EVENT DATE/TIME: AUGUST 10, 2012 / 1:00PM GMT

OVERVIEW:
SMG reported that 3Q12 consolidated net sales was flat to last year. Co. reported 3Q12 GAAP net income of $93m or $1.53 per share and adjusted net income of $99.4m or $1.60 per diluted share.
CORPORATE PARTICIPANTS

Jim King  The Scotts Miracle-Gro Company - SVP, IR and Corporate Communications
Jim Hagedorn  The Scotts Miracle-Gro Company - CEO & Chairman
Dave Evans  The Scotts Miracle-Gro Company - CFO & EVP, Strategy and Business Development
Barry Sanders  The Scotts Miracle-Gro Company - President & COO
Jim Lyski  The Scotts Miracle-Gro Company - EVP & Chief Marketing Officer

CONFERENCE CALL PARTICIPANTS

Alice Longley  Buckingham Research Group - Analyst
Olivia Tong  BofA Merrill Lynch - Analyst
Bill Chappell  SunTrust Robinson Humphrey - Analyst
Josh Wilson  Raymond James & Associates - Analyst
Reza Vahadzadeh  Barclays Capital - Analyst
Joe Altobello  Oppenheimer & Co. - Analyst
Jon Anderson  William Blair & Company - Analyst
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Josh Borstein  Longbow Research - Analyst
Jeff Zekauskas  JPMorgan Securities Inc. - Analyst

PRESENTATION

Operator

Good morning and welcome to the third-quarter 2012 earnings conference call. (Operator Instructions). Thank you. Mr. Jim King, you may begin your conference.

Jim King  The Scotts Miracle-Gro Company - SVP, IR and Corporate Communications

Thank you, operator. Good morning, everyone, and welcome to our third-quarter conference call. With me this morning are Jim Hagedorn, our Chairman and CEO, as well as Dave Evans, our Chief Financial Officer. After their prepared remarks, Jim, Dave and other members of the management team are here to take your questions. In the interest of time, though, we ask that you keep your questions to one and to one follow-up. If you have other unanswered questions, I'm glad to spend time with you one on one after the call.

With that, I want to move on to today's call and remind everyone that our comments will contain forward-looking statements. As such, actual results may differ materially. Due to that risk, Scotts Miracle-Gro encourages you to review the risk factors outlined in our Form 10-K and our most recent 10-Q, which was filed yesterday with the Securities and Exchange Commission.

As a reminder, this call is being recorded, and an archived version of the call will be available on our website. And if we make any comments related to non-GAAP financial measures that we have not covered in the press release, we will provide those items on the website as well.

With that, I want to turn the call over to Jim Hagedorn to discuss our performance.
Thanks, Mr. Jim King, and good morning, everyone. We are going to take a slightly different approach today than in the past. I'm going to set the tone for the call, and then Dave will follow with a look at the numbers. From there, I will come back and share thoughts about the state of the business and where we are headed in 2013 and beyond.

As a precursor, I will tell you now that we remain committed to our consumer-focused strategy and believe our category continues to have solid long-term growth potential. That is why category growth was our number one objective this year. We spent hard this year and made big bets to drive growth, and you will get no apologies from me for that decision.

But I will say that the growth we achieved was expensive, too expensive. What we are seeing right now is that lawn and garden is performing more in line with other consumer industries, and I don't see that changing in a significant way until the consumer gets healthier. So why believe our consumer-focused strategy is still the right long-term approach to drive shareholder value, the pace at which we invest behind that strategy in the near term will be adjusted to reflect the current reality.

We said in the press release that we want to return the business to the level of profitability we saw just two years ago. Let me elaborate.

While we are not going to unwind our investments, we will dial some of them back, and although we decided to forego pricing in 2012, it will be a part of our plan for 2013. And given our relatively pessimistic view of the consumer marketplace right now and our ability to grow within that marketplace, we will be more restrictive on CapEx and acquisitions as well.

We remain committed to returning cash to shareholders in the near- and long-term. That is why our board this week approved an 8% increase in our dividend, now bringing it to $1.30 per share on an annual basis. I will come back to this point later in my remarks.

For now let's take a look at the quarter. As you saw in the press release, consumer purchases are now up 1% year-to-date entering August. Within those numbers we have seen some wins and we have seen some losses, and I will start by saying overall we have gained about 2 points of market share this year in units. And other than non-selective weed and outdoor insect, we have gained share in every category.

Innovation was important in the areas we saw strength. Our new battery-powered sprayer was key to the growth of the Ortho business, and the Snap spreader system delivered on plan. We put Snap in the hands of about 200,000 consumers, nearly all of whom bought more fertilizer this season than users of our traditional spreaders.

For the balance of the year, we have strong programs in place for fall lawn care activity. Given the harsh summer growing conditions, we are cautiously optimistic that lawn care consumers will reengage in September and October and help us drive positive growth in the fertilizer category for the full season.

Consumer purchases of grass seed are down about 14% so far this year. As we stated in the past, we expected declines this season given the lack of damage to lawns from last year's mild weather. But the category was off more than we thought.

That said, we gained more than 250 basis points of market share in grass seed this season. But, as I said in my video message that we shared in June, the biggest unexpected challenges we saw came in the back half of the season.
Consumer engagement across the category declined sharply in May and June, but this had the biggest impact on the Miracle-Gro branded products. The other miss this year was in Europe. While we suspect the economic climate there had an impact on our business, it is impossible to quantify right now. The weather in Europe throughout the season has been really bad, especially in the UK. All-in-all international consumer sales are down 7% year-to-date, 3% if you exclude currency, and that includes some reasonably strong growth in Canada.

In both the United States and Europe, gross margins in the third quarter came under pressure from product mix, higher costs and other factors. Dave will provide the details in a few minutes, and I will come back to this as well in my later remarks. For now, I will simply say that gross margins are a top priority for us.

One final note about the business, Scotts LawnService remains on plan on both the top and bottom line with strong customer account and retention levels. And another note that I wanted to share is related to the leadership of that business.

Recently Peter Korda left Scotts to accept a new role in another service industry. We have replaced Peter with Brian Kura, who many of you have met at past analyst days. Brian is a 15-year veteran of Scotts and most recently was the head of our National Sales team. We have consolidated all sales and regional operations under the leadership of Mike Lukemire.

