The Scotts Miracle-Gro Company
NYSE: SMG

FQ1 2021 Earnings Call Transcripts

Wednesday, February 03, 2021 2:00 PM GMT

S&P Global Market Intelligence Estimates

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Currency: USD
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- EPS NORMALIZED -

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EXECUTIVES

Christopher J. Hagedorn
GM & Senior VP

Cory T. Miller
Senior VP & Interim CFO

Ivan C. Smith
Executive VP, General Counsel, Corporate Secretary & Chief Compliance Officer

James D. King
Chief Communications Officer & Executive VP

James S. Hagedorn
CEO & Chairman of the Board

Michael C. Lukemire
President & COO

ANALYSTS

Alexander Rocco Maroccia
Joh. Berenberg, Gossler & Co. KG, Research Division

Eric Bosshard
Cleveland Research Company

Jon Robert Andersen
William Blair & Company L.L.C., Research Division

Joseph Nicholas Altobello
Raymond James & Associates, Inc., Research Division

William Bates Chappell
Truist Securities, Inc., Research Division

William Michael Reuter
BofA Merrill Lynch, Research Division
Presentation

Operator

Good day and welcome to The Scotts Miracle-Gro Company’s First Quarter 2021 Earnings Conference Call. Today’s conference is being recorded. At this time, I would like to turn the conference over to Jim King, please go ahead.

James D. King
Chief Communications Officer & Executive VP

Good morning, everyone, and welcome to The Scotts Miracle-Gro first quarter conference call. We're taking a slightly different approach this morning as we're managing this call remotely for the first time. In a moment, you'll hear prepared remarks from our Chairman and Chief Executive Officer, Jim Hagedorn; as well as our Interim Chief Financial Officer, Cory Miller. At the conclusion of those remarks, we'll go live to take your questions. Jim and Cory will participate in the Q&A session, as will our President and Chief Operator, Mike Lukemire; and Hawthorne Division President, Chris Hagedorn. [Operator Instructions]

I've already scheduled time with many of you after this call to fill in the gaps. Anyone else who wants to set up some Q&A time can call me directly at (937) 578-5622, and we'll work to set up some time as quickly as we can.

A couple of IR housekeeping items before we begin. We will be participating in a virtual fireside chat at the Truist Securities Consumer Symposium on February 23. The following week, we will participate in the Raymond James 42nd Annual Institutional Investors Conference. And then later this spring, most likely in early April, we intend to host our own virtual Analyst Day event that will feature recorded presentations from several members of our management team as well as a live Q&A session. The majority of those presentations will likely focus on our Hawthorne segment in order to give you a better understanding of our current business and our future plans. With that, let's move on with today's call.

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

I also want to remind everyone that today's call is being recorded. An archived version of the call will be made available on our website as well a transcript of the call.

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

James S. Hagedorn
CEO & Chairman of the Board

Thanks, Jim, and good morning, everyone. Three things are clear when looking at the results we announced this morning: first, the business continues to benefit from America’s renewed love of gardening that resulted in millions of new customers entering our category last spring; second, that the team is doing an excellent job of execution; and third and most importantly, we've taken the right steps over the years to put ourselves in a position to take advantage of the moment that's in front of us now.

To post a profit in both the fourth quarter of 2020 and the first quarter of ’21, quarters in which we have historically posted a loss, is something none of us would have predicted in the past. I've done enough of these calls to know that some of you are already looking to ask about comps we'll face next year. Please don’t. That's not on the radar screen right now. Instead, we remain laser-focused on driving as hard as we can in ’21. That attack plan mentality is working. Entering February, both major business segments remain ahead of our best case scenarios. In our U.S. Consumer business, sales increased 147%, and consumer purchases at our largest retail partners were up 40% in the first quarter and up 35% entering February. So consumers remain engaged.
But shipments are significantly outpacing POS right now as retailers build inventory ahead of the season. As you'll hear later from Cory, we are also building more inventory. If there is upside to our year, we don't want to find ourselves where we were last year and leave sales on the table. But if the upside doesn't materialize, we're confident in our ability to manage inventory levels at year-end. Even if we do end up with a little more inventory, I'm okay with that, too.

It's not just on the cost of goods side where we're making investments. We're increasing our marketing investment with a simple yet aggressive goal in mind: to retain the millions of consumers who entered or reentered the lawn and garden category last season. We'll do that with focused and hyper-targeted social media campaigns and complement those efforts with traditional media, including our first ever Super Bowl spot. I'll delve more deeply into all of this again in a few moments.

At Hawthorne, Q1 sales increased 71%, and it was another period of strong growth across the entire product portfolio. And we're already confident enough to increase our full year sales guidance for Hawthorne. The strong growth we continue to see is even more encouraging as we make progress on other long-term initiatives, too. We've always viewed this business through a long-term lens that is focused on establishing ourselves as a true industry leader by driving value for our customers, the cultivators. I'll elaborate on this point later in my remarks and also address some of the other industry dynamics I know are on the minds of many of you.

Cory will provide a detailed explanation of the numbers in a few minutes. First, though, I want to remind everyone that the first quarter is typically a small part of the year. We know we have a lot of work still ahead of us this season, and we are heads down right now and focusing on execution.

This morning, I want to give you an update on the steps we've taken since our last call to drive the business, not just in '21, but in the long run. Before I do, I want to share just a few thoughts on some of the organizational changes we've made recently.

I welcome Cory to this call, and I'm confident in telling all of you he's an extremely qualified and capable member of this team. As the finance lead at Hawthorne since its inception, he probably knows the nuances of that business better than anyone and has been a true hands-on partner for Chris and the entire operating team. I'm sure you'll all soon discover that Cory will add a lot of value to these calls. While he's serving as interim CFO, he will also be a candidate in the search process, which we will conduct over the next several quarters. The rest of the moves we announced last month, with the exception of Randy Coleman's departure, were all part of a long-standing talent management and succession planning effort.

One of the most important aspects of a CEO's job and one that too seldom gets discussed with Wall Street is around human capital management. We've delivered outstanding results over the last several years because our business has been operating with a higher level of effectiveness. And we've been operating with an unprecedented level of intensity over the last 12 months, in particular. Clearly, the company we're managing today is different than 5 years ago. And 5 years from now, it likely will be different again.

One of the things that's become clear in the COVID environment is that there will be a permanent change in how all of us work, one that requires a different level of flexibility and collaboration than in the past. That requires us to put a team in place that maximizes our likelihood for continued success, and it also means making tough choices at times.

Over the past few months, we've done both. Beginning in November, we made a series of organizational changes that ultimately resulted in the departure of 3 senior members of the team. It also resulted in more than a dozen people being moved into new or expanded roles. They are all part of a diverse group of roughly 25 leaders who we had previously identified as the brightest and most talented people in the company. Our goal is to expand our capabilities and give them a better understanding of the breadth of the organization. We're supplementing their real-life work experiences with a data-driven assessment process that allows them to further leverage their strengths and shore up their weaknesses.

In addition to the changes we announced on January 11, Chris Hagedorn was promoted last week to Executive Vice President of Scotts Miracle-Gro and Division President of Hawthorne. Dan Paradiso was...
named Senior Vice President and Chief Operating Officer of Hawthorne. Chris and Dan have been working closely together as partners for the past 2 years.

Hawthorne was established as an operating segment in fiscal 2017 and had revenue of $287 million that year, double the year before because of acquisitions. Our guidance for 2021 would suggest Hawthorne revenue this year of at least $1.2 billion, and we haven't done an acquisition since 2018. The business has become more complex, and the industry is clearly at an important inflection point with an incredibly bright future.

Chris has demonstrated the vision and leadership skills we believe are needed to take Hawthorne to the next level. Having Dan at his side as his operating partner will give Chris more freedom to refine our strategy for Hawthorne while also ensuring we meet the near-term needs of the business and our customers.

