SMG reported 1Q12 sales of $211m and GAAP net loss of $73.9m or $1.21 per share.
Good morning and welcome to the first-quarter 2012 earnings conference call. All lines have been placed on mute to prevent any background noise. After the speakers’ remarks, there will be a question-and-answer session. (Operator Instructions)

Thank you. Jim King, you may begin your conference.

Jim King - Scotts Miracle-Gro Co - VP of IR and Corporate Communications

Thanks, Tambra.

Good morning, everyone, and welcome to our first quarter conference call. I am joined here in Ohio this morning by Jim Hagedorn, our Chairman and CEO; Dave Evans, our CFO; as well as Barry Sanders, our President and Chief Operating Officer. In a few moments, Jim and Dave will share some prepared remarks, and then Jim, Dave, and Barry will be available to answer your question. In the interest of time, we request that you ask one question and one follow-up so that we can move quickly through the queue.

And I will share with you in advance that our comments this morning will be pretty much contained to our Q1 results. Because our Analyst Day is only a week away, we’ll wait until then to provide more detail on our full-year outlook and business plans. Speaking of our Analyst Day, if you have not registered yet, we would encourage you to do so. Our meeting will be held next Tuesday, February 14, at the Waldorf-Astoria in New York.
presentations will start at 9 AM, and will continue shortly past noon. At that point, our management team will host a luncheon and we'll close the day with an extended Q&A session.

We are already very close to full capacity at this time, so if you have not registered, we would ask you to do so by the end of the day Thursday. You can do so one of two ways. You can call my line directly; that is 937-578-5622, or you can send us an e-mail at investor@scotts.com. If you can’t attend the event in person, you can listen and follow the slides via webcast. The webcast will be available on our IR site, investor.scotts.com. If you subscribe to services from Thomson Financial, you can also listen to the webcast from your Street Events site. It also will be available on Thomson’s retails networks, which include Yahoo Finance, Google Finance, and Market Watch.

With that, let’s move on to the business at hand, our Q1 results. I want to remind everyone that our comments today will contain forward-looking statements, and as such, we recognize that our actual results could differ materially from what we discuss here today. We encourage investors to read the complete set of risk factors that are outlined in our Form 10-K, which is filed with the Securities and Exchange Commission. I also want to remind you that we will provide a reconciliation of our website of any comments we make this morning related to non-GAAP financial measures that are not already discussed in today’s press release.

With that, let me turn the call over to our Chairman and CEO, Jim Hagedorn.

Jim Hagedorn - Scotts Miracle-Gro Co - Chairman & CEO

Thanks, Jim. Good morning, everyone.

I’m going to keep my comments brief this morning for two reasons. First, Q1 represent less than 10% of our year, and we’ve already communicated the results we expected in the quarter, so there is not much new news in today’s release. And second, as Jim just mentioned, we have our Analyst Day just a week from today in New York. I would rather wait until then to elaborate on how our plans are coming together, and what it all means for the full year.

But I will tell you we are operating the business hard right now in anticipation of a strong season. Our supply chain team is working non-stop on building product and getting it to the right place. Our sales team is spending a lot of time in the stores working with our retail partners in getting displays up. And our marketing team is in the midst of launching one advertising campaign and finalizing another. So while we are still a few weeks away from the peak of the season, you would never know it from walking around the halls here. We are going at full throttle.

As it relates to our Q1 results, I will tell you that I am pleased with what we saw. The numbers came in just a bit better than we expected. On the top line, you will notice that the global consumer segment was down 21% from last year. So let me provide some color. You will all remember that our fall business last year was pretty weak. Hurricanes in September and snowstorms in October really shut down consumer activity, so there wasn’t a lot of replenishment happening in the early part of the quarter. In addition to that, our retail partners worked to end their fiscal years clean from an inventory perspective. The combination of all that played itself out in the results we’re reporting this morning. The other thing to keep in mind is while the percentage decline looks substantial, the dollar decline of roughly $40 million is not. To put that number in perspective, it would represent a single strong day of shipments during the peak of the season. So we see this as nothing more than a timing shift and not something that causes concern.

While it is not reflected in our Q1 results, we are seeing a very strong start to the current lawn and garden season, which, in the South, really starts with the calendar year. Since January 1, we are seeing some really positive trends in the early breaking warm weather markets. Consumer purchases of our products at our major retailers are up more than 20% during that time, driven by strong starts, both in Florida and Texas. By the way, POS was up 20% in December, as well. So while it is still early, it is always good to have a strong start.

We expect POS for the full year to be up in the high single digits, which should drive sales growth of 6% or better. In Florida, about one quarter of consumer purchases for the season have already occurred. Weeds are growing, bugs are out, and consumers are out in the stores. In fact, we are seeing stores that are noticeably more crowded than a year ago, and products like Bug-B-Gon, Fire Ant Killer, Weed-B-Gon, combination fertilizers, and Roundup are doing very well. As a result, early season POS in Florida is up more than 25%.
We are also cautiously optimistic about what we are seeing in Texas right now. While we are only 10% or 15% into the season, we are seeing strong consumer demand across the board. Two weeks ago in Texas, we actually saw a triple-digit year-over-year improvement in POS. While they are still in a deep drought, they've had rain seven weeks in a row and consumers are almost immediately re-engaged in the category. Again, it is too early to call it a trend, but POS in Texas is up well over 50% for the first five weeks of the new season. As a result, we are moving up the timing of some of our advertising spend and retailers are moving up some of their plans as well. Due to mild weather, annual and perennial flowers, which we refer to around here as color, are in the stores a full three weeks ahead of last year. I don't want to be too specific about our full-year plans for Texas, but I think we are well positioned for either weather scenario, that is dry or normal. We are hoping for even more rain, and would like to see things growing again.

While it is still early, I am sharing these data points with you because I think once again demonstrates the resiliency of our category and the strength of our brands. I should point out that POS growth we have seen so far is occurring without the benefit of major advertising support. Our media is beginning to ramp up in Florida and will peak over the next couple of weeks. It will quickly gain momentum in other markets from there.

