The Scotts Miracle-Gro Company

NYSE:SMG

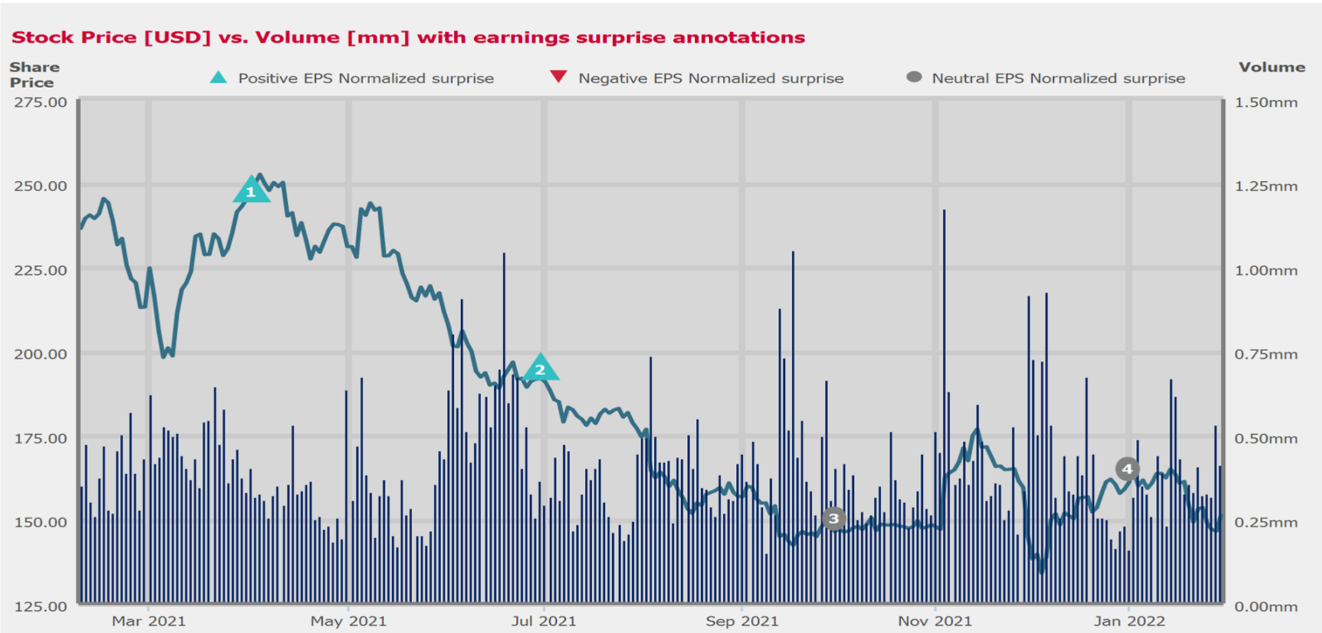
FQ1 2022 Earnings Call Transcripts

Tuesday, February 01, 2022 2:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2022-			-FQ2 2022-	-FY 2022-	-FY 2023-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	(0.73)	(0.88)	NM	5.09	8.45	9.56
Revenue (mm)	561.18	566.00	▲0.86	1712.84	4796.45	5140.87

Currency: USD
Consensus as of Jan-28-2022 12:40 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ2 2021	5.57	5.64	▲1.26 %
FQ3 2021	3.52	3.98	▲13.07 %
FQ4 2021	(0.86)	(0.82)	NM
FQ1 2022	(0.73)	(0.88)	NM

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Presentation

Operator

Good day, and welcome to The Scotts Miracle-Gro Company's First Quarter Earnings Conference Call. As a reminder, today's call is being recorded. At this time, I would like to turn the conference over to Jim King. Please go ahead, sir.

James D. King
Chief Communications Officer, Executive VP and Senior VP of Investor Relations & Corporate Affairs

Good morning, everyone, and welcome to The Scotts Miracle-Gro First Quarter Conference Call. Joining me this morning is: our Chairman and CEO, Jim Hagedorn; Chief Financial Officer, Cory Miller; as well as President and Chief Operating Officer, Mike Lukemire; and Chris Hagedorn, Group President of Hawthorne.

In a moment, Jim, Chris and Cory will share some prepared remarks and then we'll open the call to your questions. [Operator Instructions] I've already scheduled time with many of you after the call to fill in the gaps. Anyone else who wants to set up some Q&A time can call me directly at (937) 578-5622, and we'll work to set up some time as quickly as we can.

A quick bit of housekeeping before we start. Cory and I will be participating in two investor conferences during the week of March 7. The first is the Raymond James Annual Institutional Investors Conference at the Grand Lakes Resort in Orlando. We'll travel to Boston to present the next day at the UBS Annual Global Consumer and Retail Conference. We would expect both presentations to be available via webcast. And we'll publish more details related to the date and times as we get closer to the events.

With that, let's move on to today's call. As always, we expect to make forward-looking statements this morning. So I want to caution that our actual results could differ materially from what we say. Investors should familiarize themselves with the full range of risk factors that could impact our results. Those are filed in our Form 10-K, which is filed with the Securities and Exchange Commission. I want to remind everyone that today's call is being recorded. And an archived version of the call will be available on our website.

With that, let's get started this morning, and so I'll turn things over to Jim Hagedorn. Jim?

James S. Hagedorn
CEO & Chairman of the Board

Thanks, Jim, and good morning, everyone. The first quarter may comprise a small percentage of the year, but it doesn't mean things are slow around here, quite the contrary. In fact, there are several important storylines coming out of Q1 that are worth exploring in more detail.

Among them: a continued high level of consumer engagement that led to a second straight year of Q1 profitability in the U.S. Consumer segment with strong momentum as we ended the calendar year; the announcement of a third pricing action in the consumer business that will take effect in the second half of the year; an increase in our full year sales guidance for the segment; some moderation finally in commodity prices; continued restrengthening of our supply chain that has us well positioned to meet the demands for the upcoming season; restructuring efforts in Hawthorne that will make the business even stronger; and plenty of activity, including two more Hawthorne acquisitions in what is the most robust M&A pipeline we've had in 25 years.

Yes, there's a lot to cover. Before I jump into the details, I want to share a story that helps us put context around the strategy I outlined on our last call and its potential to drive value for our shareholders. As most of you know, my brothers and sisters and I own roughly 25% of the company. As part of a recent meeting with our advisers, we discussed the financial return on the family's investment since the merger of Scotts and Miracle-Gro in 1994. Just like other long-term shareholders, we've done well.

The most important part of the discussion, however, was centered around the simple question, why? Why have we done so well? And that's the part of the story that matters to all shareholders. One of the benefits, I believe, from strong family ownership in a public company is that we take a long-term view. And we're not afraid to think like an activist and recognize the need to reimagine the company from time to time. This is one of those times.

On our last call, I said we're pursuing five pillars of growth that could double the size of Scotts Miracle-Gro through both organic and acquired growth over the next 5 years. I also said we would explore the possibility of dividing the company into two pieces. Obviously, those things won't happen overnight. But the progress we've made already this fiscal year demonstrates just how seriously we're focused on this journey and how bold we're willing to be. So let's jump in.

I want to start with the U.S. Consumer business. I usually leave the numbers to Cory, but I want to start by touching on the P&L. If you're only looking at the year-over-year comparisons, I'd say you're looking at things the wrong way. Look at it with a historical context. While it remains the smallest quarter of the year, Q1 has become increasingly important on a full year basis. We've moved more shipments into the quarter to better serve our retailers, a change that has improved the performance of the business significantly. You'll miss that fact if you just compare the year-over-year results.

For example, Q1 volume is down from last year but up 107% over fiscal '20 and significantly higher when compared to the average in the 4 years before COVID. This feels like a base we can grow from. The year-over-year gross margin rate is down 2%. But the segment's margin is up more than 1,300 basis points compared to the average of the 4 years prior to COVID. And that's true in the face of sharply higher commodities.

The same story holds with segment income, which was a positive number for only the second time in our history. On average, the bottom line result was $50 million better than in each of the 4 years prior to COVID. And as we look ahead, there's good reason to believe that the first quarter of U.S. Consumer segment on an EBITDA basis could remain profitable going forward.

If we look at consumer activity, it's another good story. In Q1, POS, as measured by consumer purchases at our largest retailers, was up 3% in units. It was up 9% in dollars. Both numbers were against a plus 40% comp a year ago. Normally, I'd caution against reading too much into our Q1 POS. And that caution still applies. What's different this time, however, is the December quarter marks a continuation of a trend dating back to spring of last year that shows a level of consumer engagement that consistently has outpaced our expectations.

The COVID impact on POS continues to complicate the pure year-over-year comparison. But if you look at POS units over the past 4 quarters, we're up 22% compared to 2 years ago. More importantly, that 2-year comparison has grown stronger with time, suggesting that the COVID benefit may be more permanent than we first expected, which would result in a much higher base from which to grow. I'm not going to predict whether POS for the March quarter will be positive because we continue to have difficult comps.

But our most recent consumer sentiment data, which we received just last week, tells us consumers continue to see gardening as important to their lifestyles. It also tells us they plan for their spending levels to be consistent with last year, an important fact given the overall amount of inflation in the economy. And while we continue to expect a modest decline in overall participation levels, more than 2/3 of the consumers who do plan to participate in gardening this year said they expect to buy more plants and have bigger gardens.