Every single person who has taken on a new or expanded role in recent months will be part of the group leading this company in the future. These moves are purposeful. They are power plays and are all about creating the next generation of executive leadership.

So let's turn the conversation back to running the business and an update on our activity. Let's start with U.S. Consumer. We told you on our last call that we were striving to overdeliver on the guidance we provided for the full year. We're increasingly optimistic we can accomplish that goal, and our team has been working hard to do so. They remain confident in our ability to retain the millions of consumers who joined the lawn and garden category last season as well as invite another new group to that movement.

This Sunday, during the second quarter of the Super Bowl, you'll see our first ever TV commercial, especially created for this event. It will feature a series of A-list celebrities and athletes who all enjoy their backyards and the outdoors and will help us communicate a simple message: keep growing.

Our CMO, Josh Peoples, told you last quarter we were evolving to have a year-round conversation with consumers. And we didn't simply want to talk about our brands, we wanted to focus on the activity of gardening. We've been engaging with consumers throughout the winter, spending 3x more in media last quarter than we have ever at this point in the year. Keeping those consumers engaged and motivated is the goal of the Super Bowl initiative, which is part of an 8-week kickoff to the biggest lawn and garden season ever.

As you know, the reality of COVID has certainly created a tailwind for our business. While we believe some level of remote work will be permanent, including for Scotts, a lot of people will eventually go back to their offices, back to their kids' soccer games and once again, head off in summer vacations. But that doesn't mean they'll have to give up their garden or their lawn. We're working hard to make sure they don't. We view the broad reach of the Super Bowl as a good investment, especially given the other PR and marketing activation that comes with it.

And the timing is right, too. Consumers are getting restless this time of year. They want to get back outside. They want to do yard work again. The ability to talk to most of the country at one time makes sense and is a strong complement to the hyper focus of our digital outreach efforts.

On that front, we continue to invest behind our analytical capabilities to drive effective and more targeted messages to specific demographic groups. The delivery of those messages will be more precisely timed to coincide with seasonal growing patterns, retailer promotional efforts or more simply, the weather outside. We will coordinate our outreach with many of our retail partners, making sure our efforts complement theirs and also leverage promotional activity we expect throughout the season.

As it relates to our retail partners, we can't say enough about their engagement. They're leaning into a greater degree than we've ever seen, and that's true in all channels. They see lawn and garden as one of their most attractive categories in '21. That means greater support for our brands, which is why a significant portion of the 147% sales growth in the first quarter was related to improving retail inventory levels.
The pace of shipments remained strong through the first month of Q2. We remain confident that we'll be well ahead of our full year guidance at the midway point of the year. And as I said earlier, we're increasingly optimistic about the ability for the U.S. Consumer segment to grow again in '21.

I'll remind everyone that the tough comps don't arrive until May and June, and about half of U.S. Consumer POS has historically occurred from May through our fiscal year-end in September. As a result, we're going to take a conservative approach before reassessing our current guidance.

One more item before I switch gears. We closed on the Bonnie Plants deal at the end of the calendar year and now have a 50% equity stake in that business. This is a big deal for us and speaks to a level of commitment to a category of lawn and garden that we see is critical to our future success.

Live goods is what draws consumers into the broader lawn and garden space. It has broad demographic appeal and an emotional component that is different from the other products we sell. Bonnie is the best in the world at what it does, edible live goods. And Mike Sutterer, who leads that business, used to be one of the leaders at Scotts Miracle-Gro. He's done a great job at Bonnie, and I'm convinced the JV between our 2 companies will drive a lot of value for both.

While Bonnie is an on-ramp, especially in the area of edible gardening, there are other areas of live goods that we find just as attractive and like the idea of having a larger and more strategic presence in the overall live goods space. Among other things, live goods allow us to better leverage the native brands we're building like Knock! Knock!, Lunarly and Greendigs, which also builds more momentum for our direct-to-consumer efforts. We're willing to accept the fact that the economics of live goods are not as strong as our traditional products, but they are getting better.

But that's not the point. As we look to our future, it's a strategic imperative to own the relationship with consumers. To do that, those consumers must view us as a gardening company, not just a gardening products company. Live goods is key to that goal.

Okay. Let's switch gears and focus on Hawthorne for a few minutes. This is the fourth consecutive quarter in which Hawthorne reported sales growth of at least 60%. While the rate of growth will likely slow in the months ahead, we're still planning to see growth through September. That's why we're confident enough to raise our sales guidance just 4 months into the fiscal year.

The growth we're seeing is coming from across the country, with established growers and new ones. It's occurring in more developed markets like California and Colorado as well as newer authorized markets like Michigan and Oklahoma. It's coming in all product categories as well. Lighting, however, continues to be the biggest driver of growth in North America, up 126% in the quarter.

Many of you have asked how we're different than some of the other players in our space that have been successful in going public. I'll tip my hat to all of them. They are solid operators with nice businesses. But our business is different from theirs, significantly. Yes, we distribute products just like others, but we don't view ourselves as a distributor because we don't operate like one. Instead, we operate as a partner to the cultivators who use our products. We know our success requires their trust in the technical solutions that we provide. And we realize that doesn't simply mean buying a light or a nutrient mix at the cheapest price. They need to operate efficiently to have the best quality and plant yields possible and to continue improving their own operations.

Because of this, we embrace our responsibility to innovate. That's why in Q1, we opened the world's first R&D facility in Canada that's focused exclusively on growing cannabis. That's why we also expanded our R&D efforts in Ohio and Oregon related to the hemp market, which we see as a proxy for the cannabis plant. It's why we're working on new nutrient formulations, better controlled products and better cultural practices. And it's why we're also leveraging our world-class talent in plant genetics to develop better plants. A distributor just doesn't do that.

Our leadership role also requires us to manage and improve the marketplace and our freedom to operate in it. That's why we're investing more than anyone else to influence the political discussions around this industry and why our corporate foundation is supporting social justice issues related to cannabis reform.
I'm proud to say I believe we've earned a reputation as one of the smartest, most comprehensive and most strategic companies to have navigated this space. And we're far from done.

We've never viewed Hawthorne as a quick way to run up our stock price. Instead, we view this as a strategic opportunity to drive long-term shareholder value. To that end, we've had an ongoing discussion for years amongst ourselves and with our Board about whether our current corporate structure is appropriate given the potential value of Hawthorne. Right now, we're comfortable that it is. And while nothing is off the table in terms of considering our future options, we're not inclined to make a change unless we see a financial advantage or a business advantage that results in more optionality to grow our business.

I'm also not going to sit here and hypothesize on whether the current market valuations for Hawthorne are appropriate. The market will answer that question. But I will tell you this. 6 years after we've entered this industry, we are just now hitting our stride. We've become stronger, smarter and more strategic, and we have plenty of financial flexibility to invest in the future.

What does that mean? It could mean a lot of things. Clearly, we like our portfolio right now, but we're actively looking at adjacent categories to further strengthen it. We also may look to acquire capabilities we don't currently have that improve our knowledge base or skill sets in areas, for example, like plant genetics.

While it's pretty easy to see this industry has tremendous upside, it's difficult to predict the pace of that change. Our banks have been tremendous partners, and we appreciate their support as we've been pioneering in this space. That partnership will remain important as we explore a wider array of options to explore where and how to put money to work. Our continued free cash flow, coupled with our borrowing capacity, gives us the ability to pursue M&A in both Hawthorne and the U.S. Consumer business while also maintaining the flexibility to return more cash to shareholders. We also have the ability to invest in areas like marketing, R&D and supply chain to take advantage of the opportunities right in front of us while also better positioning our businesses for the future. And we have the benefit of our deep bench of talent being nurtured as our future leaders.

