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# EDITED TRANSCRIPT

SMG - Q1 2013 The Scotts Miracle-Gro Company Earnings Conference Call

EVENT DATE/TIME: FEBRUARY 06, 2013 / 2:00PM GMT

## OVERVIEW:

SMG reported 1Q13 sales of \$205.8m. 1Q13 adjusted loss was \$68.5m or \$1.12 per share. 1Q13 GAAP loss from continuing operations was \$68.3m or \$1.11 per share. 2013 EPS is expected to be \$2.50-2.75.



## CORPORATE PARTICIPANTS

**Jim King** *Scotts Miracle-Gro Co - SVP, IR and Corporate Affairs*

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

**David Evans** *Scotts Miracle-Gro Co - CFO & EVP, Strategy and Business Development*

**Barry Sanders** *Scotts Miracle-Gro Co - President & COO*

**Jim Lyski** *Scotts Miracle-Gro Co - EVP & Chief Marketing Officer*

## CONFERENCE CALL PARTICIPANTS

**Sam Darkatsh** *Raymond James & Associates - Analyst*

**Alice Longley** *Buckingham Research Group - Analyst*

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

**Joe Altobello** *Oppenheimer & Co. - Analyst*

**Jason Gere** *RBC Capital Markets - Analyst*

**Carla Casella** *JPMorgan Chase & Co. - Analyst*

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

**Olivia Tong** *BofA Merrill Lynch - Analyst*

**Tom Mahoney** *Cleveland Research Company - Analyst*

## PRESENTATION

### Operator

Good morning and welcome to the first quarter 2013 earnings conference call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question and answer session.

(Operator Instructions)

Thank you. Jim King, you may begin your conference.

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### Jim King - *Scotts Miracle-Gro Co - SVP, IR and Corporate Affairs*

Thanks, Amber. Good morning, everyone, and welcome to our first quarter conference call. With me here in Marysville are Jim Hagedorn, our CEO, and Dave Evans, our CFO. Jim is going to start with an overview of the current state of the business, both in the context of our Q1 results as well as the progress that we're making to meet our full-year goals, and then Dave will walk through the financials and talk about our outlook. After the prepared remarks, we will open the call to your questions.

Also with me in the room this morning are Barry Sanders, Jim Lyski, Mike Lukemire, and Randy Coleman and other members of the management team. In the interest of time, we ask that you limit your calls -- or your questions, rather, to one and then one follow-up, and if there are questions we don't address, I am glad to handle those with you offline and I think we have already got calls scheduled with many of you.

With that, I want to move on to the call and remind everyone that our comments today will contain forward-looking statements. As such, actual results may differ materially and due to that risk, we encourage investors to review the risk factors outlined in our Form 10-K which is filed with the SEC in our most recent 10Q that we filed later this week.



As a reminder, this call is being recorded and an archived webcast of the call will be available to investors on our website. If we make comments this morning related to non-GAAP financial measures not covered in the release, we will provide a bridge to those items on the website as well. So, with that, let me turn the call over to Jim Hagedorn to discuss our performance.

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

Thanks, Jim. Good morning, everyone. I want to start by saying I'm pleased with the start to the year. We saw smaller operating loss in the quarter compared to last year driven by higher year-over-year sales in the core business, a solid start from Scotts LawnService, and improved gross margins. This gives us good momentum at the start of the year and keeps us on track with the guidance we provided to you in December.

With that said, and as most of you know, our first quarter usually represents less than 10% of our full year and is always a loss quarter for us as we prepare for the peak of the season. So, it's hard to really draw any trends out of what we see in October through December. While we're pleased, we still have a long way to go.

My comments this morning will be brief, but I want to divide them into three sections. First, I want to provide a little more detail about what we're seeing in the business so far this year. Second, I want to talk about the progress we are making to meet our full-year goals as well as some longer term initiatives embedded in Project Max. And, third, I want to reserve a few minutes to talk about my partner, Dave Evans, who will be leaving us in a few days and some of the organizational changes we're making in light of his departure. Let's start by talking about the quarter.

And I want to begin by looking at consumer purchases of our products as measured of point-of-sale data, or POS, in our largest US retailers. For the quarter, we were up 1%, primarily driven by a modest uptick in unit volume. It's important to recall that while we did take a low single digit price increase for fiscal '13, these increases didn't take effect until January. The level of consumer engagement we saw in the quarter was primarily front-end load in October and early November where we saw a solid conclusion to last year's lawn and garden season. We saw especially good results in Ortho and in mulch, both of which again posted strong double digit gains. And we were glad to see a 5% increase in our soils business after a tough year in 2012.

The strength of the consumer purchases in the quarter was really rooted in the warm weather markets with an 8% increase in California, 5% in Texas, and 1% in Florida. With the exception of Arizona, which was down 2%, we saw POS gains in the quarter throughout the deep south as well as the entire southwest and west coast. If we extended our POS through the month of January, we saw those trends holding firm in all three states. We are cautiously optimistic in Florida where we are already 20% through the season. Consumer engagement levels there remain solid with year-to-date POS up 6% and strong retailer support as well.

Retail inventory levels across the US were flat at the end of the quarter compared with a year ago, so that puts us in a good position as we get ready to accelerate shipments and get retailers ready for the peak of the season. Our shelf presence is also strong at the break of the year with gains in some retailers and no worse than status quo with others. The pricing we introduced has held firm and we're seeing retailers in all channels of trade inch up their price to the consumer.

So, there is no obvious headwinds that we see right now. Still, I don't want to overstate the case. We're still early in the year and as we saw in 2012, early season gains can evaporate quickly once we get into the peak of the season. But we have some good new ad campaigns breaking over the next several weeks and we continue to believe that the goals we set out for the year remain attainable.

One more item about the quarter before I move on and that's the continued strength of Scotts LawnService. Sales in the quarter were up 19% and the business nearly broke even in the quarter with an 80% improvement in its bottom line performance. Weather was a big benefit as some revenue got pushed out of last year's Q4 and into Q1 of this year, but customer accounts remain at an all-time high and we continue to benefit from higher retention rates and customer service scores. The management transition from Peter Korda to Brian Kura occurred seamlessly and the team continues to plow ahead in executing its plan. I want to congratulate that team for its continued good work and re-enforce for our investors that we see Scotts LawnService as having strong long-term potential, a point that Dave will elaborate on in a few minutes.



So, let me transition to a discussion about the full year and some of the other initiatives we are talking about as being essential to making the year. I've already said I feel good about our marketing efforts and the level of retail support that we're seeing, so the top line is entirely about consumer attitudes entering the season. We are cautiously optimistic, but we continue to believe that consumers are highly sensitive right now. A solid housing recovery, nearly record stock prices and early signs of compromise in DC seem to have consumers in a relatively good place. But as we saw with holiday spending, consumers got skittish from all of the noise surrounding the fiscal cliff, so it doesn't take much to slow down consumer spending these days. So, we continue to approach the year with conservative expectations for Company-wide sales growth of 1% to 3% on flat unit volume.

