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EDITED TRANSCRIPT
SMG - Q1 2014 The Scotts Miracle-Gro Company Earnings Conference Call

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OVERVIEW:
Co. reported 1Q14 net sales of $196.4m, adjusted loss of $65.4m or $1.05 per share and GAAP loss from continuing operations of $65.6m or $1.06 per share. For FY14, Co. expects Co.-wide net sales growth to be 2-3% and adjusted EPS to be $3.05-3.20.
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Jim Hagedorn The Scotts Miracle-Gro Company - CEO and Chairman
Barry Sanders The Scotts Miracle-Gro Company - President and COO
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PRESENTATION
Operator
Good day, and welcome to the Scotts Miracle-Gro first-quarter earnings conference call. Today's call is being recorded. At this time, I would like to turn the conference over to Mr. Jim King. Please go ahead, sir.

Jim King - The Scotts Miracle-Gro Company - SVP and Chief Communications Officer
Thank you, Mara. And good morning, everyone, and thanks for joining us on our first-quarter call. With me here in sunny and warm Marysville, Ohio, are Jim Hagedorn, our Chairman and CEO; Barry Sanders, our President and Chief Operating Officer; and our CFO, Larry Hilsheimer. Barry will provide an overview of -- Jim and Barry will provide an overview of the business and our preparation for the upcoming lawn and garden season. Then Barry will provide some more detailed highlights of some of the growth initiatives currently underway. Larry is going to cover the first-quarter financials as well as provide some comments on our outlook for the full year, and then we'll take your questions. In the interest of time, we ask that you limit your questions to one and then to one follow up.

So with that, let's move on with the call. I want to remind everyone that our comments this morning will contain forward-looking statements, and as such actual results may differ materially. Due to that risk, Scotts Miracle-Gro encourages investors to review the risk factors outlined in our Form 10-K, which is filed with the SEC. As a reminder, the call is being recorded, and an archived version of the call will be available on the investor relations section of our website, investor.Scotts.com.

With that, let me turn the call over to Jim Hagedorn and to discuss our performance. Jim?

Jim Hagedorn - The Scotts Miracle-Gro Company - CEO and Chairman
Thank you, James. What did you say this was, your --?
Jim King - The Scotts Miracle-Gro Company - SVP and Chief Communications Officer

Sunny -- 50th call.

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

Your 50th call, which I think probably jinxes you, dude. I guess we're going to make weather jokes. So it is a winter wonderland out here in Ohio. But good morning, everybody.

We're going to keep it brief this morning. As you know, the first quarter historically represents 6% to 7% of the year and has always been a loss quarter. From a consumer perspective, the last quarter is really more of a reflection of last season than the upcoming one, so I'd encourage you not to read too much into the results.

With that said, the loss in the quarter is improved from a year ago, so we are off to a decent start. The results were mostly driven by gross margin improvement and expense control, both of which remain important themes for us. The one thing that does matter right now is the preparation for the season. For our sales, marketing, and supply chain teams, this is a crucial time of the year, and I feel really good about the work that they've been doing. Barry will elaborate in just a moment.

The one thing I do want to say is that I'm extremely encouraged with the current trajectory of the business. You're going to hear this from Barry as well, but we are launching a new version of our Bonus S product this year. We have a major innovation in Roundup. We're moving forward in a major way with natural and organic products. We have new advertising we'll be launching in a few weeks, and our retail partners are highly engaged.

So the near-term business is on solid footing. And last week, we held our strategic planning session with the Board, and I believe that we all came away encouraged by the discussion. It was a more detailed discussion on some of the themes that we shared with you in December regarding the long-term opportunities we see for growth and a commitment we have to continue focusing on initiatives that drive shareholder value.

But back to the results today. We're off to a good start. And as far as 2014 is concerned, I'm confident in our plans. We continue to have solid support from our retail partners, and I believe we are well-positioned to make good on the commitments we've made to our shareholders. We remain focused on margin improvement and expect another year of strong operating cash flow. Combined with the management of the balance sheet, we have plenty of flexibility to support the business and return cash to shareholders.

With that, let me turn things over to Barry to discuss what we are seeing so far.

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

Thanks, Jim. I know the vast majority of the people on this call today are in New York or some other northern climate, and so you might think that winter is a quiet time for lawn and garden. Just the opposite is true. Whether it's creating new advertising, preparing new product launches, building store displays, or running our manufacturing plants on multiple shifts, things are anything but quiet right now. And as I see all of the pieces of the puzzle coming together, I'm confident we'll have a successful season. I'll come back to these points in a few minutes.

First I want to go through some details from the quarter. Obviously, there isn't much gardening activity happening in any of our markets right now. I'll share consumer purchases in the quarter as measured by point-of-sale, or POS, at our largest retailers. But please keep in mind that most of the consumer activity in Q1 happens in October, so it's hard to extract any trends from the data.

Overall, POS was up 5%. That includes the benefit from our TOMCAT rodenticide business, which we acquired in mid-October. Excluding TOMCAT, POS was flat for the quarter. In branded lawn fertilizer, POS was up 2%. Grass seed POS declined 1%. Both of these numbers reflected the trends we saw throughout last year's lawn care season. In our soils business, POS was up 2%. Mulch continued to be a good story for us for -- good story
for, and POS was up 15% in the quarter. POS for Ortho was flat in the quarter, with our Home Defense product up 12% and Weed-B-Gon flat. POS of Roundup was flat compared to a year ago.

