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SMG.N - Q2 2026 Scotts Miracle-Gro Co Earnings Call

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OVERVIEW:

Company Summary

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PRESENTATION

Brad Chelton - *Scotts Miracle-Gro Co - Vice President, Treasury, Tax and Investor Relations*

Good morning. Welcome to Scotts Miracle-Gro's Second Quarter 2026 Earnings Webcast. I'm Brad Chelton, Head of Investor Relations. Speaking today are Chairman and CEO, Jim Hagedorn; President and Chief Operating Officer, Nate Baxter; and Chief Financial Officer and Chief Accounting Officer, Mark Scheiwer. Jim will provide a strategic overview, Nate will provide a business update, and Mark will follow with a review of our financial results.

In conjunction with our commentary today, please review our earnings release, 8-K filing and supplemental financial presentation slides which were published on our website at investor.scotts.com, prior to this webcast. During our review, we will make forward-looking statements and discuss certain non-GAAP financial measures. Please be aware that our actual results could differ materially from what we shared today. Please refer to our Form 10-K filed with the SEC for details of the full range of risk factors that could impact our results.

Following the webcast, Executive Vice President and Chief of Staff, Chris Hagedorn, will join Jim, Nate and Mark for an audio-only Q&A session. To listen to the Q&A, simply remain on this webcast. To participate, please join by the audio link shared in our press release. As always, today's session will be recorded. An archived version will be published on our website. For further discussion after the call, please e-mail or call me directly. With that, let's get started with Jim's update.

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

Good morning, everyone. Results count and ours speak for themselves. Through our first six months of the fiscal year, we continued on our growth trajectory and made progress toward every single one of our full year financial imperatives. This marks over two years of driving improved results and four years of hard choices, self-help and financial recovery.

More importantly, we delivered two major accomplishments that are the final pieces of our journey. They include closing the quarter with leverage at 3.71 times debt-to-EBITDA, the first time in four years that we're below 4 times and the divestiture of Hawthorne. We're at the point where everything we've been working toward is coming together.

Leverage is in a normal state where we're comfortable operating. Gross margin expansion is on track for our targets. Our mix strategy to focus on high-margin branded products is working. And free cash flow, EBITDA and EPS are all exceeding expectations. When you look at our total performance, here's where we find ourselves today.

We continue to hone our superpowers and invest in strengthening our brands, R&D, supply chain and sales. We have substantial growth opportunities and are taking market share. Our retail relationships are stronger than ever. Our consumer is healthy and engaged.

We have a proven and battle-tested leadership team. And we've lived up to all of our commitments.

The real question is where do we go from here? First, we're ready to embark on the first tranche of the multiyear share repurchase program we announced last quarter and said would begin once leverage was comfortably in the 3s. We're there. The ultimate goal is to buy back at least one-third of our outstanding shares.

It will be earnings accretive, won't add to our debt level and has zero implementation risk. That's why it's the only significant M&A we're interested in. I've asked Mark to move forward with the repurchases in a way that can be easily modulated based on our results and capital allocation needs while maintaining leverage in the 3s.

When you look at our accomplishments in total, it's clear we're one of the best consumer product franchises in America. It's just not showing up in our share price. And that's okay because it makes the timing of our share repurchase even more attractive. We don't think we're properly valued. And when you layer in our growth plans, were the type of investment that should appeal to anyone who wants to be part of a market leader with a lot of upside.

There's a second answer to the what's next question and that involves moving to the next stage of growth. The 2030 target of an incremental \$1 billion in top line sales, a gross margin rate approaching 40% and total EBITDA north of \$1 billion. And this is where Nate comes in.

He's created the building blocks to unlock this growth through a multiyear plan he calls SMG 2.0. Among the building blocks are channel and category expansion in conjunction with deep investments in our brands, innovation, marketing, advertising, and supply chain.

We think upwards of \$800 million of top line sales growth under SMG 2.0 will be generated through e-commerce alone. We, like our brick-and-mortar retail partners are shifting more resources to activation initiatives and marketing approaches to drive consumer takeaway into this channel.

I want to make it clear that legacy retailers will continue to play an important role as the incremental sales we are projecting will primarily come from POS through their online sites and our joint partnerships.

To maximize our potential in this area, our product assortment must change to reflect the type of SKUs that are more conducive to selling online while addressing consumer unique needs. This is where much of the innovation work will focus.

Nate is putting together a strong team that is future-oriented and can help us execute upon SMG 2.0. We're also expanding our capabilities with data and analytics for better insights and we're advancing the use of automation, technology and AI.

Nate is strengthening our marketing function and our approach to business development and product assortment. In line with this, I have executive level news to share. We're announcing the hiring of a Chief Brand Officer to serve as Nate's partner in leading the brands and marketing.

This is particularly important as we create new and more powerful consumer experiences. The person we've selected has agreed to start in June and we'll make a formal introduction in the coming weeks. The only reason I'm delaying the announcement is to allow our new Chief Brand Officer to work with his current organization on a transition plan.

Here's what I can tell you today. He's a significant talent who has served in a leadership role at a global New York agency known for its innovative work in digital marketing, social media and emerging trends. He's a real talent who 100% understands the changing nature of marketing and where we need to go. We know him and he knows us.

With his solid creative instinct and experience in brand, media and campaign strategies, he will jump-start our marketing mission, especially as we move further into the online space.

