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PRESENTATION

Operator

Good morning. My name is Ashley and I will be your conference operator today. At this time, I would like to welcome everyone to the third-quarter 2011 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.

Mr. King, you may begin your conference.
Jim Hagedorn - The Scotts Miracle-Gro Company - Chairman, President and CEO

Thanks, Jim. Good morning, everybody. I know we have a lot of ground to cover this morning, our third-quarter performance, our full-year outlook, and our early thoughts about 2012. But before I address any of those points, I want to make some opening comments.

I am now going to sugarcoat the reality of the season. It has been disappointing to say the least. Some seasons bring good weather and some seasons bring challenging weather, but in my entire career, I am not sure I remember a season quite like this.

Setting weather aside, competitive issues also impacted the business this year, especially in the mass merchant channel. Frankly, we have also made our own share of mistakes. I will elaborate on all of these shortly. But whatever the reason, the results were not what we had planned. We revised our full-year guidance and now expect adjusted earnings of $2.95 to $3.05 a share.

By no means am I suggesting you dismiss our results this year. However, I am also not sure there's much benefit to overanalyzing them. I will give you my straightforward assessment in a few minutes and then Dave will provide some additional detail.

But let me say this first. Unlike other shareholders, I have a unique benefit of looking at the business from the inside out and from the top down. I can assure you that I remain confident in the fundamental strength of the category, our brands, our strategy, and our team.

Though we have some cost headwinds to deal with next year, we have tailwinds as well. Weather clearly should be helpful as should new product introductions, the continued benefits of regionalization, significant SG&A initiatives, and improved customer outreach strategies.

I also want to stress that our long-term financial goals are unchanged. While we will have to push our targets out by at least a year, we are no less committed to those goals. And neither is anyone else around here including the Board. Their decision to increase our dividend by 20% speaks to our continued confidence in the business and our commitment to use our flexibility to fund future growth and return cash to shareholders.
So let me switch gears and spend a few minutes talking about the 2011 season from two perspectives. First, the issues that drove our results; and second and frankly more importantly, the key learnings we took from the season. Let’s start with what drove our results.

The first and most obvious thing is weather, which I say drove at least half of our miss. It doesn’t really matter what region you are talking about, the northern half of the US went from soggy and cold to record heat and the season never really materialized there. The southern half of the US started strong. The season got off to a good start both in Texas and in Florida but my mid-spring, both markets were seeing severe weather. In fact, Texas is in the midst of one of the worst droughts ever. And the Pacific Northwest was just lousy all year.

But there’s good news within the numbers. Although consumer purchases for the year are down 3%, we saw solid growth throughout May and the first half of June and remember that consumer purchases were up 13% through mid-March. When the weather cooperated, consumers were engaged in the category.

This is especially true in the home center channel, where about 50% of consumer purchases are made each season. Overall, the channel was about flat from last year, not a bad result considering the weather. The problem was that we just couldn’t string together enough consecutive weeks of positive POS to build any momentum.

The second issue is that we made some big bets midway through the season that did not pay off. After a slow April, we worked hard in May and early June to jumpstart the season. We put more promotional dollars in place and worked hard with our retail partners. But as I said at the outset, I don’t remember a season like this.

The third issue that impacted the season was the performance of our business in the mass merchant channel. All of our research indicates that consumers who shop in this channel want to participate in the category. But what’s also clear is that a higher percentage of these consumers are economically stressed. As a result, some retailers in this channel put more focus on opening and midtier price points than on national brands. That’s cost us shelf space and both us and those retailers market share.

I’m going to come back to this issue in a few minutes because we have some major learnings about our presence in this channel and some steps needed to improve.

So those are the three root causes of the shortfall this year, weather, our bets, and the economic impact being felt in the mass merchant channel. But we also saw some important successes. We had told you we expected a good grass seed season and that’s what we saw. Consumer purchases are up 15% so far this year and we continue to improve the bottom line of this business.

Innovation continues to be part of the story. We continue to see evidence that EZ Seed has terminally changed the grass seed market. Our competitors are already following with similar packaging designs and copycat products albeit ones that have inferior quality.

