



# The Scotts Miracle-Gro Company (SMG) Q1 2023 Earnings Call Transcript

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## Q1: 2023-02-01 Earnings Summary

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EPS of  $-\$1.02$  **beats by  $\$0.32$**  | Revenue of  $\$526.60\text{M}$  ( $-6.96\%$  Y/Y) **beats by  $\$24.16\text{M}$**

The Scotts Miracle-Gro Company (NYSE:[SMG](#)) Q1 2023 Earnings Conference Call  
February 1, 2023 9:00 AM ET

### Company Participants

Aimee DeLuca - Senior Vice President, Investor Relations

Jim Hagedorn - Chairman and CEO

Matt Garth - Chief Financial Officer

Mike Lukemire - President and COO

Chris Hagedorn - Division President, Hawthorne

Patti Ziegler - Vice President, Global Marketing and Communications

### Conference Call Participants

Jon Andersen - William Blair

Joseph Altobello - Raymond James

Chris Carey - Wells Fargo

Eric Bosshard - Cleveland Research

Andrew Carter - Stifel

Bill Chappell - Truist

Gaurav Jain - Barclays

Carla Casella - JPMorgan

William Reuter - Bank of America

## **Operator**

Good day and thank you for standing by. Welcome to The Scotts Miracle-Gro First Quarter Conference Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. Please be advised that today's conference is being recorded.

I would now like to hand the call over to Aimee DeLuca, Senior Vice President, Investor Relations. Please go ahead.

## **Aimee DeLuca**

Thank you and good morning. I am Aimee DeLuca and I would like to welcome you to The Scotts Miracle-Gro first quarter earnings conference call. I have recently stepped in to lead Investor Relations after 21 years at Scotts and other finance and strategy roles. It's been a pleasure meeting many of you already and I look forward to meeting many more of you over the coming months.

Joining me this morning are our Chairman and CEO, Jim Hagedorn; our new CFO, Matt Garth; as well as Mike Lukemire, our President and Chief Operating Officer; and Chris Hagedorn, Division President of Hawthorne. In a moment, we will share some brief prepared remarks from Jim and Matt. Afterwards, we will open the call for your questions.

I see that we already have quite a few people in the queue. In the interest of time, please stick to one question and one follow-up. Matt and I have additional time with many of you today to fill in some of the gaps and I invite anyone else who would like to set up some follow-up time to reach out to me directly.

With that, let's move on to today's call. As always, we will be making some forward-looking statements, so I want to caution everyone that our actual results could differ materially from what we shared this morning.

Investors should familiarize themselves with the full range of risk factors that could impact our results. Those can be found in our Form 10-K, which is filed with the Securities and Exchange Commission. Please be aware that today's call is being recorded. An archived version of the call will be available on our Investor Relations site at [scottsmiraclegro.com](http://scottsmiraclegro.com).

With that, let's get started and I will turn things over to Jim Hagedorn.

### **Jim Hagedorn**

Thanks, Aimee. Good morning, everyone. I talked in our last call about the challenges of fiscal 2022, and the hard choices and aggressive actions we took to return the company to acceptable levels of profitability. I stated that our leadership team was on it and that we had full confidence in our ability to right-size the business and drive value for our shareholders. This brings me to today.

For Q1, we exceeded our total net sales goal on the strength of the U.S. consumer business and the scrappiness of Hawthorne to find opportunities within a struggling cannabis market. Record consumer shipments to retailers resulted in strong load-in, an indicator of confidence in the consumer this lawn and garden season.

I will sum up Q1 this way. There is light ahead. We are moving in the right direction. We have more work to do. And once again, we are on it.

Our Q1 results reflect the transformation within Scotts Miracle-Gro. We are operating as a very different company than a year ago. We have reoriented our business. We are leaner but more focused on driving the greatest value. We have strengthened our financial position. We are demonstrating discipline. Most importantly, our entire company across all functions is performing to the highest levels.

Let me provide context. For Q1, we are working against tough comps in the U.S. consumer segment, where in 2022 we posted a profitable first quarter for only the second time in our history. Consumer engagement remained high ahead of a year that ultimately was impacted by retailer shipments not keeping pace with demand.

What our current Q1 numbers do not show is the exceptional performance of our Scotts Miracle-Gro associates in a much more challenging environment. They never blinked and they have approached 2023 with grit and a winning attitude. They are making our operating plan a reality. Here's a snapshot of what our hard work accomplished against our internal targets.

Net sales that beat the plan by nearly \$25 million, gross margin improvement of almost 300 basis points against our plan, EBITDA of \$21 million against an internal forecast of zero, net leverage of 5.9 times debt-to-EBITDA comfortably within the covenant maximum of 6.25.

We are ahead of schedule and overachieving on Project Springboard, tracking to exceed the original cost savings guidance for the year. We are guiding to mid single-digit decline in SG&A versus fiscal 2019. Overall, I am pleased, but it's too early to declare outright victory. As I said, there's still more work to do.

We are reaffirming our outlook for the U.S. consumer business and how we see it performing for the full year. There has been a massive company-wide effort in Q1 to make the lawn and garden season a success.

Hawthorne continues to operate in a tough market. We are committed to increasing its return level, bringing it to profitability by year end. This is less about sales, although, the team is working hard on this front, and more about unwinding the overbuild supply chain and excess inventory. So far, we have achieved a 40% reduction in warehousing costs, and reduced SG&A and inventory by a third. Additional optimization and operating efficiencies are in the works.

I want to provide more color around our core business as there are two dimensions to it. First, building momentum and making sure retailers are fully loaded and all in with us. We accomplished this in Q1.

Second, motivating and energizing the consumer to visit stores browse and shop online and to load up with our products. This is our focus in Q2 and Q3. We will attack both quarters with the same result as we did in Q1. Early engagement is critical. As we know consumers who make their first lawn and garden purchases before May, spend twice as much in the category.

I told you last quarter that despite our cost reductions, we would not stop making high value investments to enable growth. This year, we are increasing investments in marketing and promotions, doubling our lawn spend over last year.

Overall, our total working media spend is nearly 25% higher than in fiscal 2022 and it will be more efficient and targeted. Total media spend this year will be even higher than the pre-pandemic year of 2019.

As you know, the early season has already started in the South. Omni-channel campaigns, radio, television and digital activation are already underway. We are seeing positive POS growth in the South where in the past two weeks, Bonus S is up 68% in Florida and 54% in Texas. We are also seeing strength in grass seed during the same period with plus 24% in Florida and plus 65% in Texas.

In March, we will launch a National Early Season Lawns Campaign. Miracle-Gro is partnering with Roku and Martha Stewart to support her new show, Martha Gardens. And this month, we will begin the largest product launch in Roundup's history with the introduction of a new dual action non-glyphosate formula.

These are just a few examples of what's coming. Our investments are being coordinated with retailers, who are increasing their spend on joint media promotions and in-store activations. Lawn and garden is the leading driver of foot traffic early in the year and our combined efforts can have a 3 times to 5 times multiplier on POS. I stand behind our operating plan.

In a few moments, Matt Garth, who became our CFO on December 1st, will elaborate on the Q1 numbers and our fiscal 2023 outlook. First, I want to revisit our long-term strategy. Although we are managing our business quarter-to-quarter, we are starting to do so with a view toward growth.

In fiscal 2021, we unveiled a five-pillar growth strategy. I am reaffirming the strategy. Three of the five pillars relate to the consumer business and the others to Hawthorne. On the consumer side, the lawn and garden pillar is a mature, steady generator of cash. The bulk of the new gardeners who entered our category during the pandemic are still with us.

We see sustainable growth with our brands and continue to engage consumers through marketing, innovation and packaging, formulations and products. This includes drought tolerant solutions to create living landscapes that work in concert with the environment.