Everything we're seeing and everything our retail partners are sharing with us is cementing our optimism as we move closer to the peak of the season. We've increased our sales guidance for the U.S. Consumer business to a range of minus 2% to plus 2% on a full year basis, an increase of 200 basis points from our previous range. This increase does not require us to change our view of the balance of the year. We're able to increase the range for two reasons. First, the Q1 result was better than expected and should be a permanent benefit for the year. Also, we have communicated to our retail partners another price increase for the second half that will impact our full year results by 1%.

The difficult decision to take a third price increase in a single year, while unprecedented for Scotts Miracle-Gro, was necessary in the face of continued cost increases that created a bigger headwind than we expected. The additional point of pricing, which takes effect in Q3, will get us back in line with our goal to offset commodity increases that have been a challenge for the past year. Fortunately, we've been seeing a few key commodity inputs peak over the past month. And it's beginning to feel like the worst may be behind us. Like others, we're still seeing higher distribution costs, but I'll leave it to Cory to discuss that in more detail.

The additional round of pricing is not merely rooted in protecting our margins. It's about supporting our retailers and protecting our competitive advantages. Over the years, we've built a market-leading position and driven strong returns for our retail partners by investing strongly behind innovation as well as sales and marketing support. These competitive advantages drove both consumer engagement before and during the COVID crisis.

We didn't outperform our competitors during COVID due to dumb luck. We won because consumers trusted our brands to deliver the results they are seeking. We won because our marketing team created relevant messages that resonated with those consumers and drove them to the stores. And we won because retailers knew they could count on our sales force to help manage their lawn and garden departments during the height of the crisis.

Given the current challenges in the labor market, our in-store sales force is more important than ever in supporting our retailers, and we need to protect that investment. That's also true of our supply chain, which has been able to meet retailer demand when others could not. I said in the last call, we don't like this level of pricing, and I don't. But the actions we've taken allow us to protect those competitive advantages and strengthen our relationship with consumers and retailers even further.

Speaking of relationships, I want to provide an update on the performance of Bonnie Plants and our strategy for live goods. There is good news on both fronts. First, Bonnie POS is in line with our core legacy brands, and we're expecting another strong season in the edible gardening space. Over the past few months, there have been significant improvements to the Bonnie supply chain, both in the way of process improvement and a new influx of talent. We're also seeing continued integration of our sales and marketing efforts. This should result in better in-store experience for consumers and more cross-selling opportunities for our core brands, especially Miracle-Gro.

As you know, we see live goods as an important gateway to the relationship with consumers. Our relationship with Bonnie has already improved the category. And we believe there's more we can do to enhance the range of choices available to consumers. Together with the Bonnie team as well as our partner, Alabama Farmers Coop, we have been actively exploring additional M&A opportunities that could significantly strengthen our live goods portfolio and bring a higher level of consumer-driven innovation and retailer support to the industry. While it's too early to share any details, we're excited by the prospects, and we'll be sharing more with you as these discussions play out.

From nearly every angle, I'm extremely bullish about the potential in the core lawn and garden business right now. And I'm equally optimistic about the steps we're taking to further strengthen our franchise and transform what it means to be an industry leader. We knew before COVID hit, demographic trends were starting to work in our favor. We saw that millennials were becoming interested in this space and in our brands. But once their lives became centered around their homes, they turned to gardening in numbers we never expected. A decade ago, this group was barely evident in our results. Today, they're driving our results.

Our job is to keep them engaged, to have them see gardening as relevant to their lives and to see our brands as critical to their success. Throughout the entire business, we're taking the right steps and making the right investments to ensure this happens. So yes, I'm optimistic as we prepare for the season. That's true not just for fiscal '22 but in the years to come. And I know Mike Lukemire and his entire team see it the same way.

Okay, let's shift to Hawthorne. I'll start with the obvious. It's clear this year is going to be challenged, and we'll see a decline in sales. I'll let Cory cover the numbers, but we already laid out much of what needs to be said in our announcement on January 4. While the current market reality is frustrating, we're not discouraged. We continue to believe in this space and its long-term potential. And over the past several months, there's been a lot of activity occurring that is designed to make the business even stronger when the market returns to growth.

As many of you know, Hawthorne experienced a tough downturn in 2018. And it was on one of these calls that I publicly criticized the team for being paralyzed by the stress of the moment and said they needed to step up. You're not going to hear that this time. The learnings from 2018 have helped us tremendously. And the way the team is managing this situation couldn't be more different.

First, the team saw the market decline coming as far back as June. And that allowed us to prepare. Second, they knew they couldn't change the reality of the situation, so there was not a panicked effort to chase sales that weren't there. Third and most importantly, they put on their activist hat and said, "How can we use this downturn to make our business better?" I have no doubt their answers to that question will, in fact, make Hawthorne better.

So I'm going to pause for a few moments and ask Chris to give you an update.

Christopher J. Hagedorn
Division President

Thanks, Jim. Hey, everyone. Let me start by taking a quick moment to update you on current industry trends. It's beginning to feel like we've seen the bottom of the market. We haven't bounced off the bottom yet, but daily sales trends have been consistent for about a month. And that makes it a bit easier to navigate. Also, we're beginning to see some slightly better results in consumable categories, like nutrients and growing media, which is also an encouraging sign.

You guys know the nature of the industry's challenge right now, so I don't need to elaborate. As I said in our January 4 announcement, we expect to see growth again in the second half of the year. But I'm not going to speculate on exactly when that will happen or to what extent. What I can tell you is that our business will be significantly stronger once the downturn ends. We've made key acquisitions, have taken steps to restructure our manufacturing footprint and realigned the management team based on the future needs of the business.

You probably saw our announcement last month about the acquisition of Luxx Lighting and True Liberty Bags, but let me give you some more context. There is no doubt that Gavita is the premier lighting brand in the indoor cultivation space. It has been a home run for Hawthorne and is critical to our long-term success. And Sun System, the private label brand we acquired from Sunlight Supply, is a solid opening price point fixture.

Lighting is the most important category in our industry. It's a category where we made a commitment to innovation and to being a leader. For growers, lighting is where they spend the most money, and it's the category that has the biggest impact on their crop. The right lighting strategy creates a relationship with those growers that opens the door for us to sell a full portfolio of solutions.

Over the last 2 years, our R&D and supply chain teams have helped drive our success in the critical area of LED lighting. We created the best products in the market, which has helped accelerate the industry's move to LEDs and strengthened our market share. Even though that's true, we still knew that we needed more than we had. We looked at all the available options in the market and decided that Luxx was the brand with the greatest potential.

Luxx is unique because it was designed by cannabis growers and is widely used by commercial cultivators, who know its history and trust its performance. The current market conditions made the economics of the Luxx acquisition extremely attractive, especially when you consider the synergies it allows us to capture. The Luxx deal makes this the perfect time to begin to consolidate our lighting manufacturing to a single location.

We announced last week that we will move our current lighting production, mostly HPS lights, from Vancouver, Washington to Southern California. We'll move other LED assembly we've been doing it there, too. This move will significantly reduce our inbound and outbound distribution costs, better leverage our labor force and take advantage of one of the best manufacturing plants in the SMG network. Those savings will allow us to take substantial costs out of each fixture and significantly improve our already market-leading position, especially in the critical LED market.

As part of this restructuring effort, we're also closing the manufacturing facility for HydroLogic, which we acquired last year. We are moving that work to our Santa Rosa facility, which is the original home of General Hydroponics. And we're consolidating distribution on the East Coast to a facility we recently built in New Jersey to meet the expected demand from new markets in the years to come.

Back to M&A. The other acquisition we announced, True Liberty Bags, is a much smaller deal but speaks to our strategy of putting the grower at the center of everything we do. True Liberty's products are used in the post-harvest process to freeze, store and transport large harvest quantities. The products are designed to prevent cross-contamination and preserve the quality of the plant. It is a niche category but a critical one. True Liberty is the clear leader in the space and a brand that commercial cultivators trust.

The acquisitions in the last 6 months of Luxx, True Liberty, HydroLogic and Rhizoflora don't just add to the P&L. These brands make Hawthorne more critical to cultivators, who continue to see us as far more than just a distributor. They see us as a trusted provider that understands the nuances of their business and one that continues to invest to bring them better product solutions and generate higher returns.

The other changes that we've made is a realignment of the team to focus on the needs of the business once the market returns. The restructuring has resulted in the elimination of roughly 200 positions. While the business decision was easy, it's never a good day when you have to part with valued members of the team. We did everything we could to provide them a soft landing. And I sincerely wish them well moving forward.

We also made some changes in Hawthorne management. Tom Crabtree joined the team a few months ago to lead our sales effort. You heard from him most recently during our virtual Analyst Day as a member of the U.S. Consumer team. Tom has a great background. He started off in the SMG supply chain and then moved to sales, including a stint in which he transformed The Home Depot sales team.

From there, he went on to lead all of sales in the U.S. Consumer business. And more than anything else, Tom is a great leader. He knows how to build teams, how to motivate them and how to design programs that drive results. As we look to the future, it was clear to me that Tom was the right person to be the Chief Operator of Hawthorne, and he was recently promoted into that role.

As you can see, while sales have slowed for the time being, we haven't. Every one of these changes makes our business stronger and will help further distance Hawthorne from our competitors.

