



The Scotts Miracle-Gro Company (SMG) Q2 2023 Earnings Call Transcript

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Q2: 2023-05-03 Earnings Summary

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Press Release

EPS of \$3.78 **beats by \$0.31** | Revenue of \$1.53B (-8.75% Y/Y) **misses by \$81.38M**

The Scotts Miracle-Gro Company (NYSE:[SMG](#)) Q2 2023 Earnings Conference Call
May 3, 2023 9:00 AM ET

Company Participants

Aimee DeLuca - Senior Vice President, Investor Relations

Jim Hagedorn - Chairman and CEO

Matt Garth - Chief Financial Officer

Mike Lukemire - President and COO

Chris Hagedorn - Division President, Hawthorne

Patti Ziegler - Vice President, Global Marketing and Communications

Conference Call Participants

Chris Carey - Wells Fargo

Andrew Carter - Stifel

Joe Altobello - Raymond James

Bill Chappell - Truist Securities

Eric Bosshard - Cleveland Research

William Reuter - Bank of America

Operator

Good morning, and welcome to The Scotts Miracle-Gro Company's Q2 2023 Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speaker presentation, there will be a question-and-answer session. [Operator Instructions]

I would now like to hand the call over to Investor Relations lead for Scotts Miracle-Gro, Aimee DeLuca. Please go ahead.

Aimee DeLuca

Thank you, and good morning. Welcome to The Scotts Miracle-Gro Second Quarter Earnings Conference Call.

Joining me this morning are, Chairman and CEO, Jim Hagedorn; our President and Chief Operating Officer, Mike Lukemire; Matt Garth, our Chief Financial Officer, and Chris Hagedorn, Group President of Hawthorne.

In a moment, Jim, Mike, and Matt will share some prepared remarks, and then we'll open the call to your questions.

As always, we expect to make forward-looking statements, so I want to caution everyone that our actual results could differ materially from what we relate today. Please refer to our Form 10-K, which was filed with the Securities and Exchange Commission, so that you may familiarize yourself with the full range of risk factors that could impact our results.

I've already scheduled time with many of you after the call to fill in any gaps. Anyone who likes further discussion can call me directly at 937-578-5621 and we'll work to set up some time as quickly as possible.

Also, please note that today's call is being recorded and an archived version of the call will be published on our website at investors.scotts.com.

With that, let's get started. I'll turn the call over to Jim Hagedorn to begin. Jim?

Jim Hagedorn

Thanks, Aimee. Good morning, everyone. We have plenty to cover, but if I had to narrow it down to a single theme, it would go like this. It's been a hell of a year. As rough as it was, we're in a better place and we've accomplished it without diluting our shareholders.

Considering where we started, we've made progress and stubble important fronts in a very short period of time. It's a trajectory we expect to continue through fiscal '23 and fiscal '24. The first half of fiscal '23 is a testament to the powerful franchise of our core business. It's a reliable generator of cash that will enable us to materially delever, improve cash flow and invest in growth.

Just about a year ago, we were looking at free cash flow of negative \$1.2 billion. We reported misses in our sales numbers in the Consumer and Hawthorne businesses. We were stacked up with significantly more inventory than we needed.

Cost of goods were rising, and margin was declining. Without immediate actions, we were facing near-certain busting of our bank covenants. It was a tense and cruel time. But our associates responded. They never wavered or lost their way. They stayed engaged and kept their heads up. They've executed upon our plans with grit and determination. It's what we in our people do best.

Today free cash flow was favorable, improving nearly \$600 million through our first half. We're reaffirming our guidance of generating \$1 billion in free cash flow through fiscal '24. We're living within our credit facility covenants. I do not see leverage compliance issues going forward as we're looking at the low five times range by fiscal year end.

I will restate that Mike Lukemire and I are pushing to do even better in that timeframe. Cost of goods is improving too. While we expect commodity cost to be up almost a \$100 over fiscal '22, this is about 20% less than we projected as recently as the end of Q1. These improvements will not show up in margin rate until we work through a higher priced inventory.

We expect our gross margin rate to fall slightly below last year before achieving more significant margin recovery in fiscal '24. Through the first six months, SG&A was down \$44 million due to the cost reduction and efficiency work of project Springboard, which continues to over-deliver.

Our Springboard annual savings target was \$185 million dollars by the close of fiscal '24. We're already three forces away to that target, and by the end of this fiscal year, we expect to exceed \$200 million in annual savings. We will accomplish this without cutting investments in the most important marketing and R&D initiatives.

Our efficiency efforts have extended the Hathborne where we have significantly reduced its distribution footprint and brands. And overall, we've worked off over \$400 million in inventory. We're moving into the transition phase of our recovery. We're creating balance and nearing the inflection point where we can shift from operating in a really constrained environment to having a bit more freedom to operate.

Ultimately, this will give us greater flexibility to drive growth and long-term shareholder value.

Looking to value creation, Mike Lukemire, Matt Garth and I have agreed on four financial targets that include: getting leverage down to 3.5 x or less; achieving sales growth equal to GDP plus 100 basis points; improving total company gross margin to 30% or more; and realizing free cash flow every year of \$300 million dollars or more.

We also will continue to invest in innovation, marketing, and incremental growth within and outside of our core business. This can range from alternative landscapes and natural and organic products to live goods, as well as strategic investments in Hawthorne. To ensure we prioritize initiatives and approach them in a coordinated and measured manner, Matt is leading a new strategy team that reports to me and we'll work closely with our business units, brands, management team and the Board.

Now that you have a sense of where we are in our transformation, let's revisit the first half. Q2 the quarter we needed in our US Consumer business, where sales were in line with last year's record second quarter. In March, we had our best shipment month ever through six months or on par with the strong US consumer sales of the same period last year.

Despite concerns over consumer spending in general, our retail partners understand the importance of lawn and garden even in times of economic uncertainty. History shows the consumers still shows up for our category. As a result, our share of shelf makes it obvious we are the market leader. Our collaboration with retailers is tighter than ever.

We've developed joint promotional campaigns and backed them with thoughtful planning and aggressive early season execution. Our working media, budget is up 23% over last year. The working Q2 led to early season POS lifts in warm weather markets and product promotion attachment rates that are in excess of historic trends. Where the weather is good and our promotions are in place, consumers are showing up and often in bigger numbers, important early markets like Texas and Florida struggled last year.

In Q2, we saw significant POS lifts. Bonus S was up nearly 40% in Texas, and branded fertilizers were plus 17% in Florida. Overall, Q2 was a good quarter for our core business. Q3 is off to a solid start. In recent weeks, the weather is opening up in key markets and with well timed promotions with our retailers, we're seeing POS gains.

In mid-April, we achieved an all-time record POS week with our big three customers at \$198 million, breaking our previous record of \$193 million in 2021, and eclipsing our peak week of 2022 by over \$30 million.

Branded lawn fertilizer units across key retailers were positive through April, up 2% and we're taking share. In growing media the signals are strong. Mulch units are up 10% through April and Miracle-Gro Garden Soil units have increased 21% in the same period. Our leadership in non-selective and selective weed control remains unchallenged, with share gains at key retailers

In the Northeast and Midwest, Roundup is plus 10%. And Roundup's innovation launched the new dual action formula is performing above expectations. It has eclipsed \$10 million in POS and has unlocked incremental listings at more retailers. The consumer reviews are category-leading. Here's why I'm not worried about the weather early this season. There will be ups and downs.

