the consumer is going to show up anymore. Now there is a risk, they could show up less. But all of these plans are built on that flat POS assumption. It's just the new listings and the promo gains that're going to help drive volume.

William Bates Chappell - *Truist Securities, Inc., Research Division - MD*

Got it. And then, Matt, just a quick follow-up on kind of the revenue outlook for this year. I don't know if you quantified kind of there was some earlier than normal shipments, especially in the March quarter. So I didn't know if you -- when you're looking at that high single-digit growth for the full year, I mean, how will you grow in the first half? Or is all that growth coming in the second half?

Matthew E. Garth - *The Scotts Miracle-Gro Company - Executive VP, CFO & Chief Administrative Officer*

Yes. I mean, I think Jim laid out a little bit how the seasonality worked last year versus what we're expecting for 2024. And you will see kind of a more normalized revenue when you look at our historic averages '24 versus '23. So it will conform more to what we've done historically. So you'd see yes, first half growth because we are growing overall, but shipments themselves would be more normalized across the year.

Operator

And our next question comes from Eric Bosshard with Cleveland Research. (Operator Instructions) Our next question comes from Joe Altobello with Raymond James.

Joseph Nicholas Altobello - *Raymond James & Associates, Inc., Research Division - MD & Senior Analyst*

Two questions, sort of a clarification, if you will. In terms of the high single-digit U.S. consumer growth you're expecting this year, what is the pricing drag that you're baking into that?

Matthew E. Garth - *The Scotts Miracle-Gro Company - Executive VP, CFO & Chief Administrative Officer*

Jim said on gross margin, it was about 1/3 of the impact. We just mentioned where we think gross margins are going to be. But on the top line, that would have translated to down low single digits. So low single digits to me kind of says between 1percent and 3 percent.

Joseph Nicholas Altobello - *Raymond James & Associates, Inc., Research Division - MD & Senior Analyst*

And it does to me as well. Appreciate that. And maybe to follow up on that on gross margin. I think you mentioned up over 250 basis points this year. How much visibility do you have into that given that some of that is coming from lower input costs? And how much of that is sort of locked in at this point?

Matthew E. Garth - *The Scotts Miracle-Gro Company - Executive VP, CFO & Chief Administrative Officer*

Yes. No, that's a good question. So there's a few components to that as we unpack it. We have a very good line of sight to our controllables, which what I'm going to tell you, Joe, is probably more than half. So everything that's coming from Springboard. Nate mentioned supply chain. Maybe you can talk a little bit about that more, some optimizations that we're doing across the rest of the company. Those things are, to your words, locked in.

We have about 50 percent of our raw material costs locked in. And from what we've been seeing from a raw material side, that's urea, it's everybody's favorite to go to, what we're seeing is kind of 3/5 of what it was last year. So there will be a benefit. The piece that's open is some of the volume-related elements at the high-single digits, you're getting all of that. And again, the high-single digits, we are saying is coming off of a flat POS base, but the additional listings, the additional promos and merchandising that we're getting and the natural uplift and some of the elasticity that is driving that volume will benefit our operations side and help us from a fixed cost leverage basis. That will contribute a little less than kind of 1/3 of the overall piece there. So good performance and locking in the margin, volume is going to help us get a chunk of it.

Operator

And our next question comes from Andrew Carter with Stifel.

William Andrew Carter - *Stifel, Nicolaus & Company, Incorporated, Research Division - VP*

Yes. I don't know if you said it, I apologize, you said high single-digit consumer sales. What are you assuming for sales in Hawthorne and other?

Matthew E. Garth - *The Scotts Miracle-Gro Company - Executive VP, CFO & Chief Administrative Officer*

Yes. And it was kind of implied early on in my commentary, which was not obviously clear enough, which is Hawthorne has, as you know, a few things going for it. We got to profitability at the end of the year. We've stabilized revenue. We saw that in a daily rate as we made our way through the year. We have taken out a number of our distributed brands and some of our proprietary brands as we made through the year to improve the overall portfolio. That is going to drive sales down slightly, so a very low single-digit number there overall for Hawthorne.

