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# EDITED TRANSCRIPT

SMG.N - Q4 2024 Scotts Miracle-Gro Co Earnings Call

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## OVERVIEW:

Company Summary

## CORPORATE PARTICIPANTS

**Aimee Deluca** *Scotts Miracle-Gro Co - SVP, IR*

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

**Matthew Garth** *Scotts Miracle-Gro Co - Executive Vice President, Chief Financial Officer & Chief Administrative Officer*

**Nate Baxter** *Scotts Miracle-Gro Co - Executive Vice President and Chief Operating Officer*

**Chris Hagedorn** *Scotts Company LLC - Executive Vice President & Division President of Hawthorne Gardening Company*

**Josh Meihls** *Scotts Company LLC - Senior Vice President, Global Sales*

## CONFERENCE CALL PARTICIPANTS

**Jon Anderson** *William Blair - Analyst*

**Joseph Altobello** *Raymond James - Analyst*

**William Carter** *Stifel - Analyst*

**Peter Grom** *UBS - Analyst*

**Chris Carey** *Wells Fargo Securities - Analyst*

**Eric Bouchard** *Cleveland Research & Co - Analyst*

**William Reuter** *Bank of America - Analyst*

**Carla Casella** *JPMorgan - Analyst*

## PRESENTATION

**Aimee Deluca** - *Scotts Miracle-Gro Co - SVP, IR*

Good morning. Welcome to Scotts Miracle-Gro's Fiscal '24 year-end earnings Webcast. I'm Amy DeLuca, Head of Investor Relations. Speaking today are Chairman, President and CEO, Jim Hagedorn; and Chief Financial and Administrative Officer, Matt Garth. Jim will provide an overall business update, followed by Matt with a review of our financial results.

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 share today. Please refer to our SEC filings for details of the risk factors that could impact our results.

Following the webcast, Chief Operating Officer, Nate Baxter; and Hawthorne Division President, Chris Hagedorn will join Jim and Matt 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 An archived version will be published on our website at [investor.scotts.com](http://investor.scotts.com). For further discussion after the call, please email or call me directly.

Now, let's get started with Jim's update.

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

Good morning. Before I get into our 2024 performance and guidance for fiscal '25, I want to reflect on our journey and discuss my midterm priorities.

Doing so will help everyone appreciate the progress we've made and provide context for where we're headed. It was just two years ago we were strapped for cash and saddled with high debt. We were burdened by a cost structure we built up for the pandemic-era demand.

But could no longer afford. We were managing an extremely high leverage ratio on a daily basis, and we had to go to our banks several times to navigate it. But we owned our situation.

Faced with very hard choices, we made decisions in the moment and were determined to right-size our business. We cut over \$400 million in operating expenses. We dismantled Hawthorne to make it a much smaller and more profitable business.

And we honored our bank covenants and were accountable on every level. At the same time, we reinvested \$100 million to protect what I call our superpowers; our brands, our sales force, supply chain and innovation.

We got through these worst of times upholding our commitment to shareholders. Despite some doubters out there, we maintained the dividend and avoided the issuance of additional shares. This takes us where we are today.

Fiscal '24 was the pivotal moment in the journey. It's the year which we made the shift from crisis management to running the business with a focus on the future. We're no longer making decisions under duress.

We've made meaningful improvements to the most important financial metrics. And we've created a foundation for the three-year growth plan that we outlined at our July investor event. That plan is grounded in my midterm priorities, which include driving consistent and sustained growth averaging 3% annually, deploying at least \$200 million in advertising and marketing spend each year, improving our gross margin rate to the mid-30% range, delivering EBITDA approaching \$700 million, and reducing our leverage to approximately 3 times.

We'll make progress against all these priorities in '25, and I expect to achieve all of them by the end of fiscal '27. Accomplishing these priorities will maximize our ability to get the share price back where it should be and enable us to deliver outsized shareholder returns.

My overarching goal is to ensure Scotts Miracle-Gro is a stable and dependable consumer equity in investor portfolios. In my view, our results this past year were a huge down payment on these priorities. We met or exceeded our commitments.

In fiscal '24, we achieved adjusted EBITDA growth of 20%, finishing at \$539 million, despite a lawn and garden market that was down overall. It was a rocky season with extended periods of unfavorable weather in the Northeast and Midwest. We drove 6% top-line growth in our consumer business and took significant market share, especially in gardens and controls. POS units across our portfolio were up nearly 9%.

We told you we would achieve these growth numbers through increased listings, expanded share of shelf and investments in our superpowers, and we did. We over-delivered on our commitment to drive \$1 billion in free cash flow over two years.

We said we would reduce inventory below \$600 million, and we achieved more than that. This was historic for us. Even some of us thought this couldn't be done, and I give Nate Baxter and Dave Swihart, the Head of our Supply Chain, a tremendous amount of credit.

We pledged to aggressively pay down debt and get our leverage below 5 times EBITDA. We ended the year at 4.86 times. I commend Matt Garth and his treasury team for their hard work. And we restructured Hawthorne, making a strategic pivot from third party distribution to focus on our most profitable owned brands. Hawthorne finished '24 with consecutive quarters of positive EBITDA for the first time in two years. Chris Hagedorn and Tom Crabtree did a ton of heavy lifting to make this happen.

When you look at our overall performance, I couldn't be more proud of the SMG team. We've enhanced our profitability without negatively impacting the things that drive our business. In fact, we put \$20 million more into our brands and advertising than last year. And we kept SG&A essentially flat to '23 and 9% below 2022. I mentioned earlier that gross margin improvement was high on my list. We'd lost about 900 basis points of margin since the peak of COVID.

In fiscal '24 after adjustments, we got back over 300 basis points. And we'll recapture more in '25. I expect by the end of this fiscal year, we'll recover about two-thirds of our margin loss. But that last third is going to be more challenging. You'll recall that I talked last quarter about how we'd work with our retailers to get pricing across the portfolio. This proved to be a tough proposition. And let me explain.

Despite the easing of inflation and interest rates, consumer sentiment is below its historic average. There have been endless stories about the state of the consumer. A recent Wall Street Journal headline declared that consumers were still, seething over high prices. You see this playing out in troubles facing some of the biggest consumer brands, from Starbucks to McDonald's.

Given this environment, our retailers are highly sensitive to any price increases and potential impacts those may have on their own margins. Still, we were successful in securing north of 1% through targeted increases on key SKUs. All retail partners are participating, and we do not think this will turn off consumers. While we're pleased with the pricing we did get, it's not enough to close that margin gap. I don't think we can put any more pricing on consumers at this time.

There are other levers we're pulling to drive margin improvement. These include incremental volume growth and potential M&A. Our M&A pipeline is made up of small to midsize, branded lawn and garden companies that are in adjacent categories and would be easy to integrate. We'll also help recover it by being very deliberate with cost outs. To some extent, this is a familiar place for us over the last few years, as we work to balance cost reductions with investments in the company. We'll start by taking a hard look at our business and product lines.

That's the impetus behind our recent decision to discontinue AeroGarden. This was a business we bought and invested in for a reason. It was an entry into direct to the consumer and expanded our indoor and urban gardening portfolio.