Just in recent weeks, we've seen great weather in the Northeast and Midwest, followed by cold and rain. Consumers ride the ups and downs. California is an example. In Q2, when heavy rains were dominant, branded fertilizer POS was negative 8% year-over-year. But improving weather has become our friend. In the last four weeks, branded fertilizer POS hit plus 60% in California.

In April, California became the number one volume state for Roundup at plus 67%. This is the pattern I expect to play out in other regions as we enter May and June when the drumbeat of promotional activity will accelerate. We have the bulk of our media and promotional dollars ahead of us and we'll shift the spend to where we get the most bang for the dollar.

Looking ahead, the weather outlook is favorable. We've had three years of La Niña with extreme weather swings. Now, we're shifting to an El Niño that is more in line with historic norms. May looks to be relatively normal in temperatures and precipitation. June forecast are on similar track. An indication we can extend the peak lawn and garden season deeper into the summer.

These projected weather patterns are similar to 2018, when we crushed POS into the summer. I'm going to ask Mike Lukemire to jump in here with his thoughts.

Mike Lukemire

Thanks, Jim. We have momentum. It is showing up in the numbers and there's demand where the weather is just now breaking. Our plan is working because retailers are all in and our team is stepping up. Jim has talked about how we're flatter and leaner. We have awesome talent that's doing more with less. Our next generation leaders have a now is now mentality and an infectious spirit to attack to opportunities.

I always stress the importance of working as one team, with one goal of delivering the year. I'm seeing us worked in a more integrated way internally and this has extended to our retail partnerships. The coordination between all the teams that never been better. We're loading up the stores and leaning in with consumers. And our field sales, people are helping fill gaps caused by labor, shortages and lawn and garden centers.

Chief Marketing Officer Patti, Zigler; Head of Tech and Ops, Dave Swihart, and Head of Sales, Josh Meihls deserve credit here. Our early focus has increased foot traffic, which coincided with regional campaigns for fertilizer and seed. We overlay those with Scott for Scott and the DayLawn Saving National Campaign.

These contributed to POS lists were weather was favorable where it is yet to break, it led to some early consumer takeaway, the Midwest and Northeast are prime and California is warming up. The other key piece is mutual investment and optimization of our efforts with retailers. We're not tripping over each other. In April, retailers kicked off spring events that included joint advertising and deals, which are a huge consumer motivator.

We're going to put even more gas in the fire. We still have much of our promotional and advertising activity remaining. More event and campaigns are coming. Expanding into Miracle-Gro and Roundup, a new campaign focused on The Newbie Gardener called All You Need to Grow is part of the best gardens plan in years.

Roundup Dual Action is supported by the largest campaign in Roundup history. I like to remind people this isn't a sprint, it's a marathon. We will maximize the season. We will pivot media and promotional dollars as necessary and we will extend the season deeper into the summer. Everyone understands that. That's why nobody's even thinking about backing off, it's all out in front of us. When we lean into our activities, good things happen. I am absolutely bullish about the season.

Back to you, Jim.

Jim Hagedorn

Thanks, Luke. I'll build on your marathon analogy and say that we paste ourselves well. We like where we're positioned and we see a clear road ahead. As for Hawthorne, we're looking at it through a different lens. We're aggressively taking action to align Hawthorne with the realities of the cannabis market. There's a widening gulf in the cannabis sector creating Haves and Have Nots. It sounds harsh. But it's not all doom and gloom.

All over the cannabis sector, there are folks winning big. They're adopting new technologies, advanced growing techniques and diversified offerings. Many of them are legacy businesses. They are producing high-quality products and getting prices per pound greater than what they were a few years ago. They represent the heart of the cannabis industry.

This was evident at a recent summit we organized with leading stakeholders in the cannabis space. We brought together growers, suppliers and hydro retailers to assess where the industry is now, and where it's headed. What we learned is that those at the top want solutions and partners to help them grow and scale. We have the strengths to fill this need.

We're aligned with the cost and quality advantages they need to help them be successful. We're determined to be the only partner on the supply side to develop and deliver competitive solutions to help them grow. Along these lines, we've restructured our product line to the 58th brands of the most profitable and important to these players, creating our Hawthorne signature plus portfolio.

Our R&D is bringing innovation to secure the long-term health of the industry. Research across multiple controlled environment facilities proves the benefits of our LED fixtures, nutrients and genetics. So far, we have nine utility patents covering electrical, thermal and optics.

Take the Gavita RS 2400e LED, which can change the game for growers. It boosts yields by as much as 50% over traditional HPS technologies, while minimizing energy inputs and enabling faster crop cycles. The summit also brought consensus that consolidation is a must. A wicked shake out is underway and we expect that will result in the top 25% getting even stronger.

Hawthorne is uniquely positioned to thrive. It's an opportunistic time and that's why Hawthorne is looking to participate in innovative, value-creating, non-cash deals that advanced its scale and capabilities. If we take no action, we'll be left behind. I do want to comment on the industry challenges that are largely due to two factors.

The first relates to the growing pains that will be dealt with through consolidation. The other is market instability caused by government legislators and regulators, from failure to adopt Federal Safe Banking Act or 280e Tax Reform, to well-documented missteps and regulatory approaches in States like New York, the industry has been negatively impacted on multiple levels.

We have to remember that tax revenue, job, creation and other economic benefits are at stake here. We need governors, legislators and regulators to take proactive actions to stabilize this industry and go even further by not issuing cannabis licenses in excess of what citizens can consume in their states. This has been a significant issue.

Oversupply caused by bureaucracy and flawed planning has hurt those who have worked hard and invested heavily to create a healthy, well-functioning industry that benefits everyone and is not subject to wild swings that crush legitimate growth.

Hawthorne is very active at the regulatory and political levels advocating for policy and legislative change. This is another way we're adding important value to this industry. We're leading the way and it's my hope we begin to see substantial progress in many of these areas in the next year. We're in an enviable position, because no one else is doing what we're doing in this space.

I'll wrap up with this. As I look back on my nearly three decades, with Scotts Miracle-Gro, this by far has been the hardest period I've experienced. From a challenge and difficulty point of view, it was way harder than COVID. While the heaviest lifting and the most extreme sacrifices are behind us, there's still more to do. We have an exceptional team, a solid blend of highly experienced and next-generation talent. It's a smaller team, but more empowered.

Just as we're becoming more focused on future innovation and growth, people development is a priority at all levels. The recent addition of executive and senior leaders reflects our commitment to succession planning. We're strengthening an already strong team. I appreciate our associates, our Board of Directors, our retail partners, our banks and our shareholders. Your support has meant the world to me.

Scotts Miracle-Gro makes a difference in people's lives every day. And that's an obligation along with the ones who are shareholders and associates that drives to all of us. Thank you. I'll turn the call over to Matt to walk through the financials.

Matt Garth

Thanks, Jim, and hello, everyone. We are very pleased with where we ended the first half of the year, as well as with the early spring consumer engagement we are seeing so far. As we've already announced, net leverage at the end of the quarter came in at 6 x, versus the covenant max of 6.5 x and Springboard is on track to deliver over \$200 million in runrate savings by the end of the fiscal year.

Consumers are clearly engaged and participating in lawn and garden. In regions where weather has been favorable, we're seeing strong engagement and as expected, consumers are responding to the promotions that provide the most value.