I'll be around for Q&A. But for now, let me turn things back over to Jim.

James S. Hagedorn
CEO & Chairman of the Board

Thanks, Chris. You'll remember that the fifth pillar of our growth strategy is to explore opportunities in the emerging areas of the cannabis industry that are more consumer-facing. While SMG can invest directly in that space right now, we can build optionality that we can capitalize on later.

The creation of The Hawthorne Collective and the convertible loan we made to RIV Capital are part of that strategy. Because RIV is a public company, I can't provide many details this morning about its activity. But recall that we do have three seats on their Board, which is very active in setting the strategy and vision for what comes next.

It is through that lens that I can tell you to expect some important developments over the next quarter. As a result, we may choose to infuse more cash into RIV over the balance of the year that would increase our ownership stake if we converted the loan to equity. But we would still maintain a noncontrolling and non-ownership interest. And the magnitude of any additional cash would not approach the initial investment we made last year.

On the topic of Hawthorne and The Hawthorne Collective, I want to make one more comment. I know the discussion we had in the call last year regarding a possible split of the company got a lot of attention. Jim King has told me he had literally dozens of conversations about this issue with current or potential shareholders. I want to reiterate that we've made no firm decision about whether to proceed down this path. And it will take a while before we do.

Since our last call, however, we've established an internal team to study this issue and help explore the right courses of action. There are arguments to be made for splitting and equally compelling arguments to be made to continue operating as one company. We don't feel any pressure to lean one direction or the other, but we'll rely on the facts and analysis to guide our decision-making.

Before I wrap up and turn things over to Cory, I want to close with this thought. And it brings me back to the meeting with my family. Our business is sitting in a pretty good place right now, and it would be easy to sit back and just harvest the fruits of our labor over the next few years. But the opportunities in front of us are simply too obvious and too consequential to ignore. If we're successful in executing our strategy, this will be a much bigger and more profitable business that will drive meaningful value for our shareholders.

I'm not going to tell you we won't have challenges along the way. The degree of difficulty associated with some of our efforts is high. But any path worth pursuing can be slippery at times. I'm confident those who choose to travel with us in the years ahead will be glad they did. We have a lot of exciting pieces coming together in the months and quarters ahead. And I look forward to tracking our progress with you along the way.

For now, I'm going to turn things over to Cory to cover the first quarter financials. Cory?

Cory J. Miller
Executive VP & CFO

Thanks, Jim, and hello, everyone. My comments will be brief this morning. A lot has already been covered through either our pre-announcement last month or by Jim and Chris this morning. But there are a few key themes I want to cover, specifically about the adjustments we've made to our guidance, the current trends with cost of goods and how we're thinking about capital allocation as we look ahead.

On the P&L, there were no real surprises on the top line. Total company sales were down 24% against a 105% comp a year ago. U.S. Consumer sales were down 16% on a 147% comparison. And Hawthorne was down 38% against 71% growth a year ago. In U.S. Consumer, we saw good POS, as Jim already mentioned. And retailers finished the quarter with inventory in line with where they were a year ago. That was the best-case scenario for us.

They remain committed to the category through the fall season and kept appropriate levels of inventory in their stores as we approach the slowest weeks of the year. That leaves them well positioned as we pivot into our key selling season. And the shipments we saw through January leave us optimistic.

The midpoint of our increase in our sales guidance for the segment assumes an 8 point decline in volume for the full year, offset entirely by pricing. The trends through 4 months suggest this might be a conservative estimate. But as Jim said, we're less than 10% of the way through the year, and it's way too early to predict what will happen in the spring.

Shifting to Hawthorne. The sales decline was due primarily to the slowness of the broader cannabis market. The supply chain challenges we've mentioned previously are difficult to precisely quantify. But we believe they caused around 5% of the downward pressure in the quarter. Those challenges, primarily in the LED lighting space, have been remedied, and we are back in stock with the components we need to once again be manufacturing and shipping LED lights, which remain in strong demand.

Let's move on to gross margins because this is an area that's important to understand. As you know, Q1 results often fall prey to the law of small numbers. And that's exactly what happened with gross margin. The adjusted rate was down 570 basis points in the quarter, driven by the year-over-year decline in volume and its impact on manufacturing, distribution and other fixed costs. Commodity prices were also a headwind in the quarter but offset by a 400 basis point improvement from pricing actions.

Jim mentioned the importance of looking at the gross margin rate in historical context, and I totally agree. The result in the quarter was more than 600 basis points better than in fiscal '20 and more than 850 basis points better than in fiscal '19. Over the past several years, we have effectively moved business into Q1 to ensure retailers are properly set for the season, which should keep us at a level of profitability that is higher going forward.

As I look at the balance of the year, we are maintaining our gross margin rate guidance for a decline of 100 to 150 basis points. Right now, I'd expect us to be at the lower or worse end of that range. Margins for the balance of the year should be relatively flat but could vary a bit each quarter, positively or negatively, based primarily on timing and mix. You probably saw my quote in the press release this morning about commodity costs, and Jim touched on it slightly, too.

Let me elaborate. In total, we are 70% locked on commodities for the year, which is slightly behind normal. We would normally have all of our costs locked right now on pallets. But we're only at 30% because vendors are not currently entering into long-term contracts due to the volatility of lumber prices. On everything else, we're actually in good shape, including urea, where we're nearly 80% locked for the year.

The better news is that we're starting to see some relief. Resin has been retreating for a couple of months now. Urea has begun to do the same. No one has been accurately predicting input costs for the last year, so I want to be cautious. Still, I'm increasingly optimistic that the pricing moves we've taken should offset these commodity headwinds on a full year basis.

SG&A was down 2% after a sharp increase last year. Recall that our guidance calls for SG&A to decline up to 6% for the year, and it's an area we're keeping an eye on as we move closer to the season. The only other issue on the P&L that merits your attention is the $7 million loss on the equity income line, which is related to our 50% ownership in Bonnie. Remember, we did not have that ownership stake a year ago. And Q1 is a seasonal loss quarter for Bonnie. As Jim said, the business has had a solid start for the year, and we're optimistic about the upcoming season.

On the bottom line, our seasonal loss on a GAAP basis was $0.90 a share compared with income of $0.43 last year. Adjusted earnings, which excludes restructuring, impairment and nonrecurring charges, was a loss of $0.88 compared with earnings a year ago of $0.39. You might recall that fiscal '21 marked the first time in company history that we reported a first quarter profit. Chris mentioned in his remarks the realignment we've made at Hawthorne. We expect those actions to result in a restructuring charge of up to $5 million in the second quarter. That charge will be excluded from our full year guidance.

Let me briefly touch on the balance sheet, specifically focusing on inventories, which are up about $590 million from last year. First, recall that inventory levels were lower than we had wanted a year ago as we were shipping product nearly as fast as we could build it in both major segments. Second, recall that we consciously built an inventory cushion last year to ensure we are able to keep our retailers at the appropriate levels throughout the season. And finally, about 25% of this increase is due to the higher input costs we've been experiencing over the past year. We remain comfortable with inventory at this level and continue to see it as a competitive advantage. We expect to see some competitors continue to struggle to meet demand this year, which we believe will work to our advantage.

Finally, I want to focus on capital allocation. We are still planning for CapEx to be approximately $200 million for the year as we continue to improve our supply chain and invest in our e-commerce infrastructure. Remember, we had been investing based on the assumption that our U.S. Consumer segment would grow at 1 point or 2 per year. Since fiscal 2019, it's up around 40%, and we've pushed our capacity to its limit. So these investments are necessary.

Jim commented several times about the M&A opportunities in front of us, so let me provide some context. We are currently budgeting slightly more than $200 million for future transactions over the balance of the year. The opportunities that remain on the table, if executed, should be immediately accretive to earnings and go a long way in advancing our strategy.

In terms of returning cash to shareholders, we repurchased $125 million of our shares in Q1 and have a 10b5-1 in place for another $50 million in our Q2. We currently do not have a 10b5-1 in place for the second half of the year and would expect that any share repurchase activity during that period would occur in the open market. Additionally, we have no current plans for a special dividend this year.

Given our current outlook for the business and our expected outlay of capital, we could slightly exceed our leverage target of 3.5x by the end of the fiscal year. We were at 3.3x at the end of Q1. If we exceed our 3.5x target, we expect to get back below that level within a quarter or 2, and we would still be well within our current debt covenants.

Before I open the call for your questions, let me say that I'm really pleased with where we're sitting right now. We know we have some near-term challenges in Hawthorne, but we aren't focusing on the demand that we can't control. What we're focusing on is what we can control. And that is what we look like when the growth does return.

I'm convinced we'll be better positioned than ever with a better margin profile and competitive advantages that have been strengthened over the past several months. In U.S. Consumer, I share Jim's optimism. There's no need to make further adjustments in our guidance right now. But the trends are certainly tilting in our favor for the upcoming season and beyond.

And finally, on a personal note, I've recently completed my first full year in this role. My engagement with all of you was a new experience for me, and it's given me a better appreciation of the issues on the minds of our shareholders. Through this new lens, I'm working closely with my colleagues to ensure we're acting as proper stewards of our capital and focusing on driving value for all of you.