Speaking of media, I want to shift gears and give you a hint of what you will hear and see from us next week in New York. Our Chief Marketing Officer, Jim Lyski, will be one of the speakers. In fact, we are allocating him nearly one-third of the agenda. While he’s showing the new campaigns we have in place for the season, his presentation will be light on show-and-tell. Instead, he'll spend most of his time discussing the type of analysis we’re using to drive our marketing decisions. As you know, I announced in November our intention to increase our advertising investment by $40 million for this upcoming season. Jim will explain to you how we arrived at that number, how we plan to invest it, and how we plan to measure the success of that investment. I'm confident you'll walk away from that presentation convinced we’ve made a great deal of progress in improving our marketing efforts since our Analyst Day meeting last year.

In addition to Jim Lyski, Barry will provide more detailed explanation of where we see the opportunities for growth. He will focus on key initiatives underway this year with each channel of trade, and the steps we are taking to drive sales in several of our new – several of our product categories. Barry's comments will not be confined to the US business, but will also outline opportunities abroad. We have committed resources in 2012 to grow our business in Germany and launch a product line in China. We are excited by both, and he will provide more detail. Barry will also outline substantial opportunities we believe exist in Scotts Lawn Service. This business continues to deliver outstanding performance. While we have been primarily focused on improving the SLS business model over the past several years, we are now switching our focus to leverage that model.

From me, you'll hear a pretty formal briefing on the steps we are taking as our strategy continues to evolve. That will include a thorough explanation of our pricing philosophy going forward. I will give you a headline now in case you are thinking differently. Pricing will remain a tool as we move forward. Just because we’re taking a conservative approach in 2012, does not mean we plan to do the same in the future. I'll also provide, along with Dave, and explanation of how we’ve overhauled our incentive compensation programs. The changes are designed to drive category growth and market share in the near-term and shareholder value over the long-term. A substantial portion of our long-term compensation, which is paid in equity, will now be tied to return on invested capital. While we are not providing more detail specific to our full-year guidance this morning, Dave does plan to provide more color next week, as well as a better understanding of our long-term financial goals and objectives. I trust you'll find the time well spent. We are almost at capacity, but still have a few seats available; so please let our IR team know if you plan to attend.

With that, let me turn things over to Dave.

Dave Evans - Scotts Miracle-Gro Co - CFO

Thanks, Jim, and good morning, everyone.

As we have already said, with our Analyst Day scheduled in one week, I will keep my comments brief, focusing on the quarter’s results and then taking your questions. Next week, we will have a more robust discussion on 2012 and the longer term outlook.

The headline for the quarter is that results are in line or even slightly ahead of what we guided to in early December and on track with our full year plan. Overall, Company-wide sales for the first quarter were $211 million, as compared with $230 million a year earlier. While down 8% to prior year, they are on track with internal plans, which assume full-year growth of at least 6%. Changes in currency rates had a small dilutive impact to...
the quarter, about 20 basis points. If current exchange rates remained unchanged for the balance of the year, they would reduce the planned rate of sales growth for the full year by about 100 basis points and negatively impact earnings by about $0.05 a share. While incorporating FX risk into our plan, we have no intent to revise our guidance at this early stage, given other modest cost tailwinds.

As you can see in our press release, global consumer sales were down 21%. Sales within the US were down 25%, principally as an outcome of pushing shipments closer to the season. Sales outside the US were down 10%, or about 9% excluding the impact of FX. The decrease in international was primarily seen in France, where we are increasingly shifting from two-step distribution through distributors to direct-to-retail distribution. This change, which will ultimately result in a more value-efficient supply chain, results in shipments being moved closer to the season, following a pattern more similar to the US.

Scotts Lawn Service sales were up 1%, to $37.6 million. Customer count was up 2.5% to last year. Cancels have been lower than prior years since August, and customer satisfaction metrics continue to improve. Sales growth trailed customer count, principally due to weather in the Northeast and Texas, both of which resulted in the loss of some extra service revenue.

As was the case in the second half of 2011, sales within corporate and other were up sharply from a year ago. Hopefully you recall that sales of corporate and other are attributable to two activities, our supply agreements with ICL and sales of professional grass seed outside of Europe. About two thirds of the increase in Q1 was attributable to our ICL supply agreement. The remaining one third resulted from increased sales of pro grass seed. We are aggressively moving the grass seed inventory, consistent with our plan to exit the professional grass seed category by the end of 2012.

Moving on to gross margin, the year-over-year decline in adjusted margin rate of 1,000 basis points was consistent with our expectation and primarily attributable to three items. First, growth in low or no margin ICL and pro seed sales contributed 130 basis points of the decline. The ICL supply agreement was initiated in February, 2011, so this headwind will anniversary later this month. Second, consistent with our expectations, commodity cost increases, including fuel, contributed 430 basis points to the rate decline, increases primarily related to bird food and growing media inputs, as well as empty packaging. Costs increases in Q1 were in line with our plan. We expect the dilutive impact of commodities on margin rate to decline over the balance of the year, as year-over-year comparisons become less unfavorable. And third, lower sales reduce leverage of fixed warehousing costs contributing an additional 320 basis points to the first-quarter decline in margin rate. Given the seasonally low sales, there is greater sensitivity to changes in volume in our first quarter than in any other quarter. This will reverse itself and eventually turn positive by the end of the year.

I will now move on to SG&A, which declined $20 million, to $123 million. Recall that on a full-year basis, we expect SG&A to be higher in 2011 with the increases driven by media and variable comp. So let me explain why SG&A declined in the first quarter. First, we had two benefits in the quarter’s year-over-year comparison; non-recurrence of 2011 severance costs, primarily related to Mark Baker’s departure, and benefits in 2012 from the restructuring program we initiated last calendar year. The second reason for the favorable SG&A comparison was that the two increases we will see for the full year, media and variable comp, are loaded in the last three quarters of this fiscal year. So you should realize that, despite the favorability in Q1, we are still planning for a meaningful increase in SG&A for the full year, details which I will share next week.

Interest expense was in line with what we expected, and keeps us on track for a $10 million to $12 million increase for the full year. In the quarter, interest was $15.3 million, nearly $6 million higher than a year earlier. This was attributable to both higher average debt and higher rate spreads associated with our new financing structure. Recall that we have a higher spread on the senior secured credit facility we entered last June, as well as the $200 million tranche of senior notes we issued last December.