Turning to Hawthorne, the state of the cannabis industry remains volatile and our recent restructuring at Hawthorne reflects heightened actions to more quickly improve our profitability.

Now let's walk through the quarter in more detail. Starting with net sales for the US Consumer business, second quarter sales \$1.36 billion, just 2% shy of our prior year record. First half sales were above last year and totaled nearly \$1.73 billion. Our team has done an outstanding job in executing the first half load and plan with our retail partners and these results are a reflection of their efforts to deliver for SMG in a challenging environment.

Pricing of nearly 10% year-to-date more than offset the impact of lower shipping volumes. We call that the lower shipment volumes are related to our expectation for reduced retail inventory levels, which are down 6% in units versus the prior year. As noted earlier, the season started soft as a result of the extreme weather patterns that impacted California.

However, we are encouraged by the strong POS we've seen through April. Consumers are price-sensitive seeking value, while also remaining loyal to our high-quality trusted brands. To date, we have not seen a significant trade-down to private-label and we are seeing strong POS lists from our promotions and media campaigns, especially in branded fertilizers and growing media.

To support these trends and to continue driving profitable volume, our media and promotional plans this year will run through the fall. This contrasts with last year, when we made limited investments in the back half of the season. As of today, POS units are essentially flat and dollars are up mid-single digits at our largest retailers.

Product mix is currently favoring growing media. And we now expect this trend to continue through the full year. Within the lawns category, overall volume is down mid-to high-single-digits through April. However, our higher margin branded fertilizers, such as Scott's Triple Action, and Bonus S were currently positive and units at key retailers and outperforming lower margin, private-label fertilizers. In categories besides lawns and growing media we continue to trend towards flat units versus prior year.

At Hawthorne, the top-line remains challenged, amid continued market oversupply limited and costly access to capital in an uncertain regulatory environment.

Second quarter and first half sales for the segment were \$93 million and \$224 million, down 54% and 43% respectively versus the same periods last year. North America lighting and growing environment drove the change as large durable investments continue to climb at a greater rate than consumable replenishment.

Lighting and growing environment combined, were down 66% in the quarter and 53% in the first half year-over-year. Together with hardware, total North America durable's net sales were 50% of total Hawthorne net sales in the quarter versus 56% in the prior year quarter. We still expect improvement in the back half of the year, when the outdoor growing season picks up and our Pro Hort Lighting business converts strong prospects to orders.

However, given the overall weak market conditions, daily sales rates have yet to improve from the first half of the year and this may persist. Our focus remains on returning to runrate profitability by the end of the year and this objective is intact.

Approximately half of our Springboard savings are from Hawthorne and the changes to brand and category mix that Jim spoke to will impact gross margin rates favorably when overall volume recovers. However, even though Hawthorne saw a substantial decrease in warehousing cost in the first half, the volume decline, paired with higher material, and freight costs has outpaced year-to-date pricing actions to drive the segment's gross margin rate lower.

As noted in the press release, Hawthorne sold its Hurricane branded fans business, an action that helps to accelerate distribution cost savings through warehouse closures in Washington, California, Oregon and New Jersey. Related to this restructuring, Hawthorne posted total GAAP charges of \$141 million before income taxes, of which \$119 million impacted gross margin. These charges are excluded from non-GAAP income for the quarter.

If we take a closer look at gross margin and cost of goods to the total company, the adjusted gross margin rate declined 70 basis points for both the quarter and first half, resulting in rates of 34.7% and 31% respectively. Through the first half, pricing net of trade added nearly 800 basis points to the year-to-date gross margin, more than covering higher material costs.

However, the increase was not enough to also fully cover higher conversion costs and fixed cost to leverage, largely driven by the steep volume declines at Hawthorne and lower production volumes in our US Consumer business. With greater than 85% percent of our COGS now locked, we have a reasonable line of sight to our full-year costs.

Other than resins, we're seeing lower prices for most of our major raw materials. However, given our hedging program and remaining high cost inventory, we expect to recognize these improvements starting in the second half of 2024. Looking at the balance of the year, margins will be slightly pressured, based on a revised mix expectations and additional trade Investments.

The net cost of the changes to pricing and mix will be mostly offset by continued strong productivity gains, and moderating material costs. Overall for fiscal 2023, we still expect the total company gross margin rate decline nearly 100 basis points.

Looking to fiscal '24 and beyond, we see ample opportunity to improve our gross margins through volume and mix recovery, commodity cost moderation, and our warehouse restructuring and other cost-out initiatives.

We continue to show progress on the SGA line without sacrificing our aggressive media plans for the year. In fact, working media spend is expected to be up to 23% year-over-year. As a percentage of sales, SG&A is down from 16% in the first half of last year to 15.3% this year, reflecting our significant progress from Project Springboard.

We expect to maintain these savings moving forward yielding SG&A between 15% and 16% of net sales for the full year. Now I'll highlight a few more expected adjustments to our guidance. While we remain enthusiastic about our full year prospects and the great work on cost control so far this year, the near term pressure on gross margin rates, and the headwinds at Hawthorne, on the whole, lead us to adjust our full year operating income guidance to mid-single-digit percentage decline and our full year adjusted EBITDA guidance to a low-single-digits percentage decline from fiscal 2022.

This revised EBITDA guidance keeps us comfortably within our net leverage covenant for the remainder of the year. And the team will be working diligently to meet Jim and Mike's target below 5 x.

I'll finish up the review with a few comments on taxes, interest expense, and the balance sheet. Our adjusted tax rate through the second quarter was 26.7%, versus 21.7% through the second quarter of last year, largely driven by a one-time benefit in fiscal 2022 from the vesting and exercise of certain long-term executive compensation.

Additionally, we expect our tax rate to fall in the range of 27% to 28% for the full year. Quarterly interest expense is up \$20 million or 71% versus prior year and expected interest expense for the full year is unchanged at an increase of \$60 million. The increase was mostly driven by higher average borrowing rates of 5.3%, up nearly two percentage points from a year ago, mainly due to higher underlying sulfur. Through a combination of long-term fixed-rate senior notes and interest rate swap arrangements, 61% of our debt is at fixed borrowing rates as of the end of the quarter.

Continuing on the balance sheet, we're making strong headway improving our inventory balances. We pulled back on production volumes and we are selling through higher cost inventory. As of the end of the quarter, inventory was \$467 million lower than the same time last year.

While the improving inventory position will drive significant free cash flow, the net change in total working capital with offsets in accounts payable in other areas is expected to deliver closer to \$200 million of favorability in each of fiscal '23 and fiscal '24. Together with approximately \$300 million in operating cash flow each year, we are on track to deliver our targeted \$1 billion in free cash flow over two years.

As I stated last quarter, we will maintain a tightly disciplined capital allocation approach. We are funding, our quarterly dividend and the balance of our free cash flow will be used to pay down debt.

Let me wrap up the financial overview with this. Within 55% of our expected POS remains it is still early. We will know much more by mid-June as to how the season is progressing and we will provide an update on our progress at that time.

One final note I'm extremely excited to work with Jim to reconstitute SMG's strategy team and contribute meaningfully to long-term planning and value creation for our stakeholders. The team is already diving deeply into the non-cash opportunities for Hawthorne that Jim mentioned and refreshing our longer range plans to protect and build on the core Lawn and Garden business.