So if you look at where we stood at the end of last year's lawn and garden season, there are three things we're stressing. First, our overall market share at the end of the season was in line with 2012. So we accomplished our goal entering last season to hold our share despite a planned decrease in advertising spending from the historic high of 2012. Based on our assessment of retail shelf space, retail promotional plans, and our increased level of advertising support, I believe we should remain in good shape from a market share perspective in 2014.

Second, at the end of the season, retail inventory levels across the US were essentially in line with the prior year. That puts us in good shape as we get ready to accelerate shipments and get retailers ready for the peak of the upcoming season.

And third, the integration of TOMCAT is on track. It is now fully embedded into our business, and we have had productive conversations with all of our major retail partners about the potential for the brand going forward. Our retailers like the TOMCAT brand; in fact, it has done well for them in the past few years.

Just like the US, the activity within our international consumer business is limited in Q1, and there are no major developments. But it is worth stressing that we have completed our restructuring efforts in Europe, and we are well-positioned to drive profit improvement here in 2014.

With that, let me transition. As Jim said, Q1 marks the end of the consumer activity from last season. However, and more importantly, it marks the beginning of our planning efforts for the upcoming season, even if those don't hit the P&L until later in the year. As I outlined in December, our plan calls for sales to be flat in the US consumer business. However, we remain cautiously optimistic we can do better.

Our retail partners are fully engaged right now in getting ready for the season. All of them remain bullish about the category. They are -- they have aggressive plans to put in place to grab the consumer's attention, and all of them are taking the right steps to start the season strong. In early-breaking markets in the Southeastern US, as well as the West Coast, stores are already set. In fact, I’d say, as a group, all of our retail partners are further ahead entering February than I’ve seen in the last several years. So we feel good about the early execution of the plan.

In terms of marketing and advertising, we’re also in great shape. We are in the final stages of completing a new ad campaign for the Miracle-Gro business that will be a dramatic departure from the past. The message will focus less on the performance of the product and more on the experience of gardening itself. The campaign will use real-life stories that we believe will connect with consumers from all walks of life. It has tested well with consumers, and we look forward to getting it on the air.

From a new-product perspective, we are launching a new version of our market-leading Bonus S product this year in Florida. For those of you who aren’t familiar, Bonus S is a weed and feed product specially formulated for St. Augustine grass, which is common in Florida, Texas, and other markets along the Gulf Coast.

If you’ve followed our story for a while, you might recall that three years ago we had hoped to launch a new active ingredient called MAT 28. At the time, it was the best active ingredient we’ve had so far for controlling weeds. Unfortunately, the manufacturer had problems with the active, and it never got to the consumer marketplace. That experience left us with an innovation gap in our lawns business. However, we believe we have now filled that gap with a product that’s more effective and that has a good environmental profile. Two test markets in Florida have seen strong support so far, giving us a high degree of confidence moving forward. We expect to have a much broader launch of the product this fall and full distribution entering next year.

We’re also looking forward to a strong consumer response with our expanded offering of natural organic products. Two separate product lines under the Miracle-Gro brand are being tested this season and will determine which one we move forward with in 2014. In 2014, we also expect a nice benefit from broader distribution of our animal repellent line. More retailers will be carrying the product this year, which we believe is the best do-it-yourself solution for consumers looking to protect their landscape from deer, rabbits, and other wild animals. We believe the leadership we are bringing in this space could accelerate the growth in this category.
Our biggest launch this season, however, is Roundup 365. The season-long, non-selective weed control product is getting wide distribution with all of our retail partners and will be heavily supported with both digital and traditional advertising programs. Consumers have historically responded well to innovation within the Roundup franchise, and we believe Roundup 365 will prove that point again in 2014.

The final phase of getting ready for the season resides with our supply chain team, so let me touch on that briefly. Over the last couple of months, we’ve been focused on building finished goods and getting ready for the season. As Larry will discuss shortly, the team has done a good job of managing our commodity inputs. Even though some costs have trended higher recently, we have a good handle on the issue and we currently don’t expect any major headwinds.

Outside of commodity issues, the supply team continues to do an outstanding job on the product cost-out initiatives. Last year, we removed about $20 million of cost from our products and processes without negatively impacting the consumer experience. We believe the opportunity this year will approach that level again, which should be a major contributor to our expanded gross margin improvement. In real-time, the team is beginning to shift from manufacturing to distribution. History tells us we should expect week-over-week increases in shipping volume between now and May. We’re working to strike the right balance between keeping our own inventory levels as tight as we can while also making sure our retailers are ready for the season.

Last year, we saw inventory levels decline by $90 million. While that level of improvement is unlikely again this year, we do expect modest improvement by the end of the year.

Before I turn things over to Larry, I want to spend a few moments talking about Scott’s LawnService, where we continue to be encouraged. Unlike the global consumer segment, Q1 is an important quarter for SLS. In fact, it marks the end of their fiscal year. They are in a different cycle because it is a more effective way of ensuring the highest level of consumer service. Sales in the quarter were up 3%, and operating profit increased threefold. Customer count still remains at an all-time high, and we continue to benefit from higher retention rates and customer service scores.

The business has been on a multi-year run of strong performance. Entering 2014, it’s more of the same. They continue to improve their marketing efforts to increase their customer count and, most importantly, their retention rate. They continue to strengthen the management team, and they continue to focus on new areas of growth, both existing markets and new ones.

While lawn care remains the overwhelming piece of the business, SLS continues to expand in this service as well -- into pest service as well. We currently are exploring acquisition opportunities in this space, and I wouldn’t be surprised if we make -- if we don’t make our first test acquisition in 2014. So, absent some unanticipated headwind, we think the momentum with SLS will continue this year.

