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SMG.N - Q3 2024 Scotts Miracle-Gro Co Earnings Call

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**OVERVIEW:**

Company Summary

## CORPORATE PARTICIPANTS

**Aimee DeLuca** *Scotts Miracle-Gro Co - Senior Vice President, Investor Relations*

**James Hagedorn** *Scotts Miracle-Gro Co - Chairman of the Board, Chief Executive Officer*

**Matthew Garth** *Scotts Miracle-Gro Co - Chief Financial Officer, Executive Vice President*

**Nathan Baxter** *Scotts Miracle-Gro Co - Chief Operating Officer, Executive Vice President*

## CONFERENCE CALL PARTICIPANTS

**Joe Altobello** *Raymond James & Associates - Analyst*

**Peter Grom** *UBS Investment Research - Analyst*

**Jon Andersen** *William Blair & Co., LLC - Analyst*

**Andrew Carter** *Stifel - Analyst*

**Chris Carey** *Wells Fargo - Analyst*

**William Reuter** *Bank of America - Analyst*

## PRESENTATION

**Aimee DeLuca** - *Scotts Miracle-Gro Co - Senior Vice President, Investor Relations*

Good morning and welcome to Scotts Miracle-Gro's third quarter 2024 earnings webcast. I Aimee DeLuca, Head of Investor Relations. With me this morning our Chairman, President and CEO, Jim Hagedorn; and Chief Financial and Administrative Officer, Matt Garth. Jim will provide an overall business update, followed by Matt with a review of our financial results.

During our review, we will make forward-looking statements and discuss certain non-GAAP financial measures. 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 SEC for details of the full range of risk factors that could impact our results.

Following the webcast, Chief Operating Officer, Nate Baxter; and Hawthorne Division President, Chris Hagedorn, will join Jim and Matt for an audio-only Q&A session. To listen to the Q&A, simply remain on this webcast. To ask a question, please join via the audio link shared in our press release. As always, today's session will be recorded. An archived version will be published on our website at investor.scots.com. For further discussion after the call, you are invited to email or call me directly.

With that, let's get started with Jim's business update.

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**James Hagedorn** - *Scotts Miracle-Gro Co - Chairman of the Board, Chief Executive Officer*

Welcome everyone. At the start of our fiscal year, we outlined growth targets and financial metrics for fiscal 2024. With three quarters of the year behind us, we have greater visibility into how we're performing against them. It's clear we've accomplished almost everything we set out to do this year.

Despite an uneven and unsettled weather season, we will improve upon the financial metrics that matter when it comes to driving value and establishing a growth foundation for next year. They include market share, sales and point of sales at consumer level, free cash flow, debt reduction, leverage improvements, gross margin and EBITDA.

We've also held the line on expense control and continue to operate as a leaner, more cost-efficient organization capable of investing strategically to drive volume and sales. To that point, we not only increased our media spend over prior year, but we also efficiently focused those dollars to maximize POS opportunities in response to external factors.

The peak of the season is a perfect example. To overcome its sluggish start, we injected 33% more into marketing and sales activities. This contributed to POS growth and profitability in Q3. Inventory is another pain point that we dealt with this year.

When we came out of COVID, we were significantly over inventoried and facing major absorption issues. We committed to drawing down inventory to $600 million this year and will meet that goal. Through Q3, we're just north of that number and below pre-COVID levels when ingesting for inflation. This was a difficult undertaking, but our operating community made it happen.

When you look at the totality of our performance, fiscal 2024 is a story of considerable progress. We know we have more work ahead of us to achieve sustained growth, significant margin improvement, and further debt reduction. And I'm holding off declaring full victory in our recovery until we've delivered on each of those things, but I can say with conviction that we're well down the path to getting there.

Through the first nine months, US consumer net sales were up 2% and unit POS growth is plus 10%. We expect a strong fourth quarter and are reaffirming our guidance of 5% to 7% net sales growth for the lawn and garden business. We're also tracking to our company wide adjusted EBITDA guidance of $530 million to $540 million, a significant profitability swing of plus 20% over the last year.

Even though we set our sights on a more ambitious EBITDA target this year, it still was a damn good year. Our growth is enabling us to achieve our two-year goal of generating $1 billion in free cash flow by the end of fiscal 2024, and we'll pay down at least $350 million in debt for further leverage improvement. Leveraging Q3 was down to 5.5 times adjusted EBITDA, a far cry from the over 7 times we faced less than a year ago.

By year end, our leverage will fall below 5 times. One of our highest priorities has been gross margin recovery. We know it's a multi-year effort to get back to our historic mid-30% range. So far this year, we've improved gross margin by 260 basis points. This compares favorably to our full year target of 250 basis points. It will also enable us to recoup more than a quarter of the 1,000 basis point margin decline.

A big part of our gross margin decline is attributable to deliberate actions we took in the past two years to drive significant sales and free cash flow. We had to build the financial wherewithal to navigate our leverage situation during our financial crisis. Those actions involved trading pricing with retailers in exchange for new promotions, listings and shelf space to drive volume. This cost us margin points but positioned us for share gains. The moves we made were the right things to do, and the benefits of that strategy are evident in our 2024 performance and the foundation for future growth that we've established.

Our share gains in the consumer business are a big part of our recovery story. We knew the tradeoff with retailers would bring us lifts and share, but even we were surprised by the level of these gains. In a flat to declining lawn and garden market this year, we captured nearly 700 basis points of share at our biggest retailers. This spans our entire portfolio. And when you exclude mulch, our share gains remain significant at plus 300 basis points. In my entire career with Scotts Miracle-Gro, I have never seen a time into which we took so much share in a single year, and I want to thank our retail partners.