Beyond that, our supply chain and marketing teams are making good progress on the cost out initiatives that we outlined during our analyst day. I'll let Dave get into the specific numbers as well as the issues that positively impacted gross margins during Q1, but we continue to be confident that we will see gross margins improve up to 125 basis points for this year. I'm also confident the actions we have taken will lead to the decline in SG&A that we projected. The adjustments we made to our salesforce have reduced our costs but are not reducing our in-store presence. In fact, the number of hours that we're spending in stores is actually higher. So, these changes in no way impact our ability to serve either our retail partners or consumers.

Jim Lyski and his team have begun securing our media buy for the year. While spending will be at lower levels than a year ago, the efficiencies we continue to gain will make that reduction appear less significant than the numbers might indicate. And don't forget, while our media spending will be lower than last year, it will still be our second highest level investment ever.

At our analyst day meeting in December we suggested we would be making changes to our international consumer business as we believe the overhead structure there is not sustainable. And if you listen to my comments at our annual shareholder meeting we re-iterated that point, so where are we? By the end of the year, I expect we will be well on our way to reducing SG&A in Europe by no less than 10%. While we have a path to get there, the regulatory hurdles in Europe related to restructuring efforts are significant and it really precludes me from being overly specific right now.

As Dave has suggested to you in the past, these changes are likely to lead in some restructuring charges by the end of the year. Those will likely be more than \$10 million and will be accounted for as an adjustment to earnings, meaning that we excluded them from our guidance. So, with all of that said, we were reaffirming our guidance of \$2.50 to \$2.75 per share. By the time we report our Q2 earnings, which will be in early May, we should have a much better read on how the season is coming together.

One more point before I switch gears. Since our announcement last week regarding Dave's departure, many of you have asked whether our focus on margin improvement, cash flow, and returning cash to shareholders may change. That's an easy question. The answer is no. It's great to have a finance partner who shares and who has helped develop the vision for how we'll operate the business, but the story we laid out in December and the commitment we made to our shareholders is firm and I'm glad to say that Dave's chief lieutenant, Randy Coleman, has been an integral voice in this process since day one. Randy will remain an integral voice in task with keeping the operatives focused on the numbers that we said we would deliver.

For the record, we will file SEC documents later this week stating that Randy will be functioning as the Chief Accounting Officer for the organization until we identify a CFO. And so speaking of that, let me transition to some comments about Dave as well as the rest of the team, then I will give him one last chance to share the stage here.

Dave has been at this Company for 19 years and he has been my finance partner for the last seven, which is hard to believe it's gone by that fast, Dave. I had a lot of finance partners during my career and I don't hesitate in saying that Dave definitely was the best. He is not only a great finance guy but a great leader, a great executive, and has been really critical to the culture of Scotts Miracle-Gro over the past decade. I want to publicly thank him for his commitment and wish him well as he takes his life and career in a new direction.

I know that Dave is well respected by all of you and that you may see his departure as a loss for the Company and it's hard to disagree with that, but Dave leaves behind a very strong bench. We started a formal process of talking to a limited number of both internal and external candidates



to serve as CFO. We hope to finish the process within the next 45 days. So, whether we replace Dave with a member of the existing team or someone outside of the Company, I'm confident we will end up in a good place.

After Dave announced his resignation, Barry and I talked about using his departure as an opportunity to go beyond simply back filling his role. Changes at the executive level don't happen that often and when they do, we must attempt to end up in a stronger place than where we started. Sure, we'll have a void when Dave leaves, but we are already moving forward with some important organizational changes that should further delay the management team and make us a smarter and more nimble company.

First, we are realigning Barry's team to give him more freedom to spend in the field and work more closely with the sales and marketing teams. We will no longer have a head of sales per se. Instead, our regional offices will report directly to Barry. Jim Lyski will continue to report to Barry; and the strategic business units, lawns, gardens and controls will report to Jim. We made an important leadership change in the gardens business which will now be run by Jim Gimeson. Jim is the former chief operator of Longaberger when it was still a billion dollar business. He then joined Scotts and oversaw the closure of Smith & Hawken, he ran our purchasing group and spent the last year running strategy for Dave.

Naming a leader and general manager of his caliber to run an SBU should send a clear message regarding our commitment to driving the long-term growth and value of our gardening business around the world. In order to facilitate the changes to Barry's team, Mike Luetkemeyer, formerly head of sales in North America, will oversee all of the operating support functions beginning on May 1. This includes supply chain, IT, R&D, environmental health and safety, as well as business planning. Mike's long and diverse experiences here make him the perfect person to consolidate all the operational support functions and allow Barry to focus even more of his time and leadership on driving growth, and I want to emphasize the word growth.

While I know we have taken a conservative approach to planning this year and probably will do again in 2014, driving long-term global growth is very much what we are all about here. So, the changes occurring on the operating side of the business are all focused on that goal. We've also made some refinements to the corporate team. Jim King, who all of you know, will now report directly to me and will help drive our vision of the agenda with the entire leadership team and manage our dialogue with the Board of Directors. While other corporate functions will also be consolidated under Jim's leadership, he will continue to oversee IR and will remain principal point of contact with you guys.

And so I'm sorry to see Dave walk out the door next week and I will miss him and I think he will miss us, but I feel good about the team. I feel good about our plan. I feel good about the results for the quarter. I'm also confident about our ability to execute with the continued focus on margin improvement, cash flow, and total shareholder return. So, with that, and for the final time, let me turn the call over to Dave Evans to discuss the financials.

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**David Evans - Scotts Miracle-Gro Co - CFO & EVP, Strategy and Business Development**

Thanks, Jim, and good morning, everyone. So, for the final time, I'll take the next few minutes to share some insights on the quarter, on the year, and on some of the key initiatives that I believe give this management team and the Company strong momentum going forward.

Starting with our first quarter results, sales were \$205.8 million, an increase of 3% over a year ago and in line with our expectations. The sales increase was attributable to Scotts LawnService and US consumer. These increases were partially offset by decreases in sales outside the US and within corporate and other. I will provide some color starting with Scotts LawnService which reported a sales increase of 19% for the quarter. This increase was attributable to a 6% growth in year-over-year customer account as well as the weather-driven delay of sales from Q4 2012 to Q1 2013. You may recall, we reported only a 1% increase in lawn service sales in Q4 2012.