The second pillar is direct-to-consumer, a component of category growth that includes our e-commerce and retailer.com sites. A strong online presence enhances brick-and-mortar POS, direct-to-consumer platforms are used to learn and shop for products. The lawn and garden omni-channel shopper, one who shops online and in store, spend 2 times as much in our category than an in-store-only shopper.

With this in mind, we have improved our online product content and visibility, and last month, we migrated to a new e-commerce platform for improved efficiency and enhanced marketing and personalization tools across 10 brand sites.

The third pillar live goods is a natural gateway for consumers in their lawn and garden journey. Consumer purchases and vegetables and herbs have remained steady over the past two years and almost 60% of edible gardeners intend to plant more over the next two years.

We are strong believers in growth opportunities through Bonnie Plants where we will execute with enhanced precision at growing stations and retail stores, as well as invest in innovation to inspire more consumers to grow their own.

I will now shift to Hawthorne, where our strategy is two-fold. Number one, we will retain Hawthorne's competitive advantage in the cannabis non-plant touching space and professional horticulture. We are the leading solution provider for growers, which differentiates us from those who are primarily distributors.

Number two, through our investment in RIV Capital, we will position ourselves to become a key player in the consumer and retail cannabis space in New York, projected to be the second largest cannabis consuming state behind California.

Digging deeper into Hawthorne, I have explained how we integrated back office functions and are optimizing our network. We are windowing our focus. Just as importantly, we are innovating. Our scientists in Kelowna, British Columbia, the first R&D facility in North America devoted the cannabis research are running trials on lighting, nutrients, genetics and other technologies to improve yields, quality and energy efficiency. Similar work is underway on hemp in Oregon, Florida and Ohio where we opened a controlled environment facility to supplement our greenhouses.

R&D's work led to the launch of the market's most advanced and efficient LED ever, the Gavita 2400e. We have continued to innovate with the WEGA LED lighting portfolio for indoor growers of vegetables, fruits and flowers. WEGA is expected to surpass last year's unit sales in Europe and North America and is now one-sixth of Hawthorne's business.

We capitalized on the trend toward indoor agriculture, an industry but by some accounts is about \$40 billion annually in the U.S. with a projected annual growth rate of 13.5% through 2030. Additionally, by modifying the light spectrum for the WEGA, we can make it an excellent no-frills LED option for cannabis growers.

One final point on the cannabis industry, when it does recover and it will, growers will be ready to invest in CapEx. We will be there to support the turnaround. Consolidation is happening in the industry and we see opportunities for high-value no-cash partnerships to further strengthen Hawthorne's ability to provide value-added and innovative solutions to growers.

I will shift to the consumer side of cannabis through our convertible loan to RIV, an integrated cultivator and retail in New York that owns the Etain cannabis brand. RIV holds one of 10 vertically integrated licenses that includes a growing and processing operation and four dispensaries, is developing a state-of-the-art indoor growing facility in Buffalo.

From a regulatory perspective, New York has tripped over itself in developing and implementing rules, which has prevented the market from reaching its near-term potential. But let me make this clear, New York will become a monster market and we will see it through. There is progress in value in our investment with RIV.

To summarize, we have adjusted the speed, which we are moving forward in our strategic pillars. We have shifted from an accelerated pace to a prudent but steady investment approach that strengthens our ability to grow and drive shareholder value. When we are able, we will shift back to a more aggressive shareholder-friendly bias. We remain focused on cost control, EBITDA and free cash flow.

When we spoke last quarter, we committed to \$185 million of annualized savings across the two phases of Project Springboard by fiscal 2024. We will achieve the full \$185 million in savings by fiscal 2023 and now have line of sight to additional savings in excess of that commitment.

Reflecting on the year, times like these illuminate the resiliency and strength of our business, and the determination of our associates. We have exceptional leadership and talent. We are bringing rigor to our financial processes, forecasting and capital allocation at an important time in our transformation.

It's been a real pleasure to work with the leadership team and the Board of Directors, which has been a great partner to me and the executive team. I also want to thank our retail partners and banks. Their support and commitment has been invaluable and will contribute to our mutual success. Thank you.

I will close with this. Consumers have emotional connections to their lawns and gardens, which is reflected in our vision statement. We help people of all ages express themselves on their own piece of the earth. This comes to life in our leading brands, innovation and products to meet diverse needs. Through good times, pandemics and recessions, people consistently turn to us to enhance their lives. I have often said there's no better business to be in and this is true today as ever.

Thank you. Now I will turn this call over to Matt.

### **Matt Garth**

Thank you, Jim, and hello, everyone. I would like to begin by noting my excitement with being a part of The Scotts Miracle-Gro family. I have long been a consumer of the company's products and have firsthand knowledge in achieving a great lawn, applying Turf Builder 4 times a year and creating a productive garden using Miracle-Gro soil and plant food.

I have been warmly welcome to the company and was transitioned expertly by Dave Evans as he wound down his interim CFO role. Since joining, I have immersed myself in operations, marketing, sales, human resources, and of course, the finance practice.

To summarize my experience so far, we have an outstanding team that every day reinforces the open, transparent and accountable culture created by Jim and his team. As this quarter proves, the collective effort to improve the company's financial strength through Project Springboard is delivering. The discipline focused on improvements and savings will continue, while we also invest in our future and innovation to extend our leading positions and create significant long-term value.



Now let me turn to the first quarter performance. Record December shipments in our U.S. consumer business delivered Q1 segment sales, 8% higher year-over-year and combined with the robust savings from Project Springboard that Jim referenced, more than offset early softness in Hawthorne. We now expect to achieve the \$185 million of annualized Springboard savings by the end of the fiscal year, well ahead of our prior commitment.

Springboard actions and the continued urgency of our team will create additional upside as we move into 2024, with potential savings above \$185 million that we can direct towards innovation, consumer activation and growth. Net leverage at the end of the quarter was 5.9 times adjusted EBITDA, comfortably within our covenant maximum of 6.25 times.

Let me move on to the P&L beginning with sales. Net sales on a company-wide basis were down 7% versus Q1 last year. Sales growth in U.S. consumer reflected the strong partnership with our retailers for the early season build-out. The sales and supply chain teams were outstanding in their execution and coordination in delivering on customer expectations, including getting some Q2 volumes out in Q1.

For the first half, we still expect the load-in to be aligned with our original plan and slightly higher than the first half of last year. First quarter POS at our four largest customers was in line with our expectations, ending down 19% in units and 8% in dollars. The POS unit declines are consistent across our key customers and categories.

As we discussed last quarter, we still expect full year POS units in fertilizers and grass seed to grow by 10% and unit volume and other product categories to remain essentially flat versus fiscal 2022.

Early season performance in our Southern markets indicates that we are tracking well against our expectations. We call that Q1 represents less than 15% of the full year and our focus is appropriately shifting to our peak season in Q2 and Q3.

As we entered the year with retailer inventory units slightly down versus prior year, a strong Q1 load-in and the expected decline in POS have brought retailer units slightly higher. Replenishment orders in the second half will be driven by consumer takeaway and the inventory management actions by retailers.

Our plans align with our retail partners year-end target inventory positions and we are monitoring the consumer condition to ensure we act quickly to align production with any changes in demand levels.

Turning to Hawthorne. Continued industry-wide challenges yielded a 31% topline decline year-over-year. This result was driven by lower retail and professional grower activity stemming from oversupply, and general uncertainty on when the market will become more balanced.

Our original guidance estimated Hawthorne sales would be flat to down low-single digits for the full year. Given the soft start for the business and the state of the industry as a whole, we now expect Hawthorne sales to decline 20% to 25% year-over-year.

There are many reasons to be excited about the future of Hawthorne. We are taking the appropriate prudent actions to achieve run rate profitability by the end of the year, while also strengthening our position for the future.