Despite the strategic rationale, AeroGarden has not been profitable, and this is not the time to burden our recovery with things that are not supporting or accelerating our financial improvement. We had to make similar choices with Hawthorne, and I can tell that I personally grieve over some of the things we had to cut. We'll also continue to optimize operations.

Investments we've made in automation, demand planning and predictive analytics will enable us to take another \$150 million out of our supply chain over the next three years. We're for sure a leaner company. The next step in our organization is to figure out how to operate as a much more efficient and effective team.

It will not only include more cost reductions, but also lead to a creation of a structure and cultural mindset in which everyone is focused on the right things for the future of our company. And this will require us to be more flexible and move with speed.

To this end, Rich Turner has joined my team as the Head of Human Resources to lead this process and take a new look at the entire organization.

Let's shift to how we see '25 unfolding. You can expect us to go after more growth and bottom-line improvement. We're guiding to EBITDA of \$570 million to \$590 million, an increase of 6% to 9% over 2024's adjusted EBITDA. And we're projecting sales growth of 2% in our consumer business, along with \$20 million in EBITDA from Hawthorne. Hawthorne's narrower focus will reduce top-line sales but improve its margins. We'll ramp up investments too in both consumer and Hawthorne.

Our brands are not just to Scotts Miracle-Gro superpower. They are to Hawthorne as well. And they're going to be spending an incremental \$10 million on brand support in their business too. In our consumer business, we'll invest over \$30 million more in advertising, marketing, brands and innovation. Core consumers continue to be our primary target, but we'll do more to bring new people into our category. In addition to our higher investment spend I mentioned earlier, we're going to spend more money promoting with our retailers.

We expect this to result in increased foot traffic for them and additional listings and shelf space for us. This is powerful. The retailer programs drive more volume, along with margin recovery through fixed-cost absorption.

The net effect of all of our investments this year will be additional consumer takeaway and even more share gains, building upon the substantial share gain we got in fiscal '24. One of the superpowers is our field sales force that regularly engages with consumers and finds ways to capture additional POS within the store.

I'm throwing down a challenge to our in-store teams. I want them to do more to drive growth. I think they can deliver at least an incremental 1% more in sales. I'm encouraged by their energy and enthusiasm, and I'm confident they'll rise to the challenge through in-store activities combined with securing off-shelf and end-cap opportunities.

Line extensions will also play a role in incremental growth. This year, we'll expand the Miracle-Gro Organic line to include a full portfolio spanning plant food to indoor and outdoor soils. These products will complement the strong raised bed and mulch innovations that we introduced in '24. This year's Ortho Weed Preventer is a new space for Ortho.

Just as importantly, it sends a message. We will be taking a more aggressive approach in attacking the competition across all of our brands through multiple tactics. This includes advertising and messaging, new branded solutions and key adjacencies, and targeted M&A where it makes financial sense.

In lawns, we're going to launch a new O.M. Scotts & Son natural lawn fertilizer and grass seed. And here's what's exciting about this. This brand will feature legacy-inspired packaging made of curbside recyclable paper. It will be the first product packaging to include our purpose to grow more good. This product line will allow us to introduce Scotts brands to a whole new group of consumers.

When it comes to the power of our brands, I think it's important to do more than just talk about it. It's better to show you what's coming this spring. This starts with our marketing leadership. We've infused new energy into the brands with impactful leaders who are proven marketers and creative minds. They're young people with really good ideas on where they want to drive their businesses.

Sadie Oldham leads our gardens business with the support from Martha Stewart, our Chief Gardening Officer. Mike Davitt oversees controls and John Sass heads lawns. And we're having a lot of fun getting everything in place for next spring. Let me share these two messages I received from Martha during a recent commercial shoot

(video playing)

Yes, I'm going to let each business talk about what's up for this coming season.

(video playing)

As you can see, we're attacking the market even harder in 2025, and we're comfortable with our guidance. The analysts who cover our company will run their own models on how they think we'll perform, and they might come up with numbers even bigger than ours. But I want to stress this about our guidance. It's achievable. It's a realistic roadmap. We're confident we will deliver upon it, and we have upside to achieve more.

When you look at what we've accomplished in our journey and our plans for this year, I believe we're driving a very acceptable financial recovery. We're doing so by successfully balancing diligent financial management with maximum spend on our superpowers. I think we're creating long-term value and building a very powerful and special consumer franchise.

It's been an awful lot of work, and I have many people to thank for their support and commitment. This includes our shareholders, our associates, our board of directors, our banks, our retail partners, and my management team.

I'll turn it over to Matt for additional perspective on our performance and outlook.

**Matthew Garth** - *Scotts Miracle-Gro Co - Executive Vice President, Chief Financial Officer & Chief Administrative Officer*

Thank you, Jim, and hello, everyone. 2024 marked another year that our team made progress in returning SMG to profitable growth. We improved consumer engagement, expanded margins, and strengthened the balance sheet. We increased investments in our brands and optimized our portfolio for the long-term health of the business. I'm extremely proud of the momentum we have built and how we have come together to increase the pace in 2025.

Before we dig in, note that our '24 financials include the impact of winding down AeroGarden, a \$30 million revenue business. This difficult decision was the primary driver of an inventory write-down of \$29 million that runs through the US consumer profitability. As I discuss our performance, I will walk you through how to treat these items for comparison purposes. And now let's turn to top-line results.

Total company net sales increased 11% for the quarter, and on a full-year basis, we're essentially flat to prior year at \$3.55 billion. US consumer sales increased 54% in the quarter, driven by the previously discussed timing of shipments between the third and fourth quarters of fiscal '23, as well as the fall load-in to retailers. Retailer inventories are in a good place and POS units so far this fiscal year are up about 10%, driven by gardens and controls.

For the full year, US consumer net sales ended 6% higher than prior year, and volume and mix up 7%, offset by 1% lower net pricing. Increased media and the targeted price concessions we took yielded foot traffic gains for our retailers and the incremental listings and volumes we planned for. POS units were up nearly 9% on the year.

At Hawthorne, sales declined 46% in the fourth quarter and 37% for the full year. This result was in line with our guidance following the second quarter decision to exit third-party distribution business. From a gross margin perspective, if we were to exclude the impact of the inventory write-offs, we achieved 340 basis points of year-over-year margin improvement, which tracked well ahead of our goal for the fiscal year.

Inclusive of the write-offs, total company non-GAAP gross margin rate improved 260 basis points over prior year to 26.3%. SG&A ended the year within our guidance range at 15.7% of net sales. Excluding the inventory write-offs, operating income was around 11% of sales and EBITDA was \$539 million, an improvement of 20% versus fiscal '23. When including the write-offs, adjusted operating income for the fiscal year was \$355 million or 10% of sales, and non-GAAP adjusted EBITDA was \$510 million.

Below the line, interest expense was down by \$19 million on lower average borrowings and debt paydown. Our non-GAAP adjusted effective tax rate for the year improved to 28.5%. All in, the fourth quarter adjusted loss, which excludes impairment, restructuring, and other non-recurring items, was \$2.31 per share versus \$2.77 per share last year. Full-year adjusted earnings per share improved nearly 90% to \$2.29 versus \$1.21 in fiscal '23. Note that inventory write-offs negatively impacted current year EPS by \$0.35 and prior year EPS by \$0.25.