Those of you who know me also know that I don't obsess about our near-term results, but I truly feel bullish about where we stand right now. I'm highly confident in our guidance and our near-term outlook, but I feel even better about what the future holds. A big part of my optimism is due to my partnership with Mike Lukemire who continues to excel at running the business every day. His leadership on the operational side of the business has allowed me to focus more time on strategy and issues like capital structure and talent management. Mostly though, it allows me to focus more time on the significant opportunities that we see in front of us to drive shareholder value.

With that, I want to turn the call over to Cory to discuss the financials.

Cory T. Miller
Senior VP & Interim CFO

Thanks, Jim, and hello, everyone. I appreciate Jim's kind words. It's a privilege for me to talk with all of you today, and I'd like to start by taking a moment to introduce myself. While I've been the finance lead at Hawthorne from the early days of that business, I've been at Scotts Miracle-Gro for over 20 years in various finance roles. Most of that time has been spent supporting the U.S. Consumer business. However, I also worked in our external reporting group and as the Head of Internal Audit. Although I've not had a public-facing role, I have a comprehensive understanding of the financials and a deep knowledge of the business. I've worked alongside previous CFOs, including Randy, to help them understand the details of the business and to prepare for their interactions with all of you. I want to take a moment to acknowledge Randy myself and to thank him for his support and mentorship. My goal here today is to pick up where he left off, adding color and context to the results we announced today in discussing our outlook for the balance of the fiscal year. So let's jump in.

Jim said on our last call that this year could be difficult to predict at times. He also said we'd keep you apprised of any changes to our outlook and adjust our guidance as needed. It only took 1 quarter for
that prediction to prove true. The headline for the first quarter is that sales growth was significantly higher than we expected in our U.S. Consumer business. That was due in part to the timing of preseason inventory builds by our retailers. That volume also meant our gross margin rate in the quarter was unusually strong.

Those benefits were tempered a bit for 2 reasons. First, we started to see the impact of emerging input costs. Second, we decided to further increase our marketing investment. We expect both of those trends to continue. I'll come back to these topics later, but I want to start by going straight to our bottom line.

In Q1, we reported adjusted net income of $22.2 million or $0.39 per share. This compares to a loss in the same quarter last year of $62.4 million or $1.12 per share. This is the first time we've reported a profit in the first quarter. The quarter was driven by the 147% sales growth we reported in the U.S. Consumer segment. We had expected sales growth to be in line with or slightly ahead of the 90% growth we reported in Q4.

POS growth remained strong in the first quarter, up 40% versus last year. We saw consumer support of all of our brands, Scotts, Miracle-Gro, Ortho and Tomcat as well as Roundup. What we underestimated in Q1 was the magnitude of preseason inventory build by our retailers. Throughout the quarter, but especially in December, retailers aggressively stepped up their ordering. While a positive indicator of retailer commitment, we are assuming, for now, this represents a shift in the timing of sales between quarters rather than a full year increase in sales.

One other item to note is that the fiscal calendar shifted this year. As a result, there are 5 more days in the first quarter and 6 fewer days in Q4. The impact of that shift was about $24 million in the U.S. Consumer segment in Q1.

At Hawthorne, the 71% sales growth was led by a 77% increase in our North American business. We saw a triple-digit growth in markets like Oklahoma and Michigan, which were up 178% and 133%, respectively. Sales increased 80% in California. Hawthorne also benefited from an additional 5 days in the quarter, which impacted the top line by $17 million.

North American sales of our own brands like Gavita, General Hydroponics, Botanicare and Can-Filter, which we call signature brands, were up 97%. Sales of distributed brands grew by 47%.

Signature brands are expected to approach 70% of total Hawthorne sales this year. This percentage is significantly higher than our closest competitors, who primarily sell third-party products. Our improving mix is due in part to our continued strength in lighting, which is driven by a firm commitment to R&D. Mix also remains aided by SKU rationalization that became easier to execute with insights gained by launching SAP last year.

From a product category perspective, North American hydroponic lighting grew 126%. Growing environment products were up 83%. Nutrients increased 53%, and growing media was up 40%.

Favorable product mix in Hawthorne helped contribute to a 340 basis point improvement in gross margin rate for the segment in the quarter. However, fixed cost leverage was the primary driver of rate improvement for both Hawthorne and the U.S. Consumer segment. In fact, it led to a nearly 1,200 basis point improvement on a company-wide view to 26.7%.

While the gross margin rate is off to a great start, the Q1 result is not representative of what we expect for the full year. The fixed cost leverage is due primarily to warehousing costs. The doubling of sales volume in the quarter meant warehousing was a significantly lower percentage of overall costs in the first quarter than normal. This benefit will reverse in subsequent quarters.

Let's move on to SG&A, which was up 31% in the quarter. The single biggest increase was related to the timing of marketing spend. However, we are planning to increase our marketing investment for the full year to a higher level than what we communicated back in November. Still though, we continue to expect SG&A to decline in aggregate for the full year.
Segment profit at Hawthorne is a frequent area of questions, so let me address it proactively. As you saw in the press release, segment margin in the first quarter, which is based on EBITDA, was 13% or nearly double a year ago. This is an area where I was particularly focused while working inside Hawthorne, and I’m pleased that we’re making real and lasting improvement here.

Jim and our Board have been appropriately patient in allowing Hawthorne to get to the right level of profitability over time. If we force this issue tomorrow, I’m confident there’s at least another 200 to 300 basis points of segment profit available to us. However, we continue to make smart investments in sales, supply chain, marketing, R&D, public affairs and in simply building a deeper and better bench of talent.

Jim’s comment a few minutes ago about taking a long-term approach to driving value in Hawthorne is right on point. We’re building a moat around the business and behaving like a true industry leader. I’m convinced the business can gain further market share and also take advantage of emerging markets on the East Coast.

Before I wrap up comments on the quarter, I have a couple of housekeeping items worth pointing out. First, you may notice share count is 1.3 million higher than a year ago. This is due to using diluted shares in the current quarter because we reported a profit. We used the lower basic share number in the prior year, which is required when reporting a loss.

And finally, Jim mentioned that we recently closed on the Bonnie transaction and now have a 50% equity stake in the business. At that level of ownership, Bonnie results will not be consolidated into our financials. However, the income we earn from the business will run through the P&L differently than in the past.

Our previous stake was based on a financing arrangement, and our earnings from the business were derived from commission, royalties and interest. These showed up on 3 different lines of our P&L. Commission affected the sales line, royalties were recorded as other income, and interest was recorded as other nonoperating income. Beginning in Q2, everything will run through the earnings from equity line on the P&L. The actual year-over-year impact on the ’21 adjusted EPS is likely in the range of $0.12 to $0.15. In Q4 of last year, consistent with prior years, we recorded a noncash fair value adjustment related to the annual revaluation of our option to buy a portion of Bonnie. That was a benefit to our 2020 P&L of $12 million and will not repeat in this fiscal year.

The Bonnie discussion is actually a good transition for an update on our full year guidance. So let me provide you an update on where we stand. We remain committed to the fiscal year ’21 adjusted non-GAAP EPS of $8 to $8.40 per share. To be clear, the Bonnie transaction was not in our previous guidance. In addition, based on our strong start and current outlook for Hawthorne, we are increasing our guidance for sales growth in that business to a range of 20% to 30%. This compares to our previous range of 15% to 20%. The likely increase in commodity cost, however, coupled with previous unplanned increases in SG&A, is expected to mostly offset these benefits. We now expect SG&A to decline 3% to 8% from last year’s level. Previously, we said SG&A would decline 6% to 11%.

The company-wide adjusted gross margin rate, which we initially said would decline about 50 basis points in fiscal ’21, is now expected to decline 125 to 175 basis points compared to ’20. We expect the gross margin rate pressure to become apparent in the second quarter.