Okay. With that, let’s switch gears. I am going to turn the call over to Dave, and then I will come back to share some broader thoughts.

Dave Evans - The Scotts Miracle-Gro Company - CFO & EVP, Strategy and Business Development

Thanks, Jim, and good morning, everyone. We obviously have a lot to cover this morning, so I will run quickly through the results before turning it back to Jim.

To keep my comments limited, I will primarily focus on areas where we saw the greatest discrepancy from the beginning of the year expectations, principally global consumer net sales and consolidated gross margin rate.

On a year-to-date basis, consolidated net sales are flat for the quarter and up 1% year-to-date. Excluding changes in FX rates, sales are up about 1% and 2% for the quarter and year-to-date respectively. Sales for our global consumer segment are up 1% for the quarter and flat year-to-date. The US market represents about 80% of year-to-date global consumer sales.

And to understand US consumer sales for the third quarter, you have to start with the second quarter when you recall the season got off to a strong start in March. Weather in the north and northeast was unusually favorable in March, principally in the second half of the month, and POS increased nearly 30% over 2011 for the month.

At the end of March, POS is up 15% on a fiscal year basis. Because all the increase in POS occurred in the second half of March and because consumer demand in those weeks was so extreme, retailer inventories finished March significantly depleted. This drove a temporary but large gap between POS growth and our sales growth at the end of March.

At that time, we recognize that strong consumer purchases in March included some weather-driven pull forward of demand and expect the consumer purchase activity to moderate back to our full-year expectation by the end of April. After our second quarter-conference call in early May, we witnessed a series of negative POS weeks that carried all the way into July. In fact, for the period May through July, POS declined 6%. This leaves us in our current position of plus 1% year-to-date.

The net result of all this is third-quarter sales growth of 6% in the US, which primarily reflects strong replenishment in April of March demand, partially offset by sales declines in May and June.

US consumer sales are now up 2% year-to-date, fairly consistent with POS growth through the end of the quarter. This reflects the share gains Jim discussed in a relatively flat category.
Retailer inventories ended our third quarter roughly in line with the third quarter of last year. By the end of the full season, call it late October or early November, we would expect retailers to continue their multiyear trend of reducing season-ending inventory so we do not see anything more significant than what we have seen in prior years.

Jim already touched on our international consumer business and Scotts LawnService, so I will not elaborate further. Sales for the corporate and other line declined during the quarter, primarily as a result of reduced volumes under our supply agreements as some production we were formally responsible for has permanently shifted back to ICL.

We also saw planned declines in professional grass seed sales. Recall that we are exceeding the proceed business and expect to reclassify to discontinued operations at fiscal year-end. We will adjust the presentation of our financial statements and history to exclude proceeds at that time.

With that, I will transition comments to gross margin rate, which is well below expectations entering the year. On a full-year basis, 2011 gross margin rate was 36.1%. We entered 2012 assuming a full-year rate of 35.5%, give or take 25 basis points. Recall that the decline of up to 90 basis points that we expected was attributable to the decision to substantially forego pricing this year in the face of anticipated commodity inflation of approximately $80 million, partially offset by some benefits of cost per activity and positive mix.

In fact, our rate through the first three quarters reflects a decline of 290 basis points, and while we expect the rate of decline to moderate in the fourth quarter, the full-year rate will still represent a significant change from beginning of year expectations. This is despite a slightly improved commodity environment.

So what has driven the change? Through our third quarter, there are four principal reasons. First, poor sales mix versus our original plan, both in the US and in international. Second, the significant early-season surge in consumer activity and continued and unplanned surge in mulch volume resulted in incremental distribution costs in our third quarter to keep retail inventories at appropriate levels. Third, as we shared last year, cost of our ortho line exceeded original expectations. This has been remediated for next season. And fourth, lower than expected sales this year across the whole consumer business has led to lower than expected leverage of fixed warehousing and manufacturing costs.

As you will hear from Jim in a few minutes, we expect in an appreciable recovery in gross margin rate next year. We have already communicated price increases to our retailers, and we have a long list of cost out and other cost productivity initiatives that we expect to have a positive impact in 2013.

We have been actively locking in commodity costs where appropriate over the past few weeks, especially urea and diesel. Right now we are anticipating flat to modest inflationary increases on 2013 purchases. As we have seen in the past, though, due to the slow-turning nature of some of our product categories, our first turn of inventory in 2013 will reflect the year-over-year legacy cost increase from 2012.

In anticipation of your questions, I am not going to provide any specific gross margin guidance on this call. We expect to provide increased clarity on our year-end call. That said, I don’t believe any of the challenges we face this year represent structural issues that would hinder our ability to recover some loss margin rate next year.

Let’s move onto SG&A where the performance has been pretty much right on plan. SG&A in the quarter was $198 million compared with $192 million a year ago. Year-to-date SG&A is up $6 million to $558 million, driven by a substantial increase in advertising expense, offset by a number of other cost reductions, including benefits of last fall’s spans and layers initiative.

Recall that our guidance back in February was for full-year SG&A of about $750 million. We will come in below that number as we adjust our variable compensation for the year. In some parts of the business this year, performance is in line with expectations, and we will pay bonuses accordingly. So the net effect is that variable comp will be about $20 million below what we had budgeted entering the year.

Moving on, the rest of the P&L is pretty much in line with what we expected. Interest expense in the quarter was $16.6 million compared to $14 million a year ago. As planned, year-to-date interest is $12.5 million higher than the same period a year ago, substantially as a result of the changes we completed last year in our financing structure.
The year-to-date tax rate for adjusted earnings is 36.3%, which should be a good approximation of the full-year rate. And finally, we continue to believe a full-year share count of slightly more than $62 million to be appropriate as well.

Taking it all to the bottom line, adjusted net income for the quarter was $99.4 million or $1.60 per diluted share. This compares with $1.91 per share a year ago.

On a GAAP basis, net income was $93 million or $1.53 per share compared with $1.69 per share a year ago. The difference between adjusted and GAAP earnings for the third quarter remained primarily related to product recall and registration matters. We have been making good progress in resolving this matter and are hopeful we can put it behind us from a financial reporting perspective in fiscal 2013.