And while I've also grown to appreciate the importance of this quarterly discussion with all of you, it's also reinforced my view that we can't run the business on a quarter-to-quarter basis. Value is driven over the long term, and I'm convinced that the steps we're taking to strengthen the business will do exactly that. Now let me turn the call over to the operator for your questions.

Question and Answer

Operator

[Operator Instructions] And our first question will come from Jon Andersen with William Blair.

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

Congrats, Cory, on your first year under your belt. I wanted to start with a question on the U.S. Consumer business, really related to demand or consumer engagement as the pandemic wanes or presumably wanes. You've taken your numbers up for the year for that segment, which suggests a certain degree of confidence. I'm guessing that's coming from some of the real-time data that you're seeing through point of sale. You also referenced some survey work.

But I'm just wondering if you could talk a little bit more about what gives you the confidence in that business, again as consumers kind of return to travel, return to their workplace and the general inflation that the consumer is faced with at present across all consumer categories. Because that's a big topic for investors that we talk to.

James S. Hagedorn
CEO & Chairman of the Board

Jon, Jim Hagedorn here. There's a lot in that question. The POS data for sure is good. We've been, for a couple of years now, sort of after COVID, started saying if we could just hang on to the sales data. So for us to be saying, "You know what, we think sales will be up minus 2% to plus 2%," is -- it's still hard for Mike and I to do that.

But I think that the POS data, while it's small, basically says that the consumer is still engaged. The survey data again just says that people want a garden -- that the young people who want a garden are more interested in gardening even than their parents were, and they are willing to spend more money.

And for me, last, and I'll hand it over to Mike, is the retailer enthusiasm for the category is just -- and I'm talking both online and brick-and-mortar, is just really positive and committed to the space. And I think you're seeing that in our movement of product into the stores, and I'm going to say a much earlier and successful kind of load into retail than we've seen in the past.

And so the retailers are engaged, the consumers seem to be buying so far. It's not just us, live goods as well and then the data we're getting plus our plans to market and our innovation and new products. So I think that's what sort of drives us to say, "Sales will be flat," which it doesn't sound that great. Does that sound great to you, Mike?

Michael C. Lukemire
President & COO

No. But I'm an optimist. But we're also seeing out there that there's an upgrade in live goods and the demand for live goods at a higher quality level. And so we're seeing larger pots, and consumers are leaning in with that. So that gives us a degree of confidence that they want to do more and they want to have greater success.

And so in the premiums of -- having a premium plant, premium products has actually -- we've seen signs that, that has actually risen. So the pricing action so far, we've not seen consumers walk away from that. So that adds to our optimism. And we're seeing that in the South right now.

James S. Hagedorn
CEO & Chairman of the Board

The sort of negative that you threw out there, which is do you think pricing is going to deter people from gardening? And that, if I was going to be honest, I'd say, "We don't know. The retailers don't know." I think if you go back to sort of '20, where there was effectively no promotion at all -- and last year, I would say there was probably half as much promotion as there was in '20. But there was 0 promotion.

And the result of that was that retailers probably went up double digits to the consumer without any ability to sort of have promotions, Black Friday events that push prices down. And the business was insane. Now that -- again, I think you mentioned that it was during COVID and people were at home, et cetera. But I think people thought -- we pretty much were upfront about saying, "If we can just hang on to what we got," and we grew -- yes, I think units were up like 10% last year.

So I know that I've never seen sort of pressures like this. And I'm sure our retailers are listening. This is not covering -- so we're definitely in double-digit range on these three price increases pretty much across the board. And it's still eating into our margin rate. So I think it is the big concern of what are we going to see? I'm not too worried about it. But it's something we're going to watch carefully. And I just -- I got to be honest with you, right, which is that it's a lot of pricing. It's necessary, as I said in sort of my script, but I'm not too worried about it. I don't know, Mike, are you?

Michael C. Lukemire
President & COO

No. I mean, all indications there is consumers are not walking from that activity. And we're seeing them trading up. The live goods are early indicators.

James S. Hagedorn
CEO & Chairman of the Board

But not just live goods, Mike. Our Roundup sales in the Southwest, which is kind of a leading indicator of the market, are -- I don't know what the numbers are, but they're -- it's big.

Michael C. Lukemire
President & COO

About 45%.

James S. Hagedorn
CEO & Chairman of the Board

Yes. So I mean, I'd say so far, so good, Jon.

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

That's helpful. One follow-up, different topic completely. Jim, you mentioned you have an internal team that's actively evaluating the prospect of dividing the company. Anything else you can say about kind of the criteria you're using to determine or make a decision on that, what you need to see to make a decision and the time frame associated with it?

James S. Hagedorn
CEO & Chairman of the Board

Yes. So it's a good question, probably a complicated answer, which everybody would probably be happy if I didn't answer, but I'm going to sort of lead into it. Look, first, start with Hawthorne as a legal business. So we don't have a lot of the sort of issues on reputational risk, et cetera, that plant-touching businesses have both on taxation and banking. We have a ton of synergies by integrating Hawthorne into our supply chain and R&D efforts. So in a lot of ways, you'd say it makes sense to leave it there.

And so the question would be, "Then why would you separate it?" And there's probably two reasons that I think are probably the clearest. One is that I think in the investment community, there are probably people or entities that would say, "You've got a fantastic lawn and garden business, high cash flow, very predictable." And the cannabis market, people who want to invest in that are a different type of investor. And I think there's probably some truth to that. I'm not sure it outweighs what I've talked about before, the advantages of keeping it included.

And I'll just talk personally. Keeping it included keeps Chris sort of with us. And I'm going to say, just as a CEO, a mentor and his dad, I think having him involved in the core, which is our family enterprise, makes me happy. And it would be sad to see him make a choice that went in a different direction.

I think the other issue is what we're doing with The Hawthorne Collective, and it's going to become more clear over the next couple of months, the work we're doing through RIV, I think we'll start to make things clear. And one of the things that's important to us is some modicum of control. And so the strategy is, I think, as it becomes more clear on Apollo or The Hawthorne Collective, whatever you want to call it, I think you're talking -- I'm not talking acquisition dollars.

But what I'm talking about is the value of some of the enterprises that we want to put together as an alliance and create what I'd argue is the finest -- and this is in the future, when these things can be sort of consolidated on to a U.S. exchange. I think we'll create the most valuable pure cannabis play in the world. And I think we're pretty far down that track. And again, you'll know more about that.

I think that if you look at how do we maintain some control over this is we may need Hawthorne as a currency within that to maintain an ownership position that I think kind of reflects our commitment to the space but also our ability to sort of have a strong voice in how it's managed. And I think that, that is really important. So I don't know how I would balance it as far as which is better. But I think it will all come together.

And that's as about as honest a sort of lay of the land. So I think you could see sort of dis-synergies by pulling it apart. But I think that the value creation that could come out of creating an entity that sort of we're talking about here, I think, probably more than offsets the sort of relatively minor dis-synergies that would happen. So I don't know, does that help, sir?

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

Yes, that's terrific. Very interesting.

Operator

Up next, we'll take a question from Joe Altobello with Raymond James.

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

I guess, first question for Chris, I suppose. The oversupply of cannabis that's going on in the market, you guys have talked about a couple of markets in particular, California and Oklahoma. Are there other markets that are in the same situation? And is there a concern that we sort of see this rolling oversupply situation sort of spreading later this year rather than getting better?

Christopher J. Hagedorn
Division President

Joe, yes, so it is definitely not an issue that is contained to any one sort of discrete state market. California is significantly affected. And California obviously is our single-most significant state market, still close to half of our business. But we're seeing significant impact in a state like Michigan, which is our second-largest market.

Now that being said, we've got plenty of states, primarily Northeast -- or I should say just sort of the Eastern kind of corridor in general that are doing really well. Now it's off a small base. This is similar to what we saw kind of -- and I hesitate to even use Oklahoma as a comp here, but the growth that we saw off a small base in Oklahoma a few years ago. So we're seeing 100,000%, 200,000% growth in some states off a small base.

So there still are markets that are doing really well for us. But the oversupply, the intelligence we have, it's really driven by the sort of the legacy illicit market. And that is a market that doesn't really abide by state boundaries. So we're seeing this across the board in sort of the larger, more developed markets. The states with stronger or more developing legal markets are typically doing a little bit better.

Now in terms of how long we think the it will stick around, I don't think it's historically going to stick around for a long time. As legal markets get better and sort of we're trading kind of cannabis sales from the illicit market to the legal market, these sorts of disruption should get sort of smaller in amplitude and less frequent.

We think this one will probably be through -- we're getting kind of varying reports. We try to track wholesale prices of cannabis pretty closely because we find that. And that is a data point that's got a million smaller data points in it between legal and illegal in different state markets. All those prices vary. But that has combined been probably our best leading indicator. So we're tracking that pretty closely and talking to people that we're very close with in the market who have a pretty good finger on the pulse.

You're hearing reports maybe the oversupply was sold through in April, maybe it will be a little bit later in the kind of the early summer. Either way, we're pretty bullish that come mid-summer, we should see the business bouncing back in a pretty significant way. It's reflected in our numbers that we're projecting for the rest of the year. And for me, I'm -- and I don't want to disrespect Cory or anyone else here in terms of sort of our accountability to you guys in terms of full year results.