As Jim said, we are pleased with the steady growth and long-term prospects for the lawn service business. Over the past few years the operating team has built a stronger foundation for sustained long-term growth. And although our largest competitor in the segment is four times our size, we're now outperforming them on all key metrics, including growth in revenue, customer count, retention, and profitability. Our focus has been providing a positive service experience for our customers to deliver steady and profitable growth while continually improving yield on sales and marketing investments.



We stated in recent quarters that we now see SLS as a core part of our business, generating activity focused on increasingly leveraging two principal assets in the Company, our brands and consumer relationships, to develop service as a long-term growth platform. I would highlight that our service business enjoys higher gross margin rates than our corporate average, and that we are increasingly able to drive SG&A leverage within service through top-line growth. As it relates to 2013, we continue to expect sales growth of 4% to 6% for SLS with a strong start giving us increased confidence.

Moving on to global consumer. Sales were up 3%, or 2% excluding FX. On a constant currency basis, sales within the US were up 4% while sales elsewhere declined nearly 10%. The decline internationally was primarily an issue of the timing of shipments between Q1 and Q2 in the UK and France. The 4% increase within the US reflected lower year-over-year retailer inventory entering Q1 and growth in our POS at our largest US retailers. As Jim noted, our largest retailers exited Q1 with inventories flat to 2012.

For the second fiscal quarter we expect to see a benefit from price increases, but this will likely be offset by reduced volume. The decline in volume expected in second quarter assumes March weather reverts to the mean. Recalled last March we saw consumer purchases of our product surge nearly 30% in part due to a weather-driven (inaudible) for the season. For the full year we continued to guide to flat unit volume for the global consumer segment with price increases of 1% to 3%. You've heard Jim say we return seeking growth for the sake of growth and to that end we did see some non-core listings where margin rates didn't meet our expectations. This is incorporated within our earnings guidance.

For corporate and other, which now consists exclusively of sales under the supply agreement with ICO, sales were \$7.8 million for the quarter compared to \$12.9 million a year ago. As previously mentioned, we expect sales here to decline about \$10 million full year, almost all in the first half. Recall that these sales are a zero margin, so this has no consequence to the bottom line.

Moving on, gross margin rate increased 230 basis points for the quarter. The year-over-year improvement was primarily attributable to two factors. One, increased volume in our Scotts LawnService segment which, as I stated earlier, enjoys higher gross margins. And, two, favorable product mix within our global consumer segment. We saw modest and expected headwinds from increased commodity costs during the quarter. As noted at our analyst day, we expect this headwind to continue through our second quarter after which we expect commodity cost to be approximately neutral in aggregate to the prior year consistent with our plan.

Entering February, nearly three-fourths of our commodity purchases are locked for the year. Well, that still leaves about \$125 million of commodity costs subject to change, the value at risk is in balance other considerations including the robustness of forward markets for those commodities. For additional color on our focus on gross margin rate, I will tell you that the cross functional teams will remain focused on product cost out efforts and we continue to expect savings at \$15 million to \$20 million in 2013.

During the first quarter, we execute projects that will allow us to realize about \$7 million of those savings and we are well on our way to executing additional projects and to reaching our 2013 target as well as our long-term goal of \$60 million of savings by 2016. Recall we expect two-thirds of these savings to be achieved by the end of 2014. And while I'm on the topic of gross margin, there is also significant and continued focus on completion of our trade firm redesign within the US and continually improving our pricing insights and analytics. These efforts are in preparation for 2014 line reviews which start late this spring.

For 2013, while we continue to expect gross margin rates to decline year-over-year for the first half, we also still anticipate full year improvement of up to 125 basis points. SG&A in the quarter was \$124.5 million, relatively flat compared to last year and in line with expectations. During the quarter, we had an increase in employee-related costs, including severance, partially offset by certain cost productive initiatives. These actions reflect some of the steps we're taking to adjust our cost structure to improve near-term profitability while still balancing the need to invest and grow capabilities essential to long-term growth.

As we said in December, we believe we are positioned to reduce SG&A 2% to 3% this year inclusive of increased year-over-year variable compensation expense, calibrated to levels commensurate to our earnings guidance. The teams remain focused on driving additional efficiencies in 2014 with a clear focus on improvement and operating margin rate.



Moving on. The rest of the P&L in line with expectations. Interest expense in the quarter was \$13.2 million compared to \$15.3 million a year ago. The tax rate for adjusted earnings for the quarter was 35%. For the full year, we expect a tax rate of about 36%, give or take. And we ended the quarter with basis share count of slightly more than 61 million shares. Taking it all to the bottom line, adjusted loss of the quarter was \$68.5 million or \$1.12 per share. On a GAAP basis, loss from continuing operations was \$68.3 million or \$1.11 per share.

With that, let's shift gears and talk briefly about cash flow and the balance sheet. We are still on track to generate at least \$250 million of operating cash flow for the full year. For seasonal reasons, we always use cash and increase borrowings in Q1 and this year is no different. The cash used in operating activities was \$32 million less than prior year with most of the net benefit derived from improved inventory, accounts payable, and accounts receivable management. We are making positive strides in improving inventory management and still expect reductions of about \$30 million to \$40 million at fiscal year end. We finished Q1 with debt to EBITDA leverage of 2.8 times and, as noted at analyst day, we still anticipate our leverage ratio to fall back within our target range of 2 to 2-1/2 times in the third fiscal quarter. As we previously mentioned, as our debt level falls below 2-1/2 times, we will actively explore how best to return excess cash to shareholders.

Speaking of shareholders, let me transition to some final comments. When I became CFO, I had no previous exposure to our shareholders, analysts, or bankers and the IR function was foreign to me. After seven years, it's become one of the more enjoyable parts of my role and I appreciate the relationships that I have built with many of you listening today. I also want to acknowledge what a privilege it's been to serve as CFO for the Scotts Miracle-Gro Company for Jim Hagedorn and the Board of Directors. I'm extremely proud of the finance team without which I would not have been able to represent the Company in the professional manner I hope have. Trust me when I say the Company and my successor are in good hands with this team.

I'm honored to have served alongside so many other talented and dedicated colleagues at Scotts outside the finance group as well. They truly exemplify the word team. And I leave with the deep satisfaction, with the knowledge of the focus and commitment of the entire leadership group has on realizing the full potential of the Company's brands, market position, and competitive advantages to drive total shareholder return. Since I will remain a shareholder, this is still important to me. And, finally, I especially want to thank Jim Hagedorn for the tremendous opportunities I've had at this Company under his leadership and the friendship we developed over the past seven years. It's been a good ride, Jim.

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**Jim King** - *Scotts Miracle-Gro Co - SVP, IR and Corporate Affairs*

With that, let's get back to business and I will now turn the call back over to the operator for your questions. Thank you.

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## QUESTIONS AND ANSWERS

### Operator

Our first question comes from Sam Darkatsh with Raymond James.