While there are still a number of moving pieces related to our fourth quarter, I can tell you we currently believe adjusted earnings for the full year will be roughly $2 a share. That suggests a loss in the fourth quarter of about $0.40.

As we have seen in the past, the strength of the fall business could impact that number in either direction.

Finally, I want to touch briefly on the balance sheet. Given the shortfall we are seeing in earnings this year, our leverage ratio at the end of the quarter was about 2.8 times. We expect this rate to modestly increase over the next couple of quarters before moderating again in the second half of next year.

The other item I want to touch on is inventory, which is up $27 million from last year. This is primarily attributable to lower than expected sales. While production schedules were adjusted in early summer to reflect lower sales, units on hand are still above our plan.

Speaking of that, Jim had told you we will be more aggressively focused on margins and cash flow. As it relates to cash flow improving our working capital, especially inventory, will be an important element to improving our cash generation. And so while inventory is higher right now on a year-over-year basis, we expect to aggressively manage that number lower next year.

I will provide more color, if you would like, in the Q&A session. For now, let me turn the call back over to Jim to provide some additional color.

Jim Hagedorn - The Scotts Miracle-Gro Company - CEO & Chairman

Thanks, Dave. Okay. I'm going to take about 10 minutes to share with you our thoughts entering 2013 and beginning the planning process for 2014. I will start by addressing the elephant in the room.

I recognize that many of you may be frustrated with our performance this year, especially coming off a disappointing result in 2011. We are too.

What you are not going to hear from me today is a bunch of excuses.

Entering the season, I told you that category growth was our number one goal, and we believed our strategy would be successful against that goal. In an effort to jumpstart the category, we opted to forgo a price increase and added $40 million to our advertising budget. These were big bets. While I believe they were the right bets given our goal, they obviously did not pay off to the degree we had expected.

What is now clear is that the lawn and garden is similar to household products, health and beauty and other consumer categories. Growth is damned hard to get right now, and we're not going to chase it.

That is obviously a change from what we discussed in the past. So, how have we arrived at that conclusion?

The lawn and garden industry has always proved to be resilient during economic downturns, and that is what we saw in 2009 and 2010. And that, once again, proved that point.
When the economy had an extreme impact on many consumer companies, we were thriving. We had record sales, record profits and margins were moving in the right direction, and we were generating significant amounts of cash. Entering 2011 we believe this trend would continue. While we actually fell backwards last year, it was easy to point to the fact that weather and changes in certain retail merchandising strategies had a significant impact on the business. So we entered 2012 expecting a big rebound and with an assumption that weather would revert to the mean, and we made a conscious decision to bet hard to maximize the rebound.

Based on the facts at the time, we were convinced the bets we made were right. But given our results, the prolonged weakness in the economy, the continued weakness in consumer confidence and the performance of other branded consumer businesses in developed markets, we are now moderating our expectations.

As I mentioned earlier, we have taken share this year in nearly every category. That gives us confidence that we can take modest pricing. We have already communicated price increases to our retail partners for 2013, and for 2013 we are not expecting organic growth beyond what is driven by pricing.

So while we have moderated our growth expectations, it would be a mistake to read this as a shift in strategy or philosophy. It is not. As I said repeatedly in the past, our long-term growth is dependent on a single idea, getting closer to the consumer. That is still the case. And since we began executing against that plan three years ago, there have been clear successes.

First, we are a different company today. At the beginning of this year, for the first time in decades, 100% of our effort was focused on consumer-facing businesses. We have closed underperforming units and divested our businesses like Global Pro that did not fit into our long-term plans.

Second, our regionalization efforts are having an impact. The goal was to close the gap between the market share in the Southeast, Southwest and West Coast with our legacy markets in the Midwest and Northeast. That gap has been virtually closed in the Southwest, even as our share in legacy market continues to improve, and our performance in the Southeast this year has been right on plan.

Innovation has moved the needle. We have had tremendous success with our EZ Seed, and we saw great promise this year from Snap. Both are based on understanding consumer needs and making changes to our products that make lawn and garden easier and less time-consuming.

Fourth, despite a lot of the economy, our brands have remained strong and we have bucked the trend. We have not lost share to private label. In fact, we gained share against private label, as well as other national competitors. And fifth, our marketing organization is stronger than it has been in years, maybe at any other time in my tenure here. We have strong leadership, better insights and marketing campaigns that are clever and contemporary.

So we continue to believe the consumer first approach to the business is working, and we are committed to that path as a way to drive long-term growth.

But if our near-term reality is low growth environment, then the way we execute that strategy has to change in order to restore the profitability of our core business to appropriate levels. Gross margins must improve, and that is not optional.

I already said that we are taking pricing next year. Based on the market today, those increases not only will offset the inflation we expect in 2013, but will make up for some of the pricing we did not take in 2012, so it should be a tailwind for us.

We are also making good progress in taking significant costs out of the product without negatively impacting the consumer experience. Dave Swihart talked to you about this during the analyst day, and we have made good progress against this initiative throughout the year.

We also need more leverage out of SG&A to drive operating margins higher. That, too, is not optional. We will make reductions in spending in nearly all areas of the business. While we are not abandoning our commitment to advertising or any of the core convictions that we think are critical to running this business for the long-term growth, all of our investments must have an acceptable return.
We are undergoing an in-depth analysis right now of all spending activities. We expect this effort could result in one-time charges, though it is early in the process and we are not in the position to provide detail on the timing or the amount.

These combined steps should allow us to see a significant rebound in earnings next year. We are not providing guidance today, but I can tell you we are pushing ourselves aggressively. This business had a record level of profitability just two years ago, and we want to get back to that level and exceed it as quickly as we reasonably can.

Despite a down year, we expect to generate a couple of hundred million in cash flow this year. And with the steps I have described, along with an aggressive push to drive down inventories, we expect to drive strong growth in operating cash flow next year. And that begs the question regarding the uses of cash.

For two years, we have answered this question by saying we would use one-third for our CapEx, one-third for acquisitions and one-third would be returned to shareholders.

Based on our revised growth assumptions, we probably will not need to allocate as much to CapEx. And other than cannot miss opportunities -- and there are not many of those -- I see acquisitions as less likely until we return the core business to the proper level of profitability.