But my concern and what I've told the team is what I'm thinking about here is kind of the trend that we end this year on. And I'm pretty confident that we're going to end it on an upward trend, again as we see this oversupply sold through or destroyed because it is perishable. So that's what we're looking at is, at some point over the next couple of quarters, it will be kind of burned through and we'll be back in a growth position. But that's the intel we've got.

James S. Hagedorn
CEO & Chairman of the Board

And Chris, I want to just throw out again my own view, whether -- I think this is -- I would be generous, I think, in calling it an immature market, where there's just, "I'm going to get rich, I'm going to grow all this stuff," market crashes and we team to go through these cycles. And I think part of what Hawthorne needs to do is help be an influence to -- for people to understand production, to understand pricing.

And we're -- and this is true both in the R&D side, but also the economics of this business is something that we're hiring, I just don't want to talk names, but well-known professionals who are interested in looking at this new industry and helping understand the economics of it and do this as a service to our customers that help them basically look farther forward.

Because it does seem like the high beams in this industry go forward like 2 feet. And there's just a lot of black out there. And the ability to run in this stuff is pretty high. So again, more to follow on this. But we are looking to help this industry professionalize and to be a maturing sort of influence in the space. And I don't think our competition in any way can make these kind of investments to benefit the industry.

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

That's very helpful. I guess, just to kind of follow up on that, are there any liquidity issues that you're seeing amongst your hydroponics customers at this point?

Christopher J. Hagedorn
Division President

Joe, we have seen some of these guys, it depends at the retail level, even some of our vendors, there's, I would say, at the risk -- and I don't mean to be offensive to anybody here, certainly not our customers and our vendors. But there's varying levels of sophistication in these businesses. Some guys are really prepared and reserve plenty of cash and kind of operate their business in relatively conservative ways. Other people are much more kind of month-to-month. Some of those more month-to-month operators are in a difficult position for sure.

So we had some guys up in Michigan pretty recently and the retailers up there just feeling really down. Because to Jim's point, their horizon is pretty close in. They just -- they don't have, I think, some of the visibility that we have. And when they've kind of fought through for 6 months of just really tough, tough market conditions, those guys get down. And in some cases, yes, they're running pretty low on cash. So there's some things that we're doing to try to make life a little bit easier for some of our good, reliable customers, who are able to provide us with financials and help us understand their businesses. We're trying to do the same thing with some of our vendors.

But there's no doubt that there is going to be some kind of shakeout as a result of this market disruption. Some businesses will not survive. And for us, we look at it not so much on our -- on the retailer or customer side, but on the equipment and sort of vendor side, we look at this as an opportunity to kind of again further drive consolidation. Some folks are going to fall out. It will create opportunity for additional deal flow for us at really appealing valuation. So it's not like it's a good thing for the industry overall, but I do think we can take advantage of some of these circumstances.

James S. Hagedorn
CEO & Chairman of the Board

Yes. I mean, I'd just barely touch on what Chris said. I don't think we have any significant issues on our aging on receivables. So that maybe directly answers the question. But I do think that -- I think it was Forbes kind of over the summer, I think the headline was it's going to be a bloodbath. From a Darwinian point of view, the bloodbath is going to create stronger people. I think Hawthorne is stronger as a result of what happened in '18.

And we're absolutely committed to this space, and I don't think in a way that anybody would say is lame. We -- the Luxx deal was significantly cheaper than the original price based on market conditions. There are definitely going to be opportunities that -- now Hawthorne doesn't have a huge list of things they're after. But there are definitely going to be stronger retailers, stronger cultivators. And Hawthorne is going to be stronger as a result of what's happening here just from a Darwinian point of view.

Operator

And up next, we'll take a question from Peter Grom with UBS.

Peter K. Grom
UBS Investment Bank, Research Division

So I guess, my question is more of a broad-based question, just around the guidance for the year. I know there are a lot of moving pieces. But can you maybe walk us through why you still feel comfortable with the earnings range at this point in time? It's just -- from working through the numbers quickly, like using the midpoint of sales, gross margin at the low end, SG&A down mid-single digits. It really puts numbers at more at the low end of the range rather than the high end. And the high end seems a little bit more difficult to get to.

So maybe first, is that fair? And then second, does it embed any conservatism, should some of the key pressure points get worse from here, like consumer demand or weather? It doesn't sound like it does in the U.S. Consumer business, but just really trying to understand how we should think about framing kind of the upside or downside to the earnings outlook.

Cory J. Miller
Executive VP & CFO

Yes. Peter, this is Cory. If you look at the guidance that we have out there a month ago, we did pull down the volume in Hawthorne. The quarter came in kind of where we expected. Our outlook for the year hasn't changed a lot there. But we did pull down the sales level on Hawthorne. That's obviously going to put some pressure on the earnings line. At that same point, we feel more confident than we did when we set the guidance on our U.S. Consumer business. Things continue to go in the right direction. Our retail partners are engaged. Our POS is in a spot that makes us feel comfortable. You kind of net those two out from a revenue perspective, and you get down to a bottom line that is consistent with the range we put out.

We put out a $0.40 range at that point. Day-by-day, I kind of pick a number that varies from the low end to the middle of that range. I'd say that's probably where we're at today. Looking at margins and what we expect on the cost side of the inputs, I feel more comfortable now than I did a couple of months ago. So you kind of nail that down, you get to a range that's still in that 850 to 890. And if I was pegging a number today, I'd say we're probably in the bottom half of that range. But a lot of things could turn around. And we have some conservative estimates in there that can take it up a little bit.

James S. Hagedorn
CEO & Chairman of the Board

Look, Jim Hagedorn here, I'll throw in sort of my two cents. I think you know how violent this business is. And so much of it depends on when you can get out in a T-shirt and garden around America. And so let's just say, April through June is kind of where things are going bananas. So for us to call a year, when I think up in Vermont, we're supposed to get like 15 inches of snow Thursday and Friday, I think Cory gave you the -- so I'd start by saying, I don't think your thinking is all fubar. But I think that we continue to be pretty confident that flat for the consumer business is an achievable number. And if we can exceed that, there's just a lot of benefits that kind of come together for us.

And so we'll know a lot more sort of 2 to 3 months from now. And that would be the best time to do it. We've got a lot of control over this business. And we're not in our emergency checklist at this point trying to do anything. We're just running our business, looking to run our spring business with our partners. And so we haven't pulled our ripcord to say, "Oh, my God, we have to protect the P&L." We have a ton of ability to do that if things get tough out there, but we're just not there. Mike, anything to add?

Michael C. Lukemire
President & COO

No, I'm cautiously optimistic. And we'll do the right thing as the season unfolds.

Peter K. Grom
UBS Investment Bank, Research Division

Got it. Super helpful. I guess, just some follow-ups quickly on just Hawthorne, just the commentary that the category appears to be bottoming with kind of daily sales. I think it was said holding stable. Can you maybe help us frame what that actually looks like on a percentage basis in January? And then the guidance of kind of flat to minus 10%, just the uncertainty, right?

Because the category, we're trying to grow it in April or July. I mean, I guess, what's embedded in that guidance? Like if it is based on a return to growth in July, then an earlier return would be upside? And then just -- I know there's a lot here, but just, Cory, like in the release in January, there was a comment that preorders were up for nutrients and growing media. I may have missed this in the prepared remarks, but is that still the case?

Cory J. Miller
Executive VP & CFO

Yes, I'd say if you look at the activity we've had since we talked last or put numbers out last, I'd say we're kind of right along that path to the full year guidance. The timing that we see on a turnaround, like Chris said, is kind of spring to summer. We're figuring out what that means from a daily sales standpoint. But nothing we're seeing right now is causing us to come off of the guidance we put out there for the full year range. We still feel pretty comfortable in it.

Christopher J. Hagedorn
Division President

Yes. And just to add to what Cory said, so you mentioned what we referenced in the release last month about growing media sales and some nutrient sales. So yes, we're still seeing preorder sales that have already exceeded our full order -- or our full year preorders from last year. So those are going to go out sort of this month through June. What that really indicates to us though is that the retailers, despite that depression I mentioned during the last answer, that those retailers are feeling confident there is going to be a bounce-back. They wouldn't be ordering in these quantities if they didn't think they'd have customers coming in to buy.

Also in just the past few weeks, we're seeing a pretty significant uptick in propagation supply sales, so again, just people starting seeds, people doing clones and that kind of thing. Again, this is all kind of forward-looking kind of market confidence indicators to us that give us a pretty good feeling that, again come spring, early summer, we'll see this bounce back. I don't want to count my chickens before they hatch. But again, all the indicators that we got within our business are pretty positive right now.

James S. Hagedorn
CEO & Chairman of the Board

Yes, I want to throw in just to sort of comment is that maybe a plug for Hawthorne. I mean, part of what you're seeing is, based on these prices, people's willingness to build out new grows and invest. And I think that, to some extent, is retarded as a result of the pricing that's out there and people's willingness to build out with prices at this level. And I think if you look at like Hydrofarm, I hate to say, I don't believe it, but I think they have a consumer business in Canada that probably is artificially pushing up their number. And in addition, they don't have the lighting business that we do.

And so we're highly invested in lighting. And I think that, this is the plug part, if you look at what Hawthorne has done in the last, call it, 3 years with LEDs, if you look at HPS lighting, the old traditional lighting, those numbers are down pretty far. What you're seeing is a much more rapid changeover to LED lighting than I think anybody in this industry, and we're the biggest, would have anticipated. The work that Hawthorne has done and the acquisition of Luxx have just built a very, very powerful lighting business in the part of the market that's growing really well.