Another plus is he's passionate about Scotts Miracle-Gro and our category.

With Chris Hagedorn coming off Hawthorne, he'll be able to devote more time to our core business, filling a real need for us. His remit will be expansive as he takes responsibility for some of the big things that are critical to SMG 2.0 and our growth targets.

Chris will lead company strategy with focus on business development. He'll also work on product assortment to ensure we're giving consumers what they want and need in the online marketplace. Government relations, corporate communications and sustainability are within his purview as will be the strategic application of AI.

All this plays into the SMG 2.0 playbook. As we look to the rest of the year, we're reaffirming our guidance and will not let commodities steer us off course despite global supply pressures from the Iran war. Most of our commodities are locked where we are exposed to higher costs, we can cover them within our existing budget and plans.

Fiscal '27 is a bigger unknown. I can assure everyone we will control what we can control and take pricing in fiscal '27 if necessary. We will not sacrifice our gross margin goals. This point in time is the result of a righteous endeavor. We have worked our way out of four very tough years that were filled with hard work and many unpleasant choices.

There were suffering along the way. But the management team, our associates and Board did what needed to be done and it worked. SMG 2.0 marks a new starting point for us, another journey that will take our business well into the future.

Next up is Nate.

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

Welcome, everyone. I want to start by thanking our associates for their hard work this past quarter. We are executing this year's operating plan with discipline and focus. Our first half performance reflects the impact of this work and demonstrates we're on a clear path to the 2030 targets that Jim outlined.

I first want to provide clarity around SMG 2.0. It is grounded in two realities: the evolving consumer and the evolving retail environment. The face of our core consumer is changing as we move from baby boomers and Gen X to millennials and Gen Z.

At the same time, how all consumers shop is shifting. They're in more control than ever. They increasingly buy online, through retailers, social platforms and direct-to-consumer channels. They want organics, naturals, and products that fit their lifestyles. They take recommendations from influencers and they become influencers themselves.

Our retail partners are changing too, concentrating more on sell-through via their online sites. We are there with them. This is reflected in our double-digit e-com sales increase for multiple quarters. The marketplace is dynamic and there are more competitive pressures from digitally native startups with low barriers of entry to traditional CPG companies expanding their presence.

The good news is there is more than enough opportunity for us. We have an incredible advantage with our superpowers and market position.

Delivering on Jim's 2030 goals will require us to create a more rich lawn and garden experience for consumers. That's what SMG 2.0 is all about, transforming for future growth. Here are the building blocks. Innovation and SKU rationalization to optimize our portfolio, including moving with greater speed to bring new products to market, channel expansion, primarily e-commerce, but also in expanded retail partnerships and professional do-it-for-me space.

Category growth by bringing emerging consumers in more demographic groups into our world, connecting them through new approaches to marketing, including positioning Scotts Miracle-Gro as a lifestyle brand, operational efficiencies and savings to support margin expansion and ensure the best-in class supply chain.

Let me walk you through each of these, starting with innovation and SKU rationalization. We are realizing the benefits of a multiyear effort to optimize our portfolio through new products, including extensions into spaces where we have not played and the sunsetting of low-margin lines in favor of the higher-margin SKUs. The rationale is twofold.

One, it supports top line sales and margin growth; and two, it makes room for new products that appeal to emerging consumers and are better suited to selling and shipping online.

So far in fiscal '26, we've introduced 83 new product SKUs, accounting for \$41 million in revenue. These range from K-31 grass seed and Turf Builder liquid lawn food to Miracle-Gro Indoor plant food and small bag soils, and we have more innovation to come.

We are also moving with speed. We brought the Ortho Mosquito and flying insect traps to market within just six months. And Chris and his strategy team are targeting tuck-in M&A to help us fill other portfolio gaps quickly.

On the SKU rationalization front, we have line of sight to eliminate 30% of our lowest-performing SKUs by next fiscal year. This will be margin accretive, while reducing complexity and providing better choices for consumers. Turning to channel expansion. E-commerce is clearly the growth engine. In partnership with our retailers, we have a team dedicated to maximizing POS through digital marketing and product assortments optimized for online.

But brick-and-mortar is still important. We have product gaps here and are addressing them by strengthening partnerships with retailers across channels. Some of our new SKUs include bigger sizes suited to rural property owners with larger lots, for example.

We're also exploring channel diversification through the do-it-for-me with the recent launch of a pilot program for small- and medium-sized professional lawn and garden service providers. It's early days, but we're seeing sales traction with fertilizers, grass seed and controls for larger coverage areas.

The full season performance will gauge our future here. Our foray in the do-it-for-me reflects a start-up mentality we're instilling throughout the company. Move with speed, test the market, gather learnings and fail or succeed fast. This entrepreneurial spirit is part of the cultural shift we're making.

Turning to category growth. We are attacking this through marketing and consumer activation efforts to engage emerging consumers and drive frequency of product use. We have campaigns this spring, specifically for Hispanic consumers, a key demographic group for us. These coincide with more product listings in Hispanic-centric retail stores.

In Q2, we also launched an initiative with Bonnie Plants and Gardenuity to provide ready-made growing kits for people who are new to the category. These kits remove the barriers to gardening, simplify the process of growing and set new gardeners up for success. The goal is to convert them into lifelong gardeners.