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**Sam Darkatsh** - *Raymond James & Associates - Analyst*

I will be one of many today, Dave, in saying congratulations to you and your next chapter and it was an absolute pleasure dealing with you over the years.

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**David Evans** - *Scotts Miracle-Gro Co - CFO & EVP, Strategy and Business Development*

Thank you so much.



**Sam Darkatsh** - *Raymond James & Associates - Analyst*

Couple questions. First off, what are you seeing? I know your price increases went through in January. What are you seeing competitively in terms of other pricing actions from your competition, and then I have a follow-up as well?

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**Barry Sanders** - *Scotts Miracle-Gro Co - President & COO*

Sam, this is Barry Sanders. If you recall, last year we didn't take pricing and we saw our competitors take pricing last year and I would say this year it's reverse of that. We clearly stated we have taken the pricing, but to the best of our knowledge we haven't seen any other pricing activity in the market from the competitors.

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**Sam Darkatsh** - *Raymond James & Associates - Analyst*

And you talked at the analyst meet being retailer expectations for the season being up low single digit. Just in comparison to your flat volume guide, are -- is that a result of even though you had improved listings you're concerned about potential market share degradation because of the change in pricing or is it being conservative? And then by those retailers is it pretty much across the board each of the major three retailers are looking at low single digit or are there big gaps between the three?

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**David Evans** - *Scotts Miracle-Gro Co - CFO & EVP, Strategy and Business Development*

Sam, I'm going to start and then I will hand it over to Barry to sort of complete the question. It's a reasonable one. I think that is the question. This is one of those really hard things for people who work here and I think people who follow our Company. I look at the sales for Q1. I especially -- because maybe that's my main house is in Florida it's been a really nice season so far. POS has been pretty good. I would say the answer is conservative. We're budgeting for flat unit volume and I think we are hoping to do better than that, but it was really important in the process of building out our budget and our sort of ability to execute for a result to do it on a conservative basis. And so I think we're operating like we want more growth but we're budgeting not to get it and I think that just makes -- this goes back to the issue of predictability in earnings.

I think it's a rough time out there. I think if you look at sort of sales in November they look pretty good, sort of around Thanksgiving for Christmas, this is not our business but I'm talking just generally for people in the Christmas trade, and I think it sort of ended up, up 0.5 points or something like that. And I think a lot of it was this sort of nonsense that happens in DC and just people get worried. So, I think that we are on the right track but it's being conservative, working for a better result. I know that Barry and Mike and the regional presidents and the business operators all want and expect more. We're just not planning for it and I think this is an important sort of place for us to be at this time in how we budget.

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**Barry Sanders** - *Scotts Miracle-Gro Co - President & COO*

Sam, this is Barry again. I would say without giving any specific guidance on any of our retail partners, I would say our numbers tend to be slightly lower than what they're expecting, which is a big change from where we have been in the past. So, I think it's a prudent way to plan and make sure that we are going to be consistent. And as you saw last year, when we see big up ticks in volumes like we did at the beginning of last March from favorable weather, we have a lot of capacity and flexibility in our operations to deliver. And so I think it's a good financial planning approach. And if the numbers turn out to be better, we are certainly prepared to manage that and if it turns out that we are right, I think that's also a good place for us to end up.

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**Sam Darkatsh** - *Raymond James & Associates - Analyst*

Thank you again. And again, Dave, congratulations and best wishes.

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**David Evans** - *Scotts Miracle-Gro Co - CFO & EVP, Strategy and Business Development*

Thanks, Sam.

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**Operator**

Our next question is from Alice Longley from Buckingham Research.

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**Alice Longley** - *Buckingham Research Group - Analyst*

Hi, can you hear me?

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

Yes, we can, Alice.

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**Alice Longley** - *Buckingham Research Group - Analyst*

Okay. Just sort of expanding on that. With the other players not taking any pricing, can you give us more confidence that you aren't losing share in terms of what retailers are telling you? And also, was there any pre buying by retailers in the first quarter ahead of the pricing? Is that something that might have boosted your sales? And a last part of that is what was the upset surprise in the quarter for you?

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**Barry Sanders** - *Scotts Miracle-Gro Co - President & COO*

Maybe I will take the first part of that. I would say backing into it and I will make sure to cover all of the questions, is January is fiscal year end for the bigger retailers. So, making sure they are hitting their inventory targets and making sure they are managing their balance sheet. I did not see any forward buying. And from a market share standpoint, the data we get, and I would say it is early, we have seen no market share losses and when I look at the line reviews and where we are at from what we have sold in, I think what Dave said is that we are neutral if not positive on where we are at. And I look at the promotion plans and where we are at with the retailers, I have not seen anything. And so when you look at those pricing, I think it's basically a catch up for us from where we are at and I don't see any gaps out there in pricing that I think is going to be a real market share issue at all. Then upside --

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

I will sort of treat it like so what was positive about the quarter? I think the west coast POS is looking really good because I was wondering if Jones, he left us a disaster out there when he came over to run channel, Phil Jones. So, I'm pleased with the west coast which I think has been very difficult for us to see a responsiveness, so far is looking pretty good as does POS in Florida and I can just tell you it's been pretty good weather. So, I'm going to say I think that's a positive just from a management point of view. We have done a lot of work since Dave surprised me to really look and say how do we want to organize, and so right now my plan is to take strategic planning directly to me, Jim King will come to me and that will include government relations reporting to Jim.

In addition, on sort of Barry's side of the business, as we talked about it, it was really clear to me and I think to others that Barry's schedule is like super busy and this is not because I feel sorry for them, but it's a matter of saying how do I help him and how can he help himself to build a structure that gives time to sort of spend against the things that really drive value. And so this new structure we're talking about I'm going to say is a sort of a side benefit from taking a look at structure once Dave made his announcement and I'm really pleased with the look because it goes back to kind of a lot of the days where I had Mike Kelty and I was allowed to spend time kind of in the field and working on the things I liked to do which is drive



growth and Mike Kelty, in this case now Luetkemeyer, will sort of own a lot of stuff back here. So, this is not just the old Luetkemeyer that you guys know. This is the new Mike Luetkemeyer who has been on the road on the selling side for the last four years.

And so I think this is a tremendous opportunity for the Company and for Barry to really be able to sort focus themselves in both areas where they can add a lot of value. And the changes that we made on Lyski's team I also feel really good about as we strengthen the sort of general management positions within the brands and give them more accountability and responsibility for their P&L. So, it's kind of a long answer but I would say that's the big upside. I think the results are pretty good so far. The POS in the southern markets has been pretty darn good. And then these other changes we are making organizationally are positive and I can sort of thank Dave for being catalyst for that.