For now, I want 100% of our focus on the business that we have, not on integrating something new.

So how do we deploy the cash? The bias will be returning it to shareholders.

As Dave already discussed, given the structure of our credit facility and the strategy around managing the balance sheet, the earnings shortfall we have seen this year will mean our immediate focus will be getting leverage back where we want it to be. Once that occurs, hopefully within the next few quarters, we will once again have the flexibility to execute a plan to return cash to shareholders. And, frankly, we are aiming at having the flexibility to be even more aggressive than executing that plan than in the past.

I’m going to turn the call back to the operator to take your questions in just a minute. Before I do, I want to address one other point.

Scotts Miracle-Gro is unlike many other companies that most of you follow or own in a pretty simple way. I’m not just the CEO, and I am not just the larger shareholder.

My family has been in this business my entire life. Some of you have said that you like this dynamic, that you believe my bias to ignore quarter to quarter approach and take long-term view of the business is both correct and refreshing. Some of you said you don’t like the dynamic and believe the approach is more in keeping with a family business than a public one.

To some degree, I think there is truth to both points. While I will always have a bias toward the long-term growth versus a short-term benefit, I also have a bias, as well as an obvious vested interest, in seeing the value of this equity rise.

The investments we made in 2012 were made because we were convinced we could outpace the economy. Today we have concluded that the cost of chasing that growth is just too high right now, and it is the wrong solution for shareholders in the near-term. And whether I have a bias for the long term or not which I do, we will not make near-term decisions that we don’t believe will benefit our shareholders.

I’m sure that many of you will have questions today or in the weeks ahead that we’re not quite ready to answer. So here’s my commitment to you. We have some investor activities coming up next month. We will stay pretty close to what we are saying here today, but I want to make sure that we are out there communicating in person.

In early November, we will have our Q4 call, and I expect to have more definitive answers for you then. We are also working to move up the date for our analyst day meeting to early to mid December, and we will provide even more details at that event.
Let me close by telling you a little bit about how we spent the summer. Our leadership team has spent hundreds of hours together over the past two months, analyzing data and talking about our near-term growth. While we don’t like some of the conclusions we have drawn, we accept them.

What is important now is how we move forward. Every leader in this business is actively engaged in ensuring that we see a step change in the profitability of this business in 2013, and we put the business back on the right course. We are already setting targets for 2014 with the assumption that the consumer environment remains challenged in the near-term.

We have created a forum for open discussion and debate, and we had plenty of both. And I’m convinced that to a person, every member of this team is aligned with where we are headed. And I’m equally convinced that shareholders who travel on this journey with us will be rewarded in the long run.

With that, let’s turn the call back to the operator to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Alice Longley, Buckingham Research.

Alice Longley - Buckingham Research Group - Analyst

Good morning. My question is about what you said about the industry growth, and you compared it to other consumer staples categories. It looks to me like I think you said the industry growth this year is flat, and last year it was down 4% to 5%. And assuming this is a normal weather year because weather was good at the beginning of the year and not so good later, you look at the -- it is an easy comp. If you look at the two years together, it looks like the industry is actually shrinking a little bit.

And the concern to me is that maybe the affluent consumer has shifted back to using LawnService since the recession, and the non-affluent consumer just does not need to do lawn and garden work. And you have got a structural deterioration in the industry because people don’t need to do lawn and garden. They need to buy toilet paper and detergent, but they don’t need to do lawn and garden. So could you comment on that?

Jim Hagedorn - The Scotts Miracle-Gro Company - CEO & Chairman

Yes. There was a lot there that you said, and I want to start out by saying that we made the decision last year to hold pricing and jack the advertising. I think you were the one that said, Jim, we are in a recession. And I just wanted to say, maybe you were right. Okay? I’m not sure you have ever heard that before from me.

I think when we look at this year and we look at other consumer goods companies where if you back out pricing in their old world markets, which is I’m starting to feel like, call it, North America and Europe, where you are seeing unit volume declines and sort of other consumer staples. I think that is what our comments were referring to is that we are seeing that.

Certainly we have seen reasonable performance in our LawnService business with I’m going to say a slight increase in consumer count, but generally I’m going to start by saying part of what the LawnService business has done is what the Americans need to do now, which is run the business a lot more efficiency and the ability to make money on kind of slowly increasing customer count is really the story I think behind where we have been with LawnService and I’m going to say exceptional management that is occurring in that business and has been.
So that business is occurring, but they have not seen the decline that the other business is. I'm not sure I quite go to the fact that everybody is rushing out to LawnService, but it is certain that something is happening with the consumer, especially in the second half of our lawn and garden season.

The good news to us is that we are not seeing a shift to private label. What we think the data is telling us is that people are stressed. They will just do out of the market for a year, and they will not do anything.

Now I know that Barry and Jim Lyski and the team, we need to work on that to keep the incentive high on the consumer, even when they are feeling stretched that they need to use lawn and garden. But I think the reality is that is what we are saying, is that the businesses showing a behavior like other consumer goods companies, that we are not losing -- that they are not shifting down to lower-priced products, that they are tending to leave the category and step back in -- you know, we have talked about this before -- and step back in next year.

So I don't know if that answers the question, but I think that that is what we are seeing.

Alice Longley - Buckingham Research Group - Analyst
Well, if we have got crummy volume prospects, what kind of pricing are you talking about for next year? Is it 2% to 3%, or is it 4% to 5%?

Jim Hagedorn - The Scotts Miracle-Gro Company - CEO & Chairman
We are going to stay low single digits. That is, I think, we are still to some extent in the line review process, and so I don't really want to go beyond that.

Alice Longley - Buckingham Research Group - Analyst
And then finally, are you buying shares aggressively if you are going to help shareholders?

Jim Hagedorn - The Scotts Miracle-Gro Company - CEO & Chairman
At the moment, our focus is going to be on getting leverage down. We have an open authorization from the Board to buy shares, and when we feel the time is right, we will do so.

Alice Longley - Buckingham Research Group - Analyst
Thank you.

Operator
Olivia Tong, Bank of America.