In closing, it’s hard for me not to feel optimistic about the upcoming season. I believe we have reasonable plans in place for programs to achieve those plans, and I’m extremely confident that we’ll have outstanding execution against the things that we control. So as long as we continue to thaw out the next month or so, we should have a good year.

With that, let me turn the call over to Larry.
With that, let's cover the results. Our first-quarter net sales were $196.4 million, compared to $205.8 million a year ago. Drilling down a bit, Scott's LawnService had a 3% increase in sales in the quarter. This increase was primarily attributable to growth in year-over-year customer count. At a time when our largest competitor in this segment has faltered, we are pleased with our continued growth in revenue customer count, retention, and profitability.

Sales in the global consumer segment were $145.3 million during the quarter, compared to $153.2 million a year ago, a decline of 5%. The year-over-year sales decline was primarily due to the timing of shipments to retailers, partially offset by sales related to acquisitions. The timing of shipments is nothing new. For those of you who have followed us for several years, you know that our retailers move shipments closer each year to the actual launch of the season. The strength of our supply chain team, as Barry referenced, has allowed us to accommodate this shift over time and help our retail partners better manage their inventory levels and improve their returns.

For corporate and other, which consist exclusively of sales under the supply agreement with ICL, sales were $4.9 million for the quarter, compared to $7.8 million a year ago. We expect sales in this segment to be approximately $4 million to $5 million lower for the full year.

Moving on, gross margin rate increased 270 basis points for the quarter. Nearly half of the improvement was due to favorable mix from Scott's LawnService, which carries a higher margin, followed by the combination of cost-out and pricing initiatives in our Global Consumer business as well as the benefit from the acquisition of TOMCAT. Barry referenced our product cost-out efforts, which continue to remain a major driver of margin improvement.

Entering February, approximately 80% of our commodity purchases are locked for the year. Given the seasonality of the business, nearly all of the remaining commodity purchases for the year will be on the [spot] market. And while some of our costs have edged up recently, we continue to expect commodity costs to be about neutral in aggregate in 2014 compared to last year. SG&A in the quarter was $125.1 million, compared to $124.5 million a year ago, in line with our expectations.

Moving on, the rest of the P&L is also in line with expectations. Interest expense in the quarter was $13.9 million, slightly higher than a year ago. The favorable impact resulting from reduced borrowings during the first quarter was offset by the accelerated recognition of $2 million of interest expense originally expected to be reflected in Q2. This was due to the accounting treatment of interest-rate swaps as a result of the amendment to our credit facility and has no impact on the full year. We continue to expect interest expense to be lower by $5 million to $7 million for the year. Part of our expected reduction in interest expense is due to the fact that we recently called a tranche of the corporate bonds that paid an interest rate of 7.25%. We did not see the need to replace those bonds, given the headroom that we have under the amended credit facility. But if a need arises, whether it is — whether it be an acquisition or some other reason, we are confident in our ability to tap back into the credit market and issue new debt. Right now, we don't see that need arising.

Tax rate for the adjusted earnings for the quarter was 36.6%. For the full year, we continue to expect a tax rate of approximately 36%, consistent with last year.

Finally, we ended the quarter with a basic share count of slightly more than 62 million shares. During the quarter, we repurchased about 150,000 shares, which is consistent with what we've discussed in the past.

Taking it all to the bottom line, our adjusted loss for the quarter was $65.4 million, or $1.05 per share, better than the prior year's loss of $68.5 million, or $1.12 a share. On a GAAP basis, loss from continuing operations was $65.6 million, or $1.06 per share, compared to $68.3 million, or $1.11 per share.

With that, let's shift gears and talk briefly about cash flow and our outlook for the year.

We're still on track to generate approximately $275 million of operating cash flow for the full year. For seasonal reasons, we always use cash and increased borrowings in Q1, and this year was no different. We continue to make positive strides in improving inventory management and still expect reductions of $15 million to $20 million at the fiscal year-end.
The combination of prudent balance sheet management and expected operating cash flow will provide capacity to fund the core business, pursue acquisitions in LawnService and some of the adjacent categories we discussed at our analyst day meeting in December, as well as to return capital to our shareholders.

For the full year, we continue to expect companywide net sales growth of 2% to 3%, and improvement in adjusted gross margin rate of about 100 basis points, and an increase in SG&A of 3% to 4%. Thus, we are reiterating our guidance for adjusted earnings for fiscal 2014 in a range of $3.05 to $3.20 per share.

As Barry said, we remain optimistic about the year. The planning and preparation by our team has been strong, and we are looking forward to what we expect to be a good lawn and garden season.

With that, I'll turn it over to the operator for questions.

**QUESTIONS AND ANSWERS**

**Operator**

(Operator instructions). Eric Bosshard, Cleveland Research Company.

**Eric Bosshard - Cleveland Research Company - Analyst**

Barry made a comment that I guess, like he said, the pieces of the puzzle are coming together nicely as you head into the season. And so I'm curious if you can give a little more perspective on what's behind that in regards to either your shelf space or your market share or pricing or the amount of inventory retailers are bringing in. If you could just give us a little bit more perspective on any of those as it relates to the setup for 2014.

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

Sure. I would say yes to everything you said. And the thing that, when I say the pieces of the puzzle are coming together early, with all of our retailers, we are out way in front of where we normally are from a planning perspective. So, what the shelf is going to look like, what the promotional plans are going to look like, how we're going to use our advertising versus their advertising, the shelf space that we've got. So you bring all those things together.