On this note, our live goods venture with Bonnie Plants is performing really well this season. They have focused on improved sell-through and quality and the results are starting to show.

And finally, on operational effectiveness, we continue to invest in our business, mainly focusing on factory automation and technology implementation across the enterprise. We're pursuing a dual-track approach to AI transformation.

On one hand, we're investing in the foundational work, building a modern data lake and implementing SAP S/4HANA is our next-gen enterprise resource planning system, because organized accurate data is the bedrock of any successful AI deployment.

But we're not waiting for that foundation to be fully in place before we act. In parallel, we're reimagining core processes with an AI-first lens, embedding intelligence directly into how we operate. The data foundation and the AI transformation are advancing together each reinforcing the other.

AI is already playing a role in back office and data insights as well as consumer experiences. To date, we're working on about 40 use cases of AI ranging from consumer chat and voice agents to automated content generation, intelligent product search and productivity tools.

Beyond efficiency, AI is directly contributing to top line growth through optimized e-commerce performance and personalized consumer engagement while protecting the bottom line through cost avoidance in areas like data security and process automation.

As an example, we've developed three commercials in this past quarter using AI, saving about \$0.5 million in production costs. All our tech investments support our operational efficiency goals and have the potential to deliver significant savings.

When you combine them with our investments in automation and other efficiencies, we are striving to deliver supply chain and savings of at least 1% annually. That equates to around \$35 million in high-return cost savings each year contributing to gross margin improvement.

We've covered a lot of ground. If you take anything away from today, it's this. Jim has set the financial targets and SMG 2.0 is our road map to achieve them. We are making progress on its building blocks, while at the same time, remaining highly focused on our fiscal '26 plan. We have many great things happening across our company and its go time for our teams. Everyone is rising to the occasion.

Here's Mark with the financial details.

Mark Scheiwer - *Scotts Miracle-Gro Co - Chief Financial Officer, Executive Vice President, Chief Accounting Officer*

Thank you, and hello, everyone. Jim and Nate provided an excellent update on our growth strategies and consistent progress towards our financial targets. We have early season momentum, and we've delivered on strong performance, further galvanizing our confidence in the full-year outlook, supported by disciplined execution despite dynamic macro environment.

While we're halfway through fiscal '26, I'll remind everyone that the first six months represent approximately 25% of our full-year POS. The season is in front of us, and consumer sell-through remains the primary focus with increased investments in marketing, media and consumer activation now kicking into high gear. We're tracking to our targets for net sales growth, gross margin expansion and leverage reduction.

As Jim previously explained, in moving towards the execution of the multiyear share repurchase program, I will be the gatekeeper and we will be mindful of maintaining leverage comfortably in the 3s.

Looking at our results. You'll recall, we are excluding Hawthorne, having classified it as a discontinued operation last quarter and completing its divestiture in early April. In the second quarter, total company net sales increased 5% to \$1.46 billion. For the first six months, net sales increased 3% to \$1.81 billion, in line with our full year net sales guidance of low single digits in our US consumer business.

Our focus on higher-margin branded products is meeting expectations. Sales of branded products through the first half increased 8%, partially offset by expected declines in mulch and nonbranded product sales. We discussed in previous calls that we expected retailers to increase purchases as we drew closer to the POS consumer sales curve. This has played out in the second quarter.

The increase in shipments to retailers is attributable to three factors: one, strong, seasonal and retailer support of our branded products initiative, including year-over-year growth in branded soils and grass seed; two, an increase in early season fertilizer sales compared to the second quarter of fiscal '25.

Last year, through joint consumer activation efforts, reinforcing our multi bag purchases, our retail partners experienced strong demand and sell-through of our fertilizer products. This year, our customers are doubling down in anticipation of a stronger spring performance, and three, early replenishment orders related to higher-than-expected POS sell-through of controls products due to more favorable weather conditions in the West, one of our early season markets.

From a regional perspective, consumer takeaway was strongest in the West, where POS dollars were up nearly 15% from the previous year-to-date.

As a reminder, beginning in the last quarter, we expanded our POS data to include our 15 largest customers, including e-commerce and only for branded products, excluding mulch, private label and commodity items.

Taking a closer look at consumer engagement through the first six months, POS dollars were plus 4%, closely mirroring our total net sales growth. That was driven by fertilizers, plant food, Ortho and Roundup, coupled with consistent e-commerce growth.

E-commerce POS trends continue to demonstrate the effectiveness of our channel expansion. Year-to-date e-comm POS dollars were up 22% with growth in every category and customer. Gross margin continues to be a strong story.

Year-to-date, we delivered over 200 basis point improvement over prior year driven by favorable mix and sales of higher-margin branded products, along with supply chain savings from ongoing efficiencies. Pricing actions early in the year also contributed.

In the quarter, the GAAP and non-GAAP gross margin rate was 41.8%, a 280 basis point improvement and a 240 basis point improvement, respectively, over prior year. For the first six months, the GAAP gross margin rate was 38.5%, a 260 basis point improvement and the non GAAP adjusted gross margin rate was 38.6%, up 230 basis points from a year ago.

As it relates to potential headwinds from the Iran war, for our full fiscal year, most of our cost of goods sold are locked as we have purchased, produced and hedged a significant portion and are enacting contingency plans to minimize further impacts in the year.