Olivia Tong - BofA Merrill Lynch - Analyst
Hey, guys. I guess first question, you said you should be able to return to where you were two years ago, but you also said that category growth expectations are lower, and you will not be investing and advertising as much to “chase growth.”
So looking forward, how much of this decline that came this year you think is short-term volatile weather trends and things like that, and how much of this is structural problems? You said that 2013 should see a significant rebound, but how can you move that fast to fix what sounds to me like there are some structural problems within the business? Thanks.

Jim Hagedorn - The Scotts Miracle-Gro Company - CEO & Chairman

Okay. I'm going to say actually relatively easy expense control. If you look at our outlook really for the planning period, we just finished a Board meeting. In fact, we are still at the site where we met with the Board. We are effectively budgeting no organic growth for the period. So that actually makes at least the sort of solution of saying, how are you going to do, it pretty easy for us. It is going to be expense control and getting our operating margins up.

Olivia Tong - BofA Merrill Lynch - Analyst

And how much of that -- as you think about the operating margin, how much of that is going to come from scaling back advertising, and what do you think in terms of mix next year? Because part of that is weather, but part of that is also just the lower margin categories like mulch are doing better.

Jim Hagedorn - The Scotts Miracle-Gro Company - CEO & Chairman

I think it is to some extent, people have to remind me of the components of the question, I will stick with mix for a second.

This season this year -- look, I think that our budgeting process and our belief in the weakness of the consumer is pretty important.

And so what I'm going to really say is I don't know exactly what happened in the second half of the season, but I think we saw it broadly in retail and that other people in consumer goods saw the same thing. But that the decline in retail sales in the second half of the season hit our Miracle-Gro brand pretty hard. It -- that part of the season is the gardening part of the season, and that is pretty high margin.

So I think that at least my expectation is that the Miracle-Gro brand should do better next year, and that should be to some extent beneficial on mix.

Some of the other areas of products that sell like mulch, I think we believe there is something happening there, and that is a business that continues to year-over-year perform well and that the margin challenges we had there deal to some extent with our supply chain and our ability to make money. And Barry and Dave Swihart and the whole operating team are working hard and believe we have a strategy to significantly increase margin on mulch so that as the mulch business, we think, continues to do well, we are in a position to make more money on it.

In regard to promotional spend, I don't really want to get into detail on it now except -- on dollars -- except to just philosophically tell you the North American business had a 50% increase in media spend in 2012, the year we are in now. We are going to spend a lot more than we spent in 2011 in 2013. It is just not going to be as much as 2012. So it will still be a significant increase of what we spent in 2011. And I really don't want to get into dollars until we sort of start tying things down. But my hope is that we can be more specific with you at a minimum in December when we sit down with you at the analyst meeting.

Olivia Tong - BofA Merrill Lynch - Analyst

Got it. And then just lastly, can you talk about your share? You touched briefly on overall share gains, but can you talk about the difference in share gains across the category? So maybe how much do you gain in seed versus fertilizer versus -- or not seed, but fertilizer versus mulch? Is there sort of comparing the higher-margin categories versus the lower margin ones?
Jim Hagedorn - The Scotts Miracle-Gro Company - CEO & Chairman

Barry, do you want to take that?

Barry Sanders - The Scotts Miracle-Gro Company - President & COO

Sure. This is Barry Sanders. We are gaining share faster than some of the lower margin categories. So this year we did see a faster gain in the mulch category than in the lawns business. But as Jim and David said in their opening remarks, we did gain share in every category, except for the non-selective business and the insect business, and it ranged anywhere from 1 point or 2 up to 8 points on the mulch business.

Jim Hagedorn - The Scotts Miracle-Gro Company - CEO & Chairman

And I don't want to let the lawn fertilizer -- the change in sales trajectory that occurred, call it, starting in May, had a pretty bad effect on margin in that core of the business, which is Miracle-Gro in the tail end of the lawn fertilizer business.

But even with that, we have flattened out the units sold in lawn fertilizer. Remember, we were dealing with million unit losses per year in lawn fertilizer. So one of the small victories that we had, maybe more than a small victory, is the trajectory change in the loss of units in lawn fertilizer.

So, even with the gutting of the tail end of the lawn fertilizer business or season, we still ended up flat year-over-year units, which was a big change in trajectory.

Thanks, Olivia.

Olivia Tong - BofA Merrill Lynch - Analyst

Thank you.

Operator

Bill Chappell, SunTrust.

Bill Chappell - SunTrust Robinson Humphrey - Analyst

Good morning. I'm just trying to understand the longer-term goals and getting back to the earnings profitability you did just two years ago. I understand you are focused on the goal. But if you look back at 2010, if I remember right, everything went right. I mean weather was good, a competitor went out of business, commodities were in your favor. So is that the right type of target, and is this something in the next two years, next three years, next year? What are we looking at?

Jim Hagedorn - The Scotts Miracle-Gro Company - CEO & Chairman

Look, I hear what you say, and to some extent, there is truth to it. We had -- we took a bunch of pricing and commodities went down. So it was a good year.

Do we think it is the right year to look at as kind of a restarting point? The answer is yes, and we believe we can do better.
But this really sets out the tone of the challenge is that on basically flat unit volume in the short-term -- and the short-term this is the first time we presented our Board with a plan that was not four to five years. We basically said the planning horizon in this environment we are going to call two years. And we are going to behave short-term. When I say short-term, meaning we have got to get the earnings back, and we have got to get in a trajectory of consistent earnings and cash flow that are moving in the right direction.

And so I think that as we talk more clearly about what those numbers are, I think you will see logic in it. Just because we are relatively early in the process of nailing all the detail down on the budget for next year, that, as time goes on, we will be able to show your more detail on how we have arrived at the various targets.

But I think that the answer is, it will seem more logical to you as we can take you through more detail. But the operating team has to nail down things before we get into those discussions. But I think that the answer is, yes, we do, and we think the trajectory from there needs to be up.

Bill Chappell - SunTrust Robinson Humphrey - Analyst

Okay. Switching to your expectations for next year, I mean are you expecting with prices to go up that volumes to be flat to down, or do you think that after this year the consumer is okay and ready for some more pricing?

Jim Hagedorn - The Scotts Miracle-Gro Company - CEO & Chairman

Well, when we say low single-digit pricing, we believe that the consumer will be tolerant to that. Remember we did not price last year. Many of our competitors did. So we believe that the pricing will be accepted, and we’re effectively looking at flat unit volume for next year.