This is a testament to our brands and our proven ability to execute and adjust to external factors. No one has what we have in terms of firepower. Our sales, marketing and supply chain teams are unmatched, and the health of our brands is as strong as ever. A recent study showed that consumer perceptions of trust and safety increased this year with the Scotts Miracle-Gro brands.

Our ability to drive growth through innovation is evident in the new Miracle-Gro Organic Soil's line that was supported by a well-received marketing campaign featuring Martha Stewart. At the close of Q3 it was the single biggest driver of our unit POS growth in soils and has been the catalyst for capturing significant market share gains in the overall soils category.

Through our retail partnerships, we created success for them and us. Our marketing initiatives and joint promotional efforts brought people into the stores in significant numbers, outperforming tepid retailer foot traffic. We do the advertising, point people to their doors, run joint promotions and have our salespeople and products on the store floor. Our model works and no company in lawn and garden can match that.

Now let's talk about the fourth quarter. We're comfortable with where we're headed. We expect a strong fall supported by advertising centered on higher margin lawn and control products with targeted price reductions on key grass seed SKUs. Promotional activities will play a key role as well. We'll heavy up on them during the Labor Day weekend. Fourth quarter is also a time when we negotiate with retailers for the spring.

Pricing across our portfolio will be a part of that discussion. Inflation has hit everyone hard, and our pricing has not kept pace with our costs. We will be very modest in our approach to pricing next year given the concerns of our retailers and the pressures they have on their own margins. We do expect pricing to contribute at least 1% to net sales in 2025. Longer term, our pricing must keep up with the rate of inflation.

Shifting to Hawthorne, the business has been a cash flow contributor and is making money, posting its first profitable quarter in two years. Its strategic move from distributing third party products to focusing solely on its market leading brands led to a 6% increase in branded sales year over year and 144% increase in profit. Hawthorne also continues to develop industry-leading innovation and has just launched three new LED products under the Gavita brand. Hawthorne is leading a turnaround in the industry supply side, and we're seeing some fast followers try to mimic our business model.

Chris and his team have explored numerous options to create partnerships or separate Hawthorne from SMG. It's been a lot of work on their part, but we've concluded it's better to keep Hawthorne where it is for now, especially when it's profitable, while we create the building blocks for a longer-term solution.

At our Investor Day a few weeks back, we discussed our financial blueprint for the next three years. It's all about getting the company back to operating on all cylinders. You can get the details on our Investor website, but here's the abridged version. Matt and Nate built a three-year plan that is grounded on driving an average of 3% annual growth through innovation, pricing and expansion of our retail and direct-to-consumer channels.

We're targeting above 30% adjusted gross margins and adjusted EBITDA of $600 million with further leverage reductions below 3.5 times. These are reasonable goals that will deliver considerable shareholder value, but I believe we can do better. I am challenging and incentivizing the team to get leverage below three times in this timeframe through further top-line and bottom-line growth and outsized cash flows.

We'll increase investments in our business, brands and capital improvement. Next year we'll put an incremental $25 million into our brands and innovation. And just this month, we announced that Martha Stewart will be our Honorary Chief Gardening Officer to advise us on gardening trends, new gardeners and products. She will also be the center of our gardening campaigns in 2025.

I view fiscal '24 as the bridge year in the transition from the financial strain of the past two years to a state where we can achieve the type of returns that our shareholders deserve. I credit the management team, Matt, Nate and Chris, especially, for working together not only to expedite our progress, but to deliver on our commitments and get us to a great place for next year. I want to thank our associates for their resilience and our banks, retailers and the Board of Directors for their support.

The past two years have been the most difficult in the history of Scotts Miracle-Gro, but we're approaching our business with renewed optimism, enthusiasm and determination. I welcome the opportunity to have you continue with us on our journey.

Now I will turn it over to Matt.

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**Matthew Garth** - *Scotts Miracle-Gro Co - Chief Financial Officer, Executive Vice President*

Thanks, Jim. And good morning from Central Ohio. Hopefully you're enjoying summertime, the fruits of your spring plantings, and all the benefits your lawns and gardens have to offer with family and friends.

As Jim shared, third quarter results excelled in both of our major business segments. The US consumer lawn and garden business benefited from continued strong consumer engagement and our Hawthorne Division posted adjusted segment profitability for the first time in two years, with year-to-date free cash flow approaching $500 million and driving further debt reduction. We ended the quarter with net leverage at 5.45 times, a full turn below the covenant maximum. These results give us confidence in achieving a strong finish to the year in-line with the updated guidance we shared with you in June.

With that overview in mind, let's get into the details of our third quarter performance. Our US consumer business benefited from additional promotional activity and media support, propelling net sales to $1 billion for the quarter, an 11% increase over the same quarter a year ago. US consumer year-to-date net sales increased 2% over prior year to $2.7 billion. Importantly, the third quarter last year benefited from approximately $100 million in replenishment orders for our growing media business that we expect to ship during the fourth quarter this year, yielding nearly 50% sales growth versus last year.

This being said, we expect to end the fiscal year with US consumer net sales growth within our revised guidance range of 5% to 7% as order and shipment phasing continue to normalize through the balance of the fiscal year. In the third quarter, media and promotional activities were centered on our Martha Stewart and Scott for Scotts campaigns along with a pivot to heavier investment and controls as we responded to consumer needs to combat rising pest and weed pressure.