And then an operational plan -- given the volatility month to month and the spring that we've seen last year, doing a lot of detailed planning to make sure we know what shipments are going to be from now essentially through April to make sure that we can hit the execution plan. So both the planning side of how we're going to market and promote the product as well as any operational plan, how we're going to bring all of that together to support it. I think it's the furthest out and the best plans that we've had with the retailers since I've been here.

**Eric Bosshard - Cleveland Research Company - Analyst**

And then secondly, within the guidance, I guess there's three cornerstones. One is that you're assuming flat market share, the other is this 2% to 3% growth, and then the last would be the 100 basis points of gross margin. Which of those, if you would do better, would you most likely do better on?
Jim Hagedorn - The Scotts Miracle-Gro Company - CEO and Chairman

Eric, we've talked previously -- and some of it goes hand-in-hand. If our sales increase, our gross margin is going to go up because we're going to leverage our fixed cost additionally. But I think we have an opportunity if we really execute well in the management of our inventory, particularly transitions, and knock down our E&O that our gross margin could improve. But, like I said at analyst day, we are being prudent in how we are planning it because we look at history, and we haven't always executed well on those things. We have all of our incentives aligned to drive our management team to do that, and if they do we'll execute well.

Jim King - The Scotts Miracle-Gro Company - SVP and Chief Communications Officer

I'm just going to throw out the mike because it would be one of those things like, if you're going to do better, which -- first, you know, my view is that if there is a lesson from last year, it's don't swallow more than you can sort of handle and don't over commit. And so I think that, as we said to you guys in December, we haven't done that this year.

So if somebody had said to me, what do you think you can be -- because if you look at the way that the sales roll up, within the core it's a pretty -- it's not a sort of high level of expectation on the sort of the core business. And I don't think it's inconsistent with what other consumer goods companies are seeing. We see higher levels of growth in certain parts of the business. But, you know, we have some acquired growth that's built in there that helps us. We've got a little bit of pricing in there that helps us. And then LawnService continues to grow at a better rate. And we expect sort of better fundamentals out of the European business than we had last year as well.

But if you ask me, I would say I believe that there are opportunities on the core on the growth side myself. So I don't know, Barry, maybe because we all have different answers. It goes back to this general theme of saying if we didn't overpromise than there probably are opportunities, if everything goes right, in all parts of the business.

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

I think there is -- if you look at the economy, consumer sentiment, weather, and the things that can negatively impact the business that are out of our control, I think we have an appropriate plan hedged against those things that we're not overpromising against those variables. But if you look at the last couple of years, weather has had weather has had a fairly significant impact in the spring.

And so anyone -- we have a plan that says if those things don't go in our favor, we are covered. But if those variables turn out to be slightly better, I would agree with what Jim has said, is there's upside in the sales line. And I think, quite frankly, if you listen to collectively all of the retailers they would say that as well.

Eric Bosshard - Cleveland Research Company - Analyst

Perfect. Thank you very much.

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

And I would just throw in that I'm not sure that I believe anybody, whether it's the National Weather Service or services that we hire to predict, but there is a prediction for a more normal spring this year than we've seen previously. Although it was pretty nasty in New York last night and it's pretty nasty here in Ohio today.

Eric Bosshard - Cleveland Research Company - Analyst

Alright. Thank you.
Operator
Josh Borstein, Longbow Research.

Josh Borstein - Longbow Research - Analyst
Josh Borstein in for David McGregor. Thanks for taking my questions, and good morning. Just a question. You talked about the first quarter being a quarter of progress in preparation ahead of the season. Can you discuss the recent progress you’ve made in the -- with the independent retail channel and hardware co-ops and what the expectations are for the year? I know you mentioned previously you consider yourselves behind in terms of how you go to business relative to the big boxes there.

Barry Sanders - The Scotts Miracle-Gro Company - President and COO
Yes, you know, and I would separate, Josh, the two classes of trade. The independent retailers, we go through distributors to get to that channel. I think changes we’ve made in the program -- I actually spent some time with a number of our distributors over the last, call it, six to eight weeks. And so we are optimistic that we have a good program put in place with the distributors and how to drive that business to improve both profitability and the merchandising programs that are going to be in place for the independent retailers.

And so I would say because that class of trade -- they are by definition small, independent business people; I think they’ve been a little more pessimistic over the last couple of years. So I see more optimism there, and I see improvements in our programs and our merchandising plans. So I think we will see good improvement there.

On the hardware co-op side, I think that class of trade is improving in general just as a channel of distribution, and we are improving our ways of both how we market and how we promote in that channel. We saw really good responses on that last year, so we’ll see expansion of that program going into this year. So, I would say the optimism we have relative to our planning is not only just our big retailers, but it’s how we go to business and how we plan the business with the small, independent class of trade as well.

Jim Hagedorn - The Scotts Miracle-Gro Company - CEO and Chairman
I just want to throw just a little bit on top of that, which is that you guys know we collapsed that West region into our Southwest region. And the regional President, Phil Jones, is running what we call our, I guess, channel here, which includes the class of trade we’re talking about right now. And so I think that Phil and his team, along with Barry and just a lot of people, have been involved in really doing a lot of work. So I’m really pleased with the work that the whole team led by Phil has been doing to really make kind of fundamental change in a kind of category of trade we talk about.