Now let's move on to free cash flow in the balance sheet. We delivered on our target of generating over \$1 billion of free cash flow over two years with more than \$580 million generated this year on top of nearly \$440 million last year. Inventories ended fiscal '24 just below \$600 million, a level we will seek to maintain for the foreseeable future. We utilized free cash flow to return value to shareholders through our quarterly dividend and increased balance sheet strength by lowering debt by \$390 million. Liquidity remained strong with nearly \$1.2 billion in borrowing capacity and \$70 million of cash on hand. Leverage improved to 4.86 times adjusted EBITDA versus a covenant maximum of 6x.

Now, turning to fiscal 2025, we are continuing to take prudent steps to strengthen Scotts Miracle-Gro and build on the strong momentum of 2024. The primary objectives of our '25 plan are expanding margins, delivering strong free cash flow and EBITDA, and making high-impact investments in the long-term health of our brands.

On the US consumer top line, we expect volume increases, the result of incremental promotions, listings and share that will build upon the significant gains of 2024. This will contribute to the low single-digit growth that Jim mentioned. At Hawthorne, net sales are expected to decline mid-single digits versus last year, primarily on exiting the third-party distribution business.

But now let's take a look at gross margin. The core of our margin recovery progression is supply chain savings, which we see totaling \$150 million over the next three years. Given outstanding work by the team to capture raw material savings and drive higher fixed-cost leverage sooner, we

now expect about half of these savings will be achieved in fiscal 2025. This will yield a full-year gross margin rate near 30%, and, to Jim's earlier point, a recovery of nearly two-thirds of the margin loss from pre-pandemic levels.

As we mentioned previously, not all of the gross margin dollars will hit EBITDA, as we are investing greater than \$40 million in media and brand strength, buttressing the long-term health and sustainability of our businesses. 2025 adjusted EBITDA is expected to range from \$570 to \$590 million, with total adjustments to operating income flat year-over-year. Below the operating line, we see interest expense lower by \$10 million versus 2024 on lower average borrowings and rate for the full year.

And to finish out the P&L point of view, other expense will increase by \$10 million, our effective tax rate will be between 27% and 29%, and share count will grow by approximately 2 million shares. Free cash flow is expected to be around \$250 million, including increased CapEx of \$100 million.

And lastly, from a net leverage perspective, we expect to end the year in the low fours, well below the max covenant of 4.75 times adjusted EBITDA. So let me summarize the outlook. Progress in fiscal '25 against our three-year plan will be substantial and inclusive of investments in our future.

We are energized and driving efficiencies to fuel our superpowers. Our targets on this path are clear. Sustainable, profitable growth, gross margins commensurate with our leadership position, and robust financial flexibility. With that, I'll turn the call back to the operator so we can answer your questions. Operator?

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions)

Jon Andersen with William Blair.

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### Jon Anderson - William Blair - Analyst

Hey, Good morning, everybody. Thanks for the questions. I wanted to ask first about your top-line guidance. Thanks for providing that, by the way, for '25. But I'm hoping you can provide a clarification on that guide specifically for the US consumer business.

It sounds like there may be some one-time items or factors in 2024 that won't repeat. I think AeroGarden perhaps being one of them. How does that affect the guidance of kind of low single digits that you've offered? If you can kind of sort through some of the puts and takes there for greater clarity, that would be helpful.

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### Nate Baxter - Scotts Miracle-Gro Co - Executive Vice President and Chief Operating Officer

Yeah. Hey John. This is Nate. I'll take that one. Look, if we look at our core branded products, I think it's right in line with what Jim and Matt said. We're looking at low single-digit growth. The one-times are important, so we won't repeat the AG sales.

We also did some inventory balancing with sales of both urea and seed that were one-time in 2024 that we don't expect to repeat. So when I look at what I think matters, which is this core branded products, we see healthy growth and market share gains next year.

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### Jon Anderson - William Blair - Analyst

Okay. Do you have a quantification of what some of the one-timers may have been with AG and the urea and seed sales?

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**Nate Baxter** - *Scotts Miracle-Gro Co - Executive Vice President and Chief Operating Officer*

Sure, I'll let Matt take that.

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**Matthew Garth** - *Scotts Miracle-Gro Co - Executive Vice President, Chief Financial Officer & Chief Administrative Officer*

Thanks, Nate. And I think context here is extremely important, right, which is the investments we made in 2024 laid the groundwork for 9% growth, which I think we're going to reflect on and say that was a big win, right, volume, POS, the things that we did to drive people into the store.

We are making those same investments in 2025 to grow share, bring new innovation to the market, and position ourselves better than anyone else. What does that mean? It means we got pricing, we made investments in programs, and so those two net off. When you look at this 2%, underlying that is a 5% POS growth. I'm going to say mid-single digits.

Everyone in the room just frowned at me because they didn't want me to give a pure number there, John. But as Nate said, making investments, those one-timers are worth about 2%, John. So you really take the good work the team has done in driving volumes, that \$30 million of AeroGarden, the kind of \$20 million to \$30 million of raw material sales that we did at the end of the year, by the way, all of that essentially zero margin. So just prudent stuff to work it through, and AeroGarden we were shutting down.

That makes the baseline about zero. But as Nate said, underlying that zero is really strong improvements, and the last point on that is the share that we're going to grab. And I know the share story was a little complex this year in terms of how can we get more share.

And actually, Nate, I'm going to toss it back to you because it is a good story on making the right investments to grow this brand.

And by the way, do the right things for the long term of the company, and they're going to show up this year, but because of that 2% points in non-repeating one-time things, it's just going to show on you as a consumer around flat.

But underlying that is really strong economics. Nate, just a little.

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**Nate Baxter** - *Scotts Miracle-Gro Co - Executive Vice President and Chief Operating Officer*

So if you look at what I expect with the innovation that you saw in Jim's prepared remarks, we're going to drive a ton of incremental volume around not only those, but also the share we gained last year. I'm not looking at any losses. Know, we've got ins and outs on some of the private label stuff, but at the end of the day, we feel very good about that. I think Matt said it well. We are focused on making smart decisions around SKUs that drive margin accretion. And that's why we got rid of [AeroGarden] (corrected by company after the call). It's why we're biased towards focusing on some of our core branded products because that'll drive margin growth for us.

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**Jon Anderson** - *William Blair - Analyst*

That's helpful. Just a quick follow-up. I think Jim mentioned \$700 million in EBITDA as the goal in the prepared comments three-year target. I think it was \$600 million that was referenced at the Analyst Investor Day earlier this summer.

Can you just provide a kind of a clarification there on what the objective is? And also on the gross margin rate, just to update there, it's kind of mid-30s, still where we're hoping to end by fiscal 27th, thanks.



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

Yes, I'll take that. So, Jim here. For sure, \$700 million EBITDA by '27 is what I'm whipping the company toward. And I feel really good about sort of where we are and what we're planning for next year. And our incentive targets are very highly levered against these objectives.

By '27, that's what we're looking for. I think this lines up with trying to get leverage below 3 times by '27. It's not accidental what we got there. It's driving toward a leverage number of, call it three-ish times, by '27. What's the second question?

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**Jon Anderson** - *William Blair - Analyst*

Margin. Can you get to the mid-30s?