For the full company, we previously guided to low single-digit sales growth for the full year. We now expect that a low single-digit sales decline in fiscal year 2023 is a more reasonable expectation given the market challenges Hawthorne is facing. Gross margin for the quarter was 20%, down 90 basis points versus last year.

Strong U.S. consumer volume and pricing, better segment mix and sooner than expected progress against our Springboard targets largely offset lower Hawthorne sales and higher conversion and commodity costs. We continue to expect that gross margin will decline slightly in fiscal 2023 as the impact of lower Hawthorne volume will be offset by Springboard savings.

As explained on the last quarterly call, commodities are now about one-third of our total cost of goods sold due to historic inflation levels. At this point, we are about 65% locked on our total commodity costs and north of 70% locked on total COGS, so we have a fairly good visibility for the rest of the fiscal year.

We are seeing some bright spots in international freight rates, resins and pallets, while our larger inputs like diesel and urea continued to move with underlying energy related commodities. The team has executed well in working with our customers to manage inflationary costs and delivering pricing to largely cover our dollar exposure.

Our progress on Project Springboard is most evident on the SG&A line, which is down \$26 million or 17% versus last year. We guided for full year SG&A to be below fiscal 2019 levels, and given our first quarter results, we now expect a mid single-digit decline from fiscal 2019.

Moving further down the P&L, interest expense is up mainly due to increased borrowings and higher interest rates, call that we guided to additional interest expense of up to \$40 million in 2023. Given the move in SOFR and our spread at current leverage levels, we now expect incremental interest expense to be closer to \$60 million for the fiscal year.

The adjusted effective tax rate in the quarter was 25.5% and we anticipate the full year ETR will be between 26% and 27%.

I will also note here that we anticipate fully diluted shares will increase by approximately 0.5 million shares through the end of the fiscal year. That brings us to the bottomline where our net loss for the quarter on a GAAP basis was \$65 million or \$1.17 per share compared with a loss of \$50 million or \$0.90 per share last year.

On an adjusted basis, which excludes impairment, restructuring and other non-recurring items, we reported a loss of \$56 million or \$1.02 per share, compared with a loss of \$49 million or \$0.88 per share a year ago.

On a total company basis, the overall year-over-year decline was completely driven by non-operating factors, mainly higher interest and tax expense. In fact, adjusted EBITDA improved to \$21 million this year versus a loss of \$1 million last year.

Adjustments to arrive at non-GAAP adjusted EBITDA from our net GAAP operating loss in the quarter are detailed in the press release financials and include \$19 million related to our ongoing restructuring efforts, including Hawthorne, integration costs and other projects Springboard initiatives.

We are modifying our full year adjusted EBITDA guidance given lower than expected depreciation expense, mainly due to the timing of capital expenditures and Hawthorne impairments. We now expect the full year increase in adjustments to be less than \$20 million, resulting in low single-digit growth in full year adjusted EBITDA.

Now let me turn to an update on our capital allocation approach. We face no near-term refinancing risk and ended the quarter with over \$800 million in undrawn revolver capacity. We expect to manage the seasonal working capital build through this year and stay within our financial covenants.

We will direct our free cash flow to debt pay down, targeting a net leverage ratio below 4 by the end of fiscal year 2024. We are deploying CapEx of \$100 million in 2023 funding maintenance requirements and high return, short payback projects. Our outlook also includes continued support for our quarterly dividend.

In sum, we will maintain tight capital discipline and drive leverage down, while ensuring we fund the innovation and capability to deliver long-term growth at SMG.

Please keep in mind the guidance that I have provided is not without risk. We are diligently managing what is within our control. Performance in the back half of our fiscal year is largely driven by consumer engagement.

We have an aggressive and creative plan that is in lockstep with our customers to activate the consumer early and throughout the season. I also shared Jim's excitement about the long-term prospects for Hawthorne and the potential for growth and value creation in the business.

And let me close by putting the first quarter into proper context. Q1 is typically less than 15% of our full year. The peak of our year is fast approaching and I have confidence in the plans we have put in place and the ability of Mike Lukemire and his team to execute.

With that, I will conclude and return the call to the Operator so we can take your questions. Thank you.

## **Question-and-Answer Session**

### **Operator**

Thank you. [Operator Instructions] Our first question comes from Jon Andersen with William Blair. Your line is open.

### **Jon Andersen**

Hi. Good morning, everybody. Thanks for the question.

### **Jim Hagedorn**

Hey.

### **Jon Andersen**

I wanted to ask first on the U.S. consumer business. There are two parts. One, can you talk a little bit more about any early season reads that might kind of enhance your confidence in, I guess, particularly the lawns business and the recovery that you anticipate in the lawns business in 2023? And the second part is, I'd love to hear a little bit more about the marketing plans. You are talking a lot about kind of leaning in and activating consumers early in the season across the country and how important that is. Have you taken that approach in the past, has it been successful, what are some of the details around that? Thank you.

### **Jim Hagedorn**

Okay, John. Hagedorn here. I have been -- I tell people I am not going to like to try to answer all the questions, but this is a good one. The -- first, let's start with the budget we put in, and I think, it -- people can say, well, you are sandbagging or whatever.

We think we are pretty conservative by putting basically flat, and remember, lawns was down 20% last year. And our view is almost entirely on weather. California, Texas, Northeast, Midwest, which I don't need to go through that again, it sucked [ph].

The -- so we are plus 10 with lawns, zero for everything else. So we don't think we have a particularly challenging number, because I think, many of us who have been in the industry a long time said, it was just a very challenging weather year for us and I think the same is true in agriculture. So anybody who's following, I think, knows that we speak the truth here. The early season numbers on lawn actually look pretty good. I don't know, Mike?

### **Mike Lukemire**

Yeah. No. I mean, the last two weeks are up 57%, 64% and where we apply promotion. It is really -- it's moving.

### **Jim Hagedorn**

So we need lawns to -- I mean, we do need lawns to work. In addition, I think, Bonnie is seeing similar kind of like very positive numbers, early season. So I think the early season -- it's conservative numbers and I think this early part of the season look pretty good so far. So I'd say that, Patti, you want to talk about -- like Patti runs the brands.

### **Patti Ziegler**

Good morning.

## **Jim Hagedorn**

You want to -- no. You can't.

## **Patti Ziegler**

Okay. The team, the SBU leaders and the marketing partners, we are really excited about the season and we are, particularly, pleased with our early season activity, which we have already seen in the South, working well with our bonus product offering and we have a program in partnership with the retailers.

We are launching in the very early season to reflect Jim's comments earlier about how we know that early season consumer pays -- spends more in the category. And the program is named the Lawn Savings [ph], and we are doing that in partnership with our retailers and getting out even ahead of their Black Friday promotions. So we will continue to support this consumer, get them in the category early and we are excited about the potential of the program and what it's going to do to stimulate it.

## **Jim Hagedorn**

And the spend is real high.

## **Matt Garth**

Yes. Very high.

## **Jim Hagedorn**

So nobody is messing around here. I think the retailers wanted to work. We want it to work. We are spending behind it. We have got new talent on the sort of regular lawns advertising, we replaced Scotty the Scotsman with a new personality and the big event at the beginning of the season.

So we are not -- I think part of what we had happened last year, Jon, was we were sort of waiting for weather before we fire our activation dollars and we never just had that weather. And there gets to be a point where if people haven't bought, it's getting late in the year and the weather is kind of cool and wet, and people say, my lawn looks great anyway. There's a big reason to get them out early.

So it's a little bit of a back to the future approach, but it's very well coordinated and being spent against very heavily. So I think we feel pretty good about it, and the POS, so far, I think, says there's no significant problem with the consumer at the moment.

**Jon Andersen**

Thank you. I will leave it with that. Thanks.

**Jim Hagedorn**

Thank you, Jon.