And now I'll turn it back over to Jim.

Jim Hagedorn

Thanks, Matt. Latif, we could go to the Q&A session. That'd be great.

Question-And-Answer Session

Operator

[Operator Instructions]

Our first question comes from the line of Chris Carey of Wells Fargo. Your question, please, Chris.

Chris Carey

Hi. Good morning.

Jim Hagedorn

Hi, Chris.

Chris Carey

Can you maybe just help frame why your guidance was lowered, you know gross margin seem intact, POS running flat year-to-date and US Consumer seems actually quite a better outcome than the prospects a month ago.

US Consumer margins came in quite strong with the gross margin over delivery. And so can you just frame how your expectations have changed for the Garden business relative to Hawthorne on at first blush. It feels like Hawthorne is the key change here and you are just not yet ready to call for the Garden business offsetting Hawthorne given you still have a lot of POS still ahead. But I don't know if I'm reading that situation wrong.

And if you could just comment on how you feel retailer inventories are at this point in the year relative to your expectations? Thanks.

Jim Hagedorn

Yeah, I know Garth would like to go first here. But I'm going to sort of cut him off with the pass. Look, I have to say that, I came in this morning and talked to Matt and said, I should have called you last night and pulled that release. Because I think that Aimee and Matt are trying to sort of balance sort of expectations coming out of the call.

And I'll give them credit for that. I know it's for the sort of common good. But, I felt a little bit like you're saying it now yesterday when the press release was sort of running around for approvals and my quotes were being approved by me.

I think you're right that the big negative here is, just Hawthorne. And I wouldn't say it's a huge negative and we're more I'd say more than covering it with the consumer. So I think there is Matt and Aimee trying to sort of deal with expectations. There is negativity on Hawthorne, which is - I think basically top-line driven.

Now, let's get back to Consumer. I think we feel really great about Consumer. And, my view is, standby for violence. We had kind of like, one and a half good weeks in April and the numbers were truly stunning. And if you look at the forecast, like for this weekend, it's just exactly what's needed at exactly the right time.

So, and we've got crazy ammo going into this battle on the marketing and promotional side. So the retailers are locked and loaded. We are - so, I expect, I think, Matt and Aimee are going out probably, a month from now. We'll have to figure out how they're going to communicate sort of market update to you. But we're planning to somehow I don't know that that's done yet, because I think people aren't going to be at that normal conference that we talked at in about a month, just because people are going to be out of town.

But what I expect is, some really interesting data. And, when you look at what's sort of happening, think about California and Texas, Florida, the numbers that I passed you guys today. Those are really great and a lot of what happened is, we never had a real spring. It didn't get decent. And for those of you who are East Coast-based, you'll know that last year, just the weather, and no shit, really just sucked.

And we never really had a Midwest and Northeast season until sort of after the 4th of July. And then Texas was super droughty, California, super droughty. I'm talking like, giant states down, like 30%. When you see the data, I mean, the rain in California has Wicked been our friend, okay? I mean, not only great for Fertilizers, but great for herbicides, because the people got a lot of weeds.

And you know, you look at certain markets, like Arizona, they're just big weed markets. As people have kind of these deserted gardens and they want to keep the weeds out, so they've always been important Roundup markets but the Roundup numbers are also really stunning. And then, you look at like the lawn fertilizer numbers for Texas, just real positive, same for Florida.

And so, I think we've got a really good start to the season. Really good integrated program. And another thing I just want to - Mike said it his comments, but Mike's team on Consumer has just really killed it. The first half was really, really important for us to avoid coven and hell. We didn't expect. It was not, it's - we didn't expect more than we had agreed with the retailer's.

All we need is the retailer's to do is get the load in that we had pre agreed to get done. That's it's not excessive in units. So, we accomplished that. There was a lot of worry, I think on Matt's team. Could we get it done as we were kind of looking the last weeks of the quarter. People did it and they couldn't have done it without the work that Patti and the marketing team have done to get the retailer's into the promotional plans.

So, the first half really came well together. And I would say the seasons - seasons so far where the weather has been our friend, which lets the sub pop southern markets. California has been really good. And now we have, whether that's our friend in the Midwest and Northeast, which is like this weekend and the forecast on my tool that I use that takes us out looking warm and kind of normal, precip for the Midwest and Northeast for the entire month.

So, I feel really good about it. The retail inventories I think that was another part of your question, I think are reasonable. I wouldn't read too much into sort of unit volume in retail being down. I think that's more of a just a crazy amount of units that happen in source soils. They are just coming in sort of at the right time.

And there's - if you look at sort of the major promotional events that happen with the retailers that drives inventory into the store, that it's just hard to look at us. So I think, what - Mike, what I would say is, the Consumer market is about where it needs to be. And I want to also thank our retail partners for - I'm going on too long, but I'm trying to get a lot of stuff that I would say, anytime out on this question.

I think to the retail Partners, based on our sort of needs to get the whines we approved agreed in we were a little whinier than, than normal. And I want to thank our partners for putting up with our kind of whininess as we needed to make sure that we executed against the plans we had pre-done with them. So, really great friendships.

This is one where I know a lot of you guys were sort of forecasting doom and gloom for us. Maybe not you, but people were forecasting, covenant bursts. Our retailers knew, we needed them. And they came through for us bigger than Dallas and I want to thank them all for working with us.

I don't know Mike, anything you want to talk about the season so far?

Mike Lukemire

No, no, I think every promotion or activity when we have weather is over-indexing far beyond what we expected it to be. So, and we expect more as we go into good weather in the season. And, we are very bullish about hitting what we said we are going to do. So, Jim is right. There's a lot of – and so little kirk as we will adjust to markets as we see fit.

Jim Hagedorn

And then, last I guess is, just Hawthorne. Hawthorne is working toward breakeven. That's our mission. Okay? And there is an element where, if you were to sort of talk to me, we had a Board meeting last Monday and Friday. I don't – Monday - Tuesday and Friday, whatever the hell it was, but Friday. My whole attitude of sort of Hawthorne and cannabis really changed a lot as weren't gathering until kind of for what's happening out there.

The sales results or kind of based on a couple things. Number one is, our big category is Durables. And In an environment where it's very challenging to make money and there's a lot of people barely hanging on our dominance in lighting is going to work against us, especially when you compare it to the amount of money we invested in the business. And fair enough, people want to be critical.

The more, I studied, the more Chris was out and on the road, that was why those changes happened in my script. I mean, I don't know why we were like Version 14 by the time we finished. There is a lot of good stuff happening in the industry. It's you tend to think everybody is failing here. It's an environment where it's like regional banks, the weak ones are in trouble. And there's a lot of people in trouble in this space. The people who are good at it and there's quite a few of them are really doing well and guess what they're running our best in most expensive lights, okay? And they're getting the results out of those lights, which are no joke. We're doing like all this research.

I don't think anybody is doing this kind of work where you are seeing sort of 50% increase in outputs. The cost of lights doesn't matter when you're seeing that kind of increase, but you got to have the money and if you're barely hanging on, you ain't buying it and that's where I say there's going to be winners and losers in this space and there's a wicked shake out underway. And we have to see that through.

And so, this is one where there's a lot of good stuff happening. I would say, even on the RIV side There's a lot of pressure to get New York fixed by people in the government of New York. Maybe it's embarrassing, frankly, what's happening there? And there's a lot of changes that are going to, I think very much benefit RIV and the investment we made in New York.