Moving down the P&L. SG&A in the quarter increased 12% and to \$199.2 million compared with \$177.8 million in the prior year quarter. Year-to-date, SG&A is up 5% from \$291.3 million to \$305.1 million. The increase in SG&A was expected and reflects our increased media and marketing spend to drive consumer takeaway of our branded products. SG&A spend is on track to our full-year target of around 17% to 18% of sales.

Moving to non-GAAP adjusted EBITDA. For the quarter, it was \$437.4 million versus \$401.6 million a year ago. Year-to-date, it was \$440.2 million, a nearly \$38 million improvement over \$402.5 million in the corresponding period. Below the line, interest expense declined from lower debt balances and interest rates.

For the quarter, interest expense was \$31.3 million compared with \$36.6 million in fiscal '25. For the first six months, interest expense was \$58.5 million versus \$70.5 million in fiscal '25. We leverage at 3.71 times an improvement of 0.7 times versus a year ago was a result of higher EBITDA and continued deployment of free cash flow to debt reduction.

Year-to-date, free cash flow was favorable by more than \$100 million over prior year from higher net income from continuing operations and our focus on working capital management and disciplined inventory management.

Our current year plans and execution are driving improvement on the bottom line. For the quarter, GAAP net income from continuing operations was \$263.3 million or \$4.46 per share compared with \$220.7 million or \$3.78 per share a year ago. Adjusted non-GAAP net income from continuing operations in the quarter was \$267.8 million or \$4.53 per share versus \$233.7 million or \$4 per share last year.

For the first six months, GAAP net income from continuing operations was \$215.6 million or \$3.65 per share compared with \$154.7 million or \$2.64 per share a year ago. And adjusted non-GAAP net income from continuing operations was \$223.3 million or \$3.78 per share versus \$183.5 million or \$3.13 per share in prior year.

Looking ahead to fiscal '27, commodities are a primary focus. Given the volatility of the Iran war, it is too early to estimate with certainty what we might face next year. But we expect to manage any impacts while continuing to invest in our superpowers and advance our growth initiatives.

Jim talked about our confidence to cover material cost increases with pricing adjustments which would be consistent with how we've navigated the high inflationary period of fiscal '22 and '23 in the early stages of the war in Ukraine.

Nate and his team are also driving supply chain savings and working on sourcing contingencies to ensure we have optionality heading into fiscal '27. As always, we will develop hedging strategies to provide more cost certainty.

Overall, we are pleased with our performance as we enter the peak lawn and garden season. We are reaffirming our fiscal '26 guidance and have a high degree of optimism for the long-term financial goals.

In early June, we will provide a seasonal update at our William Blair Annual Growth Stock Conference in Chicago, and we will follow that up with a deeper dive into SMG 2.0 and our financial priorities at our Investor Day on August 4 at the New York Stock Exchange. Here's the operator.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Jon Andersen, William Blair.

Jon Andersen - William Blair Capital Partners - Analyst

Hey, good morning, everybody. Two quick questions for you. Could you talk a little bit about what you're seeing in terms of the kind of I guess, the restage on the lawns business and fertilizer, and how some of that -- I know you've done some work on the assortment and pricing structure and how that's performing. And then I know another part of your strategy is to really drive deeper into e-com and would love an update on that as well.

And maybe a last point is just, was there any kind of anything unique in the quarter from a shipment perspective and retail inventory level perspective that we need to consider as we think about fiscal third quarter results? Thank you.

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

All right. Jon, this is Nate. I'll start. I'll start with the bottom. So shipments remain strong. Obviously, through Q2, they were strong and they remained strong for the first part of Q3. So not seeing any issues there. I'm not concerned about inventory levels. Slightly elevated versus this time last year, but I think supports the bullishness of the retailers and us on the category.

On e-comm, I'm really happy with where we are. We're up double digits. We've gained both market share and are seeing a real adoption of some of the innovation because we brought a lot of that to market through e-com-first, and we'll talk more about that at Investor Day, but I'm pleased with our progress so far.

For Lawns, I'm going to let John Sass, our GM of lawns, just comment because I think that's probably the most important point that you asked. So John?

John Sass - *Scotts Miracle-Gro Co - Senior Vice President, Chief Creative Officer and General Manager, Lawns*

Yes, Jon, great question. I think our lawns business, we talked about it a lot in the past 1.5 years here, what -- we are transitioning from a product program to a portfolio and really selling a four step type of solution for consumers. The first phase of that was last year when we adjusted media plans and our promotional plans, which we had a great response from consumers and our retail partners.

And this year is the rollout of the product piece of that. So this year, we just introduced a new Turf Builder lawn food product that's for kids and pets. It's a great solution that is now showing up in retailer stores right now. And our adjustment to our media and advertising continues.

So we're really enhancing and showcasing the four feedings a year, really getting consumers back into a program that will give them a great lawn solution. So I would say the early part of the season, we're step one through the program.

We're seeing another sell-through of our Halts, our first step in the program over 20%, which is a great sort of first indicator for us going into the season. And now we go into the weed and feed part of the season. So off to a great start, a great continuation from last year.

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

I might just throw in, Nate. Davitt, where we had the biggest gap in share is really controlled on the online business on e-com. So you want to talk a little bit about what you're seeing with Ortho?