Let me reiterate Jim's note on share. The action we have taken in partnership with our retailers, helped deliver strong performance at the shelf, with SMG share growing by 7 percentage points even as the lawn and garden category declined year-over-year. Through mid-July, year-to-date unit POS are up 10% over last year, led by gains in growing media and controls, while inventory units at our three largest customers are up 2% versus prior year.

POS dollars year-to-date through mid-July are essentially flat to prior year, reflective of a heavier mix of low-priced mulch versus other product categories and continued price and promo activity funded by both SMG and our retail partners.

Now moving to Hawthorne, the change in go-to-market strategy to focus on proprietary versus distributed brands is on track. Sales of its Signature brands are up 6% in the third quarter compared to last year. Total Hawthorne segment sales for the quarter declined 28% to $68 million and 33% to $214 million year-to-date.

Given the discontinuation of third-party distributed brands, this decline in top line sales was expected and will not negatively impact the total company adjusted EBITDA target. This is because Hawthorne's Signature brand strategy is having the desired positive effect on margins. Hawthorne posted non-GAAP segment profit of $3.8 million in Q3, its first profit in eight quarters compared with a loss of $8.7 million in the third quarter last year.

Let's move on to gross margin and cost of goods for the total company. The non-GAAP adjusted gross margin rate for Q3 was 29.2%, compared to 21.3% last year. The increase from prior year is primarily due to lower distribution, material and E&O costs as well as increased Roundup commissions and improvements in product and segment mix.

On a year-to-date basis, the non-GAAP adjusted gross margin rate increased from 27.6% to 30.2% driven by the same factors that improved the Q3 rate, partially offset by pricing. With 95% of our commodity inputs now locked, we have clear line of sight to our full year costs. For the full year, material costs are not expected to have any meaningful impact on gross margin.

As we have discussed previously, we expect to unlock the benefits of recent material cost deflation in fiscal 2025. SG&A increased $19 million in the quarter, a 15% increase versus third quarter 2023 due to increased investments in marketing and sales activities to drive volume as well as higher variable compensation.

On a year-to-date basis, SG&A is essentially flat at 14% of net sales, with the increases in media spending and variable compensation, offset by decreased amortization expense, primarily in the Hawthorne segment. Taken together, these adjustments have little impact when calculating year-to-date non-GAAP adjusted EBITDA as the increase in share-based payments is largely offset by the decrease in amortization expense.

Q3 non-GAAP adjusted EBITDA improved 86% to $237 million from $127 million last year. Year-to-date, non-GAAP adjusted EBITDA was $607 million versus $553 million a year ago. The increases were primarily attributable to the aforementioned improvements in volume and gross margin rate. Below operating income, third quarter results include $23 million in equity income from the Bonnie JV, compared to $22 million for the same period a year ago. On a year-to-date basis, excluding the impairment charge recorded in the first quarter of fiscal 2024, equity income was $4 million for both fiscal 2024 and fiscal 2023.

Based on their latest projections, we expect fiscal 2024 profitability from Bonnie to end the year flat to fiscal 2023. Interest expense declined by $8 million or 18% in the third quarter compared to last year. On a year-to-date basis, interest expense decreased $13 million or 9% from a year ago due to lower debt levels, partially offset by an increase in our weighted average interest rate from 5.3% to 5.9%.

Borrowings as of June 30 were nearly $600 million lower than a year ago, driven by approximately $500 million in sales of accounts receivable, net of discount and other free cash flow generation from operations and inventory improvements. Additionally, cash on hand increased to $280 million from $27 million last year. We remain on track to deliver the balance of $1 billion in free cash flow over two years by the end of fiscal 2024.

Interest rates remain approximately 80% fixed as of the end of the third quarter under a combination of long-term fixed rate notes and interest rate swap agreements. Discount costs associated with the AR sale facility included in other income and expense was approximately $22 million through Q3. Our adjusted tax rate through the third quarter was 26.8% compared to 25.8% last year. The increase relates to the unfavorable impact of higher non-deductible executive compensation expense partially offset by lower year-to-date discrete tax items.

Through Q3 FY2024 and consistent with the prior quarter, year-to-date share count increased about 1.2 million shares from a year ago, primarily due to increased share issuance related to short-term and long-term incentive awards and media purchase with shares for both FY2023 and 2024. Through the end of Q3, more than 80% of our full year POS is behind us, providing strong visibility through the remainder of the year. We expect to finish the year in line with our guidance and are poised for further growth and margin improvement in FY2025 and beyond.

I invite you to visit our investor site to review the high-level midterm financial targets outlined at our recent Investor Day. Over the next three years, we expect to return to mid-30s gross margin rates and a more balanced capital allocation as we benefit from continued strong free cash flow and an improved balance sheet.

With that, we can now move on to the Q&A. Operator, please open the line for questions.

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## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Joe Altobello, Raymond James.

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**Joe Altobello** - *Raymond James & Associates - Analyst*

So first question, I want to go back to the three-year targets that you gave us a couple of weeks ago, the 3% annual revenue growth in the 250 basis points of annual gross margin expansion. Is there anything unusual in FY2025 as we think about the cadence of those targets? I guess, what I'm asking is, should that be our base case at this point as we think about next year?

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**Matthew Garth** - *Scotts Miracle-Gro Co - Chief Financial Officer, Executive Vice President*

Good morning. As we detailed to you at the Investor Day, Nate and I gave you a vision of how that would roll out over the next couple of years. And it was prudent to say that, that might be just spread across three years. But as we know, that could be a little lumpy. As you look at 2025 coming out of 2024, right, we've said we wouldn't get some of the raw material savings in our cost structure in 2024. There's a little bit, but that was going to come in 2025.