And so there's just a lot of good things happening and you just don't see it in the sort of get through it what do they call it when those just doesn't work for just dead bodies everywhere. But there's a lot of good stories within the battlefield and anyway. So, we're not really running Hawthorne for our top-line now. We're running it really for bottom-line and while it did slip, I think we are still confident that we get to breakeven by year end. And we are seeing positiveness there.

And we're seeing with those people who are doing well, we're seeing value per pound up there as high as it's ever been with the people who are using our product and know what they're doing. Anyway, Chris a real long answer, but I can talk less after this.

Chris Carey

That is - thank you, Jim. That was true to form and helpful. It's always helpful to get the big take.

Jim Hagedorn

I only use one man work.

Chris Carey

Yeah, well, it's, hey, I'm only the first question in the earnings call. You got plenty of time to catch up. So just, maybe just really simply put and then I'll get back in. Number one, have your volume expectations changed at all in US Consumer for the year? And number two, you mentioned 30% gross margins. Is that how we should be thinking about in fiscal '24? Thanks so much.

Chris Carey

I'll let Matt get on. I'll let Matt do those the margin side of that. Remember, what we said is, partly, what I don't want to be in the business of is dealing with you guys. I don't mean this in a bad way. I mean that, I don't want to be sort of a captive to sort of what you all think. All I can be captive is to what commitments we've made. And so we said flat plus 10% on lawns. I think, Mike and I felt that those were super easy relative to the investments we're making. And I still feel that. So, what do I think? When you say that, Mike and I are working toward leveraging the force, it sort of assumes, not a lot of positiveness out of Hawthorn and more positiveness out of the Consumer business.

And, but, where I live, as I was driving in last night our birch trees don't even have leaves on it yet. So I put this now, it's New England. But I would say, I put this as real early in the season and a lot of stuff still to do, but I think we like the weather forecast. We like the programs. We like the marketing efforts. I don't think there's - I personally don't think there's any evidence that the consumer is not gardening or staying away from our product line.

So, I think, Mike and I are expecting positiveness of flat plus ten for lawns, but that that we really going to be able to tell you that in July or something like that. When the season is kind of 80% through.

Matt Garth

Yes, Chris, from a margin perspective, I think Jim talked about it. You heard it in my preparedness a little bit. But the objectives that we're putting out for growing top-line GDP plus a 100 basis points, getting back to 30 plus percent margins, maintaining SG&A in that 15% to 16% range and then, also delivering free cash flow year in year out around \$300 million.

All of those are formative. Getting there in 2024, I think we check off a number of those things. The margin in particular was coming from sort of a full-year perspective in the mid to high 20s here in 2023, as you know, and as we've talked about there is a significant impact from raw material inflation and other inflationary items that have impacted our margin that we fully offset in pricing.

But that is margin dilutive. If you just take a look at the sheer math here, it's kind of like 800 basis points up in pricing. You see that in our pricing list that we show you in the press release tables. And then that's been offset with really, about 700 basis points, 800 basis points if I round up in inflationary factors. So you're still not getting the margin lift yet.

But as we talked about, some of those commodity factors are starting to weaken. That will run through. We have higher costs inventories that Jim and I both spoke about that we are working through and we're trying to work those through at a faster rate. Mike and his team have been integral in doing that. That could bring margin in faster.

But all of this right now, the mechanical math tells you, this is going to happen towards the end of 2024 and so 2025 is where we would start to see the 30 plus percent margins for the year come back and get.

Jim Hagedorn

Listen, it's hard for everybody that wants questions because, this is one where pricing is going to matter for us. It's clear that throughout this whole deal of inflation, that we did price for the dollars. But it was dilutive of, I don't know, at least 500 basis points. And clearly, the reason that I put that stuff in my script which was not the original plan, was to put these sort of, is to sort of make sure that my team understands that we have goal posts that we're operating on for sort of improvement to the P&L.

Gross margin is our jet fuel, it's what we use to operate the business and build our brands and it really matters. Today's Journal has this article about some companies that priced in excess and were able to do that. We either didn't or couldn't - remember, we are not like some of these companies that they threw in there that like building materials, which was highlighted in the article this morning in The Journal

We're dealing with three or four big retailers I mean, who are the dominant players in lawn and garden in America. And I think we probably pushed them on pricing about as hard as we could and we weren't shy about it. But we were losing margin every time we did that. They need to understand that and my team needs to understand that gross margin is our jet fuel and we need that to war here.

So, I think we're - I mean I don't think we're final on what we do with pricing I think it's going to depend on conversations we have sort of now and in the next month or so with our retail partners for them to understand that this - and a lot will be just how does the business look? How did brand do? Did we lose share? There's no obvious share loss here.

I think there's a just out for all out there a little sensitivity on our most expensive grass seed where we're looking at this. But, so, I think we're pricing that sort of in-market right now. But I think we do need pricing and we can get gross margin back where we need it to be if the retailers and the operating team are willing to say, pricing is just a faster way to get there then wait for the commodities to come down, which they are, okay?

Aimee DeLuca

Well, we miss you in the garden.

Operator

Thank you. Our next question comes from the line of William Carter of Stifel. Your question please, William.

Andrew Carter

Hey, thanks can you... yes, it's Andrew Carter. Thanks, can you hear me?

Jim Hagedorn

We can.

Matt Garth

We can.

Andrew Carter

Okay. Great. So I was just going to simplify your question. So, it sounds like you said the guidance change today is all is all the bad, but none of the good and specifically to Hawthorne. Hawthorne was worse than we expected. But you did reiterate the breakeven is – the runrate. Is that is that a fair question to kind of characterize the overall guidance?

Jim Hagedorn

I think it is. I think what you're looking at is a few things and how we walk through this. First of all, what Mike and the team have been able to do is absolutely outstanding. And the level of connectivity in the company today is extremely high. So, we are on top of all this, and the message should read like this to you. We've seen very good performance on the load-out that's booked in the first half.

POS so far, you heard Jim and Mike both go through that. We have seen a little bit of a mix change where our branded fertilizers performing extremely well. Private-label fertilizers, okay. But we've seen great mulch performance. And that is a mix change from what we had expected that keeps POS plus 10% in the lawns and first at lawns area and then sort of flat over the rest.

But that mix is going to change as we move through the year, because we're expecting now sort of mulch is soils to come up a little bit. And so, you may see lawn come down a little bit and growing media come up a little bit. So, there's some mixed movement there in margin, but the bigger piece, you're absolutely right is all with Hawthorne.

Now, the piece here that's extremely important with Hawthorne, is like Jim said. We are navigating many different obstacles in terms of revenue generation. But all of the delta, in terms of underlying performance is coming from our cost-outs, that's why we took a restructuring in the quarter to further re-analyze our position and reform it with where the overall revenue is.

We've taken out for warehouses to be able to do that. That brings cost out with it and the trajectory now is to keep us on track for breakeven performance by the end of the year.

Andrew Carter

Okay. Great. The second question, I want to drill in just on that, you did say POS was in lot. You expected POs to come in line with your expectations. I just want to drill down on that statement, because March obviously started behind April that was a weaker month, April was strong. So what I would ask is, are you in line with your original expectations through April, therefore kind of upside your old estimate or is this kind of guidance for full year in line kind of predicated on weather kind of staying the same in May and June? Thanks.