So the adjusted net loss from continuing operations for Q1 was $72.1 million, or $1.18 per share. That compares with a loss of $65.6 million, or $0.99 a share last year. Note that the basic share count in the quarter was 60.9 million versus 66.3 million shares in the first quarter of last year. We still expect the average number of diluted shares for the year to be about 62 million. And remember, we don’t use diluted share count in Q1 or Q4, because they are [lost quarters] and therefore no dilution -- there is no dilution from an accounting perspective. On a GAAP basis, the net loss in the quarter was $73.9 million, or $1.21 per share, compared with $66.7 million, or $1.00 per share last year.
One additional note here. You will recall that much of the charges we have been excluding from our adjusted results have been related to product recall and registration issues. This dates back to two separate incidents from 2008. The first related to a recall of certain wild bird food products, the second related to the recall of several lawn and garden products, when it was discovered that a former associate allegedly created fraudulent documents related to the federal registration of those products with the EPA. Late last month, the Company filed a plea agreement in federal court here in Ohio related to several misdemeanor charges associated with these incidents. In total, we agreed to pay $4.5 million in fines, money that we had reserved for last year. We have yet to settle with the EPA regarding potential civil penalties and as a result, will continue to exclude these costs from our earnings until the entire matter has been resolved.

There is one item on the balance sheet I want to discuss, and that is inventory, which is up $88 million to last year. There are three principal reasons for the increase. First, higher commodity costs; second, inventory build to support sales growth planned for the back three quarters of fiscal 2012; and third, an accelerated procurement of certain long lead time components sourced from Asia to ensure high service. We expect inventory levels to settle back to more historic norms in the back half of the fiscal year.

That concludes my prepared remarks. Jim already touched upon our agenda for next week. And as we've said, I'm planning to provide additional color on our 2012 guidance and discuss our longer-term financial goals and objectives in New York. As a result, we would ask that you hold your questions on these topics to next week.

With that, I will turn it back to the operator for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Leah Villalobos, Longbow Research.

Unidentified Participant - - Analyst

This is Josh in for Leah. Just a quick question on commodities. Urea has dropped pretty significantly here in December, and I think some people may be a little surprised it didn’t alter your outlook for commodity cost inflation for the year. Was that drop already built into your original assumptions?

Dave Evans - Scotts Miracle-Gro Co - CFO

Josh, recall that we had gotten ahead and locked in about 90% of our urea in the December time frame. We are benefiting a bit from the continued decline. But I would say that if the decline continues, or moderates at the current levels, it is really going to be more of a benefit looking into 2013 than 2012, at this particular stage.

Unidentified Participant - - Analyst

Okay. Great. And then just one follow-up, sticking with commodities. On the bird seed products, rising costs of commodities there, how should we think about that product longer term? Do you think you will be able to achieve the same margin on those products as you do on the global consumer segment of products?
Jim Hagedorn - Scotts Miracle-Gro Co - Chairman & CEO

That's a hot potato. I'm not sure anybody wants it. My view is probably not. This is something that Barry and Dave and I talk a bunch, which is ultimately where can we get the profitability. Definitely more profitable than it is. Do I think we can get it up to our consumer average? No, I don't think so, and I don't think anybody else could either. Barry, anything you'd add on that?

Barry Sanders - Scotts Miracle-Gro Co - President & COO

No. There is going to be -- from a mix standpoint, a substantial part of the business is big bag commodity business, and so the mix will hurt it. But I do think we can drive some innovation that will improve the margins. But I don't think it will get up to our average of what our consumer business is.

Unidentified Participant - Analyst

Okay. Great. I appreciate the time. Thanks.

Operator

Jeff Zekauskas, JPMorgan.

Jeff Zekauskas - JPMorgan - Analyst

Hello. Good morning. Can you tell me what your shares would have been if you had made money in the quarter? Your diluted shares. And how much did you -- did you repurchase any shares in the quarter?

Dave Evans - Scotts Miracle-Gro Co - CFO

Jeff, the first question, I don't have the data to answer that question, because we just don't calculate it, because it is a lost quarter. So I do not know a number off the top of my head. With respect to the number of shares purchased in the quarter, my recollection is around $17 million of share repurchases this quarter, in Q1.

Jeff Zekauskas - JPMorgan - Analyst

And then for my follow-up, Jim began the call by saying that our pricing policies this year may not be the same as our pricing policies in future years. I was wondering if you could elaborate on that. That is, why your pricing policies this year might be more mild and why your pricing policies in the future might be more aggressive, if that's what you meant.

Jim Hagedorn - Scotts Miracle-Gro Co - Chairman & CEO

That's what I did mean. To start with -- and I'll maybe hand it over to Barry to see if he can correct anything I screw up. But, start by saying, I think we have been modestly aggressive. I think that where we are this year in regard to our advertising spend and our pricing decisions were really sort of my view coming out of the summer that I really wanted to basically work on consumer demand and I didn't want to create any issues to it. And this would be particularly true in urea-containing products, like lawn fertilizer, where we have seen the decline over time on our units sold. This is, again, not a share loss. This is not a dollar decline, but it is a unit volume decline and something that I am -- I just wanted to put a stick in the sand and say look, we are not taking pricing and we are increasing our advertising. So far, I feel pretty good about that. I feel confident that our sales force agreed that that was the right decision, that our marketers agreed it was the right decision, and that our retail partners. This is in advance of the season, so we will see what the consumers think. But I would say so far, so good.
Going forward, we do understand that gross margin profit dollars is the jet fuel we use to operate our business. And that when we talk about what our advertising ought to be, one of the things we will talk about next week is what I call my core convictions, which is something that I felt obliged to provide to our internal community here. One of those is, advertising works. I think that we have not really been putting the money -- putting our money where our mouths were, when it comes to advertising spend. To do that, it requires, I think, our margin to be higher. I think proper valuation of this business requires our margins to be higher. Commodities are going up. This is strictly a holding pattern to sort of regroup and get down on the consumer and get our business model where I think it needs to be.