**Operator**

Thank you. Our next question comes from Joseph Altobello with Raymond James. Your line is open.

**Joseph Altobello**

Thanks. Hey, guys. Good morning.

**Jim Hagedorn**

Hi, Joe.

**Joseph Altobello**

I guess a question on U.S. consumer as well, retailer inventories, you touched on this. Sounds like they are a little heavy, how much of might that be to your shipments this year?

**Mike Lukemire**

To our plan, I would say that, there is no problem with that pump. And so we are just looking at, in our plants, we baked in that they may want bring them down based on POS a little tighter, but that's a conservative look. So they have not really talked about they have a significant amount of inventory.

**Matt Garth**

Yeah. Joe and in my prepared remarks, what I said was, we came into the year with retailer inventories low and with the strong December that we had plus lower year-over-year POS, those inventories have come up. However, the retailer inventories are still below where they were last year.

**Mike Lukemire**

Yeah. I think we are at like 7% below last year at the same point.

**Matt Garth**

Yes.

**Mike Lukemire**

So.

**Jim Hagedorn**

And I think internally, Joe, the conversations here, clearly we had a positive first quarter, a lot of work went into that. I think Luke has been pretty clear that sales that came in he's not really changing his first half load plan. So we are not assuming that its additive. So I think Luke has been conservative for the first time ever, but...

**Mike Lukemire**

I am worried about running out of product, because I think, it's going to be good, but I don't know.

**Jim Hagedorn**

That may be our biggest issue, Joe, is just that, we are just working really hard to keep the supply chain type.

**Joseph Altobello**

Okay. That's helpful. And maybe on Hawthorne, three months ago, the outlook for that business was, call it, \$700 million of revenue this year. Now we are looking at roughly \$550 million. So it's changed pretty dramatically here in the last couple of months. I guess, one, have things gotten that much worse or do you expect some sort of recovery, and two, assuming revenue of \$550 million, what does that mean for segment loss in fiscal 2023?

**Chris Hagedorn**

Hey. So, Joe, it's Chris. I will take the first part and I will let Matt take the second part. Yeah. It's really -- it's sort of your latter assumption there is that we had baked an assumption of some market recovery in the earlier part of this year into our plan going in. We still expect to see some recovery in the marketplace, but it obviously, didn't materialize this quarter the way that we have been hoping.



Now, I mean, I think, it's worth noting, I got a text message from a competitor of ours [ph] yesterday and this was -- this is someone who -- he was the President and CEO of General Hydroponics when we bought that business and someone we stay close with over the years and very plugged into the industry. He reached out to me and prompt yesterday and said, hey, been thinking about you just want to let you know I feel the wins at my back out here in California for the first time in a long time.

So we are starting to hear some rumblings and seeing some signs, I think, that the industry is beginning to gain traction, but obviously, with the way the last year plus has gone, we are going to wait before we start counting our checks. But I will let Matt take the second part.

### **Matt Garth**

Yeah. And on a profitability perspective, we weren't really calling for a significant increase or additive EBITDA to our full year projection coming from Hawthorne. If you remember, coming from where we were last year, doing the efforts through Project Springboard to realign the cost structure with where we are from a demand and revenue component, that was going to bring us to some positive EBITDA contribution.

Now with this call down on topline revenue, that brings it down a little bit sort of hovering around breakeven plus 5 and so we are going to navigate that as we continue to go through the rest of the year. .

And like Chris just said, whatever bright spots are there, they will kind of mitigate any further downside that may come. So we sort of split the difference on that 20% to 25% outlook coming off of a 31% down first quarter, we are calling again up for quarters going through the rest of the year and so that is some positivity that we see.

### **Joseph Altobello**

Okay. Great. Thank you, guys.

### **Operator**

Thank you. Our next question comes from Chris Carey with Wells Fargo. Your line is open.

### **Chris Carey**

Hi. Good morning.

## **Jim Hagedorn**

Hey.

## **Chris Carey**

Just I just wanted to confirm U.S. consumer. So shipments flat for the front half of the year. Just to be really specific, would imply shipments being up in Q2 and with the expectation for POS for the full year, obviously, shipments are going to track below. Is it -- are you saying organic sales growth for the U.S. consumer business should be up in the high-single digits this year and maybe shipments are not down that much, and with that sort of outcome, would you expect margins to be able to re-expand in the U.S. consumer business or is the commodity impact and the other things that you are seeing still going away?

## **Matt Garth**

So let me clarify something there. What we are calling for is on the topline. When you look year-over-year, you are actually seeing overall volumes down as we pointed to in the call last quarter, but we are pushing through the pricing. That pricing that we put through is carrying through and you see that in the press release, detailed very nicely.

So, the first half of the year will be slightly up on revenue. Again, if you look at that first quarter performance outpaced what we thought and Jim spoke to that, we probably pulled in kind of \$8 million to \$10 million from Q2 to Q1. Jim also just said that we are forecasting that we are going to hold that as we move into the second quarter. So that proves out a really strong first half. However, again, volumes slightly down really, meaning shipments, but that pricing coming through.

From a POS perspective, you are absolutely right and I am going to speak to this in two components. One, what's been demonstrated and how that's performing and you heard that from Texas and from Florida, the early spring season areas of the country performing well and showing good signs of consumer engagement. That leads to where we stand for later in the season here in the Northeast and other parts of the country as things start to warm up.

Again, still looking for a POS that is going to be slightly down, but again, pricing very strong, and as Mike just said, should the consumer come in at a good level, recall that we have made adjustments to our operations, we are producing at a lower level at this point to help us from a cash perspective and so we will be working very closely with our customers to ensure that they have the product they need should POS come in stronger.

### **Jim Hagedorn**

But I -- Jim here. I would say from my point of view and I am not sure what Mike would say on this. But we struggled, I think, pretty heavily with Dave as we kind of put together our forecast for 2023.

And Mike and I basically just plug zero and it's not because we think the consumer is sick or anything, we just wanted to put a conservative number in and plus 10 on lawns after minus 20, which we thought was weather related, we thought was also conservative and safe.

So we were basically looking to build the revenue numbers that we are just -- we are safe and so I personally wouldn't read a lot in that. I think it next call, we are going to know a lot more how the consumer is doing.

### **Mike Lukemire**

Yeah

### **Jim Hagedorn**

But I would not try to put too much precision into our forecast. We were -- this was a pretty wicked discussions internally on just what we wanted to commit to and not get on the wrong side of everything. So the flat was not because really anything other than we just wanted to put a number we were confident after what we have just viewed as a really crappy year last year.

### **Chris Carey**

Yeah. That makes -- so...

### **Mike Lukemire**

Yeah.

### **Chris Carey**

...when you say flat, you mean your organic volume shipments in the front half of the year, you are expecting flat, just to be clear. Sorry, I just wanted to confirm that. I didn't mean to interrupt.

**Jim Hagedorn**

No. No. It's okay. You are the one asking the questions and we are here to answer.

**Matt Garth**

So volumes are going to be slightly up in the first half across all categories. But when we are talking, I guess, the outlook that I gave, Chris, just to be specific about that slightly higher year-over-year for the first half is on the topline.

**Jim Hagedorn**

Great. Somebody wants to say, say it. The people here are all motioning.

**Matt Garth**

We are good.

**Jim Hagedorn**

Okay.

**Chris Carey**

Okay. Okay. And then just as a follow-up, for the Hawthorne segment, right? So this glide path to improvement in profit by the end of the year, so are you saying that you expect by fiscal Q4 that the segment profit should effectively be zero that you are running neutral, and between now and then, you are running negative. So, again, the idea is to get flat by the end of the year, and then just on that, do you have any view on U.S. consumer margin, the ability to be up or down just on the prior question? So that's it for me.