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

Yeah, we definitely can. I think the explanation was important. You guys saw me disagree with the rest of the leadership team, I think, in July at the Investor conference. I thought that the margin declined, occurred sort of post-COVID. The mirror image of that is if you look at retailer margins, they were up kind of that level. And our view is that was never intended to be a permanent end state.

Discussions that I had with leadership at retailers just basically said, look, if you guys take this kind of pricing and you don't make sure that it sticks at the consumer level, and we have to match other retailers who don't pass it on, you're going to mess up our margins at a time where our business is not super strong. And that would be very unwelcome.

And then I think a sort of mutual concern that consumers just, look, I think you just look at the election results. I think it's clear. Consumers, whether the sort of Washington thinks the economy is messed up, I think if you asked consumers, I met yesterday with our plant supervisors. These are kind of like the sergeants that work in our plant.

And I asked them how many of them were living sort of paycheck to paycheck. And these are mid-level managers at our business. And I think virtually all their hands went up. And when I was given kind of a preview of what we're going to talk about today. When we got to lawns pricing, I think there was definitely a view that, yeah, this stuff's gotten expensive. So I think the retailers pushed back and said, I don't think the consumer can handle more pricing.

So we got to this point then of saying, all right, we're limited in what we can do here. The sort of better than 1% pricing, which I think is what we said to you guys, we got, we feel good about that. But the goal is to get back to a mid-30s gross margin. I guess this is the answer to your question that I've been talking at. And the intent is still to get there. Part of our program work, which, you know, when we talk about retailer programs, this is one that's easy to get like all messed up on.

And, you know, this is not a rebate program for sort of being alive. You get what we did this year and what we're going to be doing again in '25, or sort of compared '24 to '25, is we're paying for incremental promotion, incremental listings, extended promotions.

And those things pay off. I think you look at the results this year in a down market, and I think The Scotts results are pretty phenomenal to be honest. That helps us with absorption in our manufacturing facilities. And so it is margin accretive for us to do these things. And the money we want to invest behind call it marketing, but our superpowers.

So these are all things we're doing, and the goal of mid-30s on gross margin is intact. And, you know, we are going to work really hard, really over, I think, this quarter and maybe into the first half of our fiscal year to button down the savings that augment what we don't think we can get from pricing.

**Operator**

Altobello with Raymond James.

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**Joseph Altobello** - *Raymond James - Analyst*

Thanks. Hey guys, good morning. Just wanted to follow up on that last comment, Jim, and one you made earlier in the call. I think you said margin expansion will be a little bit more challenging after fiscal '25. You're still looking for call it, mid-30s gross margins by fiscal '27. -- although it sounds like pricing will be less of a component of that. So is it really just finding other margin drivers outside of pricing to still get to that same end goal.

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

Look, I know everybody around the table probably wants me to say yes. I think the answer is no. I was deliberate in saying at this time on pricing. Retailer margins were kind of the mirror image of ours. And I never viewed those as being permanent I think it is just not an appropriate time to sort of fight with retailers over getting it back, while they're trying to rebuild their business post COVID as well. So I don't think I'm giving up on pricing. I think, hopefully, the election makes people happier and wealthier.

But if we can't get through as much pricing as I'd like, we're going to get it through more sales with good margin products and cutting expenses here in our business, and we're going to do both. But I don't think that pricing is through '27 out the window I think it is not something at this moment that we can count on beyond what we already got.

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**Nate Baxter** - *Scotts Miracle-Gro Co - Executive Vice President and Chief Operating Officer*

Agreed. Let me just add on to that, Joe. I think when you look at innovation that's in the pipeline that will be coming out, along with our business unit focus on making sure that we're putting high-margin SKUs out there I think that, along with pricing, along with the business transformation that Jim is talking about, we'll have levers to play to get to those mid-30s.

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**Matthew Garth** - *Scotts Miracle-Gro Co - Executive Vice President, Chief Financial Officer & Chief Administrative Officer*

And let me just add, Joe, because I think there's some important context and perspective. What are we talking about? We are talking about a margin in '23, that was 23.6%, and we're talking about getting ourselves back to the mid-30s, right? If you go point to point, as we showed you, at the July Investor Day, it was roughly 900 basis points. It's been '23 between '24 and '25 we're getting essentially 600 basis points, right?

So, we went from 23.6% to 27%, my math, 340 basis points in '24. We're putting on the table getting to 30-ish in '25, that's another 300 basis points. So 650 out of 900. The balance of the supply chain savings that we are talking about, we're going to get. And so that's another, let's call it, 150, 200 basis points.

So what Jim is really talking about is those 200 to 300 basis points that sit out there that we need to optimize around. But the big chunks of our margin recovery, I'm not going to say are complete because we still need to execute. We still need to go get them, but they are visible and they are planned for. So the margin recovery into the 30s very strong, very tangible.

Getting to the mid-30s we got two years; Nate and I talk about it every day. We have two to three years to get there, and we're going to get there. And it's going to be a whole number of things like they just articulated.

So, we feel really good about the margin climb out. I'm going to let other people ask questions about what happens down the P&L unless you have one, but there are other important contextual factors here in '25 and as we move forward.

**Joseph Altobello** - *Raymond James - Analyst*

Got it. Very helpful. Just a follow-up on that. I mean, obviously, you talked about returning cash to shareholders. And at least historically, share buybacks have been a big part of that. I get the fact that the balance sheet is a little bit or a lot stretched in the past, less so now. When do you guys anticipate maybe pivoting back toward that share repurchase activity?

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**Matthew Garth** - *Scotts Miracle-Gro Co - Executive Vice President, Chief Financial Officer & Chief Administrative Officer*

Yeah. And it's in the context of actually really the target that Jim laid out, right? Because it is about financial flexibility. The company historically would have had a net leverage position of around 3.5 times in the MAX financial covenant have been 4.5 times. And that was a really comfortable position. I think we've talked to you guys about it, and Jim and I have been very consistent as we find a glide path into the low 3s, we can start to take some of this debt paydown that we're doing and move it to share repurchases.

Now does that mean 18 months out from now, we're having a discussion on you guys are looking like you're getting to 3s. Can you start turning some to share repurchases? I think yes. But let's see the cash flow come in. And let's prove out that we have that pathway into the 3s to be able to meet the target that we have ahead of us. But we're not going to wait until we had a trigger. We can start to be flexible and prioritize our cash flows as we work out.

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**Joseph Altobello** - *Raymond James - Analyst*

Got it. Okay. Thank you.

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**Operator**

William Carter with Stifel.

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**William Carter** - *Stifel - Analyst*

Hi, thanks. Good morning. So kind of looking through in terms of kind of the promotion where the retailers kind of leaned in this this year to the category. Number one, are you replacing some of that promotion with the incremental this year?

And then I guess, do you have the perspective when looking at it if that promotion actually grew the category overall, or was just the customers kind of taking share from each other? Therefore, as that moves back, it's a wash? Thanks.

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**Nate Baxter** - *Scotts Miracle-Gro Co - Executive Vice President and Chief Operating Officer*

So just to be clear, the promotions last year did drive volume, and we're adding incremental promotions this year. So we're increasing our net investment there. We're moving things around a little bit in response to some of the lessons we learned last year, especially with lawns.