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**Alice Longley** - *Buckingham Research Group - Analyst*

And I would like to add something for Dave. I want to wish you all the best in your new job. It sounds exciting. I think we have all liked working with you and respected you a great deal, and I hope you have as much fun ahead as I hope you had in the past. And the other -- I do have one other question though. Can you tell us a little bit more about actual dollar sales comps that you expect in the second quarter and also EPS because your numbers can be very erratic by quarter? Thank you.

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**David Evans** - *Scotts Miracle-Gro Co - CFO & EVP, Strategy and Business Development*

Alice, I think I would just re-iterate what we said at analyst day except now you filled in the missing piece of Q1 which we expect our earnings to be at best flat and more likely to see a slight decline in our first half earnings driven by the top line which is really driven by a kind of normalization of consumer demand between March and April. Does that help you? I don't think we have given specific guidance on --

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**Alice Longley** - *Buckingham Research Group - Analyst*

You can tell me more about sales. I understand now first half earnings flat to down. What about sales for the first half?

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**David Evans** - *Scotts Miracle-Gro Co - CFO & EVP, Strategy and Business Development*

Down.

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**Alice Longley** - *Buckingham Research Group - Analyst*

Down. Like low single digits or --?

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**David Evans** - *Scotts Miracle-Gro Co - CFO & EVP, Strategy and Business Development*

Down.

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**Alice Longley** - *Buckingham Research Group - Analyst*

Okay. Thank you.

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**David Evans** - *Scotts Miracle-Gro Co - CFO & EVP, Strategy and Business Development*

Just for clarity --



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

Not like before -- I hate the word down. Last year at the start of the season, I got to tell you, from my point of view I went home several times to tell my wife it could snow the rest of the year and we'd still make our numbers last year. That's how positive the start of the year was. If we're saying we don't think that's going recur, then it will balance those sales and will move into the second half. That's all. So, it's not -- we're not like all worried and stuff. It's just basically says did we think last year was unusually good. The answer is yes in the first half.

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**Barry Sanders** - *Scotts Miracle-Gro Co - President & COO*

Alice, just to maybe be more helpful, think being how we develop our plan we look at a multi-year average. So, what I would suggest is you can look at our 10K and look at the percentages of sales that occur in each quarter over a four-year history and look at our full year and assume that the first half looks a lot more like the average of the preceding four years. That's kind of the best way we have to budget is based on long-term averages.

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**Alice Longley** - *Buckingham Research Group - Analyst*

All right. I'll do that, thank you.

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

Sure.

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**Operator**

Your next question is from Josh Borstein with Longbow Research.

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**Unidentified Participant** - *Analyst*

This is Jeff (inaudible) in for [David MacGregor]. I am just hoping you could dig a little bit more into the favorable product mix that you refer to in the global consumer segment.

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**Barry Sanders** - *Scotts Miracle-Gro Co - President & COO*

Yes, Josh. A couple of things that were helpful to mix. One is we had some strong performance in our lawn fertilizer business. Some of that was a carry forward from last fall, but that's good news for us. The second part as well is that Monstanto, through Roundup, continues to deliver strong and that helps. Lawn fertilizers and Monsanto. So, those would be the two biggest things. As Jim said, our soils performed well and Ortho performed well. So, if you kind of contrast that with last year, when we are really reporting negative mix, those were in the periods we were seeing product lines like mulch just explode and that wasn't the case in this quarter.

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

I'd also say lawn service just within the mix of the quarter is extremely positive to margin and so that's -- our service business is just pretty high quality business all around and so it's not only seeing good growth, good customer count, but consistently good and higher than average margins in the lawn service business. So, that helps as well.

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**Unidentified Participant** -- Analyst

Thank you. And then just a follow-up. Going into the spring here and maybe this applies more to the warm weather markets, but do retailers appear as committed to the lawn and garden category last year? Have they cut back at all? Have they increased at all from what you are seeing?

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**Barry Sanders** - *Scotts Miracle-Gro Co - President & COO*

Josh, this is Barry Sanders. Jim Lyski, our chief marketing officer, has met with all of the chief marketing officers of our major companies and I would say support levels at least at the same level they were last year and we are pleased with the plans that they put in place. We think they made some improvements on the messaging of what they have done last year. And so I would say at least equivalent and better plans. I don't see anybody backing up at all.

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**David Evans** - *Scotts Miracle-Gro Co - CFO & EVP, Strategy and Business Development*

And I think they have some exciting programs coming in to the spring and fall that they're excited about and that heavily involve Scotts Miracle-Gro.

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**Unidentified Participant** -- Analyst

Thanks and congrats on the quarter.

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**Operator**

Your next question is from Bill Chappell with SunTrust.

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

Dave, also positives, though I came away with more like Kenny Rogers of you picked a fine time to leave us with Jim. It does sound like it's a good opportunity. We will miss you. A couple of quick questions. One kind of more macro. Trying to understand kind of the housing market and what you are seeing. If you go back a few years ago, it seemed like your business held up relatively well as the housing market blew up and didn't know as we were seeing the housing market improve, if you're seeing that in your numbers, if maybe that's what you're seeing out of lawn service picking up as a leading indicator or anything you kind of have on the outlook over the next few months?

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

Look, I think these correlations to our business we still are trying to sort of understand. I think if you sort of do it what I call hag map, it can't be bad for us that housing is strengthening. And it can't be bad for our major DIY customers that housing is strengthening, and I'm sure Frank and all of the folks at Lowe's would say the same thing, that these are important for us. But what exactly the correlation is, I know, Dave, your folks have tried to sort of drive correlation between housing starts, sale prices, and I think there is some casual sort of correlation. Again, if it's positive I think it's positive. I don't know. Would you go beyond that?

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**Barry Sanders** - *Scotts Miracle-Gro Co - President & COO*

No. Bill, I think we spend an enormous amount of time looking backwards and I think you can start to peel out the major drivers. It's much broader when you look backwards. You look at factors like retailer support, competitive activity. And so it is hard to conclusively draw a tight correlation with high confidence other than to say there is a causal relationship and we're much more happy when housing is recovering than when it's

declining. So, that's going to be a positive for us. We also know there tends to be more of a delay in terms of delayed response to consumer when you get churn in terms of how that translates to their attention that they give to their outdoor lawn and garden. So --

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

What you are saying is inside and then after they finish their inside projects, they tend to go outside.

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

Sure. And then in terms of the lawn service business, and that now is two or three quarters is as healthy as it's been in a long time, does that say anything more about at one point you had thought about expanding and making more acquisitions? Are you still thinking about that or is everything kind of on the back burner until we get through this year?

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

No, I wouldn't say it's on the back burner. As we talked about sort of uses of cash, we did reverse the two-thirds into growth and basically we're saying two-thirds go to the shareholders. Dave and I have asked and the operators have complied with an enhancement I think to cash flow and not just this year but going forward we've set some goals for cash flows that I think are not too challenging but they are sufficiently challenging that people have to be concerned about it and work against it.