**Matt Garth**

Yeah. I think that's, obviously, you are coming out of the first quarter you are seeing the segment profitability in Hawthorn. So, yeah, the glide path as we move through the year will be improving and I think we are going to get another bite at that apple here in the second quarter as we start to see some seasonal uptick. So we will keep you abreast of what's happening in Hawthorne next time we speak and the full year outlook there, but yeah, progressively improving as we make our way through the quarter.

From a U.S. consumer margin perspective, you have seen a lot actually take place in terms of what we had expected, I think, what we had originally communicated and versus last year, what we were able to do. The performance of the team, the costs that have come out of the business, the efficiencies that we are running have put us and you saw it in the gross margin line as well in a good position to start to begin to think about how you recover back to those sort of early 30s, mid-30s type margins in U.S. consumer that Mike like to talk about and that is going to be a combination of higher volumes coming out of the production facility.

That's going to come with time and maybe we can get some of that this year. Remember, we called that down for this year. And the other component of that is going to be what happens on the commodity side and so watching that, and like I just said in my prepared remarks, we have about 70% of our COGS already tied up. So pretty good outlook for this year, but that will be helping us progress back to those margins as we move forward.

### **Mike Lukemire**

No. I think it's going to recover as the commodities adjust. We also have a bunch of costs out as well.

### **Chris Carey**

Yeah.

### **Mike Lukemire**

And so -- and then mix is always a factor for us. So strong lawn season. It's a good mix. So I am pretty optimistic we are going to get back there over time, yeah.

### **Chris Carey**

Okay. Thanks so much.

### **Operator**

Thank you. Our next question comes from Eric Bosshard with Cleveland Research.  
Your line is open.

**Eric Bosshard**

Good morning.

**Jim Hagedorn**

Hey, Eric.

**Eric Bosshard**

Two things, if I could. First of all, Matt, you talked about upside to SG&A saves into 2024, and I just wanted to dig in a little bit in 2024, obviously, we got a long ways to go in 2023. But as you think about the amount of SG&A you have taken out of the business and this is mostly on the consumer side. I am just trying to get a sense of how much do you have to reinvest back into the business in 2024 to serve customers and to drive the business or is the cost structure and the operating structure in 2023, what's sustainable and then growth in 2024 and beyond levers off of that?

**Jim Hagedorn**

I am going to take that from Garth to start at least. If you look at our in-store merchandizing sales force, we are in good shape there. If you look at the innovation work that's happening in R&D, we are in good shape there.

We are definitely a skinnier team than we did, except, Eric, you might remember that our biggest issue is we were chasing these five pillars was, you in what army. We hired a lot of people. So we are kind of back. It was -- I sort of figured like -- I think people are starting to feel better around here, but there was a lot of PTSD here. This has been -- it's been a god dam trip.

But I think that the teams are smaller, a lot in this building, a lot at Hawthorne, and I think that, that's pretty much where we plan to be. I don't think we have a lot of spring back where we have to fill in a bunch of gaps and we are not doing things we should be doing. I think we have been really mindful of trying to spend the money where we need to spend it.

Marketing dollars are up. In-store dollars are good. I think we are pretty well configured. And I think we have not committed to everything that we think we can do and that's, I think, what Garth is sort of pointing at and saying, there's more sort of sustainable cuts to G&A that you will see in 2024.

But I don't think any of the teams are really saying we need a lot more people. I think we are -- we were pretty careful in, if you look in my hallway, it's a lot -- there's a lot of different people here now on my side. I think we have been very careful to say the people who stayed are people who think we can operate this business much tighter than we were before.

And it's really the growth we were chasing that growth. I don't think we were unusual. I think a lot of companies right now are talking about that. But we were pretty careful to select people who like the way we set up now and if people acted like they didn't like it, they are not here anymore. So, Mike, anything you would add on that?

### **Mike Lukemire**

No. I think we are streamlined or I mean it's my ninth year of being the President and COO. But when I first took over, it was pretty streamlined. We invested in a lot of things to chase growth, and I think, we have readjusted. But we are not cutting the fundamentals of sales marketing and our foundational things. And then we are just more measured as we build back, we still want that growth, we still believe in that growth. How we get there will be a lot more efficient.

### **Eric Bosshard**

Okay. That's helpful. And then the second question, Jim, you mentioned the pillars. I -- on Hawthorne, I just wanted to understand a little bit better your perspective. A quarter or two ago, I think you wrote-off maybe \$1 billion you had invested in this business, a quarter into this year you took the revenue target down by 20%. I guess I was a little surprised to hear you say we are still committed to the two Hawthorne pillars from 2021 when that world has changed so dramatic that you had to write-off basically the capital you put in the business. Why you still commit to those pillars, isn't -- I guess I am just trying to figure out your vision, it sounds like it's the same it was two years ago when this world has changed...

### **Jim Hagedorn**

No. I wouldn't say it's the same. I think we have been -- and listen, we run our own business and so I am not blaming anybody acting like a victim. So don't misread what I am saying. But we kind of paid for that business.

We still believe in the growth of the cannabis sector. It is a bloodbath out there. I don't know that was Forbes or Fortune like two years or three years that it's going to be a bloodbath. Well, it has been.

But we are invested there and we look pretty carefully at our business. And Garth coming in with Mike and Chris and myself and sort of saying, who do we want to be? I mean this gets down to the sort of pillars.

And I think there was a group of people in here who said, we should just be the best little Scotts company we can be and it's a kind of low single-digit growth rate and I -- this is not chasing the value of the equity, but it basically says.

What we get from direct-to-consumer, what we get from live goods, what we get from Hawthorne is growth. And we got on the wrong side of that. We paid for that. We have taken the pain for it. And the question is, do we just throw -- set it on fire?

I had a situation with Smith & Hawken, where during the economic crisis in 2008, we bought that. I think we had thought we had a deal with Home Depot. It didn't come together in a kind of weird screwed up way with Nardelli.

But Dave was the CFO back then, and he said, look, we don't have a forecast for profitability here, Jim, and nobody is putting it together and everybody is contributing. And Smith & Hawken, you need to make a decision on Smith & Hawken.

He put it directly on me and I sort of -- I -- we burnt that thing. We auctioned off the pieces and it was a pretty bad experience. I regret it today. Smith & Hawken or Hawthorne is not in that same situation.

If you could say roughly that half of the profit of Smith & Hawken or Hawthorne is we burn by setting up a supply chain that was just bigger than clearly we need right now. That is worth. I am going to call it north of \$50 million.

So I think this business can get back to pretty easily kind of a 10% EBITDA margin and that's kind of my view of opening stakes to sort of be a contributor here. And I think we get there and I think a lot of this happens, because we resized that supply chain. It's hard and you think because there's a lot of inventory there and we have got to work through it and we will.



But I think we believe that there's growth in that business that it's about a screwed up that you can get. I blame a lot of this myself, on very poor public policy. I mean all you got to do is look at New York, and say, could it possibly go worse than what's happening in New York. But remember, in California, they went recreational in California and the entire country was down 50%.

So safe banking didn't happen and there's a lot of things that we thought would happen. But if you want me to -- I do think if -- because I do reflect occasionally and I think we assumed you would have federal normalization by now. That has been much more challenging than we thought. I think that you look at Oklahoma and Michigan as far as issuing permits far in excess of what the states require. It just -- it's pretty screwed up.

But we just think that without that we are fully invested in the space, we are committed to seeing it through and we think it will give us a growth rate that's in excess of what the consumer business can grow, and ultimately, we think we need to show growth and we can do it profitably. I don't know that's my view.

**Eric Bosshard**

No.

**Jim Hagedorn**

Garth, you got a different view.

**Matt Garth**

Absolutely not. And as you said, we sit down as a team and go through this on a fairly frequent basis. You are sitting right now, Chris, and I think, you are very aware of this, Eric. Oh, Eric, I am sorry. Yeah, I have been moving backwards.