Bill Chappell - SunTrust Robinson Humphrey - Analyst

Okay. And just last one, I mean if you look at the portfolio right now, are their categories where it makes sense just to get out of? I mean it is just not to your profit margin expectations or growth margin expectations because you are in so many different niches of the category?

Jim Hagedorn - The Scotts Miracle-Gro Company - CEO & Chairman

We are looking very hard at the SKUs that we sell and the productivity of those SKUs. And I think that we are prepared to make difficult choices. I think that is probably as much as I can say right now.

Bill Chappell - SunTrust Robinson Humphrey - Analyst

Thank you.

Operator

Sam Darkatsh, Raymond James.

Josh Wilson - Raymond James & Associates - Analyst

This is Josh filling in for Sam. First, a quick clarification question for Dave. If I heard you right, I thought you said you are expecting $2 for this year and $0.40 for the current quarter, a $0.40 loss. In order for me to get that to foot, is the $2 a GAAP number?
Dave Evans - The Scotts Miracle-Gro Company - CFO & EVP, Strategy and Business Development

The $2 is our adjusted earnings per share.

Josh Wilson - Raymond James & Associates - Analyst

Okay. And then a follow-up question on the pricing questions for next year. Do you have any sense of what your competitors are going to be doing with pricing in the coming year?

Barry Sanders - The Scotts Miracle-Gro Company - President & COO

We think that we will most likely be taking pricing that is slightly above where they are at. Remember, we did not take pricing last year, and as Jim said in his comments, we think that the two-year combined that it will normalize itself.

Josh Wilson - Raymond James & Associates - Analyst

And just one more, if I might. Your marketing dollars that you were going to spend this year, I know you said you are trimming variable comp, are you trimming any of the marketing spend this year, or is all that going to go up?

Barry Sanders - The Scotts Miracle-Gro Company - President & COO

We spent all of the marketing dollars that we planned on spending this year.

Josh Wilson - Raymond James & Associates - Analyst

Thank you very much.

Operator

Reza Vahadzadeh, Barclays.

Reza Vahadzadeh - Barclays Capital - Analyst

We are all set. Thank you very much.

Operator

Joe Altobello, Oppenheimer.

Joe Altobello - Oppenheimer & Co. - Analyst

Hey, guys. Good morning. Just a couple of questions. First, you said POS was up 1% year-to-date, and grass seed was down 14%. What was POS, or what would have been POS if grass seed was, let's say, flat this year?
Dave Evans - The Scotts Miracle-Gro Company - CFO & EVP, Strategy and Business Development

It would have been up another percent if it was flat.

Joe Altobello - Oppenheimer & Co. - Analyst

Okay. So it would have been basically POS up 2% here. Because the question I'm trying to get to is, is this year really an issue where you had, one, high expectations coming in, and two, you basically had a lot of pull forward with a lot of your volume happening in February and March and maybe the first half of April. And so when you look at the overall business this year ex grass seed, POS up 2%, not terrible, and then with that, it seems like you are saying that you guys have now connected with the consumer where historically you have always been much more resilient. And so has that really changed, or is it the high expectations and the pull forward --?

Jim Hagedorn - The Scotts Miracle-Gro Company - CEO & Chairman

You know, I wish you guys could just ask shorter questions only because I cannot remember this stuff (multiple speakers) that long. Listen, Joe, I'm going to start and then hand it over to Barry.

But look, I will make it a little more confusing. Exclude the fall and POS, now there was a lot of move in commodity in this, okay? So the mulch business was like on fire. But POS for the calendar year is up like 4%, okay?

Dave Evans - The Scotts Miracle-Gro Company - CFO & EVP, Strategy and Business Development

With grass seed down.

Jim Hagedorn - The Scotts Miracle-Gro Company - CEO & Chairman

Yes, that includes grass. The thing is, you could say yes, it was a great early part to the season. I could show you a weather map, and you would say, well, maybe it was heat and drought, and maybe it was that. I can also show you maps that show relative health of state economies where the better the states are doing, the better sales we are doing.

But overall what we think we are seeing -- and really for the first time that we have ever admitted to it, so I think it's a big deal here -- is that even when the weather was good, we did not see sales happen. I don't know that Dave touched on this, but I think like since May, we have seen one positive comp week the entire year. And it was not that there was no good weather in that period, that there was no opportunity. We were not advertising. We think that something happened to the consumer, and I think that if you look at other consumer data, retail sales in general in that same period, it's like the worst in five years.

So I think something is happening Joe. And now it is possible that our budgeting exercise -- and I also think that to some extent you could easily argue that you guys are assuming 8%, 9% growth. Clearly that is over optimistic, but when we looked at the year before, this was just getting back what we lost the year before. Okay?

So I think we have come to the right conclusion. I think it is different for us. It may be conservative, but it is the way we are going to budget, and we just cannot -- the current is really strong right now. I mean I'm going to say that the anti-consumer sentiment, and if we are in the stream paddling, we paddled hard as hell this year, and we just did not make a lot of progress, and the cost to the shareholder was high.

Now I think we had to make -- I don't think we could be where we are if we had not said -- listen, I have got to tell you, I don't know what else a company would do to drive sales than we did this year. And while I can tell you, we picked up 200 basis points a share in the calendar year, sales were up. We made significant progress in market share in the regions that we have been talking about. Our legacy regions showed very significant like 300 basis points of share gain, but it was not enough and it is too expensive.
And if you go back and start looking and never mind to my executive team, this is the second year we have not had a payout in the incentive plan. And there is a point where you say, I cannot live like this, and my team cannot live like this. But you look at our earnings, they have become very choppy.

Now the world is changed since 2007, in my opinion. But we have got to put consistency back into our earnings and our cash flows, and we are going to. And if that means we are going to be a little more conservative, then that is what we are doing. And I think we are going to be more choiceful and really focused on getting leverage down, which leverage it is not out of control, it just means really getting our earnings back, and we will solve the leverage problem. And not that it is a problem, but getting it back to where our targets were.

And then our view is that, as we wait out a change in the consumer atmosphere, we are going to become a pretty shareholder-friendly company because if we don’t have a use for the money, we will send it home. And we intend to get the cash flow of this company up to a reasonable position.