So you might see a bit more of that margin recovery in 2025 versus 2026 and 2027. But again, not going deep into guidance on 2025 yet, we'll detail that for you at the end of the fourth quarter. But I think it's okay to start to think about it as maybe a little bit more in 2025, 2026 and 2027 also continuing on that recovery path.

And then the other component is pricing. And what the team has been doing and what Jim alluded to in the prepared remarks was working with retailers. You know that takes place now and through the fourth quarter. And so maybe, Nate, if you want, you can just talk about how that's looking and how you're thinking about the next couple of years.

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**Nathan Baxter** - *Scotts Miracle-Gro Co - Chief Operating Officer, Executive Vice President*

Yes. Thanks, Matt. Like you said, we're in the middle of that process right now with our retailers. I would say we see nothing that indicates we're not going to start from a solid base of how we finish 2024. I think Matt's right.

We probably have a little bit more opportunity in 2025, but we're also being aggressive with, not only our cost outs, but our innovation and our pricing for 2026 and 2027. So I think it's a little early to tell the full story, but I think you're on the right track.

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**Joe Altobello** - *Raymond James & Associates - Analyst*

Got it. Okay. And then maybe just to follow-up on that. The one point you're expecting from acquisitions, maybe help us understand what you're looking at from an M&A standpoint.

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**James Hagedorn** - *Scotts Miracle-Gro Co - Chairman of the Board, Chief Executive Officer*

Look, I can describe the qualities. Bolt-on lawn and garden acquisitions that have very low risk on the integration side. And partners who I think would largely accept equity in Scott's payment. So that's how we're thinking about it.

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**Joe Altobello** - *Raymond James & Associates - Analyst*

Okay, perfect. Thanks, guys.

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**Operator**

Peter Grom, UBS.

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**Peter Grom** - *UBS Investment Research - Analyst*

Maybe going back to the margin question that Joe has asked. But just, Matt, can you maybe just when we -- maybe taking a step back, when we think about the margin compression and the different drivers of the margin compression over the last several years, is there any way to frame how big the raw material savings opportunity is? Just going back to the comment around 2025, you're going to recapture more of that. So just any way to think about where we are in that process, I think, would be helpful just to start.

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**Matthew Garth** - *Scotts Miracle-Gro Co - Chief Financial Officer, Executive Vice President*

We've been really consistent and thanks for the opportunity to talk about the framing over the past couple of years because I think Jim, Nate, myself, we've all reiterated the viewpoint that we've lost 1,000 basis points in gross margin. And that's come as a result of the inflationary period. It's come as a result of price in ability on moving through to the consumer over that time period.

And we find ourselves now sitting again coming out of 2024, we recovered about 250 basis points plus 260 basis points through the third quarter. And when you look at the remaining frame of that, that 700 basis points, what we have said is that you are looking now at a lot of that geared towards the recovery in pricing against those inflationary factors that have impacted us.

So where have those inflationary factors impacted us. Yes, raw materials, which is roughly a little more than half of that. But then also in our cost structure where we've taken positions in our distribution network, in our labor force, where you've seen inflation impact us, those are additional areas for us to regain pricing. Again, that have come through over the past couple of years.

So that means as we look over the next three years, that pricing that we're going to recapture is, again, we've told you 1% plus and then the cost takeouts also come into helping that with the roughly 1.5% each year, and again, we just gave you the caveat at the beginning of this call of how that might be a little more lumpier.

But that really solves the 750 basis points as we move forward, combination of regaining pricing and then also as we talked about some of the supply chain cost outs, that is also going to be recovering pricing and gaining efficiencies over that time frame.

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**Peter Grom** - *UBS Investment Research - Analyst*

Okay. Great. That's really helpful. And then maybe just a follow-up, Matt, I mean, I think you mentioned an incremental investment of $25 million next year. I mean, is that going to be offset by maybe incremental savings so you say within your long-term SG&A target range? Or would you say that that is coming, the extra gross margin expansion or the profit dollars that you anticipate? Is that going to be offset by the incremental investment?

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**Matthew Garth** - *Scotts Miracle-Gro Co - Chief Financial Officer, Executive Vice President*

So we're going to end this year on a total SG&A basis middle to the high end of that 15% to 16% range. As we look at $25 million again not getting into guidance, but we've told you we're going to spend $25 million more. I think it's prudent to say that we're going to be at the top end of that 15% to 16% range.

But what does that mean? And this is where the full team will come into this. Everything that we are doing, whether it's last year, this year, it is all positioning towards a much stronger support for our brands, for innovative products to our consumers. All of that is what we are gearing towards and creating additional flexibility for this company as we move into the future. That $25 million, on top of the additional media spend we did this year in 2024 has immediate results that we feel very good about. So I'll pass it over to Jim and probably Nate.

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**James Hagedorn** - *Scotts Miracle-Gro Co - Chairman of the Board, Chief Executive Officer*

I'll take it for a second. Hey, Peter. What I would say is, I got a Board meeting Friday, okay? And one of the things I've asked Nate and his team to do is say, what do you need to run this business properly? I think it's the perfect time to say to the new guy, excuse me -- he's got a new marketing team -- what do you really need to support this brand or the line of products that we have or multiple brands? And part of it is looking at the competitive environment.

And while I don't think Zevo is, is really going after us as it is our partner, SCJ. I think they're doing what we do, support their business with advertising and marketing funds, working with the retailers. And that's their franchise. And we don't need lessons in that. We know that.