This is not an abdication of saying we cannot take pricing. It was a holding pattern I put us into to say, here is what we are going to do. We are going take all noise out of the system, and we’re going to incentivize, and we will talk about that next week, the entire company, on sales growth and market share. These are areas where we are going to prove that we can grow this business, to you all and to ourselves. And this was really part of a holding pattern, and does not, and shouldn’t be viewed as basically saying we can’t take pricing. Anything you want to add to this, Barry?

Barry Sanders - Scotts Miracle-Gro Co - President & COO

Just one thing is that, Jeff, this is the first year we’re looking at pricing, decoupling it from commodity costs, that we’re looking at the value provided to consumer, the elasticity demand. And what you’ll hear Jim Lyski talk about next week is how we’re going to view how we price for our brands, the value that we provide for the consumer, and our ability to price for innovation and continue to drive the innovation.

If you look at, historically, where we have been, we have been in a secular increase in the cost of commodities over the last five years. And as Jim said, we are breaking that mold to say that we’re going to drive unit volume, we’re going to drive share, and we’re going to continue to drive margin and not look at our brand as just a cost-plus basis, but look more at the premium nature of our brands and how we can drive value to our shareholders that way.

Jeff Zekauskas - JPMorgan - Analyst

Okay. Thanks very much.

Jim Hagedorn - Scotts Miracle-Gro Co - Chairman & CEO

You bet.

Operator

Joe Altobello, Oppenheimer.

Joe Altobello - Oppenheimer & Co. - Analyst

Thanks. Good morning, guys. Just a couple quick ones. You said a number of times that weather accounted for only about half of the top line shortfall that you had last year. Could you give us an update on the other issues that you saw last year, at least at this early stage? And then secondly, and somewhat related, if you could break down POS maybe between mass versus home center?

Barry Sanders - Scotts Miracle-Gro Co - President & COO

Joe, I would say we don’t break it down that way, in respect to our customers. But I can speak specifically -- we said about 50% weather-related, and we said we had some difficulties with a couple of our customers. I would say the weather has turned around, and I think we are in great shape with all of our customers. And I think you are seeing the outcome of us having better account plans at some of our bigger customers this year.
Joe Altobello - Oppenheimer & Co. - Analyst
Okay, thanks, Barry. But just in terms of the POS, I wasn't looking for specific numbers, but in general, are you seeing --

Barry Sanders - Scotts Miracle-Gro Co - President & COO
-- oh, a divergence. No, I would say all of our customers, the numbers Jim talked about, they're with plus or minus a few points of each other.

Jim Hagedorn - Scotts Miracle-Gro Co - Chairman & CEO
Let me just add a little bit to this, because we have been sort of prepping for next week with you all, and as we have prepped for this call, we got into quite a bit of the detail. If you look at Florida, in particular; Texas, as well, all channels are doing well. We have put a lot of time into correcting issues that we felt, on both sides, at Wal-Mart, and I think we are on a way better track and the performance we are seeing year-to-date, call it in mass, but that is code for Wal-Mart, is really good. So I think things so far are going well and I think we are all much more confident than we felt midway through last year.

Joe Altobello - Oppenheimer & Co. - Analyst
Got you. And then secondly, in terms of the timing shift you saw this quarter, obviously you did talk about that back in December, so it wasn't a surprise. But you guys have been talking about timing shifts in terms of delivering product later, or actually closer to the start of the season, for a number of years now. So I'm just curious, are we almost at just in time, at this point, or still opportunities to push those shipments back even further?

Jim Hagedorn - Scotts Miracle-Gro Co - Chairman & CEO
That is a hard one to predict, because about the time you say it is just where it should be, they will say, we want to go scan-based, and we're not in discussions on ongoing scan-based. But, I think as long as Scotts can excel in our supply chain and deliver on time, it makes sense. If I was taking you through GMROI, which would be a sort of normal metric they would use, which is sell a lot of stuff and turn it hard in season, and sit on as little as possible in the off-season, which would be a major opportunity area for improving GMROI. I think retailers continue to look for opportunities to improve their returns by taking inventory out in the off-season. I think that that will probably continue to occur. The good news is, POS looks fantastic. We are in service and I think this is an area where Scotts can show why the hundreds of millions of dollars we have invested in our supply chain and our sales force can pay off, and why we are unique in the vendor community, if you want to call it that, especially in big box DIY, to provide, in a very violent sort of season, really pristine performance without losing any sales. I think probably it continues to go until they're sitting on zero dollars in the off-season. But we feel fine about it.

Joe Altobello - Oppenheimer & Co. - Analyst
Okay. Thanks, guys. I will see you next week.

Operator
Carla Casella, JPMorgan.
Carla Casella - JPMorgan Chase & Co. - Analyst

Hello. Just a couple of quick ones. One, on the marketing spend that you're upping this year. How much of that is going to be following the regionalization strategy versus a national marketing?

Jim Hagedorn - Scotts Miracle-Gro Co - Chairman & CEO

I'll hand it to Jim, but I think it is probably both. What we learned big time last year was that there is a more efficient way to do it than we did last year. So I think we can do both. Jim, do you want to --?

James Lyski - Scotts Miracle-Gro Co - Chief Marketing Officer

I would say right now we anticipate somewhere between 30% to 40% of our media spend to have regional messaging flexibility. That does not necessarily mean we bought it regionally, it just means that we can vary the message to match the POS curves in each region.

Carla Casella - JPMorgan Chase & Co. - Analyst

Okay. Great. And then, just given how poor the weather was last year, are you seeing much -- a pickup in the competitive situation, as everyone tries to build for a better 2012 season?

Jim Hagedorn - Scotts Miracle-Gro Co - Chairman & CEO

From my point of view, and I was on the road yesterday, I think the lawn and garden department is looking pretty good. And so I think everybody is ready for it. Do I think the world is more competitive than it probably was two or three years ago? Yes, I do, but I think that is helping us, and it is making us a better competitor as well. So do I think that there is big gaps where certain people look terrible? No, I think everybody is looking pretty good and the departments, especially in the warm season markets, look pretty well set. So I think the whole environment is good. Maybe other people are showing the POS gains that we are seeing, so I think we're doing really well. What I do not know is if we are outperforming those markets down south. I suspect we are, but I do not know that for sure.