Mike Davitt - *Scotts Miracle-Gro Co - Vice President and General Manager, Controls*

This is Mike Davitt. When you start to think of the Ortho business, how consumers are searching for controls product has changed over the last few years. Obviously, we have a ton of products that sell multiple solutions. Consumers are moving to specifics.

If you look at the portfolio we launched with mosquito, with ant, and with specific weed products, we're giving consumers new solutions that they're looking for. So as Nate talked about this next generation of consumer, we're doing it in dot-com first.

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

Yes. And it's across all our categories, we have a lot of room to grow with market share. Controls is the biggest opportunity for sure.

Jon Andersen - *William Blair Capital Partners - Analyst*

Thank you.

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

All right. Thanks, John.

Operator

Peter Grom, UBS.

Peter Grom - *UBS AG - Analyst*

Great. Thank you, operator. Good morning, everyone. So I wanted to ask on SMG 2.0. And I think the commentary was helpful, but I wanted to dig into the \$1 billion sales target and gross margin approaching 40%. My guess is we'll get more color in August, but how should we think about building to these targets?

Is it linear because that you'd expect kind of equal contributions to the top line and margin expansion over the next several years? Is it more back-half weighted? Not trying to get fiscal '27 guidance, but I'm just kind of curious how quickly some of these actions can begin to show in the P&L.

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

Yes. So you're right, Peter. We'll certainly get into much more detail as we go to Investor Day. I would say right now, I would just look at it as linear. I don't think it will play out that way. But our focus clearly is the biggest piece of the pie to go get is e-comm. So Jim talked about it in his prepared remarks. This is an area that Chris is going to focus on with product assortment, tuck-in M&A.

But we have strength in other categories, whether it's expanded programs with our retailers as well as focus on Hispanic. So I would say it's early days. We'll lay out a year-by-year road map for you when we get to the August meeting. But from my point of view, I'm really comfortable. Remember, to net \$1 billion, we're obviously overshooting. And again, we'll get into that detail during Investor Day.

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

But I would -- Hagedorn here. What I would throw in there is just getting share equal to what we have in sort of big box retailers. That's the vast majority of this. So this is one where just getting our share online up. We'll give Nate most of what he needs to get that \$1 billion.

Peter Grom - *UBS AG - Analyst*

Understood. That's really helpful guys. And then I guess just a quick follow-up on the gross margin for this year. Obviously, really strong performance. It seems like the mix benefit from the branded products emphasis is really showing through. And I don't think that was originally contemplated in kind of the gross margin of plus 32% or what have you.

So can you maybe just speak to maybe what we've seen year-to-date how is it progressing versus what you were anticipating? And then as you think about reiterating the outlook, is that simply conservatism or are there certain headwinds that we need to contemplate in 3Q and 4Q?

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

Listen, you guys are constantly thinking like there's some trick here or something. Look, I would say it's good that's happening, right? I mean, so it's a positive. Nate and I were dealing with, and this was a big factor in last year's calls about private label and are you guys losing out on private label. I think you guys are aware that with a couple of giant customers, we basically said, we don't care about the mulch business. Take it, okay? But when we take it, we're taking our promotional money with us.

And if you want that promotional money, then put it into our branded business. So to the extent that you guys were kind of living it live with us last year, and I think some people were criticizing us for it, acting like it was a vulnerability, we took the marketing money and said, if you want the marketing money, you're going to put it behind branded, and they did, okay?

And so to some extent, a little bit of a surprise because some of the strategy, Nate and I were figuring out on the airplane to go visit some customers and deliver like a sort of hard line which we're not negotiating on this. And so I think the result to some extent is choices we made, not as well planned as you thought, but it was basically saying we're not going to lose money on this stuff.

And if you find somebody who can make it cheaper, God bless, but all that money that's going into marketing it, that stays with us unless you want to redeploy it. And so I think that has worked out really well for us.

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

Yes. It is those two things. It's mix and supply chain and as always, I'm very proud of our supply chain organization and they can continue to deliver and even over-deliver. Jim is right on the mix stuff. If you look at our POS year-to-date, we're ahead in dollars versus units. That reflects we're doing less heavily discounted units. We said we were going to walk away from that. We leaned into the branded. So I think that just performed a little better than we expected, and we're happy with that.

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

You might as well get a finance guy in there because we're talking gross margin and how you feel that.

Mark Scheiwer - *Scotts Miracle-Gro Co - Chief Financial Officer, Executive Vice President, Chief Accounting Officer*

Yes, no problem. So I think Nate said it best. As far as the overperformance year-to-date on some of the branded products in the mix. So I think from an expectation standpoint, I think for the first half, we did see some of that. That gives us confidence as we wrap up the back half of the year, which, I mean, we all know that there will be some level of commodity inflation in the back half of the year that we navigate, but we definitely feel like we can deliver on the 32% gross margin guide with additional supply chain efficiencies coming in for the back half of the year as well.

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

But we're learning like, I don't know, you guys could probably criticize and say, this you have to learn. But if you look at like the Halts business. The Halts business was a business that I'm not saying it was in decline, it probably was. But we weren't putting anything behind it. And a couple of years ago, we started putting like some radio in it and got like crazy good results.

So we started to invest behind Halts. And the numbers are phenomenal. And there's these giant benefit of this, not only are we selling more. But the more we sell, it's the kind of product they have return privileges on. The more you sell, so you're selling out and you're not dealing with returns on it, it's just a very virtuous thing for us. And so I think we're also learning that advertising, marketing activation works. And so that's also helping our margins at and our mix.