And I think that, that benefit is going to play out over the next years. And so I think you have to look at Hawthorne in that Hawthorne is more impacted as a result of the biggest part of our business, which is lighting and sort of HVAC, humidification, it's been air-conditioning and stuff. And so we're much more involved in sort of build-out work. And so I think if you can logically look at what's going on there -- but I think if you look at the franchise of Hawthorne, I think it's just a much more diverse and strategic business for this industry than somebody who is effectively a distributor.

Operator

Our next question will come from Chris Carey with Wells Fargo Securities.

Christopher Michael Carey
Wells Fargo Securities, LLC, Research Division

So I guess, I want to be a little specific on Hawthorne. Did lighting drive the decline in profitability in the quarter? How do you kind of see profitability for the business trending from here? And I kind of ask that in the context, a lot of these tidbits that you threw out around inventories are back end, you have more components, demand is there, you're shipping lights. So that's kind of question one.

And then tied to it is this restructuring seems like it's going to allow you to lower pricing on lighting. And can you just expand on that, right? Is -- are you getting pushback on lighting prices? Is this -- are you gearing for this East Coast move of the industry as more states start to open up and expanding your competitive positioning? So underlying that, there's a lot of questions around lighting. But the key idea is just profitability and some of the strategic decisions that you're making to potentially improve your value proposition from here.

James S. Hagedorn
CEO & Chairman of the Board

Chris, Jim Hagedorn here. Everybody wanted to answer this one, so everybody's competing sort of, but I pull rank on this one. We are definitely not in a race to the bottom on pricing on lights, absolutely not.

Our best light source is building as fast as we can make them. And that really gets back to my comments on LEDs. And that's also true with Luxx, business is good. I think it's the HPS and CMH lights, the more traditional lights, that are under pressure.

And I know Chris and his finance guys were running over, when you were asking the question, to sort of feed him. So I won't get in the way there. Mark, do you want to -- just come over. Mark Scheiwer is our -- he's the CFO for Hawthorne. I think you guys may have known him. He was the -- Scotts' Controller before he went over to Hawthorne. You want to talk a little bit about what's kind of driving your numbers?

Mark Scheiwer

Sure. So on our sales decline, I would say, for this quarter, it's -- half of it is around lighting. And I would say about 2/3 of it is our durables product line and stuff. So I would say on the sales decline, that's what you're seeing in a big piece of it. And then obviously, with the overall decline in our profitability, fixed cost leverage impacts our numbers and our earnings for the quarter. But I think as we kind of lever up in the rebound for the back half of the year, we'll be primed for profitability. So I would say those are the kind of key...

James S. Hagedorn
CEO & Chairman of the Board

Chris, I think the important part of this is this big shift over to LEDs from the sort of old sort of -- I'm not going to call it metal-halide because then people will yell at me. But the sort of old school...

Michael C. Lukemire
President & COO

HPS is the word.

James S. Hagedorn
CEO & Chairman of the Board

But I think if you look and say, "Where is Hawthorne relative to the market," we are in a really, really good position on LEDs. And LEDs is clearly where the entire market is moving.

Christopher J. Hagedorn
Division President

Well -- and yes, just to build on that, Chris, it's really -- it's not -- this is -- the LED sort of adoption wave that we're seeing is not limited to cannabis. And this is an important part of our strategy is really looking at this -- at our product line, our offering as a much broader offering than just kind of serving the cannabis growers. Clearly, there are bread and butter and that's who we are focused on primarily. But we are selling massive lighting jobs through our ProHort business in Canada and Europe, all LEDs. So the adoption of LEDs, as Jim mentioned, is taking place really across the board in kind of controlled environment in agriculture, whether that's cannabis or otherwise.

Now clearly, seeing sort of product categories that's about half of our business kind of hit a wall here. And this is a result of people just not wanting to build out new facilities. Clearly, that's going to impact our profitability in a significant way. When the market comes back and people start growing again when it's worth it for them to do so and the wholesale price of cannabis rebounds, we are going to benefit from that much more than anybody else because of our positioning. And like I said, we expect that to be back half of the year.

In terms of the moves that we've made on supply chain, like Jim said, we are not interested in the race at the bottom here. We've got some really value-added lights, some really interesting innovation that deserve the price that they demand to the market. And we don't think customers are squeamish about paying it. The question for us has been keeping ourselves and supplying those products and make them as efficiently as we can. And moving -- in-sourcing some of that manufacturing is not just about cost reduction for us, increasing our margin or offering a lower price to consumers.

It's also about just controlling our supply chain a little bit more and not being so dependent on folks and leaving us in a lurch. Because that's -- it's a hard thing when you're going through a market like this, and you've got people that want to order product and you just don't have the profit to fill those orders. So we're just not going to leave ourselves in that position again. And that's a lot of what's driving this is just controlling our own destiny.

James S. Hagedorn
CEO & Chairman of the Board

And last on that, Chris, is Luke went out to Temecula, we have a gigantic plastics plant out there, great workforce, great management team. And Mike and Dave Swihart came back and basically said, "We're moving everything down to Temecula." And the benefit we're talking about is triple digit in dollars.

Cory J. Miller
Executive VP & CFO

On a per fixture basis.

James S. Hagedorn
CEO & Chairman of the Board

So this is one of the things -- I don't think we want to be more specific than that. But this is a very major ability to kind of right cost. And it is not about giving that back. And we can be competitive very much. We can have market-leading products, both on the opening price point and on the premium side with technology that justifies the pricing. But we're just taking all -- I mean, we're doing -- if you looked at the supply chain for LEDs between us and Luxx, it's sort of spread out all over the world. And that -- anything to add on that, Mike?

Michael C. Lukemire
President & COO

I think you'll optimize your cost, you optimize your inventory and availability. And you're also controlling how your innovation is getting rolled out. So this is the optimization opportunity that comes with LED.

James S. Hagedorn
CEO & Chairman of the Board

And puts it much closer to the market.

Michael C. Lukemire
President & COO

Exactly.

Christopher Michael Carey
Wells Fargo Securities, LLC, Research Division

That's great perspective. And I guess, and I'll keep this quick if I could almost put a bow on that from here. Profitability in that business because of the inventory, because of some of the headcount, because of supply chain or whatever it is, profitability should see sequential improvement from here. And perhaps on a total fleet basis, you're slightly profitable in Hawthorne in Q2 and you ramp more in the back half because of the improvement in lighting. If you could just frame that to kind of help set expectations for the segment, I think it would be constructive.

Cory J. Miller
Executive VP & CFO

Yes. Chris, I think you're looking at that right. Lost a little bit in Q1, looking for volume to increase and get back in the positive side in Q2. And if you look at Q3 and Q4, that's where the majority of our profit by far is going to happen for this year. So it gets us back to a full year number that certainly isn't at the earnings rate that we saw last year, but it's a rate on a go-forward basis shows a trend that we're in the right direction and getting back to that point.

Christopher J. Hagedorn
Division President

Well -- and I don't want to toot our own horns here under the circumstances, reporting the numbers that we are right now. But getting back to profitability under the current circumstances for this year, when you look at the market conditions and you layer on, on top, the fact that we've doubled our distribution center footprint, that we've increased headcount pretty significantly just to match the scale and the growth of the category over the past few years, getting back to reasonable profitability this year, I just want to sort of commend the team because that's -- it's an accomplishment under the circumstances and something we're proud that we intend to accomplish.

Operator

And up next, we'll hear from William Reuter with Bank of America.

William Michael Reuter
BofA Securities, Research Division

I just have one. In some of Jim's opening comments, he mentioned that the M&A pipeline is potentially the biggest it's been in 25 years. And then later on, when kind of discussing the year, we kind of penciled out $200 million. So on the surface, you seem a little bit incongruent. I guess, I was wondering if you could kind of take these two statements and help me put them together and then thinking about where and why that you would be willing to take leverage for the right acquisition.

James S. Hagedorn
CEO & Chairman of the Board

Let me just kind of start on the M&A pipe. So I think that Bonnie is the recipient of the growth opportunity here. And sort of the beauty of that is that there's leverage capability at Bonnie, and we are willing to contribute and so is Alabama Farmers Coop. And I was pretty careful to say our partners because they're really great partners. But we have an interesting flow into Bonnie without us having to pony up all the money. And so leverage capacity at Bonnie plus a contribution from us and AFC is -- kind of offers us the ability to sort of lever up the opportunities without Scotts having to pay for the whole thing.

In addition, the moves we're making on the RIV side, effectively already paid for. That money has already been contributed. And we talked about an additional contribution to have more opportunity within RIV. And that's probably $50 million to $100 million additionally. But again, we're using RIV to get to where we want to get to without Scotts having to contribute all the money to do that. Remember, they started with $200 million. And we contributed to that, I think, call it, $150 million. So I think that within that lens, what it means is there's pretty significant opportunity that does not have to dollar-for-dollar show up on Scotts' balance sheet. I don't know if that -- Cory, if that makes any sense.