Barry, do you want to add to that?

**Barry Sanders** - The Scotts Miracle-Gro Company - President & COO

Joe, just a few numbers just so we have been looking at the numbers pretty hard. Since 2007, we have looked at the category growth rate, and it’s about 1% a year compounded annually. Our numbers have been slightly better than that relative to market share gains.

If you go back years before that, I would say the number was more in the 2% to 4% range and probably slightly above GDP. We view the category right now as slightly lower growth than GDP.

So what Jim is saying is, rather than try to fight that trend, we are going to accept what those growth rates are and rightsize our spending relative to a more conservative planning assumption. And so if the category is going to grow 1% or 2%, then at least in the short term, we will accept that as our growth goals and plan accordingly.

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

Okay. That’s very helpful. Since I squeezed all my questions into one, I will spare you guys a follow-up.

**Operator**

Jon Anderson, William Blair.

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

Good morning, everybody. Jim, I want to come back to the question on getting back to peak profitability. I know you have addressed it a couple of different ways already. But is it fair to assume that based on the fact you talked about a two-year planning horizon, or that is how you are thinking about it currently, and the statement that you plan to move quickly to restore profitability to prior peak levels, but that is a reasonable timeframe that you are working with.

**Jim Hagedorn** - The Scotts Miracle-Gro Company - CEO & Chairman

Yes, I would say the answer is yes. And if I was talking to my team privately, I would say more than reasonable.
Okay. Fair enough. And the only other question I have at the moment is, with plans to take some price next year, it sounds like maybe a little more than you think your competitors might. How are you thinking about price gaps relative to private label, other branded competitors and your ability to maintain the share gains that you had this year? Thanks.

It is a good question. I guess I would start by saying, eyes wide open. We understand what we are doing, and especially as we make choices on certain SKUs that are either money-losing or marginally profitable. Listen, there are those within every business, especially one as broad as ours, within the lawn and garden category. We understand that there could be consequences to that. We think that they are built into our planning assumptions in regard to profitability, put it that way.

Good morning, everyone. Jim, could you touch upon your new product plans both for next year, and in the future, what is your level of confidence in terms of what that pipeline is?

Yes, let's hand it to Jim Lyski, who is our Chief Marketing Officer.

Good morning. It is Jim. I would say that if you broke it into a few categories, the first thing that we are going to do is ensure that we continue to invest in a year or two of our key innovations (technical difficulty) Snap and the lawn applicator. Those had very good years, and we feel that there is a lot of runway left on both of those. So that will be number one.

Number two, you are going to see us come out with some very good innovations around our core grass seed Turf Builder line of grass seed that we think will take the bar up once again and performance in that category.

The third is we will be introducing a brand-new line of propellants this year, something that will be completely incremental to Scotts Miracle-Gro, and it is getting very good retailer reception at the moment.
And then finally, we are going to experiment a little on different ways to tie the Miracle-Gro brand in more of the live goods growing category and see if there is any opportunity there to monetize the brand in a significant part of the gardening category.

Jim Barrett - CL King & Associates - Analyst

Okay. Thank you. And the follow-up would be for Jim Hagedorn. Jim, is the Company reevaluating all of its current geographies and whether it should be competing in all those geographies? And thank you very much.

Jim Hagedorn - The Scotts Miracle-Gro Company - CEO & Chairman

You are welcome. Too many Jims. What do you mean by geographies?

Jim Barrett - CL King & Associates - Analyst

I am thinking of Europe specifically.

Jim Hagedorn - The Scotts Miracle-Gro Company - CEO & Chairman

I'm only -- I'm choosing my words really carefully here. Whatever is happening in America, it is worse in Europe. And I think that -- as we finished our Board meeting yesterday, I think -- and we have got a pretty good Board, and I'm very confident in our management team as well.

I think what we got to is saying we really think the world is different coming out of this -- hopefully coming out -- of this grand recession or whatever it is. And we think companies are going to have to be different as well, even after there is some recovery, whatever that means, in the consumer both in America, and I'm really talking in the developed world. So I'm not really talking about Asia and Latin America. I'm really talking with old world countries like America and Western Europe.

I'm not sure the consumer is going to be exactly the same, probably not, coming out. But I don't think companies are going to be the same coming out either. And I think that companies that adapt well are going to learn to thrive in a somewhat different environment.

I think when it comes to Europe that would be the word of the day, and that the challenge to Barry and his European management team is going to be to say, how do we do more with less? And I don't think that changes. And I think we have got to embrace that as the way of the world and the way of business going forward is that at least for the foreseeable future, people are going to have to -- we are going to have to basically view the architecture of new companies as different. And I think Europe is going to -- and they have been doing a great job of trying to really hold their expenses. It's just it is not enough, not in what we are seeing, and we did really get into quarterly cuts, and I am not going to on what is happening in Europe. But it is grim, and we have got a great business, but it still grim on a profit point of view. And, therefore, I think there is as much challenge in the Europe as there is in the US because it is broken up into more jurisdictions. So that is going to have to be dealt with, and I'm going to continue to encourage my colleagues to deal with this.

But you might look back, Jim, and say that there was a period where we said we were going to exit Europe. Our Roundup, or global Roundup deal, makes that really difficult to do. And so I think it is -- I'm not sure if it is Goodfellas or A Bronx Tale, where there is kind of a bunch of bikers get into a Mafia bar and piss off the Mafia chieftain and then he says, "Nows ya can't leave." I think there is an element of "nows ya can't leave" to Europe, and therefore, we have got to make the best of it. And that is largely driven by a much, a very significantly important deal we have with Monsanto, which we want to keep. And so I think it just makes the challenge a little greater. But I think "nows ya can't leave" is probably the order of the day.

Jim Barrett - CL King & Associates - Analyst

Okay. Thank you very much. Good luck.
Josh Borstein - Longbow Research - Analyst
This is Josh Borstein in for David MacGregor. Thanks for taking my questions.

In your June statement, you said that typically gardening activity accelerates during Mother’s Day through Memorial Day, but that did not happen this year. You were trying to better understand why. Have you learned anything incremental since then about what happened?