Mark Scheiwer - *Scotts Miracle-Gro Co - Chief Financial Officer, Executive Vice President, Chief Accounting Officer*

Correct. And the only other thing, Peter, I'll just bring up. I think in the Q1 call, we talked about a shift in sales from first half to second half. I don't know if we're fully seeing that. So that's part of the overperformance as well.

Peter Grom - *UBS AG - Analyst*

Awesome. Yes, I never want to be tricked, Jim. So I appreciate all the color, guys. Thank you.

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

I just think you guys asked like somehow is like we're kind of pulling the wool over your eyes. No, not at all. It's just sometimes where as surprised as you are, like?

Operator

Jonathan Matuszewski, Jefferies.

Jonathan Matuszewski - *Jefferies LLC - Analyst*

Great. Good morning, and thanks for taking my questions. My first one was for you, Mark. And just if you could remind us of the historical quarterly sequencing in terms of how you secure raw materials for the upcoming fiscal year?

And just how we should think about maybe the current prices of raw materials, is that leading you to think about deviating from what you lock in during a fiscal 2Q or this year versus history? Any color there? That would be my first question. Thanks.

Mark Scheiwer - *Scotts Miracle-Gro Co - Chief Financial Officer, Executive Vice President, Chief Accounting Officer*

Sure. So I'll take a stab and I'll let Nate jump in as well. Generally, I would just say what you see in our P&L is stuff that was purchased most likely six to nine months previously. We have really great suppliers, really reliable sources and so we can leverage our superpower. So just as that as a backdrop.

As we look to '27, really the summer becomes an important part of just working with our suppliers on our plans for next year and our customers. This year is kind of unique, right? Obviously, with the Iran conflict, we're dealing with elevated commodity prices.

So I think our approach this year is a little more of a wait-and-see approach. There are areas where we will start to buy for '27 and lock in supply that will start to happen over the next several months. But really, the summer months here, I would say will really begin to shore up some of those activities. But again, I just go back around six to nine months is kind of the tail as we navigate that.

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

Yes. Jonathan, it's Nate. I'll just -- urea specifically, we have flexibility. What I would say is we're going to delay purchases a bit this year relative to how we've done it in the past. And we've got the flexibility in our Marysville chem plant to do that. So we've not put production for next year at risk.

And I think Jim said it well, we just don't know what we don't know, but we've got a great team that's focused on it and we'll manage and we're committed to our margin walk, and we're committed to taking pricing if we have to. So we'll talk more about '27 as we know more. It's a little early for us, but we're definitely thinking through all the scenarios.

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

Look, I think as the war has sort of carried on and we've seen whether it's resins, diesel, urea, all of the sort of big commodities for us. I think, first of all, the purchasing team has done a terrific job, like reducing the risk for this year. And I think Nate has been pushing to sort of understand '27 better.

I just think that this is one of those things while some of the stuff we just have to manufacture, and we'll get -- it will end up on the balance sheet and inventory. A lot of our purchasing decisions, I think can get much better if the resolves itself.

And so the thing that I would like to make sure that everybody on this call is aware, we are not going to sacrifice our margin goals with this idea that by accepting dilution in our margins is somehow okay. Any costs we're seeing, there's not a single company in America that's not dealing with this stuff.

And I'm I am not concerned or shy about saying that where we're headed on margins, if we have to use pricing, everybody else will be as well. And so that if I was talking to my family like right now, I would say we're not going to give up our goals for our plan because somehow we think we're doing the right thing for the consumer.

The consumer -- it could be that, right, for the consumer. But the good news for us is we know when things are bad to the consumer, people garden. They not travel as much. They haven't got the dinner as much, but they stay home and they take care of their home and their yard and garden and spend time there.

So this is something where if it's bad for the consumer, I also think we'll see goodness in commodities if the economy starts to get a little wobbly. And so my encouragement to Nate is just to try to stay loose as you can.

This is not that -- the '27 is not an issue on commodities. We're not going to eat it. But trying to get too far ahead of it and worry about it, I think, is not the issue as long as we say, we're going to take pricing to cover the cost.

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

Correct. And remember, we play in a really broad set of categories within lawn and garden. And the commodities we've just been talking about are limited to a certain segment of those.

Mark Scheiwer - *Scotts Miracle-Gro Co - Chief Financial Officer, Executive Vice President, Chief Accounting Officer*

Yes. Jonathan, for perspective urea, for example, less than 10% of our cost of goods sold. So it's like mid-single digits. So it's to Nate's point, we've got a broad portfolio.

Jonathan Matuszewski - *Jefferies LLC - Analyst*

Right. Thanks for all that color, guys. And then just a quick follow-up on in-store merchandising. Looks like RONA recently rolled out 100 dedicated Shop-in-Shops for your brand ahead of spring. Maybe just speak to any productivity boost you may have seen from initial pilots that led to this rollout? And how you think about the opportunity to replicate something similar in key US retail distribution partners?

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

No problem. Well, listen, I'm just going to say, I think it's a little early to really quantify the results from that. But again, in the spirit of retail partnerships, that's an important one. You'll see us do more with other retailers, including in the US, not necessarily all rolling out this year, but over time, whether it's digital or physical like we're seeing at RONA.