Cory J. Miller
Executive VP & CFO

Yes. I think that's right. And if you think of the activity that we've had over the last 6 months, we just completed four deals within Hawthorne. We're integrating those in. We're trying to see how much we can bite off and integrate into our business when you look over the next 9 months to get to the end of the year. And if you think of leverage, we kind of ended the quarter at 3.3. And I think in my script, it says we'll likely get over 3.5.

We can get to 3.5, 3.7, still feel like we're really safe within the covenants that are out there today. And the opportunities that Jim laid out there, I'd say we have a couple of other small opportunities on the smaller side. There would be opportunities as well for the rest of the fiscal year and just making sure we're continuing to move forward with all these acquisitions to operate the five pillars we've laid out and focus on our long-term strategy.

James S. Hagedorn
CEO & Chairman of the Board

We've also used a little bit of SMG equity and anticipate doing that in live goods as well, a small amount. On the sort of inventory side, if you're basically looking at cash, if you look at the inventory side, it's a pretty significant increase, I don't know, maybe $600 million, $700 million, I think, is roughly the number. But I think you probably could take $200 million or $300 million and say, "If we had that last year, we would have been a lot happier."

So I'm going to say 1/3 of it or so is just getting back where we should have been last year. And the rest of it is investing to make sure we can actually supply for the spring. And we'll look at that over time. But I think if we look at our inventory and retailer inventories, we're pretty happy with where they are right now. We feel well prepared. We do not feel overextended ourselves. And we don't feel that way about retailers. Retailers are ordering heavy right now. So there's no indication there's any sort of inventory at retail or with us that's an issue.

On the capital side, I think what we said is figure like -- or at least what we're talking internally is like $200 million a year for some years, I don't know, 3 to 5, I'd say, something like that. We're going to look at that over time and see if we think that those numbers are appropriate. Part of the issue, and I think everyone is well aware of this, is that we had a very well-balanced system for, call it, 0% to 2% growth.

Where you look now and you say, it's -- I don't know, Cory, I think, said plus 40%, plus 35%, whatever the number is. It's basically resized our requirements for manufacturing. And some of the investments we're making, like this year right now and next year, are part of just getting our production capacity and our ability to distribute both on the core and at Hawthorne, where it needs to be based on the growth we saw.

And remember, the growth in consumer has not gone anywhere. It's actually been maintained, so -- but I think beyond this year and next year, we'll take a look at how the business is performing. And there's no commitment out past -- as far as I'm concerned, out past that if we don't see the growth that we're looking for. Anything you'd add, Cory, on that?

Cory J. Miller
Executive VP & CFO

No, I think that's good.

Operator

Our next question will come from Bill Chappell with Truist Securities.

William Bates Chappell
Truist Securities, Inc., Research Division

Mike, can we talk a little bit more about just the pricing, both what's going in place and what's going in, in 3Q? And when I asked that this time last year, you were really leaning in on a promotional level, trying to capture or maintain a big chunk of those consumers that had come into the category. I think the thought was you were going to scale back on some of that.

So I guess, one, trying to understand how much of this is list price versus how much of it is it kind of a pullback on promotion. And two, putting in a price increase in 3Q really depends on when you put it in since there's so much of the sales happening April 1 versus June 1. So just trying to understand when that goes through and how that looks as well.

Michael C. Lukemire
President & COO

Okay. That's a lot.

James S. Hagedorn
CEO & Chairman of the Board

You should have written it down, Mike.

Michael C. Lukemire
President & COO

I know. No, I think the pricing that's going in, in April was primarily around our growing media business. And so -- and that would be timed, and we're working with the retailers on timing of promotion and activity. And so -- and Cory has the number of what it actually turns out. It's a significant number as a percent. But it nets out to...

Cory J. Miller
Executive VP & CFO

Yes. It nets out to about 1% of sales. But it's really focused on our soil business. And Bill, to answer your question, it's 4/1 is when we're looking to implement that pricing on.

Michael C. Lukemire
President & COO

Yes. We expect retailers to -- they didn't go all the way back to pre-COVID or -- yes, pre-COVID promotional. So I'd say that came out at about 50% to 60%. That's probably going to be similar on the promotional side. And so I think we're more specific on what promotions we're going to run that drive a bigger basket, and that has worked. We are leaning in more with the advertising again and what we call the -- what do we call those, Jim, the buy-in markets or whatever?

James S. Hagedorn
CEO & Chairman of the Board

The air raids.

Michael C. Lukemire
President & COO

Air raids at specific markets and hitting those markets with advertising and timely promotion more so than a national promotion. And that's been successful with all retailers.

James S. Hagedorn
CEO & Chairman of the Board

Yes. Bill, I would -- Bill, what I would say is just visiting with retailers, it does have a pretty competitive feel this year. They all seem fairly hostile and wanting to get everything they can. So we understand our programs. I just think the retailers are going to be pretty active this year looking to cement their businesses. And it's just how they talk sounds aggressive to me. So I think, yes, I might actually see higher level of promotion this year than last year.

I want to throw out there, just while we're kind of on retail, is there was this young guy when I first got out of the military down in the Southwest named Craig Menear. And so we kind of grew up together. When I was back in the private Miracle-Gro days and I first met Craig, and I want to say that I thought Frank was -- Frank Blake was a terrific CEO, one of the best. Menear was awesome. It basically says I'm getting old if people I grew up with are leaving the industry.

I know Ted has gotten people in his press releases saying it's the sort of managing sort of the art and science of merchandising. I think Menear very much was that. Anybody who spent some time with Menear, when he brings out his notebooks with all his stats in it, always tense up a little bit. But I want to sort of thank Craig for his time as CEO at Depot.

And this is not that I don't love all retailers, we do. And I want to congratulate Ted Decker on -- and he's been a fantastic merchant partner for us. And it will be interesting seeing him having everything reporting to him. So I want to congratulate both those guys and say, "Well, Craig, we'll miss you, dude."

William Bates Chappell

Truist Securities, Inc., Research Division

Can I jump in? I don't really know how to follow that. But so just want to follow up on the pricing, so just to be clear, you don't feel like there's going to be a big dropoff on volume even though promotion is being pulled back 30%, 40% versus kind of last year levels? You're comfortable that you've retained these customers?

Cory J. Miller
Executive VP & CFO

Yes. So there's kind of three waves of pricing that when you think about...

James S. Hagedorn
CEO & Chairman of the Board

The answer is yes, we're comfortable.

Cory J. Miller
Executive VP & CFO

We're comfortable. But I want to clarify it. Because I had -- I pointed out the April 1 pricing that we're kind of finishing up with the retailers now on that's going to take us back to April 1. That is wave 3 of 3 waves of pricing that we've taken. We took pricing last August. That obviously flows into this year. We took pricing again that was effective January 1.

We didn't see a slowdown in ordering then. And then again, we have the April 1 pricing that we're going to look to put in place. And it varies by item across the different areas of our U.S. Consumer portfolio but kind of nets down to a number that is in that 8%, 9% range that we talked about earlier.

Michael C. Lukemire
President & COO

Yes, I want to be careful that -- promotional level is not going back because of -- I mean, the same level. It increased last year from 2 years ago. It's going to be about the same level. It's not going back 30% to 40% because of pricing. But we're not seeing it increase either, at least that's what we're saying -- or they're saying from our interactions. So to Jim's point, as we're getting more competitive, somebody can do something. But that's what that -- all indications, that's where we're going to be.

William Bates Chappell
Truist Securities, Inc., Research Division

Got it. And then Chris, just a short-answer question, is the assumption this year kind of your outlook mainly for California, Oklahoma, others getting back to normal? Or are you expecting kind of meaningful pickup out of new markets like New York, New Jersey, Virginia, Connecticut?

Christopher J. Hagedorn
Division President

Yes. We're really looking at both a rebound in the traditionally strong markets you described, those West Coast markets, Michigan as well. But as I said, we're also seeing significant growth in those new markets. So if you look at -- let me just pull these numbers up here. I mean, you look at Florida, we're up 20%. You look at a sort of smaller basis state like Alabama, we're up over 1,000%. New York, we're up over 100%.

So we're seeing growth there. It's going to take some time for the revenue, just the scale of the markets in those states, to account for sort of the shift away from California. So it's going to take time for the -- sort of the balancing of the country to really reach a balance. So it's going to be some combination. But the primary bounce-back is going to be from the more traditional states just because the other states are still too small.

Operator

Our next question comes from Andrew Carter with Stifel.

William Andrew Carter
Stifel, Nicolaus & Company, Incorporated, Research Division

I'll keep this one quick. I wanted to make sure I understood what the cadence for Hawthorne is for the year. I think your guidance implies negative 9% to plus 4% for the remainder of the year. Will 2Q come in a similar magnitude as this one? Or will it be just kind of a hockey stick?

Second question is your kind of trailing 12 operating margin on Hawthorne is 9%. You finished at 12.5% last year and last guidance was up 50 basis points. Could you give us kind of any indication where you expect the business to end and kind of a long-term expectation now that you have the supply chain initiatives thing?

Christopher J. Hagedorn
Division President

Okay. We're going to have Scheiwer answer this one.

Mark Scheiwer

Sure. So on the second part, you'll have to repeat the first one again for me. But on the second part, just on our EBITDA or our earnings rate, we would expect in the back half of the year probably to be in that higher single digits as we ramp up our sales volume again with the market rebound. And then longer term, as we begin to flex on that, we should be able to get back to where we were at in the prior year and beyond, so -- and continue to make our push again to become closer to 15% as our overall target. So I would say it's a slight pause this year obviously and then we'll start that upward trajectory again in the next year.