Jim Hagedorn - The Scotts Miracle-Gro Company - CEO & Chairman
Maybe some one has got a better answer than I do.

Dave Evans - The Scotts Miracle-Gro Company - CFO & EVP, Strategy and Business Development
90 degrees, the heat.

Josh Borstein - Longbow Research - Analyst
The heat?

Jim Hagedorn - The Scotts Miracle-Gro Company - CEO & Chairman
Listen, I’m not going to say the heat. I think it it is what I said before, which is I could show you weather maps, and there is for sure a theme this year of hot and dry, and July was the hottest month, I think, in US history. And it did not just start in July. And I could also show you economic health charts from states that would show you a relationship between our sales and the economic health of states like Texas and North Dakota where there is a lot of energy work happening.

I also think there is a very significant consumer change happened in that period.

And so I have not made the effort to really try to figure out what it is. I know Jim has, and he has produced some charts. I’m not sure I have a lot of faith in them, but it is an effort to put like saying, is it weather, is it the economy, is it year-over-year sales, a sort of trajectory that has an effect? I think they all have an effect. And I think that everything we are talking about on this call is about periods where we would have expected much better sales and we did not see them. Ultimately we would be having a different call here if we said it was just weather.

You know, if there is a theme to this call, it is we think the consumer has like suffered and is something changed in the middle of our lawn and garden season, and we are not expecting it to get better for the next couple of years. And we are going to run our Company a little differently so that we are ready for when it changes. We are prepped for it. We bring out new products, we continue to innovate, we continue to push out into new geographies where we think there’s growth opportunities, and we continue to advertise, and we continue to be a great employer. But the world is different based on the fact that we just don’t see the growth right now.

Operator
Thanks for taking my question.
Operator
Jeff Zekauskas, JPMorgan.

Jeff Zekauskas - JPMorgan Securities Inc. - Analyst
Thanks very much. I missed the first two minutes of the call because of The Wall Street report, so I apologize if you have addressed this.

So, if you think that your volume growth more or less is zero as your base case, then presumably to hit all of your targets, you are spending has to be cut each year over a multiyear period or at least over two years or three years, something like that. So whatever the actual number of cuts, the amount of cut, I take it that that is the operating plan going forward.

Jim Hagedorn - The Scotts Miracle-Gro Company - CEO & Chairman
Just halt for a second, just so I can correct you before you get too much of a head of steam going.

Jeff Zekauskas - JPMorgan Securities Inc. - Analyst
Yes, I'm sorry.

Jim Hagedorn - The Scotts Miracle-Gro Company - CEO & Chairman
We intend to take pricing. (multiple speakers). So the unit volume we do expect to be flat. Dollar volume we do not expect to be flat.

Jeff Zekauskas - JPMorgan Securities Inc. - Analyst
Yes. That said, you need a margin of error in order to hit your earnings targets. So is it still safe to say that your overall spending for next year just simply should be lower across the board?

Jim Hagedorn - The Scotts Miracle-Gro Company - CEO & Chairman
The answer is yes!

Jeff Zekauskas - JPMorgan Securities Inc. - Analyst
Yes. And then secondly, you were kind enough to be very accurate about your intellectual agnosticism about why the consumer is acting differently. But historically you have conceptualized it very clearly, that is there is a desire to be outside. It is a healthy activity. It is something that makes people feel good. People want to do this. So I realize that there is a lot of confusion as to why thematically the consumer is acting differently, but what are the hypotheses now as to why the consumer is acting differently, even if you cannot settle on one that is the true one?

Barry Sanders - The Scotts Miracle-Gro Company - President & COO
This is Barry Sanders. The charts that Jim had talked about, that Jim Lyski has produced, we have tried to correlate as best we could. The number one correlation for what drives our sales, which led to our optimism for this year, is comps last year. And so we had that bad 2011.
Number two is the economy. And so what we think has changed relative to this and we have talked quite a bit about this is, this prolonged economy and the relative -- Jim talked about consumer products, and I think Alice Longley said this, the discretionary nature of our products, the prolonged nature we would say that the economy is impacting it, which is leading to our planning assumptions now to say we are not going to fight this headwind of the economy until it turns around. And just as you have said, we will reduce our spending to accommodate what kind of economic conditions we are operating in now.

Jeff Zekauskas - JPMorgan Securities Inc. - Analyst

Okay.

Jim Hagedorn - The Scotts Miracle-Gro Company - CEO & Chairman

But look, I think that our research data does not show differently how consumers feel about gardening. So it's not like we are seeing this big falloff in consumers' desire or intent to garden. But they clearly did not spend behind it. And what Barry left off was that right after the economy was weather. We know weather was challenging this year. I mean I know the factor was not zero, but again, I think what we are seeing is -- listen, if it comes back to what we have got to do, consistency in earnings and our cash flows we have got to restore. The budgeting assumptions we are making, which we believe in, of zero unit growth in this period of consumer atmosphere -- that is not a good word to use, but it is what I'm kind of meaning -- is safe for us, that the controllable part of how we spend money then affects what we earn.

I just think that other people may give you better answers than I can. I just have to say that something happened in the middle of this year, and it's alarming. It is really -- I would say if you are an American, if people are not buying petunias, worry. And I think we are seeing something -- maybe other people are not yet -- but something happened this year, and it is more than just the weather. That is effectively where we are. Something happening and it's more than weather.

I would ask you. You guys are the geniuses. We sell dirt, man, and seed and bags of manure. Do you know?

Jeff Zekauskas - JPMorgan Securities Inc. - Analyst

I think people are spending a lot of time mastering their electronic devices in their spare time.

Jim Hagedorn - The Scotts Miracle-Gro Company - CEO & Chairman

Okay. All right. Anything else, Jeff?

Jeff Zekauskas - JPMorgan Securities Inc. - Analyst

That is all. Thank you very much.

Jim King - The Scotts Miracle-Gro Company - SVP, IR and Corporate Communications

All right. I think that is all the questions that we have for this morning. If there are follow-up questions and you don't already have time scheduled with us, just give me a call directly. That is 937-578-5622. Otherwise, we will talk to you all during our fourth-quarter conference call in early November.

Thanks. Have a great day.
Operator

Thank you for participating in today's conference call. You may disconnect at this time.