You have been -- you are aware of this. The industry itself, as Jim just outlined, probably, not in the most advantaged position. However, what we do and I think this is not just me saying it, it's everyone in the business is fairly unique. And the proposition that we have, the strategic position that we have, the customer position that we have all put you in a very good place for an industry that has a somewhat longer time line than we thought.

That being said, you also heard Jim talk in his prepared remarks that this opens up some strategic opt for us, which are we feel we are in an advantaged position, given what we bring to the market and there are others out there who may not be in that position, but we can all benefit with together.

So, just looking at it from a holistic perspective, how you maneuver through this market, how you strengthen our position and how we set up a business that on any type of recovery is in a strength and winning position is what we are looking to do.

**Eric Bosshard**

Understood. That's very helpful. Thank you.

**Operator**

Thank you. Our next question comes from Andrew Carter with Stifel. Your line is open.

**Andrew Carter**

Hey. Thank you. Good morning. I wanted to ask about Hawthorne just digging into it like the 31% decline. I know Vegas completely incremental. I think you said sixth. So is that a sixth incremental. But could you also dig into kind of Signature brands versus non-distributed and how much of that non-distributed kind of rational or kind of shift in focus you are making this year kind of is reflected in your topline outlook for this year and also in the quarter? Thanks.

**Jim Hagedorn**

Yeah. Hi. I will leave it to the smart guys.

**Matt Garth**

Yeah. Hey, Andrew. So we are looking this year at a Signature to distributed breakout of about 65% on the Signature side of things. So lighting and new trends continue to drive that for us.

**Andrew Carter**

But the question is, are you focused -- are you focusing on your products as distributed?

**Chris Hagedorn**

Yeah. Andrew, it's Chris. Yeah. I mean, the focus is, and Tom, can give you again more specific numbers and certainly, Aimee and Matt and follow-ups. But the philosophy that we are moving towards here and this is really as we look at how the market has evolved, and frankly, constricted here over the past year, the philosophy is certainly to move towards more of what we are calling internally as Signature Plus model, which is to focus much more on our owned brands.

We have some distributed brands that we have unique relationships with. These are brands like Quest dehumidifier. And then there's other brands and products that are at least, currently, we think essential parts of our portfolio, parts of our offering that we don't make a great deal of money on and we don't feel like a great value proposition for us, but again, our customers require them. So I'd say we are in a transitional period right now moving from what has really been a distributor business with a slight emphasis on our Signature brands to much more of a Signature offering.

**Matt Garth**

Yeah. Just...

**Andrew Carter**

I guess.

**Matt Garth**

... Andrew, a key focus on the brands that we own, the brands that we have developed, the innovation that we continue to develop and continuing to also take a hard look at partnerships out there in terms of where there are other key pieces of the category that makes sense for us to stay really close to all in the spirit of doing the right thing for the grower.

**Andrew Carter**

Got you. Just to be clear, I guess, the -- I guess, I will say my question better. So that 65%-35% split, I guess, I was asking, do you expect that 35% to go down quite a bit through the year, i.e., an added headwind to sales, but one that might not show up much is probably. That's what I was asking, do you expect that split to move meaningfully and any kind of associated headwind?

**Chris Hagedorn**

Hey, Andrew. I think for the balance of the year, it will probably remain relatively steady, that 35% distributed ratio. Again, I think, the shift towards Signature Plus is going to be something we will see more over the course of, I'd say, the next 24 months or so is that and we expect that we will be able to replace a significant portion of the distributed sales that we will be choosing to move away from with signature sales.

So what we are hoping for is not a huge step back in terms of overall topline revenue from those sales, and again, that's not considering what we expect to see in terms of recovery in the marketplace, but a good deal more profitability on each dollar per dollar sale.

**Andrew Carter**

Got it. I will pass it on. Thank you.

**Chris Hagedorn**

Thank you.

**Operator**

Thank you. Our next question comes from Bill Chappell with Truist. Your line is open.

**Bill Chappell**

Thanks. Good morning.

**Jim Hagedorn**

Hi, Bill.

**Bill Chappell**

Hey. Just a few things. One, I guess, looking back at 1Q, I am a little confused of was this significantly better than you expected or was it more of a timing of shipments? You said last year, part of the problem was retailers didn't order in line with demand and so I would assume that there would be kind of out of stocks or inventory that you had replenished? And then you also said that there was inventory problem at retail. So and then I think you had said there were some 2Q shipments that came in 1Q. So I am -- just help me understand like, is this kind of a, it's a good start and we will no more less or are you really ahead of plan [Technical Difficulty] starting out.

**Jim Hagedorn**

All right. I think I understood, although, it became somewhat garbled. So I don't know if you are on a cell phone, Bill. I think the quarter was a lot better than we thought it was going to be. Remember that we had in December, so we were really managing, at least I was very focused on sort of leverage in the quarter.

We had agreements with our retailers on a rational first half load. We probably came out a little bit better, not by much, but I think we said \$25 million better. But that was not without challenges in that we had that period right before Christmas where it got really cold and shipments became a little bit painful and I think the supply chain team did a fantastic job kind of managing orders to get them out.

I don't think we have an inventory problem at all at retail. And I think that the Springboard work, which was the entire company did fantastic and that -- there's no one person you can sort of give credit to. It was a real company effort under the gun to get the orders out and drive our expenses down through a lot of very challenging sort of decisions that we had to make, especially in regard to people.

So I think we had a good quarter and for those people who know us well and you do, it was a, I think, a lot of last year, I think, we take a step forward and it felt like get two steps backwards that just things were and the great thing about this company is that the company -- this is a company that with a challenge operates well as a group. So that all came together at the end of the quarter to a result that was better than we had expected.

We were working to stay within 6.25 coming in at 5.9 was a really good result for us. And a lot of people have written on where they thought leverage was going to be for us. I -- it is a big success for us to have gotten through this.

And it goes back to our team and our retailers agreeing to sort of numbers and not excessive load, this is a natural load for us. But what we needed was commitments for Q1 and Q2 that would meet the load. But given our tightness for leverage would make sure that as long as we could execute on our side, we could -- we would get the inventory in and had orders and all of our retailers were fantastic, getting product in and our team did the work. So I think it was a good result. Mike, I don't know.

**Mike Lukemire**

Yeah.

**Jim Hagedorn**

I give a lot of credit to Luke and I give a lot of credit to the people who are running Springboard to -- because this is a -- Springboard is a day-to-day very intimate view cross-functionally at the numbers and meaning that everybody had to do what they said, any deviations had to be noticed immediately.

I think in the past, we have not operated at that site, but this was a requirement for where we were. And then I think the sales and marketing side and the supply chain, the operating side of the business did great. And Mike, you deserve a ton of credit for that.

### **Mike Lukemire**

No. And I think our retail partners working with us. We all want to be ready. We are spending earlier. We want to get out of the gate fast. We have to get the store sets done. We want the inventory in there. We do not want to be chasing inventory and I think we are ahead of that right now. So and so then we want the consumer takeaway.

### **Jim Hagedorn**

Yeah. Bill, that's another thing, which is that, the retailers -- everybody cares about sort of the spring season. Everybody wants -- has a weird concern about, you got to just read the papers, I think, feels like it's kind of easing up a little bit I think.

But I think if you talk to the merchant partners and you probably do, I think, everybody wants the season to happen. And so people are not backing away from lawn and garden, they are very much focusing on lawn and garden and that benefit accrues to us.

### **Mike Lukemire**

Right. Absolutely.

### **Bill Chappell**

Thanks. And then kind of specifically on Bonnie, I mean, I know it's the gateway you talked about in terms of bringing consumers in. But I think that business has underperformed your plan two of the past three years that you have owned it or had majority of ownership of it...