Within that, as we look at sort of opportunities to grow the business there is a lot to like, in our opinion, on the service side. The margins are sort of call it approaching 50%. The business seems to be growing. We have a very low penetration rate so that we don't need a rapidly growing service business in order to sort of take share in a very fragmented market. The fundamentals of our service business seem to be secure and good.

If you go back and look at our customer count, we are probably -- I mean, as good as it is, we were probably at customer accounts that we had a couple of years ago. So, that as we -- during the crisis we lost customer accounts. The business has improved because of the fundamentals of the operating side of the business. Now, we were seeing growth in customer account and back to kind of historically high levels of where we have been. So, that when we look then, put all of that together and say if we are investing a dollar in sort of M&A, call it, business development through acquired growth, I think we look pretty favorably at both lawn service and pest control.

And so as we -- as Dave and I have sort of discussed with Barry how much capital we would be willing to dedicate to growth opportunities which is not zero, even in today it's not zero, then I think that Brian and his team have a pretty good place in line for opportunities that are pretty easily bolted on and they, even while all the struggles happen, they have been quietly acquiring and doing a really nice job at integrating. So, I think this is a business that there are opportunities we have not made decisions on any major growth within service, but it's clearly a business that I think the management team likes and feels confident that the operating team could grow that business and given some cash. And so they'll get some this year and I think probably throughout our planning period they'll get a pretty good slug of the available cash that we make available to the consumer side.

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

Okay. Thanks for the color. Dave, best of luck.

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**David Evans** - *Scotts Miracle-Gro Co - CFO & EVP, Strategy and Business Development*

Thanks, Bill.



**Operator**

Your next question is with Joe Altobello with Oppenheimer.

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**Joe Altobello** - *Oppenheimer & Co. - Analyst*

Thanks. Good morning, guys. First to Dave. Obviously I want to echo the sentiments of everyone on this call. Good luck on your future endeavors. It's been great working with you the last few years here. That being said, I did have a couple of questions. First, you guys mentioned that your warm weather markets are doing well early in the season. I did want to talk about your other markets, mainly midwest and northeast. I think last year you got impacted by consumer sentiment but also the warm winter left a lot of those lawns pretty pristine. And so this year I think we got a little more snowfall than we did last year, so I'm just curious what those lawns look like in Ohio and in Indiana and upstate New York, for example, vis-a-vis where they were last year?

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

Joe, I would say snow in the winter is good for us and the drought last year left them in pretty bad shape. So, I think this year our expectation, when you look at those markets, it should be good for the seed business and should be good for the lawn and fertilizer business. And I would say that extends all the way from the west of the midwest all the way up through the northeast. And so our expectation would be is those markets should perform pretty well this spring.

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**Joe Altobello** - *Oppenheimer & Co. - Analyst*

Okay. Great. And then secondly in terms of retail support, you mentioned that you are expecting it to be as good as last year. I'm just curious, what sort of determines how retailers decide how much support they are going to give to the category and is there any correlation between their support and what they feel like you guys are going to give in terms of advertising spending?

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

I'm going to start and then hand it over to Barry. I do think that last year we felt that as we sort of pre announced our significantly increased support that there was some gaming of that so that it unfortunately, put it that way. I think what I understand from the operating team is that the level of support will be equal to higher. And that even accounts that aren't spending more, and this I think will be a reference to Lowe's, that the quality of the media support will be more focused on brands as opposed to kind of rolling a carpet out and we feel good about that so that the advertising as we understand it from conversations with our retail partners, we believe will be more effective and more tied to our work. So, I don't know. Barry.

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**Barry Sanders** - *Scotts Miracle-Gro Co - President & COO*

I think, Joe, what they do is they look at the category and we participate in a segment of category. There's a lot of other merchandise around us, live goods, the equipment and so forth. And I think they first take a look at what they think the category is going to do. And I would say all of our big retailers are bullish next year on what they think the categories are going to do which determines what the spending is going to be and then we work with them on the specifics on what those programs are going to be. They share with us.

I think the thing that's improving quite a bit is there used to be their program and our program. I think one of the good things that Jim Lyski has done to help our marketing is build better integrated plans with them and have them share with us what they are going to do and what we're going to do, so I think our line of sight is much better for what they're doing and the quality of both of our advertising and what we're doing and what they're doing is better integrated and it's complementary. I think the other things that drive it is when we come out with new innovation that gets a lot of support and I think they support it from both their merchandising and their communication efforts as well as what we're doing. Like I've already said, the programs of what we put together.

And I think what you would see from our standpoint is our brands are big foot traffic drivers. I think people try to get away from that and maybe try to manage the mix but it always comes back to the brands that are going to drive the foot traffic. And I would say as we worked with them and what Jim has done with them to develop a programs, I think there is a good balance between driving our brands and then driving the overall category. I think it's in good shape.

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

I also think, Joe, that the -- there is a lot of psychology to lawn and garden. It's really the first real seasonal product that happens after the winter in the year. And I think a lot of retailers look at it as a fairly low cost project business. It's well branded. There's a lot of, I think, pent-up demand. Consumers want to get outside and put color around their house. And I think they view it as kind of a bell weather for how the season is going go. It's always surprising to me when you talk to some of these big retailers how important lawn and garden is to them and that their commitment to it I think largely is based on getting their year starting properly and I think it's really important to them and I think that's good for us. And I don't see that changing at least this year.

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**Joe Altobello** - *Oppenheimer & Co. - Analyst*

Okay. That's helpful. Thanks again, guys, and again good luck, Dave. Take care.

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**Operator**

Your next question is from Jason Gere with RBC Capital Markets.

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**Jason Gere** - *RBC Capital Markets - Analyst*

Dave, again, congratulations and the best of luck and it was great working with you the last couple of years. Most of the questions have I think been asked, but I guess just the one thing I was trying to get more color on is when you look at the market share gains last year when you didn't take pricing and now as the price gaps I guess will widen where you are taking pricing, are there any categories out there that you feel like you might need more merchandising support that are a little bit more sensitive, the consumers might be a little bit more economic sensitive to just as the year plays out. So, obviously innovation is going to play a big role here. I'm just wondering where you have the greatest confidence in terms of categories that are taking pricing versus where maybe the innovations are not as strong? Thanks.