Carla Casella - JPMorgan Chase & Co. - Analyst

Okay. But no retailers you think have cut back any of their space, given how bad last year was?

Jim Hagedorn - Scotts Miracle-Gro Co - Chairman & CEO

No, it has been one of the important and gratifying things, is that as we have spoken to these retailers, and I have been meeting with many more of senior management of our biggest retailers, is that almost to a person, they are extremely committed to lawn and garden as a category that really leads them into the new year, and not at all a diminished sort of presence or commitment as a result of a poor season. I think they just see it for what it was. Most people who have been in lawn garden recognize that if the weather sucks, it's going to be hard to have a great year.

Barry Sanders - Scotts Miracle-Gro Co - President & COO

The only thing I would add to what Jim said is that they were positive going in, and with these early good results it's just gaining momentum and everybody has a renewed focus on it. So I think it is all good.
Okay. Great. Thanks.

You bet.

Eric, this is Barry Sanders. As continued, and Jim already fielded one of these questions, we believe that we need to take -- to continue to take inventory down at year-end, and for them to not to over-winter the inventory. Our calculation would say their POS would be up higher, but then we would take the inventory out at the end of the year. Part of that is what has happened in Q1 as well, is we made sure that they were in good shape going into Q2.

Eric, our plan would say that that 7% to 9% is our POS, and implicit in that would be some growth or gain in market share by Scotts this year.

And then the last question, I know you have affirmed that $80 million -- or reaffirmed the $80 million input cost pressure for the year. Could you remind us of what the assumption is about how you offset that? I know that you are talking about less price than normal, but can you give us a little sense of what’s on the other side of that to get you to what sounds like a little bit of gross margin pressure for the year?

Well, Eric, I'll have a lot more detail to that next week. I think what we've said so far is that we do expect gross margin rate pressure, because as we have been very public about while we took some pricing and we did drive some increased productivity out of trade firms, it was not sufficient to cover the commodities. There will be margin rate pressure relative to the commodity cost increase. I will talk more to that next week, as well as kind of our longer term outlook for that.
Eric Bosshard - Cleveland Research Company - Analyst
Okay. Very good. Thank you.

Operator
Olivia Tong, Bank of America Merrill Lynch.

Olivia Tong - BofA Merrill Lynch - Analyst
Good morning. Thanks. I want to talk a little bit about the POS improvement. While small numbers, since it’s the beginning of the season, what do you think drove that? Is it more the fact that the weather has been better, or are there early signs from -- have you already launched some programs associated with the marketing expenditure increase? And then further, on top of that in mass, can you give us, you mentioned that the rates of growth between the home centers and mass is sort of normalized. Can you give some color and some specifics on what you’re doing differently to drive that turnaround?

Jim Hagedorn - Scotts Miracle-Gro Co - Chairman & CEO
Which one do you want to do first, Barry? Why don’t we do the mass one first, and then we’ll go into the second one.

Barry Sanders - Scotts Miracle-Gro Co - President & COO
Could you repeat the question on mass?

Olivia Tong - BofA Merrill Lynch - Analyst
Sure. Just what you are doing differently at mass to get those results better this year?

Barry Sanders - Scotts Miracle-Gro Co - President & COO
I think they have a new management team in place that we are very pleased with. They are very aggressively driving sales. We are partnering with them very well, and I think we both have come to terms with what the opportunity is for us to grow the business this year. And they are as aggressive as we are of going after it. I think that is a good plan. It’s a good partnership. Our goals are aligned, and I think the results are in line with what we expected.

Jim Hagedorn - Scotts Miracle-Gro Co - Chairman & CEO
I would add on that that I think our off-shelf display is going to be significantly better than it was last year, and our tab support -- so this is support we are putting behind it, and then support that Wal-Mart is putting behind lawn and garden in general, is going to be enhanced from where it was last year. I think that a lot of this stuff is all to come. So based on the POS we are seeing now plus what we know is coming down the road is in regard to tab support and display support, it is -- there is good reason to be optimistic.

In regard to just generally what is happening -- Olivia, I would say that these are not small numbers right now. To be 25% into the seasonal year in Florida and to be up more than 25%, you’re starting to get into the point where you saying, it might actually mean something. What do I think? I think things economically are somewhat better in Florida. I think people are feeling a little more relaxed. I think that a lot of the cheapest foreclosure
stuff has been sort of swept out. But I think the weather has been superb. Given the fact that our advertising -- we had wanted to pull it up hard, but based on the amount of political activity that was occurring in the state of Florida prior to the Republican primary, we basically could not compete with that. So we went into the market and are in the market now, right after the primaries were over. So that the results we are seeing really have not had any impact from advertising. And the advertising is going to be substantially higher. So if you believe, and we do, advertising works, then I think most of it is just due to somewhat more favorable economics, just generally out there, and two, just terrific weather. Now with the advertising going up, it is a little bit like the discussion about Wal-Mart, there's a lot of good things coming down the pike. And what we do is really coming into effect now. So far, so good.

Barry Sanders - Scotts Miracle-Gro Co - President & COO

I would add to what Jim said, this is year three of regionalization in the Southeast and the Southwest. So our teams are doing an excellent job. You couple good weather -- exactly what Jim said, good account plans and then what I would say is the best execution we have ever had in those regions. You put that scenario together. It all combines to get the results.

Jim Hagedorn - Scotts Miracle-Gro Co - Chairman & CEO

Barry's totally right. And I totally neglected to mention the really good efforts that are happening. Regionalization -- if anything occurred last year in the stress of complete crap weather, the results of I was a much better execution plan going into 2012 than we have had, and a much more aggressive leadership profile from the regional presidents. That is also happening, and I neglected to say that.

Olivia Tong - BofA Merrill Lynch - Analyst

Got it. Thanks. And then just following up on that, you mentioned in the press release that you were doing an updated look at your longer-term financial goals and objectives. Should we be reading anything into that, or is that, we're having an Analyst Day and we're obviously going to update you on the longer-term?