### **Jim Hagedorn**

Well, that was...

### **Bill Chappell**

... or is it just something different that's going on this year?

**Mike Lukemire**

I would say, urban vegetable actually performed well. We expanded into some flower and that was -- did not go as well, which the whole market was down and our execution wasn't there. So we are really focused on getting out, early indications are, I mean, you are going to see us much more integrated with our field sales in the Northeast. But it's about execution and not getting out and throwing a bunch of plants away. So I am expecting a good year from Bonnie very focused.

**Jim Hagedorn**

But, Mike, I mean, fair enough. But -- if you look at the last couple of years, have you been disappointed?

**Mike Lukemire**

I have been disappointed so especially in our expansion opportunities. So, I miss there. Too many varieties, not very good execution on some of our expansion opportunities.

**Jim Hagedorn**

And by the way, part of that is our fault. I mean, we have got a lot of say in what happens there. We pushed them into a lot of stuff. And this doesn't mean against their -- what they wanted to do. But I think that this is a huge volume business and we have learned a lot and change in that business has been, I think, harder. But I think the team is on it and I think Mike and the group down at -- our partners at AFC and the guys at Bonnie and women are pretty organized and they know...

**Mike Lukemire**

Yeah.

**Jim Hagedorn**

... they have to achieve this year.

**Mike Lukemire**

Yeah.

**Jim Hagedorn**

We try to change a lot at Bonnie and it was a little too much. So but I love that business and it is a gateway for us. I mean it still has that 6% to 8% growth, which is beyond the U.S. consumer and with the tie-in and the execution together is a path for our future growth. So not giving up on it.

### **Mike Lukemire**

Yeah.

### **Jim Hagedorn**

We are pulling back. We just want to execute it better is what I would say.

### **Bill Chappell**

Yeah. And then one last one on Hawthorne [Technical Difficulty] New York a couple of times, I mean, can you just help me understand if you are going to invest further into that and why that -- you say it could be the second biggest market in consumption. Some would say it already is the second biggest market in consumption, it's just illicit. And so how does that actually benefit you if they still don't get supplied by Oklahoma and Michigan and California, and how does that actually change and become an opportunity over the next four years or five years? Thanks.

### **Jim Hagedorn**

Wow, that's -- you save the biggest one for last, I think. I'd start by if people are going to be selling out of their trunks or their cars or in bodegas and the state is not going to do anything to enforce. That's a big problem and it's a big problem in Canada.

And you -- to take a business that is the size of the beer industry and have people making the stuff in their backyard and selling in other chunks of cars. It's not how the market should roll out. And there's plenty of history, Colorado is a good example of the market being rolled out in a sort of much more thoughtful way.

So I think you say it is a big market and we believe that, starting with the governor and the legislature that they will be rational in allowing the people who spent the money or have gotten permits from the social justice side that they can actually make money.

I don't think that there's any like short- or mid-term requirement for capital in that business. I think that business is properly capitalized. And had -- and maybe one of the few permits in New York that is sitting on in excess of \$100 million in cash. So this business is capitalized and giving up on it, just I don't know really what it accomplishes.



We don't own shares in RIV. We are a creditor to RIV. And we believe that, that marketplace is right. I also want to talk to our sort of partners that are investors in RIV that we don't view this as just a loan.

We view this as this market matures and we have got very simple sort of rules internally on this conversion. I don't know if we have actually talked about it outside, which is that the ability to normalize relationships with banks, meaning the plant-touching businesses can bank and U.S. exchanges, NASDAQ or NYSE allow companies to list that touch plants. These are really our conversion sort of parameters. It doesn't assume on legalization federally it assumes kind of that we can bank and have a relationship with the public exchange and I don't think that's that crazy.

But I think what that tells people is, we act like we are equity holders, but we are not, we are sort of creditors to that business, the only creditor and the most senior creditor. But the business is capitalized. It is a monster market. We are not chasing multiple states down here. We basically say we won a big state.

We kind of focused early on, and I think, you guys knew this. New Jersey or New York, one of the big states in New York, we landed that license. It would be very easy to say you overpaid for it. I think we probably would not our head to that.

But that's where we are. The business is capitalized and we are going to see this through and we think, ultimately, it's worth doing. But we are not required to put more money up and we are not chasing it to the extent where we don't think.

It's actually -- they are actually moving ahead like we want. If the state of New York would actually come out with their rules and listening to people and try to give the -- not just us but the other MSOs who have invested billions of dollars in their footprints in New York, some advantage here for the amount of money that's been invested, that would be helpful, but it's frustrating, but it's worth doing.

And I think every time we say to ourselves and plus we are in. So it's like there's no here for us to go. They are not in default. They have got the money to see this through and we are going to hang in there and be with them. Actually, Chris, anything you want to add on this?

**Chris Hagedorn**

Sure. Yeah. I think you said most of it. But look, RIV, which -- and it's a business that I pay a great deal of attention to and I am on the Board of that company. RIV has one of, if not the strongest and most unique balance sheets in the cannabis industry. As Jim touched on, they don't need further investment, at least not for some time.

And New York, yeah, look, it's right now, I think, anyone who walks down the street in Manhattan and steps into a corner bodegas sees that there's a thriving illicit market there. That is not something we expect to persist over the course of many years.

When the legal market there becomes the standard, which it will, we believe resonate are positioned to be really just to be -- not -- I wouldn't say dominant in the state, but to take more than their fair share of the market, just because of the resources they have at their disposal.

So it's something we remain really enthusiastic about as the last year had a discouraging moments, of course, it has and anyone who's been involved in the cannabis industry, I think, knows that has experienced it. But the commitment on our side certainly on my side remains pretty firm and I think the upside that we have seen, it's pushed out a little bit, but the end thesis is still in place.

### **Bill Chappell**

Great. Thank you.

### **Operator**

Thank you. Our next question comes from Gaurav Jain with Barclays. Your line is open.

### **Gaurav Jain**

Hi. Good morning. I have a few questions. So one is on the leverage of the company and the bonds, so they are trading at \$0.85 to the dollar, so you can literally retire like \$1.2 billion of debt with this \$1 billion of free cash flow you will generate in the next two years and accelerate the deleverage and I understand you have restricted payment restrictions because of higher leverage. But is that an option you can look at and I think that you can buy about \$25 million per quarter when it comes to this bond sort of buying it in the open market. So are those options you are looking at?

### **Matt Garth**

Yeah. I think we have a number of opportunities to use the free cash flow that we are going to generate to deleverage. You just named one of them and the practice of going through and determining what our highest cost debt is and what the opportunities are is what we go through. So as free cash flow is generated, we will direct it to the highest interest rates, pay that down.

I will tell you that we do have a very nice maturity profile. We have a very good structure in place for how our debt is laid out and the rates that we have on our bonds are very advantageous. So the prioritization would more than likely be taking care of the Term Loan A, getting the revolver back down and then looking at the bonds for potential opportunities to buy them.

### **Gaurav Jain**

Sure. And then, let's say, over the next two years, you generated this billion free cash flow EBITDA has improved, because raw material prices have come off and leverage is closer to 4x and then what happens, like, will the excess free cash flow then start getting back invested again in cannabis ventures, because you still believe in the long-term thesis, are you...

### **Matt Garth**

Well, that has -- thank you for the trap. No. I think what we have tried to convey to all of you in this conversation is a disciplined approach towards growth. Whereby we are measuring every dollar and determining the potential payback and the returns that we expect to generate.

As it comes to Hawthorne, RIV, those types of investments that we have made and the conversation that we just had with you, you heard Jim say non-cash. The cannabis industry, the companies that are involved in there are at very, very low valuations. There are opportunities non-cash to consolidate and provide a basis for value creation moving forward.