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

I don't know. It's going to be hard for me to put all of the dots together of what you ask except to say an area that has been disappointing for us mostly on a margin side is mulch. Mulch is a really fast growing business right now, I think in part because consumers are looking for sort of a lot of value for not so much money. And as that product is kind of moved hard to mid-tier, meaning not commodity but sort of toward the middle, a good product highly promoted, branded, our margins have really suffered in that. I would say that if you look at the business, it's not really an innovation drill except the innovation is in the supply chain. The amount of work that's happened over the last 12 months within our supply chain and under Barry's leadership and Dave Swihart has been very significant innovation in the supply chain to get our margin up by, I'm going to say, at least 10 points within the mulch business and that's hugely critical and so to me I'd almost look and say where is the fastest growth rates happening and how are you doing there.

A question that hasn't been asked and I'm not going to look to sort of deal with it hard here is that there is a lot of white space which is what we're calling white space opportunity for us to grow our business and sort of what I call adjacent categories that we're really not participating in enough or at all. Repellents would be one that we're doing now. I think naturals. There's quite a few different sort of categories even within growing media and live goods that we aren't playing particularly hard in and so these are future opportunities for us as we look to say even if the categories are



growing slower than our existing categories where can we go. I would say this is big issue for us is mulch and getting our margins right and we made a lot progress there. You going to add something better?

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**Barry Sanders** - *Scotts Miracle-Gro Co - President & COO*

No, Jim, just compliment.

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

Gee, we are all being so nice to each other.

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**Barry Sanders** - *Scotts Miracle-Gro Co - President & COO*

I would say we said a couple of years ago we would get better at understanding the consumer, not just the retailer and so forth and we have had a good effort against that. And I think the way to think about this is, and this is what Jim Lyski has added, is as we define categories it's benefits divided by cost equals value for the consumer. And for every category I think relative to our brand the competitive environment, the products and so forth that's different. And so we've looked at all of the categories. I think we were doing a better job at understanding the competitive environment and the elasticity. And so I think don't perceive that we're taking pricing just ubiquitously across the board.

We're looking at every category, determining what we think the value of the consumer perceives and we're taking that pricing. And so when I look across our categories, the most competitive category we have is in our controls market, primarily Ortho. And so we are investing quite a bit in innovation. You've seen the wand. We're coming out with new packaging and I think we are developing better claims, but we're also very cognizant of managing that price that so we understand what the impact is going to be. And so why we can say we are comfortable is we looked and managed what we think those gaps are going to be and we are very comfortable that we don't think we're going to lose share this year given the pricing.

On some other categories where we don't think we have the value equation right, and Dave talked about this in his script, with maybe some bird food and some commodity soils, we don't think we have that equation right and we aren't going to take the negative margins that we have to take on those, so we have given that away and when we get that equation right, we will go back after that. And so I think we are looking at it all. I think Ortho is our most competitive environment. Quite frankly, we have added our partnership with SEJ there and we are seeing some real benefit and value from doing that. And so I think we are comfortable that with the pricing we have taken we don't see that as being a problem this year with the price gaps you are going to see.

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**Jason Gere** - *RBC Capital Markets - Analyst*

Okay. And then just on the note and I guess as you talk about some of the white space opportunities, but still when you brought up bird food, when you look at some of the categories there where it might be hard to differentiate or add value, you guys haven't been shy in the past about exit, it just economically didn't make sense. So, as you look at the portfolio now, are you any closer to making some tougher decisions or how do you think about that over the next couple of years?

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

I think we are actually making those tough decisions. If you look at the -- our sales of kind of our core business excluding sort of opening price point commodities, especially in dirt and bird food, the numbers are up quite a bit more than what you're seeing this release and that's a result of basically making choices. And so I don't think we're ready to exit bird food, but Dave and I have been clear to Barry and I think the operators agree. We're not into businesses that lose money. And we will be neutral to positive on a earnings point of view on bird food this year and that's a big deal because if you said what's the one business that you're in that basically you are kind of scratching your head and say five years from now you guys will be like King Kong and making money in it. I don't know that we had an answer that anybody would like, put it that way, in regard to bird food.





And so the choices we are making is accepting it's going to be a smaller business that we can -- that's net positive to the P&L is the choice we've made.

We made choices to where we didn't think it added value to our business or the relationship with a retailer that we are just not going to chase a price down into the dirt. And I think that's the kind of work we're doing now. We are highly focused on our consumer business. We're focused on our service business and we like those businesses, but that's kind of who we are. And so within that business if you say what is it that you don't like so much.

And the next thing would be, which is a very major project that Barry and Mike and [Michelle Gazneay] are going to be working on is Europe. Europe, if you looked at the numbers in '11 you would have said was really making good progress. Legitimately, the weather was terrible in Europe last year. The result -- our results were terrible. P&L results were terrible in Europe. There is this huge sensitivity to if it's good it's pretty good and if it's terrible, it's really terrible. And that we basically go back and look and say our expense structure is out of line and drives sort of a lot of negative leverage, especially when the business, and we're in a seasonal weather-driven business. I would say bird food and Europe are going to be highly focused sort of configuration within the existing business and with an expectation that if we can't fix it we exit.

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**Jason Gere** - *RBC Capital Markets - Analyst*

Thank you.

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**Operator**

Your next question is from Carla Casella with JPMorgan.

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**Carla Casella** - *JPMorgan Chase & Co. - Analyst*

Hi, with the cost savings that you are looking at generating this year and the better cash flow, can you just tell what your priorities for cash flow? You talked a little bit about acquisition, investing in the business. If you could rank them, how would you rank your priorities for cash flow?

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

Return to shareholders.

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**Carla Casella** - *JPMorgan Chase & Co. - Analyst*

Okay. Great. Thanks.

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**Operator**

Your next question is from Jon Andersen with William Blair.

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

Dave, congratulations and best of luck going forward.

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**David Evans** - *Scotts Miracle-Gro Co - CFO & EVP, Strategy and Business Development*

Thanks, Jon.

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

My question is on the independent retail channel. I realize it's a smaller part of the consumer business, but you recently appointed a new head of the channel and I'm wondering what your expectations are for that business and kind of how your approach to the garden centers, the hardware co-ops may change this year versus prior years or going forward versus prior years?

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**Barry Sanders** - *Scotts Miracle-Gro Co - President & COO*

Yes, Jon, this is Barry Sanders. I would say we have built what I would consider some world class capability into the Company and the way that we market our sales approach and also our supply chain and I would say the benefits that we had been given to the independent retailer were lagging from what we were doing with our big customers. So, we needed to make a change. We needed to apply all of the capability we have as a company. It's an important channel to us. We needed to get the programs right with them, the way we are approaching the business and be better business partners with them.

And so our expectation is that that business should be growing equally as fast if not faster than the rest of our business because we have the lowest share in that. And when we announced our regionalization initiative three or four years ago, we said a big part of that approach was going to be getting what we consider to be our average share in all geographies and all channels of business. And so we with shutting down our west coast office, Phil Jones had done a very good job with that independent channel on the west coast and really innovating the way we went to business with them. We thought that that would be a good utilization of the restores of making them in charge of not only the independent channels but all of the channels outside of the big boxes. We brought them back into Marysville and I would say so far the performance of what they are doing is actually very good and I would say that our business in that channel specifically, the independents, are up ahead of the rest of our business this year. So, good progress so far.