Jim Hagedorn - Scotts Miracle-Gro Co - Chairman & CEO

We'll save the headlines, but it's exciting. That's what I would say. Dave, in addition to the financial side of the house, the strategic side is also reporting to him. And as Barry and I have been really focused on sort of our operating profile, call it, Dave has been highly focused on what our financial objectives ought to be as we try to create value. So really what you're going to hear is a merging of a really good operational strategy tied to, I'm going to say some modestly to maybe more modest -- to more aggressive financial objectives that I think drive value. So I think you will view it as a positive, and we will find out next week.

Olivia Tong - BofA Merrill Lynch - Analyst

Got it. Thank you.

Operator

Bill Chapel, SunTrust.

Unidentified Participant - - Analyst

This is Mike filling in for Bill. Good morning. I just wanted to ask a question around advertising. And I know you are going to provide more color next week. But given some of the commentary in your prepared remarks about moving the timing or shifting the timing of your ad spend forward,
due to some of the favorable weather you're seeing, could you maybe give us some more color on the cadence of your advertising marketing spend this year? How that differs maybe from prior years?

James Lyski - Scotts Miracle-Gro Co - Chief Marketing Officer

Mike, this is Jim Lyski. What we are trying to do this year is to lead our POS curves, by geography, approximately two weeks out, so that we are building both the awareness and recognition levels that we need as you get into a peak environment. So it's kind of like leading the bird when you go out shooting. That is kind of what we are doing as far as the cadence goes, and then trying to be able to match that through the season. I'd say that is what we meant by changing the cadence.

Unidentified Participant - Analyst

Okay. Great. And then a follow-up, --

Barry Sanders - Scotts Miracle-Gro Co - President & COO

I just want to add on that, because remember, what we had, by weather -- we had a very significant portion of our spend last year weather-triggered. And the problem is, the weather was so long poor that it really ended up delaying that spend. Instead of leading the bird, we kind of trailed of the bird. And what we found out was that while weather-triggered, I think still is a important arrow in the quiver, you can't go 100% that, or a majority of that, or you'll find out, in a poor season, that none of that brand building effort in advance of the season could hurt you. I think this is really a move back to what Jim described, which is not that new for Scotts, but we had moved very much into a weather trigger.

Unidentified Participant - Analyst

Great. And then a follow-up on advertising. Given what you're seeing with POS thus far, and understanding that we're only a month into the season, we have not hit the heart of the season. If you continue to see strong double-digit POS this season, would you have the ability or the opportunity to maybe rollback or scale back some of that advertising spend, or is that something that is already booked for the year, regardless of how POS does?

Jim Hagedorn - Scotts Miracle-Gro Co - Chairman & CEO

You're talking to the wrong dude, man. If it was me, I would spend more. Pour gasoline on the fire. I don't know if Jim would say that.

James Lyski - Scotts Miracle-Gro Co - Chief Marketing Officer

I would absolutely agree with my CEO on that one. (laughter)

Unidentified Participant - Analyst

Alright. Great. Thanks, guys.

Operator

Sam Darkatsh, Raymond James.
Good morning, Jim, Dave, Barry. How are you?

Barry Sanders - Scotts Miracle-Gro Co - President & COO
Good morning, Sam.

Sam Darkatsh - Raymond James & Associates - Analyst
Most of my questions have been asked and answered. There's only so much we can ask here in February. At the risk of paying so much attention to only 2% or 3% of the season's sales, you mentioned Florida and Texas very strong POS, you did not mention Southern California which, it looks like the weather has been fairly normal out there. Are there issues there with POS early in the season?

Jim Hagedorn - Scotts Miracle-Gro Co - Chairman & CEO
Let's start by saying, we know that our national POS is up 20% since January 1. So within that, the numbers are not as good as Florida and Texas. The whole national program is not bad.

Barry Sanders - Scotts Miracle-Gro Co - President & COO
Sam, Southern California is around flat, and as you go north, it gets a little worse than that. I would say that is primarily driven by a replenishment strategy of trying to get closer to the season. Plus they've had a little bit of rain out there. So California, not as good as Florida and Texas, but I would say as good a shape as we have seen California in. And I think from a marketing plan standpoint, we have expectations that California will be equal or better to what we are seeing, which is high-single digits for the year.

Jim Hagedorn - Scotts Miracle-Gro Co - Chairman & CEO
So a little bit of color, as people are walking around the table here. Arizona is plus 22%. So, Arizona is good. To me, California, we can tap dance around or we can say, have we really figured out how to big-time move the needle in California like we have the East? Or for that matter, has anyone figured out how to really move the needle in California? I think everybody is challenged a little bit with California. And I want to make sure that our Regional President out there, Phil Jones, has the tools to get it done. Because part of what we're looking to do this year is show that we can drive top line numbers.

California, I think, has been -- it's part of the whole regional approach to the business, is saying have we seen the kind of growth we have seen in the East? Is it as responsive to advertising, or the same messages? And the answer is no. So it is a challenge. I'm not going to walk away from it. The West is not doing poorly. Southern California is not terrible, it's not great, but it's one of those things where we are really focused on it and making sure that our folks out there have the tools to get the job done. And I think four months from now, we will be talking about this and saying, okay, how did we do out there?

Sam Darkatsh - Raymond James & Associates - Analyst
My second question would be, if my memory serves, your comparisons on mix and volumes do not begin to get easy until April and beyond. With the higher marketing spend and with the higher discretionary spend, would there be a reason why Q2 would not be down on a year-on-year basis in earnings?
Dave Evans - Scotts Miracle-Gro Co - CFO

What I would say is, I think directionally you are correct. As we have done in the past, we’re not going to try to start calling guidance by quarter. What I will tell you, and I think we will talk about this a little bit more next week, if you look at our historic pattern of shipments and take it over a four-year average, if you applied that to our expectations for full-year sales this year, I think you would get to a reasonably good outlook for what we are planning for this season, which is kind of average weather. You are correct in that we have some more challenging comps from last year over the next several handful of weeks. And then, as you probably remember from last year, the season kind of tailed off, and it will be easier comps then for the balance of the year. That is the direction I would provide you on that.