Jim Hagedorn

There's a lot going on there. Let me – I was going to say, I'll kick off, but we can go straight to Mike. I have not.

Mike Lukemire

No, I think we're already in line with our current expectations, based on – or just based on greater takeaway based on the timing of the season. There is so much POS add to this that we are not changing anything as far as our guidance. We are just running various models based on our POS comes out.

Matt Garth

Yeah, Andrew, I do think that, you'd probably - at least from my point of view, overthinking it. I think what's clear is gods did not want to see the numbers go up coming out of this call. I don't think we're sitting around re-forecasting every week on what we see in North America. I think people are just running the business right now. But I think it's a positive season so far. And, is there any disappointment in the season?

Mike Lukemire

No, I mean, it's always lumpy. We got 50% of our POS out of this. So there are - these ups and downs of weeks. We've had fabulous weeks. We've had weather weeks. So and we constantly make adjustments. But we're staying with our guidance where we're going on US business. So we've not called in...

Matt Garth

And that - that would be typical. We typically would not be calling up or probably down our numbers this early in the year. Well, generally I'll talk to the finance guy about any number total after May 31st. Because it's just the way how the season rolls out. So - and by region and by weather effect. But everything that we've done promotionally this year and timing with retailers is actually big beyond our expectations.

Jim Hagedorn

But Luke isn't messing around. I think we generally do not want to spend a lot of time re-budgeting at this point in the season. I think we just run the business and I think we feel - I would say neutral to positive about the Consumer business. We'll blow it out this week.

Andrew Carter

Okay. I'll pass it on.

Jim Hagedorn

Thanks, Andrew.

Andrew Carter

Hey, thanks, guys.

Operator

Thank you. Our next question comes from the line of Joe Altobello of Raymond James. Your line is open Joe.

Joe Altobello

Thanks. Hey guys. Good morning. So, I guess, staying on POS for a second, flat through April, given where you were three months ago, it sounds pretty positive. Can you remind us what your comparison look like in the back half of this year? So you kind of put that into context?

Matt Garth

Super easy. They are very soft. Do we have any – I am looking at the sales guy over here? He's has been a computer now.

Mike Lukemire

If you look at throughout the year, low-single-digits to negative double-digits comps. So, we got negative comps for the balance of the year.

Joe Altobello

Okay. Helpful. And secondly, on in your guide, if my math is correct, I think you're guiding somewhere in the neighborhood of about \$570 million this year. Obviously, it's well below what you spent the last few years here. How much of that is temporary? And how much of that might come back, I guess in '24? Or should we kind of stay at that, call it mid-15s percentage of sales?

Matt Garth

Yeah, that's what we've been very diligent about giving that guidance, because I think we had a lot of questions earlier in the year about that. And you're exactly right. Sort of mid 15s I am saying between 15% and 16%, that's down from that 19% level. But again, we detailed for you, where we've come from, which was a much larger revenue trajectory.

Through Project Springboard, we realigned our SG&A spend. We are thinking between 15% and 16% as a good way to look at that moving forward. So, as revenues grow, Joe, we will bring back some spend. But we're keeping that pretty locked.

Jim Hagedorn

Joe, I we've known each other a long time. It was crazy painful right here, okay? I mean, it was a, I think I told people it's going to be a long goddamn winter and it was. We let a lot of people go, a lot of people we had basically just hired. We went from kind of we can do anything, and I think what was it we called that Mike? Unconstrained?

Mike Lukemire

Unconstrained.

Jim Hagedorn

To super constrained in a in a really short period of time and that that hurt. But I would invite you, Joe, you've been a friend for a long time. I would say, come visit with us. Maybe we can set up an event where you can actually meet the sort of operating team. So, there's fewer people. Pretty diverse crowd. But really enthusiastic. They didn't get down.

And it would have been really easy to kind of lose our way and everybody be down. We got a Monday Young Warriors who are running this business and I'm really proud of them and I would say we should find a way for you and others to meet some of the team. So it's a smaller team. But they are super engaged and they are kind of rocking and rolling. So, while the numbers are down and it hurt, I do think that the surviving team is super on and you'd like it, if you, if you met them.

Joe Altobello

Appreciate that, Jim. I'll try to get up on that. Thank you.

Operator

Thank you. Our next question comes from the line of Bill Chappell of Truist Securities. Your question, please, Bill.

Bill Chappell

Thanks. Good morning.

Matt Garth

Hi, Bill.

Bill Chappell

Hey. Just one, I guess first quick one on, not quick, but on Hawthorne business. I mean, help me understand, what gives you confidence that you cut enough to get a good profitability? It seemed like you implied that the kind of the daily sales numbers hasn't really picked up as you would expect it to by this point. I know there's not a whole lot of visibility to that industry in general. So, I you know, it what guideposts are you looking at that feel like, okay, we're going to on that path to breakeven on that path to improving just with the assumption that top-line is not going to improve and maybe, maybe stays as we get not weaker for the foreseeable future?

Jim Hagedorn

Well. I don't know. I'm going to, I'm going to - I'm looking at Chris and Matt on sort of trajectory on sort of operating profit. I guess, this is how we talk about that. But I would say, we've been talking about where we're going to start seeing industry bottoming out. I think that within the Hawthorne crew and with the industry people, we've talked to, I think people are viewing like we're either been there or we are there.

And so, I do think that that's part of this is that it feels like there is starting to be enough positive signs on sort of value per pound. I think, and consumption of product with people who know what they're doing. That we're sort of at that inflection point.

On the cost side, I don't know, they - when we talk about cutting expenses here, like on a annual rate of like nearly a quarter billion bucks, Hawthorne was like half of that and that has been, I give credit to everybody there that whatever Mike and I have done, Chris has done, like about the same amount of money.

And so, it's been very challenging. I do think you heard comments about we got to do something. Part of what I'm looking at is, there gets to be a point beyond breakeven but depending on the sales volume and the mix but you just say, is this a place we can stay. And, you we're not giving up in this market. I think if you look at just consumption by Americans of pots, those numbers are okay to good.

I don't think that Mike or Matt or Chris or me would look and say that we just want to be in North American Consumer business. I think we get back to where we have been in the past before we started making these investments of saying of the five pillars that, do we need live goods? Do we need Hawthorne?

And I think the answer is yes. We like the growth characteristics of that and we still believe in both of those. I do think that at the volume numbers we're talking here, we're going to need to hook up with other people who were in similar situations who need scale. And that's what you should read from the hints that we threw out there.

But Chris, I don't know where you are just on the business and then Matt I think we talked about sort of the operating profit.

Chris Hagedorn

Hey, Bill, it's Chris. Yeah, so just a little bit more detail on why we've got some confidence in the second half here. And, Jim mentioned, I think we're starting to see some, some tailwinds materializing in the industry. And they may take, another month or two to hit us just where we occupy kind of the value chain in the industry that once those end-producers do see some price recovery for their products that will work its way through to us. But there's a little bit of inventory in retailers and all sorts of things at work its way back. We're also expecting just a pretty standard seasonal lift that we see kicking in, in Q3 and into Q4 with outdoor grows on in places like California. So we expect that as well.