So that was the terminology of we're not yet seeing a change in the trajectory of sales performance at Hawthorne or in the industry. But with those movements that we've made in the business, it will be slightly down.

William Andrew Carter - *Stifel, Nicolaus & Company, Incorporated, Research Division - VP*

Okay. And then a second question I wanted to ask because you said in your commentary around Hawthorne is looking for a vertically integrated company, which is interesting because you have an investment in a cannabis operator. Are you looking to do something with RIV in this instance to like de-risk the earnings profile from Hawthorne and go separate? Or are you still pounding the pavement looking to add scale to Hawthorne in the hydroponics sector?

James S. Hagedorn - *The Scotts Miracle-Gro Company - President, CEO & Chairman of the Board*

Pound the pavement, we're not that desperate. We're not out on the street walking. Are we, Chris?

Christopher J. Hagedorn - *The Hawthorne Gardening Company - Division President*

I wouldn't describe it that way.

James S. Hagedorn - *The Scotts Miracle-Gro Company - President, CEO & Chairman of the Board*

Here's kind of where I'm at, and this is the guidance I've given the team and I wish we had like [NDAs] with you guys, and we could brief you. I'd actually love to get your opinion on kind of how things are forming up. But I think that I start with Hawthorne on the we can't stay here category. They're back at profitability, it will be a contributor. I think Chris says that we may be able to move out of mom-and-dads basement, but we're just getting kind of a studio and kind of a ratty part of town. That has taken a lot of work and a lot of people have suffered to get there. And there's probably not an analyst that knows more about it than you. So the journey, you understand, has been challenging.

And this idea of, for us, we can't stay here. I think fortunately, there's other people kind of in the same category. And the guidance that I've given to Chris and the team that are working on this, which includes Matt is, I think the business needs to be well north of $1 billion. It needs to be earning in sort of EBITDA terms, triple digits. It needs to be significant strategically. I mean it has to have a sort of theme. And it's got to be large enough to be followed. And I do think we have gotten there. And it's not like we are -- I don't think we're dominant.

But I think when the stock was in the 200s, we thought the consumer business and the Hawthorne business were fully valued. And therefore, splitting them apart, there was no real benefit. I think today there's probably a negative valuation on Hawthorne. I think it's unappreciated, I mean not in the most critical sort of way by our shareholders or at least a lot of them and they'd like to see a solution where it's not part of Scotts. And so these are kind of the priorities that Chris is trying to manage.

Christopher J. Hagedorn - *The Hawthorne Gardening Company - Division President*

Yes. So just to build on what Jim is saying and address in as much, I think, detail as I can, your question, Andrew. When we look at the options for Hawthorne, I think all of which we're considering involve moving it outside of SMG in some fashion. There's a bunch of options. As Jim mentioned, there are a lot of companies that have, what I would consider, sound fundamentals that have been victimized by just a really brutal market downturn who are also looking for partnership.

Those are some companies on the hydroponics kind of equipment supply side, like Hawthorne is and other companies that are more like RIV. And look, I'm going to be cautious just because I'm obviously an employee here at Scotts and a director over at RIV. I think if there were an opportunity that was beneficial both to RIV shareholders and to SMG in Hawthorne, I would love to see a world where those -- I'll just look at those as sort of 2 elements of our kind of investment constellation in cannabis.

I would love to see those bucket under the same roof. So if the opportunity presents itself, it's something that we would -- I think we would pursue or at least be interested in. But right now, our focus is on, again, companies that we believe it's, I would say there's 3 criteria: transactions that are beneficial and accretive to SMG and its shareholders, beneficial to the business we've built in Hawthorne, which is allow us to continue to pursue and support things like innovation -- equipment innovation, particularly as it relates to lighting. I think that's an area that we have made great strides. I think the industry as a whole has benefited from that.