So what do I think it's going to be long-term, I think that they're going to show up with a wish list, and I don't mean that in a casual sense that's probably double what we're spending today. Now we got a business to run, and we got to figure out how to do that profitably and remember we are investors too, maybe the biggest investors in the company are sitting at this table.

And so we get that part that is we have to do this in time. But I think what you're going to see is that the need to spend behind this business, which we're going to have to throttle as fast as we can. And this gets back to the Board meeting, which is it's not just what do you guys think you need to run the business. And that's, I think, the biggest area that I think we feel like we need is brand support, which is directed at the consumer, plus some incremental innovation money. Do that while driving margins back to historically where they've been, call it, 35%.

And that margin will go a long way to helping pay for this stuff, but I think my challenge to them is going to be can we within our planning horizon get to that point of, call it, $200 million or so in direct media, which we think is righteous number. But the trick is, and this is where the tension exists between the operating community and the finance community here is how to do that without trashing our P&L.

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**Matthew Garth** - *Scotts Miracle-Gro Co - Chief Financial Officer, Executive Vice President*

And a key component of that and Nate, if you want to step into it. That spend, and we've seen in the past two years, consumers respond, and we do get the growth that we are looking for in those investments.

And so yes, a growing top line will provide us more percent of SG&A that we can spend. And so that's what Jim is talking about, those dynamics. So we'll maintain the discipline on all of our lines. But clearly, there is a path towards growth and improving the overall --

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**James Hagedorn** - *Scotts Miracle-Gro Co - Chairman of the Board, Chief Executive Officer*

Look, I think the good news that came out of it is we cut about $400 million of expenses so far, of which a quarter of it went back into the business. And I think use that as a guide to where we're going.

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**Peter Grom** - *UBS Investment Research - Analyst*

All right. Thank you so much. Appreciate it.

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**Operator**

Jon Andersen, William Blair.

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**Jon Andersen** - *William Blair & Co., LLC - Analyst*

Could you help us just or help me with the bridge on point of sale? You said it's up in units 10% through mid-July, but flat in dollar terms. And given your outlook for 5% to 7% growth in the US consumer business, how do we connect the 5% to 7% revenue growth with the flat point of sale dollars through mid-July. And I know there are some things that you control, and there are some investments that the retailer are making. But can you walk us through that?

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**Matthew Garth** - *Scotts Miracle-Gro Co - Chief Financial Officer, Executive Vice President*

Yes, very clean, and thank you for the little bit of leading the witness there because you are correct. Point-of-sale dollars, that's what happens at the register, not always necessarily tied to our dollar revenue unit, right? That comes through our shipments. When you look at the POS dollars flat versus POS up 10% what we said in the prepared remarks and let me just detail it here a little more for you. About 50% of that is mix. So that is -- we are selling through a lot of mulch, a lot of soils and those are all good things, really good strategic positions with our partners.

The other piece of the other 50% is extended promotional activity that we have and also our retail partners have. So they can be taking price at the shelf that will result in a lower POS dollar. And that's what happened there versus the 2% to 3% that you've seen us so far this year. Now looking at the 5% to 7% for the rest of the year, Jon, really simple.

Yes, there was an anomaly in Q3 last year, and we talked to you about it. Just a shipment component that went into Q3 versus Q4. So our Q4 normally has about $300 million-ish in it. This year, you will see roughly a 50% increase in sales year-over-year just based on the normal timing of those shipments taking place in Q4. And so that's what helps you as you do the math, get to that 5% to 7% for the full year.

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**James Hagedorn** - *Scotts Miracle-Gro Co - Chairman of the Board, Chief Executive Officer*

If you don't mind, I'll just add a little color, Jon. It's a very strategic play with our retailers that resulted in flat POS dollars, and that is driving footsteps, right? So if you look at retailer traffic, it's flat to up 1%. But if you look at lawn and garden, it's up 6%. So that's the value we bring to the market and a lot of those incentive programs, whether we fund them or retailers fund them are based on driving those footsteps and creating larger baskets for the consumers that go into the retailers.

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**Jon Andersen** - *William Blair & Co., LLC - Analyst*

That's helpful. And that ties into my second question. So here we are 80% of the way through the season in 2024, at least on a POS basis and you're starting discussions or having discussions with major accounts regarding 2025. How are your customers sizing up the success of the 2024 season because they did make commitments to Scotts in terms of additional listings and additional shelf space. How are they viewing the success or lack thereof of the season? And what does that imply about your ability to retain those new listings in shelf space or maybe extend them in 2025? Thanks.

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**James Hagedorn** - *Scotts Miracle-Gro Co - Chairman of the Board, Chief Executive Officer*

That's a big question. I start with, I think generally, the season was fairly disappointing, to be honest. I think we did quite a bit better, thankfully, than that. But I think if you look at live goods and everybody else, it was probably down market. I think the Northeast really dragged everything down. And if you look at live goods, which I think is a pretty good barometer for I think they were significant double-digit declines in market for live goods at, call it, the home center business. And I think that's actually a pretty good indication of what happened for the season.

Honestly, I'm trying to -- so I can use this call a little bit as I know our partners listening to these calls. I think what we did really worked. I think what they did with us really worked. And I think the numbers would have looked a lot worse if we hadn't been promoting the heck out of our joint businesses together. And I do think it comes at the price of margin it does. And I think our partners have to remember what we were trying -- all trying to do is get customers to comment and buy stuff at a time when a lot of major durable categories are more challenged.