Lawns is a big focus of ours as we all know that that business has been shrinking, and we have a focused effort to try to turn that around. So I think from that perspective, we feel good about additional market share gains associated, especially with the new listings that will be out. Jim went through them, but an exhaustive list of New OM Scott, the new expanded MGO line, the weed preventer -- we have ortho simple, non-selective weed that we're going out with, that's safe and effective.

So, I feel pretty good that we've got an opportunity to gain. Now we won't gain share like we did last year. I think we did take share from others. The market was generally down lawn and garden when you look at it in the context of our fiscal year. And I think we'll continue to do the same.

Retailers, I will tell you, are leaning into these promotions. We're getting out earlier. I think the fall POS has been strong. The load-in has been strong. So I think all signals are that we're setting ourselves up for an early start to what we good season.

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

I don't know, Andrew I'm going to talk and just tag onto that a little bit, which is I hope the message that people are hearing is that we are being absolutely aggressive in attacking this marketplace. And I think that -- it's a very significant attitude change with our young marketeers who run our brands, and I'm really proud of them.

Combined with a lot more money, they can invest behind their brands combined with programs that are gaining sales opportunities with the retailer that's good for both the retailers and us. And if I'm listening to this, as a competitor, I'm kind of worried that Scotts is going to be a much more dangerous competitor than we have in the past.

And I think we're coming out of this very challenging period for us with a pretty bad attitude, if you're a competitor of ours. And I'm pretty good about these retail programs because -- it's not just saying we'll give you another 1% of sales or I'm making a number up there. That's not a real number. But we will pay for a menu of opportunities to sell additional products. They're all about it. They're investing at least as much as we are behind these promotions.

They're very committed on our sales -- I'm going to call it programs, but it's kind of a different word, the commitments they're making toward this spring season, there loading earlier than they have, which is also good for us.

So it's one of those things where you look at it, I really like it. And I hope it feels like we're on the move to you guys coming out of a pretty challenging period where we were kind of -- I think we're doing the right things. We invested in our superpowers, but I think that this is a company that was a bit on it heals and we're moving out of that with gusto.

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**William Carter** - *Stifel - Analyst*

Thanks. I'll pass it on. Thank you.

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

Thank you.

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**Operator**

Peter Grom with UBS.

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**Peter Grom** - *UBS - Analyst*

Thanks, operator, and good morning, everyone. Hope you do it well. I guess two quick ones. So maybe just more on from a housekeeping. So when we think about the 2% core US growth, can you maybe just unpack? Is that just entirely volume growth versus any sort of price? Or are you including M&A in that at this point in time.

Apologies if I missed that. I just want to make sure I have the components correct? And then I guess just on the incremental investment spend. So I think back in July or August, the last time we spoke, it was \$25 million. Now I think 40 million or slightly more than 40 million. Can you maybe just unpack where that incremental investment is going?

Where are you focusing more? And then, Jim, just kind of touching on your last point being more dangerous competitor changing how you're thinking about growth. But -- and you clearly are investing more, but the top line guidance isn't really all that different. So maybe you can just kind of connect the dots for me there? Thanks.

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

Yes. I knew this -- like I'll start with the end. I think what we're looking for -- and I'll be -- Matt picked it up and was a little less conservative, and I will be as well. But if you say mid-single digits invoice sales prior to sort of corrections that we're making of non-recurring stuff.

I think that will really help you. And I think this helps you understand that we are getting return on the sales. If you take AeroGarden out and say that's worth 1%, say that the bulk sales we did for inventory reduction, which was part of our plan to sell excess inventory that we had of raw materials. We did that say that's worth 1%.

We said more than 1% in pricing. So I don't know what you want to use that, but 1%, 1.5%, I think you're not going to be far off. And that's how you get down to sort of what will show up to you guys is like 0% to 2%. So I think it's actually a pretty fair return.

Now we also -- and listen, I guess people's reaction will sort of be a little bit of a vote on how they feel about it. I also feel we're making multiyear investments in our brands and our franchise. And I think that's -- if I'm an investor and look, my family is the largest investor in this company, I think it's a little bit what John Sass said. If you look at Miracle-Gro or you look at Scotts or you look at Roundup, these are hundreds of millions of dollars of brand investments that drive the value of these licenses, these brands, which are licenses to the consumer.

And so, for where we are in the recovery, moving towards \$700 million of EBITDA, 3x leverage. If I can do that without being so concerned that sort of for every dollar we invest in our brand support and innovation work and our other superpowers that I get all of it back today I think it's a good investment. And if I'm an investor, I feel that's a proper use of the money, if I can both make my financial commitments reasonably at the same time investing in a franchise that I think if you look at this business, and it's another one of those things I was trying to communicate in the script.

I hope I was successful at it, that The Scotts Miracle-Gro Company is an extremely rare consumer franchise. Lawn and Garden is a really good category. It's healthy. We are wicked dominant in this space, and we're going to grow that, and we're not being attacked by, really, I actually don't want to super get on this. I was having a conversation with Donald Trump a week and a half ago, and he asked, who are your competitors? And I basically said, private label.

And so I think investing in this franchise responsibly, where we're balancing our financial output with the long-term value of this franchise is a good investment, and that's kind of how I'd answer it. I don't know if that works.

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**Nate Baxter** - *Scotts Miracle-Gro Co - Executive Vice President and Chief Operating Officer*

And I can add a little color to it, which is if you look at that net increase in investment, roughly 75% to 80% of it is going directly to brand support this year that will drive volume and bring people into the stores. And this has been a topic of discussion amongst Matt and Jim and I.

We're also using that last 20% to 25% to start building the midterm capacity, whether it's consumer experience around revamping our websites, D2C, retailer.com, R&D investment in new actives, et cetera. So I think it's balanced, it's righteous, and it's part of the multi-year growth plan.

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

No, come on, come on. Throw something in there, Matt. I just think that, I hope people, we're pretty fanatical about this here, that if we can do both, please our shareholders with return on this business and this recovery, balance it with license to grow. I don't know.

**Matthew Garth** - *Scotts Miracle-Gro Co - Executive Vice President, Chief Financial Officer & Chief Administrative Officer*

Okay, here's what was happening. I have a bad brother face and it's hard for me to hide it, right, which is we walked this fine line with you all. And I think over the last two years, we've proven out that we are going to make the right decisions for the generational health of The Scotts Miracle-Gro consumer. And yes, there were legacy investments that we were getting out.

There were cashflow issues that we were having. There was an over leveraged position that we had. We are now signaling today that we feel better about the steps forward. This guidance for all the questions that sit out there kind of says, and we said it in our scripts, it's conservative, which by the way, and this goes to all of our investors, you asked us to do.

And so this is prudent steps to provide you with a path to numbers that secure our future. What does that mean? Growing US consumer. Okay, I have some baseline adjustments that net to zero. I got it. Hawthorne, the amount of steps that we've made in Hawthorne to go from a loss of [50 million] to break even this year to plus \$20 million, by the way, with revenue falling by half, prudent steps.

And that leads the groundwork for a more profitable Hawthorne moving forward. These investments in what we've done and gaining gross margin over the past couple of years, we're going to deliver 30% gross margin this year, which I feel extremely powerful about near 30, let's say, because Jim just corrected me. What does that mean? It means we have the power to make investments in the brand.

So that \$25 million, Peter, that we were talking about, bumping that up to \$40 million, that's the power that we have. And from a P&L perspective, it's good. And yielding 570 to 590 of EBITDA on a conservative basis, because again, there are unknowns as we move into the year.