We want to continue that. Other further-looking investments in R&D like genetics and then ultimately something that benefits the industry. So those are the 3 criteria. I think there's a lot of transactions out there that fit that bill. We're pursuing a number of them in earnest at the moment. And as Jim said, it's a lot of interesting stuff. I would love to share more of it with you guys. But I think we'll have a lot more to share here over the next few months.

James S. Hagedorn - *The Scotts Miracle-Gro Company - President, CEO & Chairman of the Board*

But so we're clear. We're not chasing and we're not struck dumb with sort of -- this was 3 years ago, and the idea is valuation. I think this is where we can partner. I think we're using in previous releases, cash free or something like that. But I think this is where we partner, we accept that we will be one of the partners, possibly get to distribution of those shares to the Scott shareholders, but start with -- we don't have to own this. We don't have to necessarily be the boss, but we do want to be a respected partner in how the business is managed.

And I think that as we've talked about this business, and I think -- these were in, I think, Matt's notes as we prepared. This business started out as a professionally managed business, and it still is. And we have a professional management team that can contribute here. And within that business, as you know, there's lots of different sort of levels of professionalism. So I think on top of we've got these great brands, we've got this great R&D pipeline. We also have a professional leadership that's used to being in a public company that can contribute into this whatever co.

And it's pretty exciting I think. Now it's like all kind of deal discussions. Everybody we're talking to now is enthusiastic. That's not the issue with enthusiasm. It's just getting down to the meat and potatoes and what flaws do people have in their businesses. We know one thing about how we're looking at this. And to some extent, it's -- whether it's Hawthorne or RIV. It's 100 percent clean and not a burden to anybody. And that, as you know, I doubt there's any other business that can say that.

So we feel like we have a lot to offer these combinations. I can't speak for RIV. But RIV is sitting on a relative mountain of cash that doesn't exist anywhere else in this business. And so we also are enthusiastic, and we have a Board meeting on Friday to kind of keep them current. I want to give credit to Chris especially because this is one where -- because it's not just one party we're talking to, it's multiple parties. It's complicated and there's a lot of permutations to it.

And I think it can get tedious, where you're trying to maintain a lot of opportunities and conversations and things change a lot and people's attitude changes and people get in bad moods and people fight old battles. But I think that if every -- I'm sure some of those people we're talking to are on this phone call or will be listening to the phone call, if everybody can maintain a balance, we can create a very unique business in partnership with other people. And I think that's a really good solution for this because some of those businesses can make a lot of money, and we have something of great value that is not a burden to anybody's balance sheet.

Operator

(Operator Instructions) And our next question comes from Bill Reuter with Bank of America.

William Michael Reuter - *BofA Securities, Research Division - MD & Research Analyst*

I just have 2 quick ones. So the first is, and you kind of got into this during the first question in Q&A. But the amount of incremental shelf space or slotting's that you received as a result of the price reductions, is there any way to contextualize that?

James S. Hagedorn - *The Scotts Miracle-Gro Company - President, CEO & Chairman of the Board*

It's pretty significant. I'm not sure I want to, but I think if you say this $3-plus billion business and you're talking high single digits, which I would say is accurate. You can just multiply it out and you'll come to a number. And there has been -- Matt has really led a process of really pressure testing this issue of how does the operating side feel about this.

Nate Baxter - *The Scotts Miracle-Gro Company - Executive VP & COO*

Yes. This is Nate. No, actually, this is what I love about Matt is he's keeping us honest. And what I would say is that we did a full bottoms-up, working hand-in-hand with retailers. We're not quite done with that process. As most of you probably know, we'll finish it up and just call it before Thanksgiving. We're through almost all of the operating plans, hand-in-hand, working on those with our retailers. And as Jim said, you can do the math. But we're pretty confident in those numbers. And again, I would say, just what I will frame out is new listings and promos and merchandising, those are about equal and the bulk of it and then the smaller bit of it is on the price elasticity related growth.