I think that just speaks to the nature of where we need to go from a consumer activation standpoint, and we'll be happy to talk more about that test with RONA when we see you in August. I think we'll have more data then.

Operator

Joseph Altobello, Raymond James.

Joseph Altobello - *Raymond James & Associates - Analyst*

Thanks. Hey, guys. Good morning. I guess I'll stay on the pricing subject. But Jim, I think your thinking on pricing seems to have evolved over the years. There was a time when you were on hesitant to do it, but now you feel like -- it feels like you're more comfortable? And I know the situation is volatile, but if nothing were to change on the cost side. Would you view the pricing that you'll need to take next year as manageable from the consumer's perspective?

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

Thank you. I was going to say 100%, but that's probably unsafe. But yes, I absolutely feel. Look, we were -- Nate and I were down at a big retailer last year, and they were dealing with all the tariff issues like huge. And I think we were down there for like a couple of percent. And I said, seriously, guys, like with all the trouble you have, you're worried about a couple of percent from us.

Yes, I think that the damage we do to this company by not staying on top of our margins is way worse than people who are buying a product once or twice a year in an environment where they're seeing pricing like this all -- in fact, I think we're probably pretty shy compared to a lot of stuff that people buy. So yes, I guess it has evolved.

But I do think that where we're going with SMG 2.0, that listen, in part, Nate's promotion is based on the results here. And so I am big time encouraging him to get it done. The share repurchases, like I kind of meant what I said, which is I think this is a fabulous opportunity. And I think last year, for those of us who have had the sport of being on these calls, there was a lot of frustration with me on good results that didn't get reflected in the share price.

I think my view right now is we'll buy our own shares back. And so the more money that Nate can create, faster and deeper we can buy shares back at a price that I think is attractive and the Board does as well. So that's kind of where I'm at. And so I think being less comfortable with pricing puts a lot of that stuff at risk.

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

And John, I'll just -- sorry, Joe, I'll just add, remember, I'm looking at this to the lens of a five-plus year strategy, right? So certainly didn't anticipate two months ago what was happening in the Middle East. But like everything else, we've been through this, right? We've seen \$900 to \$1,000 a ton urea in the past. We've managed through it. We've taken pricing. To Jim's point, I'm keeping my eye on the long ball, which is a commitment to be a branded-first company with a very, very strong gross margin profile.

Joseph Altobello - *Raymond James & Associates - Analyst*

Very helpful. And just to shift gears a little bit to this e-commerce shift, if you will. How does it impact your margin structure? Does it require any investment on your part? Does it required more or less working capital? How does it change your business model, I guess?

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

So I mean, it obviously affects all of those. I mean not so much on the working capital, but certainly investing in the people to come in and help us drive e-com with that experience to drive product development, again, is going to pick up a big piece of this. There is a margin delta, but on a like-for-like between brick-and-mortar and e-comm today, and that's something that we'll continue to chip away at by bringing innovation and then bringing costs down on the back end of it. So there's a target, there's a challenge. I'm not particularly worried about it. It's a few hundred basis points delta. And we're putting teams and plans in place to manage that for the long term.

Mark Scheiwer - *Scotts Miracle-Gro Co - Chief Financial Officer, Executive Vice President, Chief Accounting Officer*

And Joe, what we're talking about leveraging our retail partners. So we're not going to be doing direct-to-consumer like all across the country where we'll have to build out a massive network and stuff from a cost in perspective. So we leverage our customers through that process.

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

Listen Joe, personally, I think it's really exciting. And we had a Board meeting last week, Thursday and Friday. And at the dinner, I got on to sort of the soapbox, which a CEO can do at a Board dinner and just talk about not participating is suicide for us. It's -- so this is not something that we really have a choice in.

We're under-penetrated. There's all kinds of opportunity. The retailers from our existing brick-and-mortar to other retailers are incredibly enthusiastic and want to play. So they see the opportunity as well that they are under-penetrated in lawn and garden.

And a lot of it remember, 80% of the volume we're talking about is with our existing retailers. And so it's not like we have a choice. I do think that it it's a little bit more expensive to operate. And I think Nate and team will deal with that.

But if you say to yourself, it is not optional that not playing in the sort of dot-com space works. It just doesn't. And so we've got to figure it out, and I think we have a lot of opportunity there. And if margin is sort of the issue and a lot of new products are going to have to happen in that when people are buying online to make it more convenient, to make it ship better just because consumers want more choice. This is an opportunity for Nate in the design process to sort of build margin in.

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

Yes. And I'll just put a pin in this by saying as we talk about product assortment, we recognize the need for differentiation in these channels and among retailers. And so when I talk about SKU rationalization and innovation, just keep in mind it contemplates that.

Joseph Altobello - *Raymond James & Associates - Analyst*

Okay. Thank you, guys.

Operator

Chris Carey, Wells Fargo Securities.

Chris Carey - Wells Fargo Securities LLC - Analyst

Hi. Good morning, everybody. Good morning, Chris. I know this was asked. So I apologize for coming back to it, but we get a lot of questions around inflation curve, I guess, if you will, into fiscal '27. I know that you're going to be strategic, as you had mentioned already on the call about locking in for exposure. You would look at pricing. I realize urea, as an example, is quite seasonal through the summer.