And I am being a little bit on the edge here to say I feel better about performing against that guidance than I have in my last two years here, because we have taken the right prudent steps to ensure that you have clarity that we are making the right decisions for the future. Because by the way, outside of this call, the vast majority of the conversations are, how can you get from 30 to 35? How can you get from 3.5 billion to 5 billion? That requires these growth investments, and they don't all pay off this year. And that's okay.

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**Peter Grom** - *UBS - Analyst*

Got it. Thanks so much for that. I'll pass it on.

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**Operator**

Chris Carey with Wells Fargo Securities.

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**Chris Carey** - *Wells Fargo Securities - Analyst*

Hi, guys. Good morning. Just one quick modeling question, then a follow-up. What is the year-over-year impact on EBITDA from changes from paying people more in stock to paying people more in cash? Can you comment on that? And I can expand if that doesn't make sense. But I understand there was more use of stock comp in fiscal '24, and presumably there will be less use of stock comp and more use of cash in fiscal 25. What's the year-over-year dynamic with EBITDA on that item specifically?

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**Matthew Garth** - *Scotts Miracle-Gro Co - Executive Vice President, Chief Financial Officer & Chief Administrative Officer*

So, the add-backs that we guided you to on EBITDA are equal to what they were last year. And so what's happening from an incentives program, we are going to continue to use equity similar to what we did in '24. If we outperform, and Jim laid out some targets about how we can outperform, we will flip that to cash. And so within that guidance that we are giving is a provision for some incentive comp in cash which doesn't get added back to EBITDA.

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

Okay, so it's clean.

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**Chris Carey** - *Wells Fargo Securities - Analyst*

Go ahead. Correct.

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

I guess it's clean at target. I guess that's what you're saying. I think the Board and leadership want to get back to paying people with US dollars. And so if you look at our internal numbers that exceed what we're telling you guys, anything over target would be paid as normal in cash. So the up-to-target director and above, which is fairly high-ranked here, is in equity. Above that would be in cash. And the board and leadership want to get back to moving away from using equity for incentive.

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**Matthew Garth** - *Scotts Miracle-Gro Co - Executive Vice President, Chief Financial Officer & Chief Administrative Officer*

And Chris, can I also just use this as one quick opportunity just to make sure that we all look at the baseline of '24 the same? I'm not sure if it's lost in the noise of all that is taking place. I think this is one of Jim's fears in how we laid out the financials.

But baseline, my view, 340 basis points of gross margin gain, '23 to '24, EBITDA of \$539 million in '24, which was a 20% increase year over year.

So just want to make sure that that's how it shows up in the financials. Obviously, when we write inventories off, those go through the P&L. You just can't adjust it out in the financials. So want to make sure we're all looking at it the same way.

Thank you for allowing me to do that.

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**Chris Carey** - *Wells Fargo Securities - Analyst*

Yeah, of course. Chris, on Hawthorne, there has been obviously real challenges in calling the top line for the business. What if revenue comes in worse or materially worse? And I'm not saying that's going to happen, but such is the volatility in that category. What is your visibility on the profitability outlook for that business for different swings in revenue? That's it. Thanks.

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

I would say it's really good. You know, the operating team, this would be Chris, Tom Crabtree, and the rest of the guys and ladies that are running that business are extremely competent. The idea of a revenue meltdown at this point, I think, is I suppose anything is possible, but I think the possibility of that is pretty low. I think they're managing actually more upside at the moment than they are downside risk.

And remember, I'm not sure it's within the marketing, but they came back to us and said, you know, we can earn \$30 million next year, okay? Remember, I told you guys \$20 million. We looked at them and said, you know, okay, great, but are you spending the money you need to spend behind your brands and driving your business, or has that been kind of strangled out of your business through these hard times? And the answer was yes.

So Matt and I made the decision to tell them it's \$20 million. You take \$10 million for driving your business. So, I think that the risk in there is pretty low. Not only are they very tight with what their numbers are, and I think a lot of that disappointment over the last few years is already baked into our sales numbers. But if you look at what they're doing right now, I think they're actually very successfully selling their product lines.

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**Chris Hagedorn** - *Scotts Company LLC - Executive Vice President & Division President of Hawthorne Gardening Company*

Hi, Chris. It's Chris. Yes, I mean, look, echoing what Jim said, I think we've got a fair amount of -- I would say sort of our revenue and earnings numbers, I would call them kind of risk-adjusted already. Look, if things get bad, and one thing we know about cannabis is there is the potential for significant volatility, both good and bad, we do have contingencies that we can break glass in case of emergency that are not dipping into that brand spending that Jim mentioned, because I do believe that's necessary.

So we've got moves we can make here over the course of the second and third quarters if we need to. I don't anticipate that, as Jim mentioned. Tom and the team are doing a heck of a job managing. We've got really great support from our retailers, from the distribution partners we brought on. I feel reasonably good about it. But we do have some downside contingencies if needed.

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

Yeah, I want to throw out just, we can look at the election results and we can sort of be disappointed and recreational in Florida. I just want to remind everybody that this was an election cycle where we had both presidential candidates wanting to fix the laws that have been really hindering this business.

And, the biggest surprise was Donald Trump saying he was going to vote for Proposition 3 in Florida, that he supported rescheduling, that he supported Safer Banking. And he's been elected. The process is underway with DEA to begin that process of rescheduling. And I'm hopeful the president and the vice president continue to pressure DEA to get this done.

But if you say we have, whoever won this election, we had a president that was supportive of this business in solving the tax issues and the banking issues, and one of them has been elected. This is a really good thing for this industry and our customers. And I think it's a major reflection point in this election cycle is two presidential candidates, both of whom supported this change. And that's going to be good for us. It's hard to see that being bad.

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**Operator**

Eric Bouchard with Cleveland Research & Co.

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**Eric Bouchard** - *Cleveland Research & Co - Analyst*

Thank you. Good morning. Just one question, I'm trying to get clarity on what you're outlining, a path to growth, getting the gross margin to 35%. And I'm trying to square that with the difficulty in raising price and your comments of hard to raise price.

It does feel like there's some changes or traction with private label. And it's pretty clear that the long category continues to see pressure. And so, what's the path through those limiting factors that were in place in '24 seem like they're in place in '25? How do you navigate that path?

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

Well, I got to say, like, there's people who are smarter on this than I am in this room, and they can answer that. I'm not seeing any share slippage, okay? What happened in private label, I just want to be super clear because I've been reading your work on it. And so, this will help illuminate it.



When we bid for private label and it's real low margin, like near zero, if people want to underbid us and we don't see a strategic reason to be in it, they can have it.

And, I think we're being careful on private label. I don't see the effect of, I went down, I was visiting with one of our biggest retailers and said, you know, what the hell on this? And I put this in the, just saying, why are you giving someone else business we had, even though we had sort of drawn a line on it.

And what I was told was that this came from up high, all the way from the top over only private label and diversifying the vendor base and private label, that this was not directed at the branded side. So, we just completely do not read that this is a lack of commitment to the branded business or the idea that Scotts is getting too big with our retailers. In fact, we're becoming bigger with them on where there's margin business.