And I think we were highly successful at that. And I think that they need to remember that when it goes back to this question, how do they look at the season, they should be pretty happy, I think, about how the season went. And not focus so much on margin, focus on footsteps. And I think lawn and garden had a major effect, and I think we bucked the trend in part with their help, but at a modestly substantial cost to us and margin as we helped a so-called cost outs. Those -- as far as I know, and this is my expectation because programs will change, if they're not, is those programs are intact.

The numbers that we thought we would get, and this goes a little bit back to our call down earlier this year. What we expected from the deals we did with retailers, we expected a pretty substantial revenue increase from that. And it was much more challenged than that. But it was not because the retailers didn't do what they were supposed to do. They did. It was just the market was down. And so my expectation, and I think this is from discussions with them, as those problems are intact and might even be enhanced.

**Matthew Garth** - *Scotts Miracle-Gro Co - Chief Financial Officer, Executive Vice President*

Yes, I'll comment on that, Jim. From where I sit, and again, we're still in the middle of developing these programs with our retailers. I'm very comfortable that we're going to build on what we started last year. We'll do some optimization around some of the new SKUs that maybe didn't sell through as much as we would have liked. But remember, we've got a bunch of innovation coming in 2025.

So I think it's more of the same story. And I'll hold further comment until we get through the fourth quarter and finalize our plans. But I'm feeling pretty good about where we are right now.

**Jon Andersen** - *William Blair & Co., LLC - Analyst*

Great. Thanks so much.

**Operator**

Andrew Carter, Stifel.

**Andrew Carter** - *Stifel - Analyst*

I wanted to ask, you've said that, hey, you expect to get 1% pricing next year. And I know that that's that portfolio average. So specifically, when you get into lawns and ferts, that's the higher margin category, it's been under pressure. Would you think about putting more into that category, specifically with what inputs are doing? I know if site one mentioned that grass seed was down, pricing was down 20% this year on top of last year. Thanks.

**Nathan Baxter** - *Scotts Miracle-Gro Co - Chief Operating Officer, Executive Vice President*

Maybe I'll take a stab at that. Look, Andrew, I would look at it this way. We're not going to take pricing in areas where we know the consumer isn't going to respond well to that. And we're going to have to make adjustments on the back end from a cost perspective to be able to play there and drive the margin we want.

But there's a lot of category opportunity, I would say, and it may not all be in lawns and ferts and seeds in particular, to go take selective pricing, and that's what we've said. It's going to be surgical. It's going to be done in partnership with our retailers.

I am comfortable that we will get there. Jim, as you know, has pushed us for more pricing in 2025, we think 1% is achievable. I still see 2025 as a little bit of a transition year given where the consumer is. But I'm confident we'll be able to work with our retailers to get that pricing.

**James Hagedorn** - *Scotts Miracle-Gro Co - Chairman of the Board, Chief Executive Officer*

Andrew, I want to go a little bit into -- I think since thank you for digging into the weaknesses, grass seeds lawn ferts. The grass seed market for everybody was disappointing. I personally think a little bit of elasticity mostly just poor weather in the Northeast. And I hate to say it, but it's a cool wet beginning of the season. We'll see how the fall comes, and that will be a really great thing for us to see because I am seeing, as I aviate back and forth to the East Coast, some pretty brown lawns. It's been pretty warm.

So we'll see -- part of the issue for us is that we have multiyear purchasing agreements with our suppliers on grass seeds. So we've got a lot of grass seed inventory. And I think I'm not as clear to me what happened in -- other than the weather was bad and maybe grass seed was getting expensive.

But I do think that we're going to be playing around with price on grass seed. And so there's going to be opportunity on grass seed because I'd like to see the inventory go away, and we'll invest behind it.

We saw some slight market share erosion on grass seed in the first half of our fiscal year. We've seen recovery in the second half, although that's in the face of overall declining market. But we're starting to find some levers we can pull, and I think we'll just continue to explore that, and we're optimistic about the fall season for lawns. So I think there's deals to be had on grass seed because I personally -- I hope Matt agrees, we'd like to see that inventory get used. On lawn ferts, we were talking before the call started with how do we feel about.

And I think nobody's satisfied here that we've completely figured out what's happening on it. So I would probably put it into as a category. It's an area we have more work to do. It's an important one for us because it's high margin. We're not giving up, but I think we're going to be having our, what is it, the green eye shades on as we think about level of investment behind lawns, which is can we get unit volume up. And that would be the objective. And if we decide we can't, then it will be a different approach to how we support the brand.

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**Nathan Baxter** - *Scotts Miracle-Gro Co - Chief Operating Officer, Executive Vice President*

But let me add to this, Jim. On ferts, specifically, we came into the year after a terrible 2023 relative to what our plan was saying if we could just maintain our share in that category. Take grass seed out of the equation. It's not good enough. I agree, but we did pretty good. We roughly held it flat.

So it's the beginning of how do we reimagine that business and engage the consumer. We think the consumer has gotten a little apathetic on lawns, and that's going to be a big focus of our overall media play.

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**James Hagedorn** - *Scotts Miracle-Gro Co - Chairman of the Board, Chief Executive Officer*

I think, remember, we have interim people in our controls, in our lawn business, and we're going to be looking to bring outside talent in to bring a new look to both controls category, which is actually vibrant right now and lawn. So I would say standby for words on that, and we'll keep you up to date.

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**Andrew Carter** - *Stifel - Analyst*

Sounds good. The second one I wanted to ask, and I mean the earnings recovery is taking hold now. When you think what's your expectation on demands from Bonnie's. I mean, where could that be? I know that's going to be a volatile business because it's nursery. And then also remind us, Bonnie's is just beyond just the business itself. It does create the incremental touch points of people in the store that is a strategic benefit that I don't think you're willing to sacrifice. Thanks.