Since our Q4 call, we have increased our internal forecast to further build our own inventory. While about 3/4 of our total commodity costs are locked entering February, we’re behind our normal monthly pace on urea and resin due to this higher inventory forecast. In addition, we’re seeing cost pressures from those 2 commodities, in particular, and also see some emerging cost pressures related to distribution. These cost pressures will likely decrease the gross margin rate in our U.S. Consumer business, which we previously expected to be flat.

We still expect Hawthorne gross margin to be in line with our original guidance for the year. However, the higher sales growth in the Hawthorne segment puts even more negative pressure on the company-wide gross margin rate. We would expect both segments to see strong sales growth in the second quarter, but below our Q1 growth rates. U.S. Consumer sales will likely increase upwards of 20% during that period. Hawthorne sales will likely grow at twice that rate.
Before we take your questions, I want to say I share Jim's optimism about our full year outlook. We are well ahead of where we expected to be 4 months into the year. And we expect to be well ahead of our full year guidance when we report Q2 earnings in May.

Given last year’s record second half, we know we have our work cut out for us in the months ahead. Still, the momentum in Hawthorne continues to drive that business to new levels. And we're also taking all of the right steps in the U.S. Consumer business with the peak of the lawn and garden season fast approaching. Thank you for your time this morning.

Let me turn things back over to our operator so we can open the line up for your questions.
Question and Answer

Operator

[Operator Instructions] And we will take our first question from Bill Chappell with Truist Securities.

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

So just help me understand a little bit more on the gross margin, the kind of bridge and how it works. I think I’m right in saying, typically, you're locking in with 75%, 85% of your commodities by September, October, then going to pricing agreements with the various retail customers in November. And then so you're pretty well set, good visibility as you go into the next year. But it sounds like, I guess, there was a decision made to step up the amount of inventory to capture, which I totally understand, to capture what could be another big season and to hold on to those customers. And so as a result, you're not covered for that excess inventory you built and at the same time, the inventory and then the commodity costs went up. And so that's -- and you said had already priced. So that's where we are. Is that the right way to think about it? I just want to make sure I understand the dynamics.

James S. Hagedorn  
*CEO & Chairman of the Board*

Cory, Mike, you guys want to take that one?

Cory T. Miller  
*Senior VP & Interim CFO*

Yes. This is Cory. I think you got parts of that, that are on. If you look at where we're at today with our commodity costs, we are about 75% locked for the year. But we are looking at building inventory over the second half of our year to get in a position to better fulfill the needs of the customers. So as we are looking to build our own inventory, our forecast went up, which will require more urea and resin in just internal distribution costs than we [indiscernible] we've built the forecast. Those are the areas where we're seeing some pressure.

So as we have an outlook from this period of time going forward, we're making sure that we have a conservative approach on pricing in those areas for those inputs and feel like we've captured what we think the gross margin rate will be in the go-forward plan.

Michael C. Lukemire  
*President & COO*

Okay. So think about it -- go ahead, Bill. Sorry.

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

No, Mike, please. Please go ahead.

Michael C. Lukemire  
*President & COO*

Think about it as if we're flat, we pretty much have business as usual. We're building that it could be higher. And so those costs could come into play. So -- and so we're building ahead, and we're expecting a -- I'm an optimist. So I got optimism. I want to be ready. And so if the sales aren't there, then I think we're more than usually covered. But if the sales are there, then there is cost pressures at a higher rate.

William Bates Chappell  
*Truist Securities, Inc., Research Division*
Got you. But just to kind of finish the thought that -- but at the same point, we're in February. So while you have the excess inventory and/or excess costs on the forecast, you're not baking in upside to sales at this point because we haven't really kicked off the season. Is that fair?

Michael C. Lukemire
President & COO

That's fair. That's -- so okay. But those pressures are out there as sales would increase. So...

James S. Hagedorn
CEO & Chairman of the Board

Bill, Hagedorn here. What I would throw out there is that we've talked about this plenty of times, that we sort of run with kind of 3 set numbers. One is the numbers we tell you guys. One is the numbers that we build our incentive plan off of with the Board. And one is, call it, Mike's internal operating plan, which would be the highest of them. Mike is operating somewhere toward his own plan. And I agree with it, and you would too if you were completely familiar with it.

Mike's bigger concern, honestly, based on how we feel about this year, is that we can't make enough product for this year. So I think that -- try to back into it from that sort of way of looking at it and I think you'll be -- it'd be easier to understand what we're talking about.

William Bates Chappell
Truist Securities, Inc., Research Division

Okay. That's great. I think I understand. And then just one follow-up for Cory or Chris, if he's on. There's a lot of noise about legislation on cannabis. I think I'm right in saying that the most impactful would be kind of on the commerce side and banking laws changing. So can you maybe give us an -- your thoughts of if we do see something over the next 2, 3 months, when would you start to see any benefits? Or would you see benefits from that this year?

James S. Hagedorn
CEO & Chairman of the Board

All right. I'll start with that one, and then Chris can pick it up. While I'm sort of sad when I look at people talking about taxation and stuff, I think the Democrats in both the House and the Senate are much more open-minded. The Banking Committee -- we've talked a lot about sort of banking and taxation as being sort of ridiculous, kind of [ quertrons ] in the commerce of marijuana in states where it's legal. And so the Banking Committee is now chaired by our own [ Sheriff Brown ] from Ohio. And we've spent a lot of time talking to sort of both delegations to the Senate, but lately on the Democratic side. And I think we're pretty comfortable over time that you're going to start to see normalization.

And we talked a lot, as we prep for the call, what do you think about sort of the environment? And I think, as usual, the politicians are last to the party, that when it goes to the people, the people decided, New Jersey was like 2/3 of the voters were in favor.

So we do think things are getting more positive. It is hard to predict sort of the glacial pace of politicians for whatever reason they have, but it would be a gigantic benefit to this industry if they were taxed and -- as a normal company and could bank like normal businesses and have access to credit, et cetera.

The question of when sort of state laws change until we start to see benefit, it's a question I know Chris spends a lot of time sort of talking about.

Christopher J. Hagedorn
GM & Senior VP

Bill, Chris here. Yes, so as Jim said, it is something we think a lot about and we pay close attention to, looking at states that have changed their legislation and then doing postmortem on when our business starts to see some impact. Typically, it's about 12 to 18 months from laws passing to the regulations being put in place and then us ultimately seeing an uptick in our business as cultivators start to build out.
that's the time line we typically operate on. So again, if you say the laws change in November, you just -- you will run that out 1 year or 1.5 years.

As far as the taxation and banking laws that Jim talked about, look, obviously, those were huge benefits. And it's something that we -- that we're lucky enough we've got some scale and some influence to actually get in the room to talk to legislators and real change makers. It's an outrage, frankly, that the cultivators who choose to follow the rules are penalized by a crippling tax rate the way that they are under 280E. It's something that we're going to push hard to see change.

As Jim said, predicting the movements of the federal government, I think anybody right now would say it's a pretty unpredictable landscape. It's easier at the state level, but obviously, that's not where we need to see quite as much change. So we'll continue to do what we can, but it is a difficult thing to predict.

James S. Hagedorn  
CEO & Chairman of the Board

Well, just 2 things I'd add. Number one is I think the benefit of where we've invested is we don't have any decisions ourselves. This is really -- we're talking for our customers here. The -- on the selfish side, we would be investing probably differently in this space if the laws were different. And so we're very optimistic and hopeful that the government gets around to making this a priority in dealing with it for all kinds of reasons.

Operator

And we'll take our next question from William Reuter with Bank of America.

William Michael Reuter  
BofA Merrill Lynch, Research Division

A first question is I didn't notice any free cash flow guidance. Prudent to say that is has been $325 million for the year. Is that the same? Or will input cost inflation and inventory build that's going to be a little more aggressive reduce that number?