Christopher J. Hagedorn
Division President

Yes. So again, echoing what Mark said, the long-term objective is to be a 15% operating margin business. We have every confidence we're going to get back to that -- or I should say, get back to sort of marching towards that goal, the path that we were on in the past few years. As far as the first part of the question, we expect to see the second quarter to be sort of closer, I think, to flat from a sales perspective and then for quarters 3 and 4 to really see that significant bounce-back.

It's what I said at the beginning of the call, one of the first questions was I'm more focused on kind of how we end the year from a trend perspective. So like -- yes, like I said, this quarter is kind of a punch in the gut. We expect to see Q2 kind of flatten out as the spring comes. This is -- traditionally, Q1 is our weakest quarter even in good years. And then we expect to see more significant sales -- a return to sort of significant sales growth in quarters 3 and 4.

Operator

And our next question will come from Gaurav Jain with Barclays.

Gaurav Jain
Barclays Bank PLC, Research Division

One quick one. So based on what you have said on Hawthorne margins, it would imply that your U.S. Consumer margins are actually not down a lot for full year '22. So when commodity costs start trending down, let's suppose they start trending down at some point of time, then does it imply that you will retain the pricing on the consumer side and your consumer margins will actually improve quite significantly from the numbers you have this year?

James S. Hagedorn
CEO & Chairman of the Board

Okay. I'll take the beginning and pass it to Cory, which is basically it's a little bit like the benefit of moving lighting manufacturing down to Temecula. We don't view that as a tool to reduce our selling price. I think that the only factor on the consumer side is moderation in cost of goods, which we're very hopeful for. I don't think we'd look to sort of reduce our pricing. I think that's a discussion we have with our retailers. And a lot of it would be based on what we're seeing with sort of the elasticity with the consumer.

So I think the idea would be to hold those -- hold that pricing and -- but just look and see what's happening with the consumer and if we felt it was weakness. And again, that's a discussion we would have with our retail partners on kind of what we're all seeing in the marketplace. But Cory, I don't know what you would add on that.

Cory J. Miller
Executive VP & CFO

Yes. I'd just add to the point that when you look at our margins, there's going to be two main components to make sure that we can get back to a margin rate that is kind of flat to last year. One is going to be the sales volume. As we continue to see sales volume increases above our original plan, that's going to be a positive fixed cost leverage for us that will help our margin rate. The second one is going to be around commodity costs. As we've locked in kind of 2/3 to 3/4 of our costs for the year, we feel like we're in a good spot.

For that remaining portion that's still out there to buy, we're seeing some favorable trends. Costs are starting to come down a little bit. That could allow us to get some benefit over the remainder of the year and the remainder of the amount that we purchased to get our margin rate down to a spot that's about flat as well. So depending on how those two things come in for the rest of the year, we could be down around flattish for U.S. Consumer margins.

Operator

And our final question will come from Eric Bosshard with Cleveland Research.

Eric Bosshard
Cleveland Research Company

On the consumer business, clearly, you are -- have a lot of confidence in how the season is going to play out to raise your numbers here in February. What I'm trying to figure out is the source of that confidence as we go into a year where you've got these three price increases that have gone in. Your inventory levels, I understand you're comfortable with them, but they're higher than they've been historically by a pretty wide margin.

I guess, the core is -- the question, two things. One, why the level of conviction? And two, if the consumer shows up in April, looks at three price increases and decides to behave differently, how do you manage through that? Or is that the retailers' issue to solve?

James S. Hagedorn
CEO & Chairman of the Board

Dude, it's all of our issue to solve if we see sort of elasticity issues. So I think that -- I'm just trying to like carefully be careful with my words here. Because I think we kind of answered that question already. I don't think the expectations on POS that we have called flat are particularly aggressive, to be honest. The retailers -- and dude, you probably have the best intel in the analyst community on what's happening sort of at retail. But I would be shocked and amazed if you haven't sensed the level of conviction for lawn and garden and the level of aggression that they see this as a sort of core category that they want to press on. The homeownership, the demographics of lawn and gardening are just really good for us at the moment.

I was dealing with a personal tax issue yesterday talking to our accountant from PwC. And she has a kid, and she's like, "We're going to move to New Jersey." But she said, "We can't find a house. Like if we don't make an offer like instantly above ask, we keep losing these houses. And it just makes it very stressful trying to get out of the city." So I think that, that trend is something we've talked about a lot that just, I think, benefits us long term. Because this is a huge group of people who are interested. And I think just like her, and this goes back to Menear telling me this sort of a year before I believed it, which is that when young people have kids, they want a home. And our data says that they want to have a nice yard and garden.

And so I think if you look and say, "The retailers are optimistic," and you would know that almost as well as we would, sir, just because I know how you do your work, and that's a compliment. The POS data is good. It has been good. And all the demographic data and our survey data, I think, reinforces we have great plans this year. We continue to refine our marketing efforts and our innovation efforts. So I think we're about as good as -- what's the big question mark out there? It's are these prices -- now remember, these are people who tend to buy once a year. These are not people who are out in the market buying multiple times per year generally.

And so I think we're somewhat buffered on that side. But it is a lot of pricing. I don't know if you add it all up, but it's probably in the teens from compared to last year. So it's a question. And I would say it's just not the retailers' problem. We won't look at it that way. But we've got a lot of money to put to use marketing our products. We are doing it, as you know, very much differently than we have before. Mike talked about these air raids, where we look at weather and the time of year, what's growing, and we're able to be much more flexible and focus money on making things happen. We're not just believers in that, so are our retail partners. We're moving more and more from sort of predefined programs to act sort of at the moment.

So I'm not worried. That doesn't say that there's no risk based on this. But dude, you follow us, and you and I have been talking for, it seems like, decades. And I think we've had some pretty significant price increases over time, particularly in lawn fertilizer. And it probably reduced the volume, but the profitability on the lawn line was significantly went up. So I think probably pounds, at least initially after that big increase. I don't even know when that was. That was probably '08 or something like that?

Cory J. Miller
Executive VP & CFO

'08, '09, yes.

James S. Hagedorn
CEO & Chairman of the Board

I think we sold somewhat less bags, but we made way more money doing it. And I think the business is very, very healthy. So I don't know. Does that answer your question? And Mike, he may have directed at you, so...

Michael C. Lukemire
President & COO

No, I would say we've taken our pricing in phases more specific than certain categories. We're not -- actually, we're seeing volume stronger. So we haven't seen any decline. Now that's early. And so that's one good indication. The other is we've got more people leaning into the category than ever. And so you're seeing in Tractor Supply and Ace even doing more and TrueValue and Costco. So it's not -- it's there are a lot of people that are putting more into lawn and garden than ever before. And so the interest in the category is much greater than it has been. So could the consumer walk? We're not seeing it. And so our degree of confidence grows with that.

James S. Hagedorn
CEO & Chairman of the Board

But I'd also add that our partnership in the retail environment, there is no doubt that you go into, I don't care who it is, what you're going to see is much skinnier labor force just as they are not able to fill all their positions and the importance then of the Scotts' team in there. And as you look at our sort of live goods approach in addition to our kind of legacy lawn and garden business, the objective will be to put more people in the stores. And that's a big advantage for us to be sort of be there when even the store labor can't cover what's happening. So it gives us a lot -- I wouldn't call it control but a lot of ability to take advantage of opportunities that other people just don't have the labor to execute against.

Cory J. Miller
Executive VP & CFO

Yes, I was just going to add three points, Eric, as well. Retailer engagement is really strong. Our positioning with our additional inventory this year, we missed sales last year because we couldn't ship out quick enough. So our additional inventory this year makes me more comfortable than we were a year ago. And I'll say that the final point on why I feel more comfortable in looking at the sales this year, our key weekends last year were kind of lousy.

You think of every weekend that we went into, we had rotten weather in every one of them. I think it was Memorial Day. There's snow on the ground, and it was like one of the coldest ones ever. So you go into those key weekends with good results, it doesn't have to even be great results, but good results will get us to a spot where flat unit -- or I'm sorry, flat dollars feels like a bet that we're willing to make at this point.

James S. Hagedorn
CEO & Chairman of the Board

Yes. And I'd probably -- on the online marketplace, and some of that is our legacy retailers, their online business, but also pure online players plus our own, that business is starting to get pretty big. I mean, I think that business -- all online sales for us that goes in Patti's category, which is our direct-to-consumer, I think you're getting up to like $300 million or maybe more. What was the number she drew out a couple of days ago? But call it roughly $300 million. It's getting to be meaningful numbers. And that business has an above-average growth rate as well.

James D. King
Chief Communications Officer, Executive VP and Senior VP of Investor Relations & Corporate Affairs

Okay, everybody. Thanks for joining us this morning. Again, as a reminder, we've got a couple of IR events coming up in the week of March 7. So we'll be making some announcements beforehand in terms of the date and time. And if there are any other follow-up questions that we didn't get to today, feel free to give me a ring directly. I'm at (937) 578-5622. Thanks for joining us, everybody. Have a great day.

Operator
And everyone, this concludes today's call. We thank you again for your participation, and you may now disconnect.