At what point is it that you have to kind of make decisions either on locking the current costs or you need to start having those discussions with retailers? And clearly, you have some momentum in fiscal '26. You put strong investments into market.

Does that give you a bit more ability to take pricing, justified pricing if indeed you see that inflation prove to be a bit stickier into fiscal '27 such that you can continue to achieve the margin targets that you set out there. I just -- I want to drill in a bit more on that.

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

Well, first, I think it's a good question, okay. I'm not sure what the guys are going to answer on this. I would say that merchandising decisions, we probably got three months. I'm looking at sales right now too, he's putting up. So I think that you're probably talking 8 to 12 weeks where these decisions need to be made. So I think that sort of frames your question, which is when do you have to get on top of this?

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

No, I was going to say Q3, our fiscal Q3, Chris, that's exactly when we have to make all these decisions. And like I said, the team has done a great job. We understand the dynamics as they are today. We've done a lot of scenario planning, including some simulations. And it will all come together where we have to go sit and talk to retailers for line reviews, and we'll have those discussions with them. And we're always transparent with our retailers about what we're trying to bring to the table.

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

Because you're going to see that like what happens is as the finance people start working with the operating team to develop numbers for next year, they're going to start putting standards in for what stuff is going to cost. It's got to be relatively certain within that time frame that the standards are going to be higher than where they are today.

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

Absolutely.

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

So I think this sort of drives you that I think pricing is going to have to be a tool in the quiver this year, and we've got to just agree to that. And if we do see prices down that make for opportunity, if retailers are listening to this, we can probably find ways to get money back if it turns out our costs go down. But I do think pricing is going to be something that has to be used this coming year.

I don't want people focusing on next year, this year, because I think navigating this year is what's important to us. If you look at the results, it's going really well. I think purchasing has sort of minimized sort of pain. I would say, and this -- I had this conversation with the Board. It is a little bit unfortunate.

I think we've talked about sort of headwinds that are entirely manageable, which are built as of this year, it just sucks for the managers of the company who are paid on results that we're seeing incentives being eaten up.

I tried using what the Board force majeure. I think they were somewhat vulnerable to it, which is the ability of like the management team is doing a great job in managing this really well. It just kind of sucks that something that's beyond our control is eating into upside for this year. The good news is we have it covered.

And that's what I want people focusing on now. It's pretty soon, we're going to have to start focusing on next year. And I think we've kind of answered that question.

Chris Carey - Wells Fargo Securities LLC - Analyst

Yes, helpful. I think that's it for me. Thanks so much, Chris.

William Reuter - Bofa Merrill Lynch Asset Holdings Inc - Analyst

Thanks, Chris.

Operator

William Reuter, Bank of America.

William Reuter - Bofa Merrill Lynch Asset Holdings Inc - Analyst

Good morning. I have two, which I think will be fairly quick. The first is you mentioned price increases. Were these the price increases that were taken kind of in normal line review timing? Or were there additional price increases taken, I guess, maybe at the beginning of the second quarter or end of the first?

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

We haven't taken any additional pricing since establishing with the retailers last quarter.

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

I mean we talked about it. Should we put a surcharge on for fuel. I think the issue we got into, to be fair, is probably half of what gets picked up from our plants. Retailers are picking up. And we just figured we get into pricing on a fuel surcharge, they're going to say, well, cool, like we're picking stuff up, you should give us a surcharge. And I think we just basically said we got this manageable.

So I think again, for retailers who are listening, we were calm this year in spite of the fact that we had pretty significant increases. But remember, we had a lot of hedges in our diesel. So I think we make money on those hedges. This will be typical line review pricing we're talking about coming up here in the summer months.

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

It would be pretty distractive to change pricing in the middle of the load and with retailers. So obviously, try to avoid that all costs.

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

We've done it before, but it's been an emergency.

William Reuter - *Bofa Merrill Lynch Asset Holdings Inc - Analyst*

Got it. And then, Jim, clearly, you're very focused on the share repurchases as an investment. How should we think about what the leverage profile is going to look like over the next handful of years? Should we assume that more or less, you're going to keep leverage where you are now and that share repurchases will just be at an amount that will kind of keep us where we are today?

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

Yes. I mean that's what I would say. We've talked at the Board level. I know Mark has a point of view. I think Mark would probably like to be closer to 3.5. I -- we said in the 3s. I think notionally, 3.75 is a fine enough place. Remember, this is one where we can't get all screwed up here because all we got to do is like take our foot off the gas pedal.

And what I've told Mark in his gatekeeper role is that -- in the Air Force, when you're in air combat situation, anybody can call knock it off. And the fight stops, everybody says, what just happened. And Mark has knock it off rights here. And I think that's appropriate as our Head of Finance. And so -- and we'll all respect that.

But I'm saying I'm pretty comfortable where we are, and he might like a quarter turn difference. I would just make the sort of argument that to be at, let's say, 3 times or maybe even less, that basically puts it off another year. And I'm not really willing to do that. We talked about at the Board. I got support at the Board level to do this. Mark, I think, is cool. He cares about his knock it off rights, and I'm happy for that. So I think the answer is yes.

William Reuter - *Bofa Merrill Lynch Asset Holdings Inc - Analyst*

Great. I'll pass to others. Thanks so much.

Operator

This concludes our question-and-answer session and also today's conference call. Thank you for participating, and you may now disconnect.

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