James S. Hagedorn  
CEO & Chairman of the Board

Cory, why don't you take that one?

Cory T. Miller  
Senior VP & Interim CFO

Yes. The free cash flow guidance of $325 million is what -- is currently out there today. We're going to confirm that guidance going forward. And as we look at the consumer takeaway of products, as we look at what we ship into different customers and the inventory required to hit those service levels, we'll continue to weigh the inventory levels that we have against any pressure that we might see on that cash flow number. But if we get into a situation where we're building that inventory, sales are probably in really good spot as well. So we'll be weighing those things against each other. And we'll talk more on guidance as we roll into the May call.

William Michael Reuter  
BofA Merrill Lynch, Research Division

And then on Jim's comments around M&A, you mentioned plant genetics. Previously in the last call, you said that any M&A would probably not be that large or wouldn't increase leverage substantially. Are there some targets there or other targets that may have changed that outlook and that M&A could be, I guess, larger in scale than you previously expected?

James S. Hagedorn  
CEO & Chairman of the Board
Look, I -- so Jim Hagedorn here. Good question and fair enough. We went through a process a couple of weeks ago, just sort of saying there's a lot going on here, what's our kind of our own capital situation and what are we looking at for leverage, et cetera. And based on everything we know and where we think the business is going to come in, even if we say we have a fairly robust pipe of M&A opportunities at the moment on both the Hawthorne side and on the Consumer side, plus shareholder friendliness, call it, roughly what we did last year, we came in kind of right where we expected to and wanted to be and what, I think, we previously told you guys, which is below 3.5x on leverage. That's based on what we think the business is doing right now.

So I think we're in a real good place from an opportunity point of view. We're already in Q2. And I think we're going to look to time anything that would be meaningful into sort of the second half of the year so we have a lot more visibility, just like the question you asked earlier, which is how is free cash flow looking. So I think we're not looking to get too far over our skis, but I think we have a pretty robust pipe on both sides of the business. And even the ability to be approximately where we were last year on kind of, call it, shareholder friendliness, probably mostly looking at a special dividend. So -- but that's not final yet. That's what we're in discussions with amongst ourselves and with the Finance Committee of the Board. But I think we're probably leaning more toward excess money going into a special dividend than share repurchases at this point but that -- again, not [ yet ] decided.

So I think when it came down to it, we're not looking to overpay. We feel very comfortable where the business is and that there's upside and that we've got money to do anything we want and that we have a really good eyesight, I think, to things that we think were exciting and would be good for this business for the future.

Operator

We'll take our next question from Joe Altobello with Raymond James.

Joseph Nicholas Altobello
Raymond James & Associates, Inc., Research Division

I want to go back to the SG&A guidance for a second. And I guess the increases from your previous guide or lower -- decrease, I should say. Is that all marketing? I guess number one. And number two, if it is, can you help us understand how your thinking has evolved in the past 3 months? Is it simply that you see a greater opportunity this year and want to capitalize on it as much as you can? Or did that come through conversations with your retail partners? Or both?

James S. Hagedorn
CEO & Chairman of the Board

Mike, why don't you just talk to how you view the sort of opportunity landscape for '21, the relationship with the big retailers. And then we -- I think it's best -- then we can now talk -- we can talk to Cory just about how he's -- about just SG&A in general. But I do think that it's a very exciting time to sort of be at Scotts and it's -- I don't think we've ever had sort of better or more optimism amongst all of our partners for the [indiscernible]. So Mike?

Michael C. Lukemire
President & COO

Yes. This landscape has totally changed. So you really can't think about it like we traditionally said, the big 3, blah, blah, blah promotional. The activity -- and we ran a bunch of commercials seasonal. It is a dynamic of a continual conversation with the consumers. And what we're doing is we're constantly talking to them, engaging with them. We're seeing that lift that they want to garden, they want to take care of their home that we're communicating. So the marketing that we used to do would probably be 500 pieces, and we're doing millions. It's a daily conversation. We're making investments. We're engaging with them. We're tying it back with the retailers. We're changing the way we're promoting. There's promotional activity, but it's more targeted. It's more specific. We build it across all channels. And we're all about the convenience and keeping them engaged in the business and really helping them with their health and wellness at the home.
So when we look at it, we said there's an opportunity every day to engage with them and talk to them about whether it's in your house or outside, and that is following all the way through in our thought process. So the engagement on the spend is dynamic to the consumer interaction, and we're going to continue to build that. I don't see that like as a onetime event. I see it as a continuous improvement to capture the growth.

**Joseph Nicholas Altobello**  
*Raymond James & Associates, Inc., Research Division*

And where do you see your...

**Michael C. Lukemire**  
*President & COO*

You want to add to that, Jim?

**James S. Hagedorn**  
*CEO & Chairman of the Board*

What's our share of voice?

**Joseph Nicholas Altobello**  
*Raymond James & Associates, Inc., Research Division*

It's always been enormous. I'm curious, it sounds like it's going up.

**James S. Hagedorn**  
*CEO & Chairman of the Board*

Well, it's definitely going up. Well, we -- look, we learned a lot last year. I would say we were 100% of the share of voice last year. It was only toward the end, sort of when it became safe. And that -- I'm not calling anybody out on that. But I'm saying when nobody knew what was happening, when nobody understood essentiality, we got behind our own business, and I think we were probably 100% of the entire industry voice for many months during that sort of high of the season last year.

The -- this year, I assume there'll be some other people messing around in the space. The thing is we are not messing around. And the retailers -- the relationship that we have with our retailers today is so much more healthy. And it wasn't bad before. It was just we didn't know any better. Today, the marketers on Scotts side and the retail side are super engaged, working together on a daily basis, just doing what Mike talked about.

Store ops -- it used to be that like [craftery] folks would have a relationship with the merchants. Mike and I would do the sort of top-to-top stuff, and that was pretty much it. Now the marketeers are involved. And as important to that is store ops. It turns out that I think we all thought store ops people were just a pain in the neck. And I don't know, part of it is the fact that they get what we're doing in lawn and garden, and they see how important it is to their stores. But it turns out, when you bring the store ops people in with merchants, with the marketeers, with the top-to-top discussions that Mike and I have kind of always had, it is a much healthier environment where everybody is relying on each other to drive the business.

And it's pretty exciting, and that's also driving not just work that we're doing for lawn and garden, but work that pretty much every one of the retailers, both directly and online, use of social media, everything is up. I think probably the one thing that's down, other than the Super Bowl thing, is probably broadcast and cable television, I think, as people are starting to get more and more intelligent about our sort of online spend.

But it is 100% different. But for sure, we are -- Mike is operating on a very aggressive point of view. And I think it's the right thing to do. If you look at our sales forecast, the original sales forecast, I think, for consumer was like 0 to negative 5. We just don't accept that, okay? So retailers didn't accept that. So the question then is what are you going to do to make sure that's different.
And when I talk about my relationship with Mike and the operating community, this is what is really good for me, I think, good for the shareholders, but for me anyway, is that Mike is one of these guys who sweep smartly. We have a conversation about like what are we going to do to drive the consumers and keep the ones we have and if we can, drive the business harder.

Remember, our view is -- I mean, it's a slightly different number than you've heard before, but I think it's thoughtful and refined. As we think between Hawthorne and Scotts, all of the consumer side, that we probably lost nearly $300 million in sales last year that we couldn't ship. And so there were no retailers effectively really promoting other than some of the hardware chains, and we give them a ton of credit for that work and their bravery in the face of what was an unknown. But people weren't promoting last year. We didn't have the product we needed. So that -- when I say to Mike we want to keep those customers and grow the business if we can, which is completely different than the -- what we threw out to you guys of 0 to minus 5, that's what we talk about, that Mike's operating plan is quite different and very aggressive and not so committed that we can't correct if we don't see everything coming together.