I don't see that, I think if you say and you listen to what we're saying, just north of 1% pricing, half of \$150 million, so-called \$75 million coming back in margin. That's awesome. Thank you, Nate and team. And incremental sales opportunities that will drive volume and absorption plus looking internally to say, okay, where we need to pick up a percent or so, we can do that internally.

This is not something new for us. We've cut \$400 million of annual expenses out of this company without affecting our go-to-market strategy. And we can do more. And I'm not sure it would be high on my list to have to tell the company we got more work to do, but I made a change in leadership. We are looking at how this enterprise operates in a go-forward view that says we can operate this company cheaper and we're going to.

And we're going to look at anything that gets in the way of our warfighting capacity. And we're going to look to cut that where we can and invest even more in our capacity to war fight. And I would challenge my team here to say, are you guys concerned we get back to [35%] (corrected by company after the call)? And there's no one raising their hand and saying, I want to go home. So I'm very confident we can get where we need to get to.

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**Matthew Garth** - *Scotts Miracle-Gro Co - Executive Vice President, Chief Financial Officer & Chief Administrative Officer*

A key piece of this, though, their launch point for 25, let's just say. We're saying we got pricing. We got pricing on selective SKUs that we wanted to get. We've chosen to make some reinvestments in promo activity, which offsets that. And listing activity and getting positions that we want. This is the prudent work that we're doing.

But it's one step higher, actually, Eric. Let me also answer something I think you might have in there. Launch point 24 to 25. At mid-single-digit volume POS that we're talking about, like we said, you have a third of non-repeat kind of sales. You have a third of investments that we and retailers are making. And then you have a third of what we're going to call an inventory load in 24 that gets us to the right level that won't repeat in 25.

And it's just a percentage point or two of additional sales. And that gets you from mid-single-digits growth this year down to flat. But within that, remember, pricing happening. That will continue. Share continuing and growing. And we will maintain that.

And then innovation, all the things that Nate has laid out as important to the future of the US. consumer business, we are acting on. And so that lays what we think is a really nice ramp to get to that 2% to 3% algorithm of growth once you unshield all of these one-timers and things like that. M&A not necessarily in the purview right now.

Jim spoke about it. We have a pipeline. We're working it. That's that 1% incremental growth that we'll get. But the core innovation pieces, we told you they were going to take time to layer into the algorithm, and they are. But we feel good about growing that top line going forward. I think it's just this wonky for 25 comp that we're going to have to work through.

**Nate Baxter** - *Scotts Miracle-Gro Co - Executive Vice President and Chief Operating Officer*

Yeah, and Eric, this is Nate. I'll give you my thoughts on private label. There are puts and takes every year. And while Jim said it right, we never like to lose any business. That little piece of business wasn't for us. It's not very big. But the discussions that Josh and I are having with retailers, we're talking about opportunities in '26-'27.

So, I look at it as a continuum of puts and takes. But remember, our focus is on growing margin, and some of these decisions, while tough, or decisions we make in terms of how we bid for things reflect that. Lawns I want to talk about. You asked about lawns and the pressure. We 100% see that. And John Sass in his prepared remarks talked about our message of getting back.

You know, we've been focused on product, right? Last year was Healthy. We've talked about Halts, Turf Builder. We're now going to get back to talking about multi-step and how to help consumers take care of their lawns. So a lot of the investment on the brand and media side, both for lawns and for gardens, is on feeding.

We are not happy with the performance of either plant food or lawn food. And that is going to be a big part of how we talk about it. Now, that's sort of a Band-Aid. We've now got to get our sort of digital lawns program up to speed to engage more consumers in the ways that they shop. And as I mentioned earlier, the mid-to long-term investments and new AIs that we can bring to bear sort of for the fertilizer of the future.

And I'm talking about stuff that goes from not only just changing traditional chemistries, but starting to look at biologicals, because Big Ag is doing a lot of work there. So just to put it in context, I think you're right on lawns, but I feel good about the plan we have this year, and I feel really good about sort of the mid-to long-term view as we try to turn that business around.

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

Eric, I try to , de-confuse folks about kind of partly what happened in lawns this year. This is very much a Midwest-Northeast business. I don't know, like I think between the two regions, it's nearly 70% of the business.

The weather for all of us who live in the Northeast was really bad. All the POS data, I'm sure you're looking at it, kind of showed the market to be pretty significantly down. And our lawns business is very much concentrated there, and it's very much in sort of a few weeks in the core of when the weather was poor. If you look at the fall season, the business is doing really well.

And, when everybody's trying to figure out what's going on with lawns in the spring, and they don't want to get yelled at saying it's just weather, and then they say, what's happening in the spring? What's changed? Part of it is, to look outside. It was really dry. Lawns got pre-baked, with long periods of no rain. People felt they needed to put seed down.

They needed to put fertilizer down. And they did, and the POS looks really great. And it's one of those things where, we got feeling pretty bad about the lawns business, and then the fall happened, and everybody's like -- that looks much better. I don't know. Josh Meihls is here who is our Head of Sales. How did the fall feel?

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**Josh Meihls** - *Scotts Company LLC - Senior Vice President, Global Sales*

The fall really turned around. So we saw the key lines in the fall. You talk about WinterGuard, our sell-through rate on that.

We've already surpassed last year at this point, when we did all of last year, and we could see continued momentum into October. Craft feed of almost double digits over that time. The Northeast and Midwest, to your point, really driving those results, which we haven't seen all season long. So we're seeing consumers respond to the need. We're seeing retailers really lean in promotionally.

And we expect that to continue into the spring. What we typically see when we have fall damage like this, not all consumers take advantage of it in the fall. They wait until the spring. So we expect big things in the spring. Our retailers see the same. So, we're pretty darn bullish when it comes to next spring.

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**Eric Bouchard** - *Cleveland Research & Co - Analyst*

Okay. Thank you.

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**Operator**

William Reuter with Bank of America.

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**William Reuter** - *Bank of America - Analyst*

Good morning. My question is on input costs and your outlook there and how maybe that may be contributing to some of the gross margin expansion this year. It looks like urea is down a good bit. Transportation, I don't know, maybe it'll be flattish. But how are those going to be on a year-over-year basis in totality? And then how much hedging have you put in place at this point?

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**Matthew Garth** - *Scotts Miracle-Gro Co - Executive Vice President, Chief Financial Officer & Chief Administrative Officer*

The walk from the [27% to around 30%] (corrected by company after the call), that we've been talking about, like I said, in my prepared remarks is mostly supply chain driven. Within that supply chain category, what we've talked to you about is the benefit that we would be seeing in '25 from those lower prices. And that benefit is roughly a third of that overall supply chain savings, which, again, is the biggest piece there.

So you are seeing those raw material costs, and that's the full basket roll through into the cost structure '24 to '25. As you look at hedging, the one that I think we talk about the most is urea. And at this point in the year, we're 60%, 70% hedged for '25.

And if you look at the hedge price year-over-year, it's down kind of \$200. So that price flowing through locked in and real, but that goes through the rest of the cost structure. We have seen some areas where resins are up year-over-year, diesel fuel spiking around a little bit. We've made advances in our purchased energy, so we feel good about that.

And by the way, locked in those prices by and large. So overall, on the inflationary basket or the moving volatile basket of commodity factors, feel good near locked in. And then as we've said time and time again here in this call, everything that Nate, Dave Swihart, and the team are doing on the supply chain side, that had been basically orchestrated through springboard and now being realized underlies the rest of that climb out on the gross margin.