But I think we have not executed as well against that trade. We tend to be sort of big-box DIY. We’re pretty good at that. I mean, maybe better; very good at that. So, in an area I would say of just generally lower consumer growth, this is an area we need to do well in, and I think we’ve made quite a bit of progress in that we’ll -- in the next call, we should be able to really talk about kind of what we are seeing there.

Josh Borstein - Longbow Research - Analyst
Thank you for that color. And then just one follow up. Does the extreme cold that we’ve been having this winter, whether it’s temperature or the amount of snowfall, does it either bode well or poorly for any product categories come spring?
Barry Sanders - The Scotts Miracle-Gro Company - President and COO

It does a fair amount of damage to the lawn, both with the condition that it's in as well as the plows and the snow blowers tearing it up. So as long as it goes away in a reasonable time, it should be good for the lawns business.

Josh Borstein - Longbow Research - Analyst

Great. Thanks, and good luck on the rest of the season.

Operator

Olivia Tong, Bank of America.

Olivia Tong - Bank of America Merrill Lynch - Analyst

First, just a quick question on the sales that you expected to come through in the December quarter. Did those actually come through in the March quarter?

Larry Hilsheimer - The Scotts Miracle-Gro Company - CFO and EVP

Do you mean did it shift into (multiple speakers)?

Olivia Tong - Bank of America Merrill Lynch - Analyst

Right. Right, exactly. When you said the timing of pre-season shipments, have you seen those -- I assume that they were towards the end of the quarter, so have you already seen them come through in the March quarter?

Larry Hilsheimer - The Scotts Miracle-Gro Company - CFO and EVP

Yes, I would split it into two segments because, like we talked about, October is really part of last season. If you go back to 2012, 2012 had been a relatively bad summer, and there was a lot of pessimism going around. And the retailers found themselves short of inventory leaving September, and so there was a lot of catch-up shipments in October in 2012. This year, we corrected that to get out in front of it. So I think part of it was moving shipments better in line with where POS was going to be, so that meant moving some shipments out of October into September just to better merchandise the stores.

But then also, in the December quarter, I think there was both weather as well as -- Jim said we have a pretty good supply chain, so we are able to shift shipments. And so December is not related to POS, and some product has shifted out not only into January but January into February. Just matching as the retailers’ year-ends are at the end of January. So the answer is yes, Olivia, but it's on both sides of the quarter, not just the December side.

Olivia Tong - Bank of America Merrill Lynch - Analyst

Got it. Okay, that makes sense. Can you give any color on the magnitude of the size of the shift in the sort of the tail end of the 2013 season versus the pre-shipment for the 2014 season?
Larry Hiltsheimer - The Scotts Miracle-Gro Company - CFO and EVP
Yes. You know, if you look at year-over-year, it’s like $9 million, Olivia. So for us it’s absolutely immaterial. That’s 1/3 of one-day shipments right now. So there’s a little bit of shift, but it’s absolutely nothing more than timing.

Olivia Tong - Bank of America Merrill Lynch - Analyst
Got it, got it. Okay. And then with the departure of Jim Lyski, should we see any change in your approach on marketing, the level of spend, anything there?

Jim Hagedorn - The Scotts Miracle-Gro Company - CEO and Chairman
I guess the answer is no. I would say more, not less. So Barry and I and the Board -- you know, we’ve all talked about how we intend to fill that job. And we do. Probably a slightly different role where the business units will report to Barry, and we will have sort of a marketing group that works with the businesses and Barry and myself. So I would say no. And the commitment to sort of our core convictions, which is that advertising matters and we need to steward the brands even if we believe that we are dealing with -- we get a good result with sort of 1% to 2% sort of unit volume growth and a great result with another 100 to 200 basis points of incremental sales of the units on top of that, which we believe is doable. That we have to steward the brands properly without damaging the P&L.

So I think that this is a major discussion item. We kind of highlighted it to you guys in December. We had a very, I think, deep discussion about this at the Board level. The Board is supportive with the management plan. And so, no, I would say we’re not less committed; we are more committed. And good luck to Jim.

Olivia Tong - Bank of America Merrill Lynch - Analyst
Got it. Thank you.

Operator
Alice Longley, Buckingham Research.

Alice Longley - Buckingham Research Group - Analyst
I apologize if somebody has asked about this. I was off the call for a little bit. California. The droughts in California and the potential that people won’t be able to water their lawns. Is this -- can you comment on what effect that might have on you?

Barry Sanders - The Scotts Miracle-Gro Company - President and COO
Alice, this is Barry. Right now, California is our best-performing state. So we’re not seeing the impact of it right now, so we are off to a good start. And we’ve had -- just to make a comparison, Texas has had some major drought problems. Jim talked about our West region now, which is headquartered in Houston. They developed what we call our drought recovery plan; it’s been well executed in Texas. It is a communication plan. The consumers want to have a nice lawn and garden, and we tell them both planning-wise, product-wise, and then educate them on how to do that.

So we’ve had great in Texas -- we’ve had great partnerships with our retailers as well as the local communities to make sure that the consumers comply with the watering bans and that we actually encourage them on how to do it the right way. So that plan is already being executed in
California. And I would say we've developed a plan that, relative to the drought, actually gives us some upside if we execute the plan the right way. So it's unfortunate the drought is there, but I think we have a good plan in place to actually deal with it.

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

And Alice, I'd only throw in because it's a little different. If you go to, like, the Southeast, as we been talking about Bonus S, Bonus S is the number one SKU every month in the Southeast. Okay? In California, it's a dirt business. You know, it's very much a growing media business. That's the kind of the core of our West business. So that if you look at sort of our dependence on the lawn in California, it's just much lower; I think culturally it's lower. And that's been kind of vexing for us, but it does reduce our risk, I think, if people put watering bans on lawns.