Barry Sanders - Scotts Miracle-Gro Co - President & COO

The only thing I would add, Sam -- this is Barry -- is that it wasn’t April. Negative comps last year started in week 11, in March, and it was downhill from there. So it starts getting better mid-March from really easy comps going forward.

Sam Darkatsh - Raymond James & Associates - Analyst

Okay. Thank you.

Operator

Reza Vahabzadeh, Barclays Capital.

Reza Vahabzadeh - Barclays Capital - Analyst

Good morning. Just following up on that last question, so would you generally anticipate for the entire fiscal year sales mix to be favorable for you?

Dave Evans - Scotts Miracle-Gro Co - CFO

This year, so if you’re talking about product mix, we would expect it to be positive, because as Jim said, we’re going to grow units in fertilizer, and last year was not a very good fertilizer season, given the Midwest and the Northeast, all the rain that we had. What we’re seeing in the Southern markets is it’s kicking off and fertilizer is positive, and we expect the same thing as the season rolls South to North.

Reza Vahabzadeh - Barclays Capital - Analyst

Would that sales mix being favorable, would that also contribute to better gross margins? Or not necessarily?

Dave Evans - Scotts Miracle-Gro Co - CFO

That, in isolation should. If you remember last year -- we did talk about mix from a negative perspective. And what we said was, last year where we saw the greatest declines was in lawn products. Lawn fertilizer, weed control, as well as non-selective weed controls which related to Roundup. Those were all things last year we were providing as explanations for our margin rate deterioration. If we have a normal year, which is what the plan is, we would see some tailwinds this year to our margin rate from a positive mix. There’s a lot of other variables affecting rate this year, but that in isolation should be a positive.
Reza Vahabzadeh - Barclays Capital - Analyst

Fair enough. And as far as use of free cash flow to be generated this year, any updated thoughts on how you would apply that?

Dave Evans - Scotts Miracle-Gro Co - CFO

Really no updates. It would be consistent with what we've articulated in the past. I would say the guidepost that we have laid out in the past is first, from a capital structure, we’re going to keep one eye on our debt leverage, and our guidelines are 2, 2.5 times. On the other hand, we are going to focus on kind of one third of our operating cash flow to shareholders, and two thirds for growth, both organic and inorganic. Short of finding value accretive inorganic opportunities, we would choose to return that to shareholders as well. But our first choice would be to dedicate two thirds of our cash to growth.

I would say those are general guidelines, not something that we live and die by, but it certainly directs how we think about this on a quarter to quarter basis.

Reza Vahabzadeh - Barclays Capital - Analyst

Got it. Thank you.

Operator

Jason Gere, RBC Capital Markets.

Jason Gere - RBC Capital Markets - Analyst

Thanks. Good morning. A couple questions. One, just thinking about the international outlook with the very weak macro backdrop there. You had some positive comments earlier in the call, but I was just wondering how you are thinking about that market and what you're seeing out there right now.

Barry Sanders - Scotts Miracle-Gro Co - President & COO

What we are seeing right now is the economic back drop is not affecting lawn and garden sales. That’s not to say that something won’t happen going forward, but culturally, the geographies that we compete in, we're not seeing any impact from our sales at all.

Jason Gere - RBC Capital Markets - Analyst

Okay. Great. And the second question really is on the role of promotions. Last year, obviously there were some inefficient promotions out there. You guys have pledged, we do not want to go back that route again. In terms of thinking about the rest of the year, and hopefully, God willing, we do not ever see the type of weather we saw last year, but how do you think about the balance of promotions in there if weather does not cooperate, or is not as normal as what we hope it could be this year? Just thinking about that role in there. Thanks.

Jim Hagedorn - Scotts Miracle-Gro Co - Chairman & CEO

Barry’s looking at me like, who’s going to take this one?

When you say inefficient promotions, I assume that you mean we spent money and got like nothing for it. I guess that qualifies as inefficient. But everybody around here is even laughing, I can’t believe this, guys. No laughing. To some extent, we were chasing the business. We were trying to,
basically, make the most of the year and invest behind promotions to drive the business. The hope was that the weather would improve and we'd be in the position to have the displays and promotional activity that would drive the business. That did not play out, and therefore it qualifies as, around here, we say chasing the business and inefficient promotional activity that we do want to work away from, and we're not planning to repeat.

If you're saying, if the same thing was to happen again, I think we would try to be much more careful about it. I'm not sure what else to say, except to say, we were trying to operate the business real-time and did the best we can. It did not play out. And I think we could have more effective promotional spend, and I'd start with our advertising. Instead of relying completely on sort of on the floor display activity, I think we'd go to advertising and we could do it much more realtime, depending on the weather. And if the weather did not play, not invest that money.

I don't know, Barry, it's kind of what would you do differently if the whole thing happened again?

Barry Sanders - Scotts Miracle-Gro Co - President & COO

Going back to where we started on pricing, we did not take pricing this year and the promotions that we have done are an indirect form of a pricing action. So we did not take the pricing. We think we have the right pricing, and the mix of the spend that we are going to spend, and you're going to hear more of this from Jim Lyski next week, is it is going to be spent more on brand building activities and driving the longer-term and getting participation rates up this year, more so than what Jim termed as chasing the business last year. I think we have a much better marketing plan. It is integrated with our customers better. The cadence of it is not only to get it up in advance, but we have a very good marketing plan all the way through to our fall business next year. And I would say this year we'll probably be a little more patient with letting the marketing plan play out and focusing more on brand building activities than more so pricing action.

Jason Gere - RBC Capital Markets - Analyst

Okay. Thanks.

Operator

Connie Maneaty, BMO Capital.

Connie Maneaty - BMO Capital Markets - Analyst

Good morning. I do have a question on the first quarter. What would you imagine that a normalized gross margin is in the first quarter, given all of these moving parts? ICL anniversary, sales keep moving into the second quarter, so capacity utilization would be not as high as the rest of the year, and it's going to be plus or minus the impact of commodity. So what is normalized now for the first quarter?