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**Nate Baxter** - *Scotts Miracle-Gro Co - Executive Vice President and Chief Operating Officer*

Yeah, and the only comment I'll add to that is, if you look at commodity prices, they're, I would say, flattening and starting to rise. But as Matt said, we're probably 70% locked on urea and north of 50% on all our commodities.

So we feel good about our position for '25, and we'll continue to manage those appropriately. But we have other levers in our supply chain savings, network optimization, warehouse automation, all the stuff that Jim talked about in his repair group remarks.

**Matthew Garth** - *Scotts Miracle-Gro Co - Executive Vice President, Chief Financial Officer & Chief Administrative Officer*

And we laid out to them in July.

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**Nate Baxter** - *Scotts Miracle-Gro Co - Executive Vice President and Chief Operating Officer*

Yeah, we talked about that. So we have levers. I feel good about where we are for '25 with commodities right now.

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**William Reuter** - *Bank of America - Analyst*

Great. And then just one quick one. On the third quarter call, I think Jim had mentioned potentially moving towards a 3 times leverage target. In an earlier question today, there was talking about when you would return to share repurchases relative to debt reduction. Is the official leverage target 3.5 times, or is it 3 times, or do you not really have one that's that explicit at this point?

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

Well, Matt wants to get upset when you say we have no plan, and we're just sort of winging it. Well, I would say, unfortunately, that's probably a little true. Here's my view, and I think this is Matt's view as well, is that we were pretty happy living in a world of 3.5 times to 3.75 times leverage before we went through this shitstorm. I think our view is that a little more conservatism probably would be appreciated by our lenders and our shareholders and our own selves.

So I think that leverage target is lower than it was. And I think Matt and I would probably agree that 3 times is a real safe place for us and kind of a sweet spot. I think part of it's going to say, as we go out and renegotiate sort of our credit, what do our lenders and bondholders say when they price stuff out?

But I think people might say, a little more conservative than you guys have been in the past would be a good thing. Because remember, we didn't see back when everything blew up, we never saw a number in any planning we did that went above 4times.

And we know what happened. So I think a little conservatism now, as those numbers get better, I can speak for what I think my oldest sister, who's Chairman of the limited partnership, would say is, getting back to shareholder friendly would be good. And so there would probably be pressure as we approach three to say, can you guys balance this out?

But I don't think we have a firm target. I think the target we have, and this gets back to, how did we get to \$700 million? Or how did I get there? How does that reflect with our leverage targets? They go together. I think \$700 million of EBITDA is going to sort of get you right about at 3 times.

And those are our targets by '27 that are now committed as of today, but that doesn't mean that we might not consider shareholder friendly work before that, if we feel good about the glide path. And we're in discussions with people who lend us money that they would be supportive of that as well. So it's a balance. That's what I would say. I don't know, Matt, if you'd add anything to that.

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**Matthew Garth** - *Scotts Miracle-Gro Co - Executive Vice President, Chief Financial Officer & Chief Administrative Officer*

I think that was well articulated. We've demonstrated we know what to do with the cash flow to get us to the position that we need to. We will continue to yield high free cash flow and as we get to a level of more comfort, and this is why you're probably not hearing a firm target. It's because, yes, we agree three is good. But that is not going to limit us as we approach three. We can start to be more flexible with how we use that strong cash flow that we have.

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**William Reuter** - Bank of America - Analyst

Perfect. All right, thank you. That's all for me.

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**Operator**

Carla Casella with JPMorgan.

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**Carla Casella** - JPMorgan - Analyst

Hi, somewhat of a related question. It looks like you paid some more debt down in the quarter. I know you had earlier talked about paying down \$200 million additional on the term loan. What was the additional paid on beyond that? Was it more term loans or did you buy back some bonds in the market?

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**Matthew Garth** - Scotts Miracle-Gro Co - Executive Vice President, Chief Financial Officer & Chief Administrative Officer

No, it's more term loan. And we're going to focus on our term loan. We do have a note coming up in 2026 that we'll begin to take a look at how we want to manage that. That's a \$250 million maturity. So we'll be able to manage that either with cash flow on the revolver as we move forward. But the payments we're making right now are clearly targeted towards term loans.

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**Carla Casella** - JPMorgan - Analyst

Okay, great. And then on working capital, I mean, given that you're exiting AeroGarden and the Hawthorne third-party suppliers, should we think about working capital similar to the cadence of last year or will there be significant differences in the spikes or troughs?

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**Matthew Garth** - Scotts Miracle-Gro Co - Executive Vice President, Chief Financial Officer & Chief Administrative Officer

So the last two years working capital has been a significant source of free cash flow. And what we've told you all is that we will have worked through our inventory positions and excess inventory positions by the end of '24. And so if I'm looking at '24 to '25, I would not expect working capital to be a source of cash flow if I'm modeling that out.

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**Carla Casella** - JPMorgan - Analyst

Okay, great. And then just lastly on the M&A environment, can you talk about, I mean, are you seeing any changes in the M&A environment? I mean, the tone of it, whether buyers, sellers, pricing looks more rational, anything you can give there?

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**Matthew Garth** - Scotts Miracle-Gro Co - Executive Vice President, Chief Financial Officer & Chief Administrative Officer

I think if you look at the pipeline that we have, within that pipeline, there are a number of tens of millions of revenues all the way up to hundreds of millions of revenues and pretty much across the board the profile of those businesses somewhat mirrors our profile, where everyone believes maybe next year or the year ahead is better as far as timing.

And that's okay because we're strengthening every day. You're seeing it in our EBITDA recovery and our margin recovery as well. I think timing-wise, people's heads are 12 months plus and we'll see if we can motivate somebody within that.

On the valuation side, you're not necessarily seeing a big movement in our target pipeline in valuations, because growth expectations are kind of consistent. Margins, we're outpacing. I think the delta multiples will also favor us as we move forward, but continuing to work it and it is a good

area for us to look for not only deleveraging opportunities if these things are all accretive, but also the natural brand positions that a portfolio and a capability like our company should have. These pipeline opportunities are very much brand leveraging our systems and our capabilities. We're not stepping out of bounds in this pipeline.

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

Look, I want to just throw a couple of comments on that. One is that we outperformed the lawn and garden category last year. So by definitions to some extent people we're talking to have not. We're trying to build up our financial strength. They're trying to say what occurred last year was a one-timer. And so that's pretty reasonable, I think.

And that means that there's no rush, but these are virtually all adjacencies, low integration risk, businesses that we sort of know. What we did say which gets to valuation is that if we like a business and either people are not interested in talking to us or the price is not reasonable, we're going to compete. And our position is strengthened, not weakened here.

And so if people want to take that risk, that's kind of up to them. I'd say join the team. So a little bit of a message being passed here that if we like a category and we want to play, we'll reach out if we can get a deal done and it's good. And waiting a year for us is not a big deal, but it allows us to strengthen, but if people aren't interested, we're happy to compete as well.

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**Carla Casella** - *JPMorgan - Analyst*

Great. Thank you.

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**Operator**

This does conclude the question-and-answer session. Thank you for your participation in today's conference. This does conclude the program. You may now disconnect.

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