So the lawn is a less important factor to us in the state of California. I probably would say if they have a really long lasting water emergency, it probably is not healthy for anybody. It's in many industries. So it's probably not a positive, although I would say the business is doing well so far. And it sort of depends, and we wish and hope for rain out there.

**Alice Longley - Buckingham Research Group - Analyst**

Well, can you give us some sense -- I know you've tried not to do this in the past of how big California is relative to your sales. Maybe compare it in size to Texas or the Southeast or something like that so we have some feel for the exposure.

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

Sure. Texas is number one; California's number two; I believe Florida is number three. So, Alice, I'm just going to do the math in my head. It's 5%, 6% of the sales in total. 5%, 6%, 7% of the sales in total in California.

**Alice Longley - Buckingham Research Group - Analyst**

That's helpful. Thank you. And then my other question is about the -- your innovations for this year. I mean, the Bonus S, am I getting the timing right? It's not going to be -- when you said it's going to be in full distribution next year, do you mean fiscal 2014 or 2015?

**Larry Hilsheimer - The Scotts Miracle-Gro Company - CFO and EVP**

It's going to be some kind of mix. I think we are -- part of what we're doing right now is -- I don't know that we have -- we probably have at this point like all of our Gulf Coast registrations. But when we were in the planning mode, we had Florida but we weren't universally done with the state registrations on the new active. We are also drawing inventory down. We did want to get some experience this spring, and so we are launching the product in some markets that we can sort of generally isolate in (inaudible) Florida; that would be Jacksonville and Fort Myers with the new active.

So I think you're going to see much deeper distribution sort of later in the season in this year, and it will be fully exploited in the 2015 fiscal year. But -- so part of what we're doing right now is just -- it's a transition. We did want to get some experience in the spring, even without our full portfolio of state registrations. And so -- and I think -- I'm going to say so far, so good.

**Alice Longley - Buckingham Research Group - Analyst**

I guess I'm having an issue with -- that's sort of in test and the two organic lines are sort of in test, and your big thing seems to be the Roundup 365. And I'm just wondering whether that's enough in terms of innovation.
Barry Sanders - The Scotts Miracle-Gro Company - President and COO

So let me go back to Bonus S because I think maybe there is some confusion in the way that I spoke on the script. We are testing that now, Alice, just to -- not as a test to see whether we're doing it or not as far as marketing and how it's received and so forth. So we're doing that in a couple of markets in Florida. There will be expanded distribution this fall as part of 2015 and then roll into full distribution -- fall of 2014, and then full distribution into the markets in 2015. So for us, like Jim said, it is the number one product in the South every single month of the season for us. So that is a big deal. And do you want to add to that, Jim?

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

Because all I would add, Alice, is like -- to some extent, I'd say fair enough. If you wanted to say, is it really enough. The question would follow that and say, so how do you feel about what's going on just generally within the business 2015 and beyond. And I've got to say from my point of view as CEO, pretty darn good. If I look at all the businesses, whether it's Ortho, Roundup, Miracle-Gro, Scotts -- there's been very significant improvements in sort of the pipeline of innovation and improvement in the products. And so I just feel much better about it.

You might argue is there enough. Remember, part of where we have been is it's not like the world has been kind of screwed up. You know what I mean? And I think we've been struggling to -- 2012 was kind of a year we said, can we stimulate the market for growth. A lot of what we've been doing is making sure that, kind of in a low-growth world, we've got this business under control. And a lot of our focus has been on sort of getting our operating plan that is not overcooked and that we can deal with contingencies. And I think that that has been our focus.

And so if we basically said beyond this year do we have a lot of stuff, is a question, I would say I feel very comfortable there. I also feel very comfortable that the -- that Barry and his team's control of the operations of this Company, and can it deal with bad weather and other unexpected negative surprises, I think the answer is yes. And so that's kind of the journey we've been on. And it's not that I'm feeling defensive about it at all.

I think -- but fair enough, what you said. Would we like to have more stuff? Would we -- you know, if you've asked me two years ago do I think the pipeline is full enough, I would've said, you know, I don't know. And MAT 28 was a major loss when -- I mean, that was the real focus of an entire sort of business unit for us. Look at the Miracle-Gro packaging. It's an entire, like -- when you look at this product [that] on the shelf this year, what you're going to see is the Miracle-Gro business unit has completely new livery of the brand that's really good-looking. And if you do said to me, again, a year ago, what brand looks sort of the most old-fashioned and like left behind, I would've said the Miracle-Gro business. So for them to do a complete livery change that sort of matches up with our global work that we are doing in Europe, they've done that. The Ortho brands -- we got briefed by the Board; they have a lot of new stuff going on. I think a major push with aerosols. The [SCJ] business continues to do really well for us. So it's -- good things are happening, and I think we have a pretty healthy pipeline as we move forward. I'm sorry if I sound defensive.

Alice Longley - Buckingham Research Group - Analyst

Great. Thanks.

Operator

Jeff Zekauskas, JPMorgan.