Dave Evans - Scotts Miracle-Gro Co - CFO

Connie, as I think about your question, in many respects I would say that what we saw this quarter probably is more normalized. Because if you consider the fact that the sales shift is something that we would not anticipate to return back to Q1 next year, so that is permanent, ICL is now embedded in our financials for nearly a full 12 months. So from the perspective of the first quarter, that will not go away. The one thing that we will benefit from next year would be the professional grass seed business, that we said we are intending to exhaust the inventories and exit. That will be one adjustment, I would say, that would need to be thought through to call what is normal. But I really think, the big question then is going to be commodity assumptions, in terms of what is normal in the future for commodities. So if you say well, was this year the anomaly or was the past the anomaly? In many respects, I would say this year might reflect more the new normal, given the pacing of the season and the composition of our sales in this quarter.
That is helpful. And then on the accelerated procurement of long lead time inventory, what is that about?

There is a handful of items that we really source from China -- not from China, from Asia, I'll say more broadly. The core, which is a key part of some of our highest growing items, soils and easy seed, source from that region. As well, some of our new innovation that we are launching this year in our Ortho product line, has components that are sourced from Asia. From the perspective that it’s both related to innovation that we want to make sure we have good service on, I would include in the innovations Snap as well. Some of the importance of Snap come from Asia. It’s coming from innovation and our higher growth product lines. The decision was made this year to more aggressively source those materials ahead of the season to simply de-risk any issue later in the season from a service perspective.

Did we think that these long lead time items sourced in the first quarter are also part of a new normal?

I would think that — a couple things. One is, the key drivers, the order that I explained them in would be representative of the order significance, in terms of the growth of $88 million. The increase in cost was the largest. The second would be the more rapid build and production plan anticipation of growth from the back part of the year. I will tell you on that, I think we will put to progressively get better, as we drive for improved inventory turns year in, year out. And then I guess I will look to Barry, in terms of the supply chain from a sourcing perspective on these components.

Connie, this year, which is pretty remarkable given this time of year, the conversations that I’m having with our customers are already about when the product starts moving, make sure I’m the one that gets the allocation. What we wanted to do this year, given these new innovations, we do not really know how high high is with these. And what we did not want to do is kill the innovation in a full national launch year, and so we took a pretty aggressive approach on the inventory. I would say those products next year will have a much better feel, and I think we can do a more regular flow. But any of these new innovations that we’re coming out that have long lead time items, given the seasonal nature and the flow of how our sales goes at the retailers, we could really damage our sales by missing a week. So I think you will not see this exact same repeat, but as we have new products, we’ll evaluate that and make sure you guys understand how we’re going to manage that.

Okay. Thank you very much.

Amber, listen, in the interest of time, I think we’re going to take two more questions and then we’re going to wrap things up.
Jim Barrett - CL King & Associates - Analyst

Good morning, everyone. Jim, could you talk about your lead markets? How are your regional and private-label competitors pricing their product relative to a year ago?

Jim Hagedorn - Scotts Miracle-Gro Co - Chairman & CEO

Maybe I'll ask Barry --

Barry Sanders - Scotts Miracle-Gro Co - President & COO

We have not really seen any change, Jim. So I do not think anybody is really taken pricing, which is consistent with where we're at, and we think it's the right thing to do.

Jim Barrett - CL King & Associates - Analyst

And Barry, on a follow-up, any change in the promotional efforts by the mass-merch retailers in support of private-label or store brand, or is it unchanged from last year?

Barry Sanders - Scotts Miracle-Gro Co - President & COO

I would say on the private-label side unchanged, but I think you will see a much more aggressive branded approach.

Jim Barrett - CL King & Associates - Analyst

By your competitors?

Barry Sanders - Scotts Miracle-Gro Co - President & COO

By us.

Jim Barrett - CL King & Associates - Analyst

Yes, by Scotts.

Barry Sanders - Scotts Miracle-Gro Co - President & COO

By Scotts.

Jim Hagedorn - Scotts Miracle-Gro Co - Chairman & CEO

I also think that you're going to see, if we are talking mass, I think the tab support is a very welcome change for the whole category, and I think my understanding is that it is very focused on branded products.
Barry Sanders - Scotts Miracle-Gro Co - President & COO

Branded products, correct.

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Jim Barrett - CL King & Associates - Analyst

Okay, well thank you both.

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Jim Hagedorn - Scotts Miracle-Gro Co - Chairman & CEO

Jim, just to throw in there, because I think it’s important, is that I think us not taking price drove a lot of the fact that even in an increasing commodity period, other people weren't pricing. And just remember, the effect on their margin is much more destructive than it is to us.

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Jim Barrett - CL King & Associates - Analyst

Understood. Thank you very much.

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Operator

Jon Anderson, William Blair.

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Jon Andersen - William Blair & Company - Analyst

Good morning, guys. Thanks for taking my questions. Just a question on the cost side, the restructuring benefit for the full year, what you are expecting there and maybe how much of that impacted the first quarter?

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Dave Evans - Scotts Miracle-Gro Co - CFO

Jon, I'm going back to -- I'm trying to recall the exact number I provided on the fourth quarter call. I think what I described is close to $20 million full-year benefit, and that is a fully loaded cost. So what we saw in the first quarter was probably order of magnitude around a $6 million benefit in our first quarter.

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Jon Andersen - William Blair & Company - Analyst

Okay. And is that separate and distinct from the ongoing supply chain savings associated with the multi-year program that you’ve had going on there?

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Dave Evans - Scotts Miracle-Gro Co - CFO

Yes. It’s absolutely distinct from those savings.

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Jon Andersen - William Blair & Company - Analyst

Terrific. Thanks, guys. I'll see you next week.
Operator

I will now turn the call back over to Jim King for any closing remarks.

Jim King - Scotts Miracle-Gro Co - VP of IR and Corporate Communications

Okay, thanks, Amber. Again, thanks for joining us this morning, and we look forward to seeing you all next Tuesday in New York. Again, if you want to register and you still haven't, you can call my office directly today, 937-578-5622, or send us an e-mail at investor@scotts.com. And we ask if you haven't registered, that you do so by the end of the day on Thursday. Other than that, we look forward to seeing you next week. Thanks, guys. See you guys later.

Operator

Thank you for participating. You may now disconnect.