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

[Luke], you want to add anything to that?

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**Unidentified Company Representative** - *Scotts Miracle-Gro Co*

No. I think Barry covered it. I think that capability to be built we were actually probably five years behind when we were on the big boxes.

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

I think not to belabor kind of the question, Barry went out on the road and came back and said Christ, we still treat these guys like it was 20 years ago and the sort of whole approach to running the business within sort of our top accounts is pretty advanced and extremely professional and this is not a cut on that it was unprofessional. It just wasn't at the same level and the amount of work that happens at the supply chain, at the sales level, inventories, shipping, how we go to business, Barry came back and said there is a lot of room for improvement here. And I think Phil has been after it pretty hard and I think put a new team in place to sort of get at it and look at things differently and I think it's viewed positively by the accounts.

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

Thanks, that's helpful.

**Jim King** - *Scotts Miracle-Gro Co - SVP, IR and Corporate Affairs*

Amber, I'm going to interject here. We are going to two more questions and then wrap up.

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**Operator**

Our next question is from Olivia Tong of Banc of America-Merrill Lynch.

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**Olivia Tong** - *BofA Merrill Lynch - Analyst*

Thank you so much. I guess on lawn service, how would lawn service have looked had you not had that weather benefit, and with the improving margins on the gross margins side if I remember correctly the operating margin SG&A is higher so the operating margin is still a little bit below corporate average. So the improvements on the gross margin side do you think that longer term lawn service gets closer to consumer margins?

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

Volunteering, you guys can all volunteer for this one.

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**Barry Sanders** - *Scotts Miracle-Gro Co - President & COO*

Olivia, you said what was the weather impact. Well, we know our customer account was up 6% so that wasn't weather driven. And we also know we had increased penetration with different services within those customers. That's a specific objective that they always have is getting greater realization through additional services, so that's all been good. We had 19 with average weather between for the whole season, no, but I think we still would have been looking at high single digits.

Where is this business going? We like the business because over time we really built a solid strong foundation for kind of responsible growth. And because we were such low share, there is an easier pathway to understand where we get that growth. It's a business that's generating, as Jim said, gross margins of closer to 50 range. And as we grow, what's attractive about the growth is increasingly allows us to leverage our SG&A to drive that operating margin rate up. It is a -- it's hit the double digits now. I think earlier in past years, two, three, four years ago we were talking about operating margins in single digits and they are double digits. And I think probably within the next couple of years they are going to be up similar to what you expect in our consumer business. So, there is a lot of opportunity here for kind of a nice growth factor for the company to continue to drive growth and growth in its operating margins at the same time.

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**Olivia Tong** - *BofA Merrill Lynch - Analyst*

Thanks. And then on the consumer business, if I recall you guys said that the US was up 4% for sell-in but POS was up 1%. Usually at the beginning of the year you see the reverse of that. Could you, as you whittle down the inventory at year end, so could you kind of just bridge the gap there?

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**David Evans** - *Scotts Miracle-Gro Co - CFO & EVP, Strategy and Business Development*

Olivia, we ended Q4 down around 8% in inventory because we had such a strong September in some of the categories so part of that was really just a retailers getting back in stock. So, they ended September lower than where they expected and where they needed to be inventory-wise we hit their targets for their quarter, but we had to actually ship back in more to get them back in stock where they needed to be.

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**Olivia Tong** - BofA Merrill Lynch - Analyst

Got it. Got it.

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**David Evans** - Scotts Miracle-Gro Co - CFO & EVP, Strategy and Business Development

And we went from 8 to essentially flat which is where they wanted to be.

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**Olivia Tong** - BofA Merrill Lynch - Analyst

Okay. That makes sense. And then just lastly on average pricing spend last year when you did that big uptick you also pulled it forward closer to the season, so how do we think about the cadence of advertising spend for 2013? Would it be similar to 2012?

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**David Evans** - Scotts Miracle-Gro Co - CFO & EVP, Strategy and Business Development

Yes, I think the spend will be very similar. We will pull up slightly in Florida right now. As Jim alluded to earlier, the weather has been quite nice down there. The consumers are engaged and the stores have programs in them. So, slight improvement Florida of one of two weeks, otherwise we are sticking to plan. I would say we pulled some advertising aggressively into March last year to take advantage of the activity that was going on. We will monitor March to decide if we do that again this year.

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**Olivia Tong** - BofA Merrill Lynch - Analyst

Understood. And best of luck Dave in your next endeavor, it was great working with you.

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**Operator**

And the final question is from Eric Bosshard from Cleveland Research.

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**Tom Mahoney** - Cleveland Research Company - Analyst

This is [Tom Mahoney] on for Eric. I just wanted to get you guys to talk about key new products or innovation this year and how you are doing on placement with those ahead of the seasons?

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**Jim Lyski** - Scotts Miracle-Gro Co - EVP & Chief Marketing Officer

This is Jim Lyski again. I would say first our retailers are significantly behind year two innovations like Snap and the Ortho lawn. And so we will expect them to aggressively support those in the US, and then in Europe year two of the round up gel has seen significant interest from retailers over there. We will expand to another six or seven countries.

This year the in the US the number one introduction will be on Ortho animal repellents. We've seen great sell-in across our retailer based on those and we are just starting to see consumer take away down south and it's been above our expectations already. We were introducing a lower opening price point product line up, \$5 line up that SEJ is helping distribute into grocery drug. They have been able to sell that product into every account that they manage for us. So, we are bullish on that one also.

And then in Europe this year we are introducing flower magic across multiple countries playing off of the benefit we got off of EZ Seed which is known as Patch Magic over there. Flower Magic, big introduction in Europe and the retailer support of that has been significant both in shelf space and in promotions.



**Tom Mahoney** - *Cleveland Research Company - Analyst*

Great. Thanks.

**Operator**

Thank you. I will now turn the call back to Jim King for any closing remarks.

**Jim King** - *Scotts Miracle-Gro Co - SVP, IR and Corporate Affairs*

Thanks, Amber. If we didn't get to questions today, just feel free to give me a call directly later on in the day, 937-578-5622. One house keeping item. Barry, Randy Coleman, and myself will be presenting on March 6 at the Raymond James conference in Orlando. That's going to be a webcast event, so you'll be able to listen in to that if you don't attend. And other than that, we will be communicating again with you in early May when we report our Q2 results. So, thanks for joining us today and have a good day. Bye.

**Operator**

Thank you for your participation. You may disconnect that the time.

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