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**Nathan Baxter** - *Scotts Miracle-Gro Co - Chief Operating Officer, Executive Vice President*

Yes. It's totally right, Andrew. We love live goods. Look, we went into the year optimistic. I would say this, Bonnie had some structural things they needed to fix from a service level perspective. That was probably the biggest area that we, as a co-owner supported them on. I think they did very well, and that's based on feedback from the retailers. Bonnie needs to grow. And so they have a plan to grow organically 20%, but we're also starting to look at M&A for Bonnie that will accrete on their top and bottom line.

So absolutely not giving up. We love live goods. There is a strategic attachment for us, but it was a very tough year for live goods. Things really fell apart in our Q3. And I'll say what Jim said earlier, which is they actually outperformed the other live goods retailers, even though everybody is down, call it, double digits.

So I'm happy with the investment. We can always do better. And part of this changing of the guard that's happening in marketing with Sadie Oldham coming in on Gardens, she's going to directly own Bonnie as part of that, and we're going to make sure it's an integrated play with our gardens team.

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**James Hagedorn** - *Scotts Miracle-Gro Co - Chairman of the Board, Chief Executive Officer*

So Andrew, just step up one level, maybe two levels. And remember, what we say at every conference, what are we in the business of doing? Whether it's growing more good, whether it's bringing gardening to people's doorsteps and allowing them to enjoy the fruits of an investment in time and love in creating great vegetables or greater herbs or great flowers or just enjoying time when their backyard with their families on a great lawn that allows you to play sports and dig in and just really feel a part of the outdoor space. That's what we do. And so I'm just reacting to the sacrificing Bonnie comment, which is -- and you heard it from Nate, absolutely not.

It's straight down the pipe with what we do. And I'll go even one step further, which I hope you're open to. The performance in Hawthorne and what that team has been able to do in a very volatile environment is exceptional. And I know we've had a lot of discussion, meaning we the company with all investors, all analysts over the trajectory of that business and where it fits in our portfolio. This is a very good outcome to say we've been able to do what we've said we were going to do in a business whose environment is very challenged.

But remember, it's straight down the pipe with what we do. We help people grow great products get great results and do it in a manner that provides them the greatest satisfaction. So the whole entire portfolio, all the way from lawns to growing media to controls to Hawthorne is centered around that vision and that satisfaction with our consumers.

And as Jim said earlier to the question on M&A, there's more brands that we should own. There's more straight down the pipe positions that we should have, and there are ways for us to get them. So just keep that in mind, as you think about the Greater Scotts in our mission. There's great opportunity, great profitability in everything that we do. We're going to maximize that and these positions that we have today are strengths that we're going to further leverage.

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**Andrew Carter** - *Stifel - Analyst*

Thanks. I'll pass it on.

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**Operator**

Chris Carey, Wells Fargo Securities.

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**Chris Carey** - *Wells Fargo - Analyst*

Maybe just simply put, what do you need to see in your lawn business in Q4 to hit the POS numbers? Sorry if I missed it earlier, but I guess, in general, there's been a little bit of a mix headwind year-to-date. Just remind me, your visibility on that Q4 specifically recapturing some of that gap between POS and your outlook. I know it's been covered, but I'm still getting questions, so maybe just a bit more context on that? Thanks.

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**Nathan Baxter** - *Scotts Miracle-Gro Co - Chief Operating Officer, Executive Vice President*

Yes, Chris, this is Nate. Look, I think we've said this. The fall lawns business is, call it, 20% to 25% of our business. I think, as Jim alluded to, we're feeling optimistic given the fairly brutal summer of heat humidity, lawns are not looking great. We're starting to see response on the fert side in particular. And we've already addressed the grass seed, and we're going to lean into that with better price points for consumers in the fall.

So I think I'll stop short of predicting where we're going to end up, but we feel like we've got things positioned and we know there's a need, and it's really about getting the messaging out there in front of the consumer.

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**Chris Carey** - *Wells Fargo - Analyst*

The second question is, just given the strength that you're seeing in gross margin or better gross margin versus expectations, do you think you're maybe pulling forward some of the goodness that you're expecting over the next couple of years? Just how do you feel maybe about the base for this year relative to maybe expectations a month or two ago and what you think you can do maybe next year and specifically next year, but the speed of gross margin recapture.

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**Matthew Garth** - *Scotts Miracle-Gro Co - Chief Financial Officer, Executive Vice President*

Yes. So we answered this at the beginning of the Q&A, but let me reiterate it this way, and frame it for 2024. What we said for 2024 is that we were going to have a margin recovery of 250 basis points plus we are on track to deliver that. So we feel good about that. That means that we're not pulling forward from 2025 to be able to deliver 2024, and that is not a conscious effort. That was the planning and discipline that we put in place, and we're getting that margin recovery as we move through the year.

That sets up, like we've said, to get the balance of the roughly 700 basis points that we feel we're missing over the next three years. And to your question on timing, what we said is while two weeks ago, I think, three weeks ago at the Investor Day, we said, think of it as evenly spread. There may be some opportunity to have a bigger 2025 based on some of the raw material impacts. But that noise, we will give you more indication of as we move into 2025.

So let's get through Q4. Get on to Nate's point earlier, our POS trajectory intact for fulfilling our guidance. That includes the way that we've talked about the fall for the past couple of years related to lawns, normal, not necessarily outsized. And then as we look at, if you're going to go down the path of retailer inventories, feeling very good about those positions. And remember, there is a timing difference. Our Q4 is the beginning of fall and retailers Q4 is actually our Q1. So you will see a load-in that takes place in our Q4 for the fall sell-in, and then that fall actually happens in our Q1.