And we've also got a number of pretty high upsides. What we believe are high upsides East Coast, take places, like New York, Maryland, I know Missouri is on East Coast, it was an emerging market for us. So we expect start to see some velocity. And then we've got a, we've got a pro-hort business that, in spite of everything that's going on in the North American cannabis market, the pro-hort business for us which is primarily the Agros Plant brand is doing extremely well.

And those are sales due to the seasonality of their customers, which are professional, pro-hort a lot of veggie growers and that kind of thing in Europe and Canada, their season, they want to buy products at the end of our year. So those are sales we expect to see kicking in, in Q4, but they're big numbers. So, we're optimistic.

Look at the market continues to have struggles, we will continue to make moves whether they're large, strategic moves, as Jim mentioned or the type of internal moves we continue to make. But I think there is a lot of signs out there in spite of the headlines that are making us optimistic.

Matt Garth

I think just to come on from a position of trajectory and profitability, the top-line, we're being pretty conservative about, and how we're talking about it today. I think Chris and Jim both shed a light on there could be potential improvement. So there is positivity, pretty much in every product line that we're talking about.

But specific to how we are talking to you about it. The profit trajectory is based on the actions that we've already taken. As Jim said, Project Springboard, half of that was coming from Hawthorne. That's built into the recovery trajectory. The restructuring that we took also is directed at Hawthorne. That takes out a significant amount of warehousing costs in and of itself that is the major delta between today and the end of the year.

So, don't necessarily need a revenue change to help us get to that profitability point. So, it's really on us and we've already taken the big actions and now it's just working it through in the next couple of months.

Bill Chappell

Great. And then, just one follow-up, back on Consumer POS and just maybe, hopefully this is a short-answer question. But I get that that you're pleased with how the market or how the business is reacting, when the weather is good. But really weather in March was bad. And I think you said there was only one and a half, good weeks of April.

And so, and historically in the years that I've covered it, it's been rare where you could kind of make up those March and April sales in May, June, July in the southern half of the country. So, is your expectation and your kind of optimism for the POS that that the northern half or the other – the market that have been broken are going to be better than expected? Or do you actually expect, consumers who – for weather reasons didn't show up in March or April are going to still show up later in the season to make the equal amount of purchases because you're going to go deep into the season?

Jim Hagedorn

Well, I don't expect - I don't see us being that far behind. I'd just say, we're going to make up - we're going to deliver what we said we're going to do. And that we're going to execute against it. So - and I would tell you that we've actually been a lot more aggressive early like with birds and given the weather. We actually saw in markets where it wasn't weather-related that were actually flat to slightly up in units because we got consumers out. So I am actually more bullish that what we have out there, so.

Bill Chappell

So, you don't think the weather has been that much of an issue?

Jim Hagedorn

No, it's not been that as big as it's historically been. Back I think it's probably in some cases better than I thought.

Bill Chappell

Okay.

Mike Lukemire

If you look at, if you went back two weeks ago, I know Luke was that that point saying, we've got this, we're going to run supply channel products. Then we get like two shitty weekends. And there's two bad words now and people were looking concerned. This is over like a couple of bad weekends. Look at the weather forecast right now, like again, mind goes out like 14 days.

Just looks really great and I think - I think there has been a move in our business towards, May, June honestly. So, I think if somebody said to me, you're going to get April showers are you worried about it? I would say not really. So, I don't think we don't need a lot to happen. I expect a lot to happen. I don't think we need a lot to happen.

I expect POs to be there. So it's a question of where we ended inventory for those types of things. Not a POS issue. I think people hanging on – too much more than saying whether retail inventories at the end of the timing of shipments.

Jim Hagedorn

Yeah, Bill, a few things, that Luke is, we want to see increasing inventories not crash. Retailer inventories are down a lot, right? We want to keep retailers in the game. And I think what this, what this weekend, the next like week and a half will loop was, we will be forcing retailers to buy product from us. And that's a good thing, so.

Bill Chappell

Got it.

Jim Hagedorn

They never want to be long on the inventory. So, I think that it's – they really need to get POS for is helpful. But as far as POS being there I am really, and we are trending towards like 2018, where we kind of blew it away on POS, so. I think people say POS type of shipments more than – and so.

Bill Chappell

In 2018, the POS was May to June right? And that's why we gone in.

Jim Hagedorn

We're not going to be short in. We are talking direct.

Bill Chappell

Yes. I can only try.

Operator

Thank you. Our next question comes from the line of, I'm sorry - comes from the line of Eric Bosshard of Cleveland Research Company. Your question please, Eric.

Eric Bosshard

Thanks. Maybe I have two questions. I guess, one for Matt and one for Jim. To start with Matt on the numbers one. On Consumer it's clear today that device is upside than sales in Consumer. And I appreciate the outlook and the clarity on that. On the gross margin side, what I'm trying to understand is, you have that same sort of sight line to progress.

I didn't totally understand why the gross margin didn't start to improve through the second half of next year? So what are the moving pieces in gross margin that influence that both near term? It seems like pricing holds in and the promotional budgets are set for this year. But are there moving parts within gross margin, as well in Consumer that that we should be thinking about it both the near term and year '24?

Matt Garth

Yeah, thanks for framing it up that way because, pricing does hold. Promotions are working. You just heard the whole volume story and how we're looking at that through the rest of the year. The biggest piece in margin formation and, by the way, margin degradation from the 30s has been the inflationary impact. And so, what we've done and you know this, we pretty much locked up this year.

So we have 90% of our COGs locked up in 2023. You've begun to layer in, in 2024. We do that both from a supply assurance perspective and also a price perspective on our COGS. So that we have that visibility to work with our retailers on. That being said, in addition, we also have high cost inventories that we're continuing to work through.

Remember, we came into this year within the neighborhood of about a \$1 billion of excess inventory between both of the businesses. We're working through a significant amount of that. And that is some of the, if not, all of the inventory release that we're going to get over the next two years is that higher cost inventory.

The activities that Mike spoke about to bring those in faster, we are looking at. So, you have those two phenomenon, which is price is being locked in. Inflationary factors coming down, but at the same time, we're already locking in 2024 and then you have the high cost inventory that we're working through and trying to do that more quickly.

On the backside of that, you'll get back to that natural in the 30s for US Consumer type margin. Nothing else at play. And by the way, that's why Jim talked about we have other levers, right? We've done great work on the SG&A side. We continue to drive out operational efficiency throughout the entire organization. There is additional pricing to go. Should we need to go for?

Eric Bosshard

And then, Jim, you talked about early in your script about this being the base or foundation I think you said that. But you talked about it a transition now to growth for the company. And so, I'm curious, you talked about reforming the strategy team in this transition to growth. I'm curious what that looks like strategically?

And I guess, I also was surprised to hear that Hawthorne was mentioned in that considering the path that has been laid with Hawthorne. And I appreciate Chris' comments that there's tailwinds growing in that business. But help me understand when you talk about transition to growth, what that what that looks like or what's on that menu?

Jim Hagedorn

Okay, let's just start with innovation, dollars that Patti has. I think if you look at the dollars that the marketing group had going into this year. I think they had, I'm not going to say limited dollars, but I think they had kind of what they wanted on their core brands. I think if you're in, kind of a secondary or tertiary brand, I think, those were those were pretty tight.