And right now, if I were you all taking anything out of this call, it's having sort of first quarter POS of plus 40, I think it was, and through the end of the month, like plus 35 or some bulls***, something like that. What do I think? It gives us a lot of faith that the consumer is not going in a different way than our plan is at the moment. So you do see a lot of inventory build but you're also seeing, particularly -- and I'm talking currently where the weather is good, Florida, Southern California, et cetera, very excellent POS sales growth. And so it's a pretty exciting time. It's a good question.

Cory, I don't know if you want to put it all together in the numeric form, what's happening with SG&A for the year.

Cory T. Miller
Senior VP & Interim CFO

Yes. Thanks, Jim. Looking at SG&A changes that we have, the vast majority of the increase is going to be in media and marketing. We do have some additional dollars that we're looking to invest in real-time analytics to help us improve on our media marketing efforts as well as some improvements in our supply chain and our sales team. So if you look at the increases that we called out, the majority is within media market.

Operator

We'll take our next question from Eric Bosshard with Cleveland Research.

Eric Bosshard
Cleveland Research Company

Maybe just a little bit of clarity. What I hear you doing is taking kind of 100 basis points out of gross margin versus the old guidance and adding $25 million to SG&A and doing nothing with the sales guide. And so it's almost like you're giving us the worst case on the margin and nothing on the sales line. And so I guess my -- it's an observation. I guess my question is, like what you're outlining on the margin line kind of only happens if the sales line ends up being better. Or is there a greater cost of doing business?

James S. Hagedorn
CEO & Chairman of the Board

Good. That is a very complicated question. I'll try to be as honest as I can. When we put the -- just remember where we were when we set guidance for '21. Nobody knew where we're going to be with COVID. We never had a bigger difference, at least since I've been here, between kind of our internal numbers and the guidance we set for The Street. And we felt that, that was necessary given everything we did not know, okay? And by the way, it still produced an excellent number on the earnings side. So that's kind of how we justified it to ourselves.

If you look at the Hawthorne business, as an example, they just keep blowing through the numbers. And so we basically had no choice but to sort of come off the Hawthorne top line number for the year just
because it was going to become impossible to defend, okay? We're close to that on Consumer. We just didn't quite bridge it. We spent a lot of time internally talking about it.

And so part of what you're seeing, Eric, is the conflict that was sort of always there but not that obvious. It's going to become more and more obvious as we go through. But remember why we did it. We did it because we didn't know so much, and we didn't want to underdeliver when we could basically promise or at least guide to what we thought was a superior result without much growth. And we thought -- and again, so that gap was huge. We couldn't sustain that conversation, I think, logically on Hawthorne, but I don't think we've raised the earnings number for it. I think we just said watch out on sales gross margin or something. I think that was just -- but it's more trying to maintain kind of where we are and keep people so that -- I don't want to lose this war because you're one of the best guys out there, dude, if not the best, and -- when it comes to understanding the business. So I recognize the challenge here.

So like I said, we were close on a Consumer number, we're saying. So I think that if you read carefully the script, what you'll see is that we're increasingly optimistic, kind of we blow through the top end of that range. I think that's roughly the words that are out there. And we just don't really want to change our cash flow numbers and our EPS numbers yet until we have a little more visibility.

So your question gets right in the middle of that to say I kind of can't help you on that because -- but I recognize the challenge of it. And to some extent, that's what you get paid for, is to kind of listen to our nonsense and see what you make of it. But I think you're right, if that helps.

**Eric Bosshard**
*Cleveland Research Company*

Okay. Okay. Second, a bit unrelated. In terms of promotions last year, the retailers backed way off. The sales were good. What is the current plan or expectation in terms of their engagement promotion this year? Does that matter for your profitability? And what do you think that means for the influence that has on volumes in Consumer in '21?

**James S. Hagedorn**
*CEO & Chairman of the Board*

I think it's gigantic. So it is not an exaggeration to say if we make Mike's numbers, our numbers will look a lot better on sort of what you guys care about. So that, I think, is kind of a truism.

So if you move to that and say, "Where are the retailers? Are they leaning into this?" It's insane. Retailers are not just buying the inventory because they want it. They want to sell it. And all of them are planning to move that stuff off the shelf, and so are we.

The part of the problem that is -- it's not a problem. We -- Eric, we talked about this -- we've talked about this for years. I couldn't really get the retailers there, this commitment to Black Friday events. But we've talked about this on our calls, which is that if you look at Black Friday events, they're extremely costly. They tend to be early in the season, and we tended not to get the weather we wanted so that we did them, they were not that effective. They really messed up margins. Mostly, I think for -- they were costly for us, but they were also very costly to the retailers from their margin point of view. I think there's a much more sophisticated view of promotion today than there was then. And a lot of it comes out of what everybody learned in COVID. But I think there is a very robust and sophisticated marketing plan that goes behind all of the retailers. And I have never seen a more unified group of people who recognize that lawn and garden is an extremely important category to lead the year off on.

And I also think that, look, your reports are always one of those things that include a lot of views of the retail-merchant relationship, what's on the shelf. My understanding is that there is -- it's challenging to get a lot of the offshore-sourced patio stuff. And so -- no, I think our space has also improved because our product is available. And so I don't know, Mike, anything you disagree with that I said there?

**Michael C. Lukemire**
*President & COO*
No. And I think they're a lot more sophisticated on targeting and the amount of people in the stores. And -- but they're going to promote, Eric, which is going to be different or is going to be more effective. And they learned a lot this year. So -- and I think it will be better for both.

Operator

We will take our next question from Jon Andersen with William Blair.

Jon Robert Andersen
William Blair & Company L.L.C., Research Division

I wanted to ask about the newer consumers or households you've acquired since the start of COVID. How much do you know or what have you learned about these new or kind of reentry consumers and their commitment to the category? And I'm asking just to try and get out what gives you the confidence or the degree of confidence you have in keeping them post COVID.

James S. Hagedorn
CEO & Chairman of the Board

I'm going to say a good question. Mike, you're going to take this once I get done kind of spinning it a little bit. If you look at our numbers over the past few years, and we're spending a lot of time internally as a management team and with our Board talking about sort of the basic assumptions that are in our incentive plans, et cetera, and kind of what they were designed about. But when -- we're in last year of that multiyear long-term incentive plan, and it's going very well, if you're a participant. And -- but if you look at the assumptions, we looked at the Consumer business as being kind of a 0% to 2% business. And we looked at live goods and hydroponics as being sort of 2 to 3x that. So if we could diversify into some faster-growing categories like live goods and like Hawthorne, we thought that was good.

What we've seen -- and this is before COVID, so this is in a couple of years leading up to COVID, is that everyone thought that young people are going to stay in sort of metropolitan areas, and that they were going to live in apartments and condos, they didn't want a yard. And it was crazy near, I think, was the first one who told me, those metrics are bulls***. Nobody knows more about sort of homes, I think, than we do, Jim, at Depot. And we started like looking at those numbers, and we said, we see like a lot of -- and then we started hiring demographers to look at that, and we saw it in our own numbers, is that 0% to 2% became kind of 3% to 4% or 3% to 5%. And so this is prior to COVID, okay?

And so I think we started seeing a turn like what [ then you were ] saying even before COVID. What is clear in COVID is that people value the home experience, they value a yard, the ability to be with their families, everything that kind of we're about more so. And then if you look at the demographics of whether it's AeroGarden, I don't know -- Chris, AeroGarden sales for this last period?

Christopher J. Hagedorn
GM & Senior VP

[ So far ] for the year, they're up over 100%.

James S. Hagedorn
CEO & Chairman of the Board

So AeroGarden, indoor growing, younger people, plus 100%. If you look at the sort of indoor, just in general, it's higher. If you look at herbs and veggies, younger, pretty significant commitment. So -- no, what do I think? I think we're actually being attractive to them. There is the question, which gets back to this whole thing with Eric of saying, can we retain these customers? That is the challenge that we're going through for.