Jeff Zekauskas - JPMorgan Securities Inc. - Analyst

My understanding of what happened to you last year is you -- in your consumer business, you grew your big-box revenues, but your US non-big-box shrank, and it offset all the growth in the big-box. So how are you doing, and how do you think you'll do this year in your US non-big-box? Do you think you'll shrink? Do you think you'll grow? And sort of what are the magnitudes?
Larry Hilzheimer - The Scotts Miracle-Gro Company - CFO and EVP

Jeff, I'm not sure where you're getting the information that we grew in big-box and shrank everywhere else because actually some of our fastest growing businesses are outside of the non-big-box. And so there were a couple of accounts that were down a few million dollars, but I would say our accounts in the non-big three -- several of them are growing equally as well as the big boxes which, unfortunately, are not -- overall is not growing.

So for this year, whatever the question was earlier on our plans for the non-big boxes, we have excellent plans in place for club. We are expanding our distribution on grocery drug with SCJ. We have a good program. We've -- what Jim said earlier, what Phil Jones and his team have done with the independents, and I think we are doing a much better job of how to do business in the hardware co-op channel. And then on the online business, we have full distribution with Amazon. And so, I would say overall our expectation for growth is equally as high in the non-big mass retailers as it is in the mass retailers themselves.

Jeff Zekauskas - JPMorgan Securities Inc. - Analyst

Okay. What I can do is I can follow up with you guys later on the data of it. Right. So my follow-up is, your LawnService business made a few million dollars in profit this quarter, and the revenues really weren't so much different from the year earlier. So why did you make money this year, but you really weren't able to make it in previous years in the quarter?

Mike Goodrich - The Scotts Miracle-Gro Company - Controller

I think material costs are down. We are more (multiple speakers).

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

Dude, come on up. It's muffled. It's Mike Goodrich, who is the sort of finance for the service business.

Mike Goodrich - The Scotts Miracle-Gro Company - Controller

So it's a small quarter for us. Also, it's wrapping up the season. We get more direct impact of material costs, so urea costs were down during the year. That directly benefited us. Fuel costs were down. And just good of labor as we wrapped up the season.

Jeff Zekauskas - JPMorgan Securities Inc. - Analyst

Okay, great. Thank you very much.

Operator

Bill Chappell, SunTrust.

Bill Chappell - SunTrust - Analyst

Just wanted to take a relook at kind of commodity costs and pricing. And didn't know if California has any impact. I think most grass seed is up in Oregon, North, but I think there had been some pressure there. Didn't know if you'd seen anything new there or if there was any incremental pricing you might have to do as you look going into the season.
Barry Sanders - The Scotts Miracle-Gro Company - President and COO
(Inaudible) as far as -- there is -- we have no plans on incremental pricing going into the season.

Bill Chappell - SunTrust - Analyst
(Multiple speakers) But in terms of -- go ahead.

Jim Hagedorn - The Scotts Miracle-Gro Company - CEO and Chairman
Consistent with what we've said at the analyst day, yes, we've seen the benefit of urea pricing trending down. But, yes, grass seed is one of the ones that was counter to that as well as packaging costs and others that lead to our sort of breakeven analysis.

Jim Hagedorn - The Scotts Miracle-Gro Company - CEO and Chairman
Well, the bottom line is -- just so we are really clear, we are way better than we thought we'd be last year on commodities. And we executed low single-digit pricing, which has been implemented. And so we are in a pretty fine place as far as margin goes and our cost of goods and what we are executing as far as on the revenue side. So right now, it's just a matter of sell stuff to consumers; that's the part of the year we are in. But we don't -- we're not going in with anything negative compared to where we thought we'd be.

Bill Chappell - SunTrust - Analyst
That's great. And then just on the [Tesco] acquisitions, the confidence level. Clearly, just like LawnService, it's a highly fragmented market. Is there a certain margin you are expecting? Sales base you are expecting? Ability to have both test and lawn in the same business? I mean, how should we look at that through this year, and would you expect most of them to kind of come in the first half if you are to make multiple ones?

Jim Hagedorn - The Scotts Miracle-Gro Company - CEO and Chairman
There ain't much left in the first half. So I know there is work going on and discussions with outside people who -- of businesses we could acquire. But I would say like any conversations, there is -- even when people shake hands on deals, they, a lot of times, don't get done. But I know the service business does a lot of their own work. It's not like corporate's got to, like, babysit them a lot. These are folks who know how to acquire, and they know how to integrate. So, I would say it's probably a little dangerous other than to say this is an area of focus for the business, and we have authorized acquisitions in that space to that team. But saying when they'll occur; my expectation, I would say lumpy. Okay? But the priority of that we want to acquire in the space is, I think directionally, what we wanted to communicate.

The -- I know the business believes that -- and this is maybe just my own concerns. I want to be careful what I say here. My expectation is we should do deals that are standalone and that the price we pay, they could standalone. I think if the team can operate them out of the same office, that's all the better. Okay? And I think they believe that, based on work they've already done and branches we have today that operate both pest and lawn, that they can do that.

I think that my only concern with that is ServiceMaster has not been particularly successful at integrating their branches. So I just want the deals to be priced based on the fact that, if we don't integrate, we haven't overpaid. If we do integrate, they just look all the better. And I think they understand my point of view. So I think the plan is to integrate the branches, but I don't want to do the financials assuming that they have to be integrated in order to make the deals work. If that makes any sense.
Bill Chappell - SunTrust - Analyst

Yes. I guess the question is I think the last time you embarked on this strategy was what, seven or eight years ago, and the problem was there were a lot of lot of little fiefdoms with various margins, various marketing, various management teams that had kind of uneven results. I'm assuming you've kind of come to terms that, hey, we can make it work this time and have a more consistent approach.