William Michael Reuter - *BofA Securities, Research Division - MD & Research Analyst*

Got it. And then you guys did a great job explaining the way you're going to change kind of the marketing strategy in terms of where you're spending the dollars. I just want to make sure I got some of the numbers that you laid out correctly. Did you say that you increased marketing by 50 percent in fiscal year '23. And then I think you said you're going to further increase it in fiscal year '24. Did you put any numbers around that? I don't think I caught any...

James S. Hagedorn - *The Scotts Miracle-Gro Company - President, CEO & Chairman of the Board*

Okay, it's 25 percent, okay. That was the year that just ended. I want to spend more. On my giant whiteboard here, is where Matt is keeping kind of tally of motion in the '24 budget. He still had an additional media number up there that's changed since yesterday, but it's a positive. And so we're looking to put more money in, but it's going to be as we solve issues toward the solution that we're looking for, which I think we said to you is $575 million. And just for a little bit of visibility. $575 million is what we need to achieve from target incentive payout, okay? So I'm kind of giving you a number that the entire management team is highly incentivized on.

The other number is a -- I'm not sure if I said 50 percent, but it is basically, it is more than 50 percent, which is taking money that would have been spent in digital and moving it back into traditional forms of media. So it's maintained at least what we spent last year. If we can put more in, and that's what we're working toward and then a very significant move toward more, what I think I call, traditional media because I think people call it like analogue or linear, something that I find insulting as an older person because I'm probably in that category. I do not use a flip phone though..

Nate Baxter - *The Scotts Miracle-Gro Company - Executive VP & COO*

So Bill, I'll just comment. The story isn't so much increasing the media spend significantly, although we are looking for dollars to do that. It's how we're going to spend the dollars. And Jim referred to our new agency of record, and our partners in Mediahub. The way we'll spend the dollars this coming year to be totally different than the way we spent them last year. And I think that's the bigger piece of the story on the working media.

Operator

(Operator Instructions) And our last question comes from (inaudible) with JPMorgan.

Unidentified Analyst

I just wanted to ask what we should be expecting in terms of working capital build for the next 2 quarters and if you expect to generate cash from working capital for the remainder of FY '24? And if you expect to be able to fully pay down revolver during 2024?

Matthew E. Garth - *The Scotts Miracle-Gro Company - Executive VP, CFO & Chief Administrative Officer*

Yes. So we have a normal seasonal working capital build in our business. As we would expect, we're a highly seasonal business. So getting inventory in place to be able to ship out to our retailers as the season comes is what we work on in the first quarter. So you see cash absorption in the first quarter. And then you see the peak of our working capital build in the second quarter of the year. That generally goes from an inventory position of where we are plus 25 percent to 30 percent higher. And that's the main driver along with AR as you move through the first half of the year. So that will repeat. And the back half of the year is when we generate the bulk of our free cash flow, as I said, this year in '23, pretty much all of our free cash flow was generated in Q4. That will be consistent with what happens in '24.

And then we will use that free cash flow to pay down debt. The debt that we choose to pay down, you pointed to the revolver. We also have Term Loan B that is available to us. We have senior notes that are in place that don't come due until beginning of 2026, and that is a manageable maturity of $250 million.

So we have choices, but it's most likely going to go to paying down the highest cost debt that we have at that time, which will be either the revolver or the term loan B.

Operator

And that concludes our question-and-answer session. I would now like to turn it back to Chief Operating Officer, Nate Baxter.

Nate Baxter - *The Scotts Miracle-Gro Company - Executive VP & COO*

I just wanted to say that we're in the beginning stages of planning a field day for investors. We'd like to bring you all out, call it, late spring. So stay tuned. I think there's a lot that's changed here, with Matt and Jim and the rest of the team and I, and we'd like to sort of share with you not only operationally what's different, but also some of the innovation that we've got in the pipeline. So stay tuned for that.

Operator

Thank you for participating in today's conference. That does conclude the program. You may now disconnect.