I don't think what you would find -- I don't think what you'd find is less commitment to the space. We've got survey data that says the vast majority of people who participated in this year not only intend to do it again, but would tend to do it even bigger. And that's true of my wife and I. Now we don't fit in that young people category. But I know -- I think we're typical actually, which is we want -- we've never really done our own garden before. It's just kind of pathetic to say. We've always had people do it for us. Up here,
we've done it ourselves. And we learned what worked and what didn't work, and we want a better garden. It was a very important thing for us. We would come back -- if we were -- went somewhere for a day, the first thing we'd say is, "How does the garden look?" It was like it was one of our kids or something. A lot of people felt that way.

And so Mike, you want to talk about sort of what we're doing to maintain and how important sort of the younger gardeners are to us?

**Michael C. Lukemire**
*President & COO*

Well, we're talking to them every day, just even from the [ how ] the media. We've got so much analytics. Jim and I are sitting here, we're getting talk from all the marketers on how we're engaging when we have -- we're just talking differently to the consumer. It's not the traditional gardener from how you look at it. And I think from that is -- it -- we are -- they're talking to is about convenience. We've stepped up our D2C activity, the convenience of getting in. They want to know more. Food is a big thing, food supply and safety, and that engagement area is curiosity in improving that whole home.

And we're getting that -- our data is so much better than we ever had in our conversations and was tied to the marketing effort. And then we're going to create products. We've created some digitally native brands that relate better and -- like Knock! Knock! and Lunarly, which are tied to their home and their improvement, and Greendigs, which is the whole -- now think about your home, a plant in your home and how it affects the cosmetics of your home and improving your design.

So we're so much more engaging and tuning in -- and our innovation is tied and our communication is tied to these people more so than ever. So -- and so -- and that's how we're trying to capture them and communicate with them. And I mean, I'm probably more optimistic, I'd go on and on. But we're getting feedback, and we're talking to them and relating to them, and it's happening.

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

Yes. It makes sense to me. The reason I asked is when you work in your yard, you build a garden, there's a certain level of commitment, and there's a certain level of benefit you derive from that, which would seem to have a longer tail on it than perhaps some other kind of product purchase or activity. So that's helpful.

The second question is on Hawthorne. You touched on this a little bit, but I'm wondering if you can talk about your signature brands. And it sounds like you're moving that part of the portfolio or expect to move it to 70% of the business. Where has that been historically? Where do you think that goes in the future?

And then on the margins in Hawthorne, 13% or so from a segment margin perspective this quarter. What kind of longer-term objective do you have for profitability in that part of the business? And is your commitment right now more towards, let's say, if I had to give you a question around sales growth through aggressive pricing versus profit expansion through more rational pricing, can you talk a little bit about how you weigh in those objectives. So again, mix with the signature brands, margin objectives and just kind of competitive positioning?

**James S. Hagedorn**
*CEO & Chairman of the Board*

Look, I'll start and hand it over to Chris. I think that we do distribute products. We have some very important partner companies that I want to assure we're not looking to shoot them in the head where we distribute.

I think where we view is our kind of key pillars. Our view is we can rationalize the line. And so some of those activities, we're going to own. And I -- but I don't think there's any surprise, and I think you can look at our business and see where that is.
In regard to kind of the advice I’m giving Mike and Chris, I’d call it a slightly more competitive environment out there than has been in the past. I think largely, there’s other smart people who are looking at sort of valuations out there and saying we should participate. So it’s -- no, I’m not afraid of that at all. This is not like we're, "Oh, poor us, it's competitive."

But I think that my bias towards them is -- I think I’m probably still biased a little bit this way, and I have a lot of salesmen in me, I think, is toward -- for growth. I don’t think it would be -- I don’t think making a choice that said -- because by the way, I am bothered like a son of a b**** on what’s happening to some of the commodities that I think are completely unjustified when it comes to pricing and that you’re hearing about kind of for the first time from us, but we’re kind of on it right now as well. This idea of sort of plastics, ocean freight, domestic freight, insurance, it’s a bunch of damn nonsense that people are taking the kind of pricing they’re taking on that stuff. I think it’s really bad for America. And I think it's really bad for America, but the folks that are now on [ UDC ] think that they should take tax rates up by 33% on companies like us. It's seriously, like, what the hell?

So I’m pretty much biased on sales growth with these guys. And when it comes to competing, I’m all for that. And I wouldn't make a choice right now to sort of take excessive amount of pricing. We’ve very much looked at the Hawthorne programs and simplified them. This infinitely fewer versions of our programs, they're very focused, especially when it comes to competition where -- we like that. Anyway, I don't want to take all your [ ship... ]

Christopher J. Hagedorn
GM & Senior VP

All right. So look, he already said most of the...

James S. Hagedorn
CEO & Chairman of the Board

Sorry, Chris.

Christopher J. Hagedorn
GM & Senior VP

No, it's cool. Our ratio of sort of owned, what we call signature brands, and business relative to what’s distributed, I think 70% is probably about where we want to be. It's probably about 20 points higher than where we have been historically.

Now one thing to bear in mind here is that Hawthorne, until the Sunlight Supply deal 3 years ago, we weren't a distributor at all. All we sold was our own products. So coming into Sunlight, what is now sort of our distribution kind of hub for Hawthorne, we’ve been transforming that business into the business that we want it to be, not the business that it was. And I’d say we're probably not done with it, but I think we're getting a lot closer than we have been.

And look, there are certain categories that, for whatever reason, whether it's just the type of business is outside of our wheelhouse, we don't -- we aren't going to manufacture it, whatever. There are certain products that our consumers are always going to want that we might not necessarily want to be in the business of making. And as Jim said, we've got some really key strategic vendor partners that we have no intention of moving on from, who partner with us in a really excellent way.

I also agree with Jim in terms of balancing sort of progression in terms of trying to take and maintain market share relative to profitability. I think we are still -- we've been at this for about 6 years at Hawthorne. I still think we are at the infancy of this industry and, I think, are biased towards being aggressive in maintaining or taking additional shares where we need to be.

I do think we can a little bit have our cake and eat it too here where -- as we continue -- as Jim said, we had over 20,000 unique promotional programs, and that was largely something that we inherited from all the business that we acquired and Sunlight, where all of them had unique deals with individual dealers, with individual retailers. And we’ve gone through a really comprehensive process over the past year and
really simplified it as Jim said. So we're still promoting, I think we're doing it much, much smarter, much more precisely.

And Jim alluded to the competition. Look, we talked about it in the scripted portion, there are people going public in this space, acquiring a lot of money and being very aggressive. And I think we need to take that competition seriously. We do. I think we use the breadth of our portfolio, all the products we offer, along with targeted promotion to make sure that we're defending our share. So my bias is going to be towards growth ahead of profitability. But again, I think we can deliver pretty good margin numbers while attacking the growth numbers as well.

Now Cory, do you want to talk about long-term kind of margin numbers for Hawthorne? Obviously, it's something you've worked on for years.

**Cory T. Miller**

*Senior VP & Interim CFO*

Sure. Thanks, Chris. Jon, I know that if you go back a couple of years, we've talked about trying to get to 15% from an earnings -- from a segment earnings percent. We're still trying to get it to that target. So we're balancing the March to 15% against spending against promotions and going out and capturing additional share of space. And we're going to continue doing that. We want to grow the category. We want to grow Hawthorne within the category. So we're going to continue focusing on that. But we never lose sight of the fact that we're trying to get back to that 15% segment.