So, I think if you look at R&D, the R&D budgets were fairly intact. I think if you look, compared to the sacrifices that happened all over this business, R&D was relatively immune to that, not completely. But I think we talked about on these past calls that if something had a, sort of marginal payout or payout that was farther down the road, we either eliminated the program or we put it in suspended, we put it in a refrigerator until later to deal with it.

Not let it go bad, but take it out later. So, I do think that as we, I think we, Eric, we basic, I would say we see light at the tunnel. The winter - again, I don't know how to say it any differently, it really sucked. We - we're talking about islands. It felt like an island here. We believed in ourselves, I'm not sure everybody else believed in us.

I think this company deserves a ton of credit for doing what was required both in making sales numbers and getting expenses out. For us, north of \$200 million of sustainable savings coming out of the business, that is some amazing stuff and heroic. Not - nobody was sitting around really talking about growth, okay? Now, as we're looking at light at the end of the tunnel, it's not really survival.

It's how do we grow out of this? I think we're starting to queue up investments. I think the strategic team, we Aimee ran our strategy group. And that group was eviscerated in like a day. And what's clear is that in corporate and we're basically repurposing existing high-end thinkers into Matt's group. What's clear is that corporately we need to think through a bunch of these opportunities.

Not really burden the operating team with this, but partly come up with metrics that we can use as guideposts for the business going forward. But also to make the investment choices that will drive growth in both sales and margin here in the company. And so, that's what I meant by is that. I think we're seeing light and we're basically saying growth is going to become something that matters. And how do we thoughtfully get there. I didn't say that we're free. But I think, I think we see a view of this less burdened than it was.

Eric Bosshard

Okay. That makes sense. Thank you.

Jim Hagedorn

I think it makes sense.

Operator

Thank you. Our next question comes from the line of William Reuter of Bank of America. Your question, please, William. William Reuter, your line is open.

William Reuter

Hi. Good morning. You've mentioned taking additional pricing, is the expectation that you would consider doing that mid-season? Or is this more in reference to when you have shelf space resets at the end of the season?

Jim Hagedorn

Well, it's not really shelf space resets. The negotiations with our largest retailers for next year are happening now. And so, this is a current discussion. And I haven't taken pricing off the table. I think, probably there's pressure not to take pricing. I'm just partly what I'm passing to my team and to our retail friends who are looking to this call is that, our gross margin really matters the ability to grow out of this which everybody needs us and our retailers is going to be, do we have enough ammo to run the business?

And so, we've come out of a period that was pretty tight. So, if we need pricing to get us back to historical margins, because that's what we're talking about. Then as far as I'm concerned that's a tool it's in our tool bag. Do you accept that, Mike?

Mike Lukemire

I accept that. Okay.

Jim Hagedorn

We're first trying to get there.

Mike Lukemire

It is out. The cost in line with our retail partners, not have to do that as much we need to.

William Reuter

Understood. That helps a lot. And then, on the \$200 million of runrate cost savings by the end of the year, I can't remember if you provided the breakdown of what percentage of that is in SG&A versus COGS. Is there kind of a rough outline for me to think about?

Matt Garth

I think the last time we spoke about it. It was roughly a third SG&A and then two-thirds in COGS. So – I am sorry. The other way around. Two-thirds in SG&A, a third in COGS.

William Reuter

Okay. And then just lastly, for me, I was curious if you could share any changes that you have in terms of your long-term plan for Hawthorne? When you've been asked about this historically, I know you basically said, look, this is not an opportunistic time to do anything. We need to fix the business. But Jim in an earlier response, you mentioned that your perspective on cannabis has changed a little bit. So I was wondering if that maybe has changed strategically how to think about the asset?

Jim Hagedorn

We'll look, I'm - the strategy of going to cannabis was something that is about 10 years old at this point and was highly supported both at the Board level. I think would be investor community it's a time it was, but maybe people are having amnesia now. But I led it. So, I think, Luke and I and Matt believe in this business. We - I know we said, that we're sort of pulling off the table any sort of view of kind of spinning or any merger that would kind of result in a spin into a different equity.

And, and that isn't and was true. I think what's changed in the last, call it months, is that, as we look at this industry and just look at the sort of devastation out there, with some really good companies that I think we have a little bit of analysis island view of, bring us, what was it Chris?

Chris Hagedorn

Your poorness matters. You are not going to be profitable.

Jim Hagedorn

So, I think we're looking out and there's other people in this good companies in the same situation as us. And I we're looking really hard at saying what combinations could there be where everybody kind of throws their businesses into it, a new business that has the scale to sort of get to a place that we're not making excuses all the time and they survive.

So I think within that sort of line of discussion, we're really confident in what we own, which are really the best brands in the supply space, very dominant. And that there's other people that add things to it that make both companies better and we're open-minded to those combinations. And I think that's what's important is that, I do think that staying where we are is tough. And it's just because, I think, when you have a business that is earning - I don't know \$10 million, \$15 million, \$20 million, whatever the number you want to throw out there, I think it's one of those things that it's a lot of work. It just doesn't - it feels like it's constantly trying to find money. And I think you I think we need to be sort of with a business that is North of \$1 billion in top-line and sort of north of \$100 million on the bottom-line before it starts to feel like it really strategic, a market leader that is sustainable. And so, I think we've got a great business to sort of go to Ellis Island with, but I think we need some more immigrants to huddle masses to join us. Chris. I don't know, what you would say?

Chris Hagedorn

Yeah. Look, I think Jim said a lot of it. My personal and it's - I'm not going to say optimism here. But also just my conscious in this space is, we put a lot of, a lot of time, a lot of money into this space, as you guys know. We put you put a lot of pain into it over the past 18 months. And this is, Jim mentioned the contributions that the Hawthorn team has made towards overall cost reduction within Wisconsin.

I just - I want to I want to call out Tom Crabtree in particular, he's here in the room. But Tom has really led the day-to-day work on getting those numbers down for Hawthorne and it was, it was tough, tough work that I know was hard on Tom and everybody in the team. So I just - I want to make a big shout out, and just to express my gratitude and appreciation I respect for all the people that did that.

But we didn't do that work for no reason. We didn't do it to get out. We did it to make this business sustainable to sort of reinforce its fundamental soundness and prepare us for the next phase here. So the business is going through disruption. Everyone recognizes that. And it's frankly, it's tough to have to leave it through that and feel responsible for it.

But there are there are transactions to be done here that we see that are - I think would be accretive in pretty much every regard. There's some good players that are out there. And look, I think we got an obligation of to explore those opportunities, not only because we need to find a way to realize synergies and get that business as Jim mentioned to a place where it's a profitable to level that we can really be proud of. But aside from that is, there's such incredible opportunities now where, if that falling knife of cannabis valuations hasn't hit the floor yet, it's awful close. And we think there's many opportunities here to create partnerships and alliances that may not exist in the future. And we just – we got an obligation just as kind of hunters in the space to take a shot right now so.

Matt Garth

To re-emphasize one thing that both of you had said, which is, this is about value creation. And we do have an extremely unique position with Hawthorne providing the complete solution and as Chris said, that has a significant value for our customers. And so, as we look at consolidation, Jim said it, Chris said it, this can be done in a non-cash way.

That is formative to how we move forward. And honestly puts us in a stronger position for any decision that we make going forward on where this activity results.

William Reuter

Very helpful perspective. Thank you.

Operator

Thank you. And ladies and gentlemen, that does end the Q&A session and conclude today's conference call. Thank you for participating. You may now disconnect

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