The free cash flow prioritization that we talk about, and that you are pointing to is, one, ensure that we are investing in the organic growth and capability of the company, those high return, short payback opportunities we have inside the company, doing that, making sure that we do that. That's \$100 million of CapEx. However, we could probably spend \$125 million to \$150 million and continue to position this company for growth and free cash flow generation in those investments.

Moving back down to 4x leverage gives you the opportunity to start looking at the window for the balanced approach between continued debt pay down, M&A and shareholder return activity. Remember, the history of this company in that 3 to 4 range is to pursue shareholder friendly acquisi -- activities through share repurchases, one-time dividends, those types of things and that gives you the flexibility under 4 to begin to do those things again.

So a lot on the table as we generate free cash flow, deleveraging over the next two years with the \$1 billion that we are going to generate, that's priority one and then we will take a look as we move below 4 at the more balanced approach.

### **Gaurav Jain**

Sure. And one last question and I apologize if this has been answered already, but U.S. consumer pricing very strong. What is like the private label share right now? What are the price gaps? Is there anything that worries you, if you could just comment on that?

### **Mike Lukemire**

Well, we are not concerned about the price gaps right now. We are not seeing share change on private label versus, in fact, we are picking up share, people -- consumers tend to prefer branded. So that is not necessarily a concern.

### **Jim Hagedorn**

But let me just throw in my too sense on this. I do think that the price gap between private label and national brand mostly us, did get larger than it was as. Remember, the contracts that the retailers had with us re-price once a year and I think that allowed, they were getting, I mean, I think we were losing money on a bunch of those private label deals.

I think you will see a correction that we took pretty significant pricing as much as we possibly could and these are double-digit pricing that occurred. But we did not see share loss to private label last year in spite of that increased gap. I think you will see that gap probably come down. But I think it's worth looking at and we will continue to talk to you guys about that as we look at sort of our pricing versus private label. But I think low concern at this point and probably correcting from last year.

### **Mike Lukemire**

Yeah. We were seeing it. Correct. So that's in the right direction. So, but we do run price elasticity studies and all that with our retail partners to be sure that. I mean I am more worried about -- I am always more worried about category growth than I am share at this point.

**Gaurav Jain**

Sure. Thank you so much.

**Mike Lukemire**

Welcome.

**Operator**

Thank you. Our next question comes from Carla Casella with JPMorgan. Your line is open.

**Carla Casella**

Hi. Somewhat on the -- a little bit of the same lines with the getting to your 4 times leverage target by year-end with a slight decline in EBITDA implies a big debt pay down. Can you just talk about what you are expecting from working capital if you still see \$400 million inventory release for the year and/or the timing of that?

**Matt Garth**

Sure. And just to make sure that's correct. We said \$1 billion of free cash flow generated over two years beginning last, I think, Q3 and then we also said under 4 times by the end of 2024, so not by the end of this fiscal year.

When you are talking through and taking a look at the working capital perspective, the inventory that we are looking to take out is \$400 million. That will take place as we move through the year, obviously, we are in a bit of a filled position right now. We have talked about the fact that retailer positions are down 5% to 7% versus last year and that our production is down year-over-year. So we will be releasing that inventory that we have in place.

That \$400 million in inventory release is going to help generate a working capital benefit this year north of \$200 million, right, because we are going to grow some sales, we are going to have some AP that's going to come through and we are going to pay, and so the net of all that on working capital is just north of \$200 million.

That leaves the cash from operations, excluding working capital, less CapEx to generate the balance of our free cash flow this year and next year. And so as you look at it that way, you are kind of looking at north of \$300 million in sort of nonworking capital related free cash flow plus the working capital release.

**Carla Casella**

Okay. Great. And then if I could just ask a follow-on. You said you have strong liquidity with over \$800 million available. Can you just talk about what your drawings were on the ABL versus the AR facility and if that \$800 million availability was the two facilities combined?

**Matt Garth**

No. The \$800 million is sitting on our revolver. The ABL and the AR facility, you are -- we didn't change really over the -- from last quarter that much. So I think they are kind of in the \$400 million range.

**Jim Hagedorn**

For the season.

**Matt Garth**

Yeah. For the season.

**Carla Casella**

Okay. Great. Thank you so much.

**Operator**

Thank you. Our next question comes from William Reuter with Bank of America. Your line is open.

**William Reuter**

Good morning.

**Jim Hagedorn**

Hey.

**William Reuter**

In terms of your -- I am trying to think about elasticity, you said you guys have done some studies and worked with your retail partners and I know that this varies by product. But is there any way for us to think about how much higher your prices are this year versus last year?

**Jim Hagedorn**

Yeah. I -- what I would say is, we took pricing, I don't know, August, I think?

**Matt Garth**

Right.

**Jim Hagedorn**

Which I think probably averaged 8 or something like that. I don't know what it was.

**Matt Garth**

Yeah.

**Jim Hagedorn**

So I think that's probably what you will see is that pricing will show up. Now remember, we have got Real Mondo promotion early season. So I think you will probably see lower retail margins in the early season, particularly on lawns as we promote very heavily with the retailers. But I think, generally, what you would see is a 5% to 10% increase in retail compared to a year ago something like that. That's what I would -- you have.

**William Reuter**

Okay.

**Matt Garth**

I don't have the exact number on that.

**Jim Hagedorn**

Yeah. But I think it's -- remember, we sell the retailers set their pricing.

**Matt Garth**

Yeah.

## **Jim Hagedorn**

But they are going to pass through some of that pricing or all of it. So I think 5% to 10% higher than last year is what you should expect to see.

## **Matt Garth**

Yeah. I mean I am sitting across from Joanna Mefford, who's the CFO.

## **Jim Hagedorn**

Oh! There you go. You got it.

## **Matt Garth**

And the way that she has characterized it previously is from a price elasticity perspective, part of the reason that we are pointing to POS flat in all categories, except for essentially seed and fert being up 10% is because of that price elasticity, right? So raising prices and some of that is offset -- coming in lower volumes. So, net-net, that's what's driving the POS that way.

## **William Reuter**

Great. And then just one follow-up, in some of the prepared commentary, you discussed that there is risk this year. You then immediately talked about consumer engagement. You have locked in prices on 70% of your products. Are there other major risks that I didn't mention there that you guys were thinking about for this year?

## **Jim Hagedorn**

No. I would say there's -- the big question always is the consumer and maybe throw weather in that, because I think that's probably the biggest single factor with the consumer. But I think based on the economy, sort of the health of the consumer, that -- the work we have done on the first half is the work that we all know about.

We build work with our retailers. We ship it in, load the shelves, merchandize it. At the end of the day, it's going to come down to the consumer showing up, and that of course, is the risk that I think everybody in the consumer business is looking at.

Again, I think we have a pretty conservative sales number of flat to kind of the world's crappiest year, get back half of what we lost last year in lawns. Again, we think that was mostly weather. And then, I would say, Hawthorne, just starting to make numbers is -- I would think those are the two risks and we are covering a lot of that risk.



When we say we can do better than \$185 million. It's -- we have got room to cover if we have to. I think on the positive side, which people are starting to feel a little bit positive, particularly on the consumer side is, how much of that money can they reinvest back into the consumer activation. Remember, it's already up, but I think Patti's expectation on the brand side is that, if they overachieve early season that there's more money to continue to push activation.

So I think the big risk is the consumer showing up in Hawthorne. Springboard savings are ahead of plan, and they will continue to be ahead of plan. And that gives us room to sort of cover and I think that answers the question, I think.

### **William Reuter**

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

### **Jim Hagedorn**

Thank you.

### **Operator**

Thank you. That's all we have -- the time we have for questions. Thank you for participating in today's conference. This does conclude the program and you may now disconnect. Everyone have a great day.

### **Jim Hagedorn**

Thank you all.

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