And one thing just to add on to signature brand mix. If you look at signature brands and you look at the growth we've had, a lot of that growth is related to the innovation we've had in our products. A big piece of our signature brands is our lighting portfolio. We introduced an LED light a little over a year ago. And the growth of that LED light, along with the other lights that we have in the market, have really driven up the total lighting business that we have, taking the signature brand mix up with it. So we think that 70% is about right, though. And we're not looking to deviate from that number and drive that number either up or down.

**Jon Robert Andersen**

*William Blair & Company L.L.C., Research Division*

That's really, really helpful. I'm going to cheat and squeeze one more in, if I can. Just wanted to ask about Roundup. I think there were some decision points that maybe you were coming up to on Roundup with the relationship with Bayer. Any update there in terms of milestones or thoughts or plans on that business?

**James S. Hagedorn**

*CEO & Chairman of the Board*

Yes. So I'm looking through a video link in my lawyer. It is a good question. The answer is yes. We had an opportunity to leave the relationship, I don't know, probably about 3 weeks ago. We moved -- over the last, call it, 18 months every single Board meeting had a segment on, as we led up to that decision, what we're going to do. And with very sort of eyes wide open visibility at the Board level on that decision or at least the recommendation that the management made, which was to let that option expire, the -- I'm not going to say that anybody is perfect in this.

I can tell you one thing, we independently believe in the safety of the product. And that's because we've done our own work to look at that. I have a next EPA administrator on our Board who has also had an oversized voice as we've made decisions. So we -- we're very comfortable with the safety of the product. I'm generally supportive of Bayer's work to put this behind them. And I think they're -- they've made a lot of progress on that.

We look at the contribution that Roundup makes to our business versus the value of the option that we had, and we just believe that we were comfortable continuing. And so -- and the business continues to perform well in -- not only last year, but has continued to perform through the first quarter well. So the answer is yes, we did have an option. It was not that attractive to us, and we elected to continue.

So Ivan, anything you would add to that?
Ivan C. Smith  
*Executive VP, General Counsel, Corporate Secretary & Chief Compliance Officer*

No. I think that's well put. We've been in conversation with Bayer about this over the months, and we're comfortable with how they're handling their risk on it and continue to get good retail in our consumer engagement. And so for all those reasons that you listed, Jim, I think we've decided to move on from that.

**Operator**

We'll take our next question from Alex Maroccia with Berenberg.

**Alexander Rocco Maroccia**  
*Joh. Berenberg, Gossler & Co. KG, Research Division*

My first one's for Chris. Obviously, the recent news focus for Hawthorne has been the cannabis opportunity. However, can you give us a sense of the current vertical farming market and discuss any growth in your partners there?

**Christopher J. Hagedorn**  
*GM & Senior VP*

Yes. Vertical farming is something we keep an eye on. Obviously, it was one of the initial sort of guiding tenants for the nation of Hawthorne. Candidly, it's not something we've seen the degree of growth in that we hoped. I just think it's hard to grow food profitably in an arrangement like that, the way that it exists currently.

We're seeing more and more people put money into it. Elon Musk's brother, Kimbal Musk, has been investing aggressively in vertical farming. We've seen a lot of new people entering the space and attempting to make it work. We obviously encourage all of that.

A lot of the products that we've launched, while they are focused on our development and our marketing is focused on the cannabis sector, they are applicable for -- and are used in vertical farming operations. But right now, I don't think it's a very material part of our business. Again, we continue to market things there as sort of a secondary focus for us. But right now, I'd say it's in such a nascent stage, but it's not really something that's...

**Alexander Rocco Maroccia**  
*Joh. Berenberg, Gossler & Co. KG, Research Division*

Is it different in Europe?

**Christopher J. Hagedorn**  
*GM & Senior VP*

On our radar. Europe, it is different. You're seeing -- I'd say it's different in Europe less for vertical farming operations than it is just indoor production in general. That is really where our European business is kind of centered upon. And we're seeing good strong growth over there, particularly in our lighting business as we continue to see more and more greenhouses for food production built out. But here in the U.S., I think it's -- we're still at too early of a stage to really say.

**Alexander Rocco Maroccia**  
*Joh. Berenberg, Gossler & Co. KG, Research Division*

Okay. That's helpful. And then shifting gears a little bit. How will you be assessing the return on the Super Bowl commercial investment versus other marketing you've done in the past? I mean it's clearly the most watched broadcast annually, but I'm just trying to see how the audience overlap significantly differs from the normal targeted ad spend, a couple of people just walking into retailers and seeing products prominently displayed?

**James S. Hagedorn**  
*CEO & Chairman of the Board*
I guess I'll take this. I'm not the hugest expert on this. When I first started running kind of a business that I was responsible for, it was our English business. And this dates me a little bit, but there was really only 4 channels in the U.K.: 2 of them were BBC channels with no commercial TV; and 2 ITV channels, kind of one with normal programming and one kind of educational TV. So it really meant that there was really one prime channel. And there was a show at the time called Coronation Street, which like 40% or something like that of all U.K. televisions were tuned to, and is made for an extremely efficient buy.

The Super Bowl has those kinds of attributes. You have just a real high viewership. I think demographics are a lot of what we like actually. I think there are young people, a lot of guys. So for certain parts of our business, it's important.

So I think when you look at a sort of cost per $1,000, it -- and you look at sort of modern, I don't know what -- whether it's YouTube and Facebook and Instagram, and you look at the sort of the power -- TikTok, the power of those buys are pretty powerful when you look at sort of reach. I think the Super Bowl is like that. We typically tended to spend on sort of basketball a little bit later in March madness kind of stuff. We didn't really graduate to that -- the size of that.

What we're trying to do now, and with the retention of what we want for new consumers, existing consumers that we had last year that we viewed it as something worth doing. And what's interesting about it is that the activation that goes behind it is like 8 weeks long. It's got like a sweepstakes element to it. Each one in the talent sort of people that we have brought in, which are all really interesting, we can market towards each one of them, and each one of them has kind of different demographics. And I think it fits in well with what we're doing now.

I think people were flashing stuff at me, trying to get me to read, "Stop." Okay. So I think that it's a very interesting way for us to sort of attack our issue this year, which is retention of people who joined. And it fits in well with a lot of the social media work we're doing. And the marketing team, I think, is completely on game here with almost no rules from Mike and myself as far as how we attack these consumers, attack them, meaning we communicate and promote ourselves to them.

Mike, would you add anything to this?

**Michael C. Lukemire**  
*President & COO*

I think it's that definition of gardening is significant in that whole -- and we're hitting it really hard. And so -- and it allows us to cascade and reset with all these new consumers. And so -- and I think that's setting the tone for where we're going versus how we traditionally looked at it. So I'm optimistic it's going to be very effective because I got much higher numbers than what we're sharing. But -- and so...

**Alexander Rocco Maroccia**  
*Joh. Berenberg, Gossler & Co. KG, Research Division*

All right. That's very helpful.

**James S. Hagedorn**  
*CEO & Chairman of the Board*

Is that it? Do you want to clarify Roundup or not? Do we think...

**James D. King**  
*Chief Communications Officer & Executive VP*

Yes. Why don't you, Jim?

**James S. Hagedorn**  
*CEO & Chairman of the Board*

If it's not clear, and I just must be because we're getting feedback somehow. We have stayed in the relationship, and we have not exercised an option to leave the relationship with Bayer. So we are continuing our relationship with Bayer in regard to Roundup, just in case that was not clear.
James D. King  
*Chief Communications Officer & Executive VP*

All right. Catherine, I believe that is all the questions that we have in the queue today, so we appreciate everybody joining us. We'll be issuing press releases in the next couple of weeks regarding our participation in both the Truist and Raymond James events. And again, if people have follow-up questions and want to reach out to me directly today or anytime during the week, I'm at (937) 578-5622. Thanks, everybody, for joining us, and we'll talk to you again soon.

Operator  
That concludes today's presentation. Thank you for your participation. You may now disconnect.