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

Well, look, come on. What I want to do is to, like, remind everybody who's sat at that -- when we first started doing this business, I sat with a lot of you guys, and we all sort of voted at my table at one of our investor meetings, keeper or weeper LawnService. And I think every one of you guys voted that it's a weeper. You will get out of it. It is a business that -- if you look at the financials of the business today both on a return on capital, their operating margins, they have operating margins as good as the core business now, and their return on capital is well above our cost of capital at this point. So we like the business, and I think it's turned into a really nice, growing $0.25 billion business for us. And it has not been like the most awesome journey ever, but it was a business that we entered into. We started with a bunch of acquired growth. And I think instead of saying all the things you said -- and this is not to massively disagree, it's to say that we acquired a lot of stuff probably too fast and didn't control it as well as we could have.

And we had some pretty significant integration issues that we have corrected. I think in the process of making those corrections, I think we understand the process of running businesses better. And especially that team, who is a very well battled-tested, highly experienced group of managers.

And so when we talked at the Board level about our commitment to sort of expanding that business beyond just lawn -- and they have been making acquisitions, by the way, throughout their history. And they have been sort -- we have been silent to them, and they've been integrated well. Entering this pest area, I think the concern was we just can't go too fast and end up where we have the same sort of -- we start to lose control when we are acquiring at a rate. But we do -- we have focused quite a bit of budget money for them to make deals, but the expectation is that we don't get ahead of ourselves and become stupid because people get fired here as a result of sort of mistakes like that.

Larry Hilsheimer - The Scotts Miracle-Gro Company - CFO and EVP

One thing is we've got a clear path in that business to be at operating margins at our overall level, and that will happen in short order. Right, Mr. Goodrich?

Bill Chappell - SunTrust - Analyst

Perfect. Thanks for the color.

Operator

Jon Andersen, William Blair.

Jon Andersen - William Blair - Analyst

Just sticking with the service business for a moment. Could you just remind me, the LawnService market in aggregate, how big is it? What's your share today? And then as you look at kind of pest control, how big is that market? And what would your kind of share ambitions be over a three-to five-year time frame?
Barry Sanders - The Scotts Miracle-Gro Company - President and COO

Jon, this is Barry. The lawn care business, we estimate at about $4 billion; so we roughly have 6% share. The pest business, we estimate at about $7 billion -- which our share right now is non-material. So I think your question was as far as what share do we expect, I would say that goes back to the question that Bill raised is, we are -- and what Jim said is we have acquisitions planned that will not be -- that will be certainly accretive for us, but not significant share gain on the pest business over time. We are going to build both -- make sure we make the right acquisition relative to the team that we are working with, the location, how it integrates with our business, and make sure that we get the model right and that we are providing excellent levels of customer service before we get to scale that model. So I'd say our plans right now is more in line with, over the next couple of years, acquiring a few businesses and make sure we get it right before we begin to scale it. And so we have 6% share on the surface on the LawnService side. I think we can continue to grow that pretty aggressively, but right now the focus on the pest business is to make sure that the quality of the business is good and the customer service is good before we begin to scale it.

Jon Andersen - William Blair - Analyst

Okay. Thanks. Just this was probably asked earlier. I apologize; I just toddled over. The kind of cold and harsh weather in the central part of the country, East Coast, what are the implications there? Or can we learn anything from history in terms of the need to be engaged in the category to maybe repair damage?

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

Yes, we said earlier, it’s -- I would say it does quite a bit of damage to the lawns, so that’s positive for our business. I think psychologically with the consumer it also makes them want to get out of their house in the spring. So it’s that tribal kind of nature of the human. So it’s good for the business, both with the consumer as long as the weather goes away and it’s good for the lawns business from a damage and repair standpoint.

Jon Andersen - William Blair - Analyst

Okay. Last one. Are you still doing regionalization? And when I ask that question, are you still moving the ball forward in terms of getting more tailored in product offerings, marketing messages, communications by region. Or has that work now been complete and the benefits have been reaped and you’re kind of in a steady-state mode there? Thanks.

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

The answer is we’re still moving forward with it. I think from a product standpoint we continue to do that and figure out how to roll products out, and I think we are seeing nice gains there. There was an earlier question about the drought in California. And specifically a program was developed for Texas, and we are rolling that out. So I would say we’re hitting more of a steady-state, but we continue to get better at it all the time. And I think what we’ll see in California this year is the team will do a good job of managing the drought situation, and it’s providing more stability to our numbers and our ability to execute locally than just the national perspective that we used to have.

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

First of all, I’d say good question. I think that if you look at sort of -- so there’s nothing new we are throwing out here that we didn’t sort of, I think, at least sort of raise the covers on a little bit in December. But I think if you look at a lot of our opportunities, they are, by definition, regional and the area that we believe there’s above-average growth opportunities. And it’s really hard to look at them as saying they are sort of national opportunities. I think they add up to what we view as a good opportunity worth chasing. But I think that, without thinking regionally, those opportunities would be much less valuable to us.
Thanks, guys.

Operator

That concludes our question-and-answer session. Mr. King, I’d like to turn the call back over to you for any additional or closing remarks.

Jim King - The Scotts Miracle-Gro Company - SVP and Chief Communications Officer

Okay, thanks Mara. I know I have follow-up calls scheduled with many of you this morning and afternoon. If anybody else has a follow-up question that we didn’t get to, please give me a call directly. I’m at 937-578-5622. Other than that, thanks for joining us today, and we will talk to you again next quarter. Thanks. Have a great day.

Operator

That does conclude the conference for today. We thank everybody for joining us.