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**James Hagedorn** - *Scotts Miracle-Gro Co - Chairman of the Board, Chief Executive Officer*

But Chris, I haven't seen a number that anybody is thrown at me as we're getting close to ending our budgeting work for next year. It's less than like 200 basis points of margin improvement for next year. So I think we're going to continue down that. I think they have more than that, but I think that's what they're willing to pony up on the piece of paper right now.

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**Chris Carey** - *Wells Fargo - Analyst*

Okay, thanks, guys.

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**Operator**

(Operator Instructions) William Reuter, Bank of America.

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**William Reuter** - *Bank of America - Analyst*

I have a question on the industry weakness. I've always felt like this was a relatively non-discretionary recession-resistant business. Clearly, there are housing challenges in terms of lack of existing home sales. I'm sure when people buy new homes, they're a little bit more excited to spend on improving the appearance. Do you believe that the housing market has been the contributor to the weakness this year? Do you think it really was just the weather in the Northeast to what do you attribute the market weakness?

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**James Hagedorn** - *Scotts Miracle-Gro Co - Chairman of the Board, Chief Executive Officer*

Right. I'll speak for myself. I start with, I think it was mostly weather. I think people never want to hear that. It's like -- the street thinks, but I tell people in season. It's easy to like to predict our business look outside. If you can go out in a T-shirt in the spring, it's a good day for us. I do think pricing did become an issue.

And I think if you look at just earnings that's coming out now, whether it's Starbucks, McDonald's, I think the consumer is not as flush as the democrats think. And so I do think that if you look at -- we know last year when we reprice lawn fertilizer and grass seed last year, we knew -- we could see instantly that unit volume went up.

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**Matthew Garth** - *Scotts Miracle-Gro Co - Chief Financial Officer, Executive Vice President*

So part of our Q1 outperformance.

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**James Hagedorn** - *Scotts Miracle-Gro Co - Chairman of the Board, Chief Executive Officer*

Yes. And that was great for us, great for the retailers. But I think what it said to us is -- and I'm generally pretty skeptical of this elasticity thing when you say, it's a couple of percent, like somebody's not going to buy. But the problem is some of this stuff got to the point where -- I don't think it was $100, but you're getting near $100 for a bag of grass seed or a bag of lawn fertilizer. And I think that unless lawn looks terrible, I think people are just saying, you know, I don't know.

So I think mostly weather, but I do think pricing contributed. I think long term, the demographics of our business are fabulous. I think houses need to be built, young people need to buy them. I think interest rates need to come down. I mean, personally, I think it's hard for young people to buy a home today. And so I think if the Fed can start reducing rates, I personally good with that. But I think if you look at demographics long term for us, I think it's pretty healthy out there.

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**William Reuter** - *Bank of America - Analyst*

Great. (multiple speakers) sorry, you go.

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**Nathan Baxter** - *Scotts Miracle-Gro Co - Chief Operating Officer, Executive Vice President*

No, sorry. I was just going to support what Jim said with the science being the geek I am. We're building models and weather was the biggest factor for sure. Agreed pricing, consumer confidence, I think there's a scale of discretionary spending. And as lawn look okay and consumers feel pinched, they definitely linked when they look at prices, but weather was --

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**James Hagedorn** - *Scotts Miracle-Gro Co - Chairman of the Board, Chief Executive Officer*

But they didn't move to private label. They just wouldn't be.

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**Nathan Baxter** - *Scotts Miracle-Gro Co - Chief Operating Officer, Executive Vice President*

Yes. They just paused on the category.

**William Reuter** - *Bank of America - Analyst*

Okay. Yes. So you mentioned weather is the primary issue then pricing and elasticity. Historically, has there been any correlation to existing home sales or new home sale?

**James Hagedorn** - *Scotts Miracle-Gro Co - Chairman of the Board, Chief Executive Officer*

For sure.

**William Reuter** - *Bank of America - Analyst*

There is. Okay. So that would maybe -- I mean, those being depressed could be a third component of the weakness?

**Matthew Garth** - *Scotts Miracle-Gro Co - Chief Financial Officer, Executive Vice President*

Yes. I mean we've seen that over the past couple of years, and there's been stories and various publications on that, right? So if existing home sales are slower, people are doing less projects to unify their homes presale that it's inside small projects and outside small projects.

And so one of the things that we talked about last year was even in that environment, we had seen $500 projects continue as people were working on their front yards, their entrance ways to their homes. But they weren't necessarily extending out the rest of the home or into the backyard. And so that's continuing.

**James Hagedorn** - *Scotts Miracle-Gro Co - Chairman of the Board, Chief Executive Officer*

I think if you look back in the history of these calls, and this would go back some years, we started to convince ourselves that like young people were going to live in condos, not want yards. And we hired some demographers who basically said like there is so many people who are getting into their 30s and having families.

And I had this debate with Craig Menear when he was CEO of Depot and a really good guy. But he said, Jim, we have the best data on homes in the world. And it's people have a couple of kids in a dog, and they want a yard. And so that was important for us to convince ourselves that we were a zero pricing, call it, company. We were a sort of GDP plus a couple. And I think, generally, that's what we've seen.

**William Reuter** - *Bank of America - Analyst*

Awesome. That's all for me. Thank you.

**Operator**

Thank you. I'm showing no further questions at this time. This concludes today's conference call. Thank you for participating. You may now disconnect.