And the impact of the innovation goes beyond the US. The strength of our grass seed businesses help the international component of our global consumer segment.

This business had a solid year. We saw good growth in most markets driving a 3% increase in topline for the quarter net of FX. That growth rate includes our largest international market, the UK, which was flat after the unexpected bankruptcy filing of a major retailer there.

We have also seen continued momentum with Scotts LawnService. I am extremely pleased with their performance and the opportunities going forward. We are on pace to report another year of record profits. We believe we’ve improved our market share this year and we also continue to make good progress in keeping cancellations under control.
The business model we have created at Scotts LawnService is definitely scalable. As we continue to see topline growth, I believe we will continue to see the opportunities for better operating margins as well.

All in all, Companywide sales in the quarter are down 10% and down 4% year-to-date. The more important question is what we learned from the 2011 season and I will tell you there are three primary insights. First, we need to free up dollars to invest more behind our brands. I have said for years that advertising matters in this category. This year we saw our competitors advertise more, which helped drive this grass seed category in particular.

We hope they and all of our competitors continue to advertise and do more to drive overall category growth. But as they step up their investment, we must do the same. We will take a big step in that direction in 2012, which is a point I will revisit in a few minutes.

The second lesson, we need to do more if we want to keep price-sensitive consumers in our franchise and we have to work more closely with our retail partners in that process.

Over the past two seasons, we've seen significant adjustments in merchandising strategies of retailers that are focused on these consumers. During that time, we have also made changes to our leadership team that works daily in this channel. This is a channel of trade where I believe lawn and garden must have a stronger focus and we are stepping up our efforts to work with our partners in this space to make that happen.

The third insight is linked to the second. In order to provide consumers with value and protect our margins, we must refine our innovation strategy. We don't want to change it but we just need to make some adjustments.

Given the continued economic uncertainty including the volatility of commodities, we have to do a better job of taking costs out of our products. Let me be clear. Our primary focus will remain moving consumers up the value chain. We believe consumers will continue to pay more for real innovation and in fact, it will be an important part of our 2012 plan. But we also have to be more focused on value at the same time.

With that, let me transition and talk about some of our plans for 2012. I want to start with innovation.

In 2012, we are going forward with a major innovation, the nationwide rollout of Snap, our proprietary new spreader and lawn care system. We saw good results from our test this season from Snap and our confidence in the product has increased significantly. Consumers who purchase Snap consistently praise the product and its performance. They tell us it makes lawn care easier and faster. That is exactly what we were hoping to hear. More importantly, they were applying lawn food more frequently.

With a price point of $29 for the Snap spreader itself, we are looking at this as a razor and razor blade model. After two years of testing, we've made some changes in the packaging and price point. We are seeing that consumers typically use nearly three bags of lawn food, a nice step up from the number of bags purchased by consumers of our traditional product.

Also, and this is important, nearly half of this Snap users were new to the category or had been out of the category for at least the last year.

It is too early to give sales projections, but our retail partners are excited by the launch and encouraged by the potential of the product. Our team is working on new in-store displays and highly visible marketing campaigns. This will be one of our biggest marketing initiatives in years and we are confident will resonate with consumers.

While I am talking about our lawn food business, many of you have questioned whether we will introduce MAT-28 next year as planned. If you aren't aware, MAT is a new active ingredient we are planning to bring to the market next year. There is no doubt it delivers far superior performance to anything on the market today and represents a major breakthrough in its environmental
profile. However, DuPont, the maker of MAT, made a professional version of the product available this year and has since acknowledged that trees were damaged by this herbicide. In fact, they announced a return of the professional product last week.

While the action does not affect our registrations, we do want to do more research before we bring it to market. Obviously we want to work in a responsible way not only with DuPont but with the EPA and the states to make sure that the product is appropriate for home use.

While we think our testing will show that it is, we will take a conservative approach and work closely with both DuPont and our regulators.

Some of you have speculated that the lack of a national rollout would materially affect our earnings next year. It won’t. This is a replacement to an existing active to be used in our market leading products, Turf Builder +2 in the north and Bonus S in the South. While I believe MAT28 has the potential to grow the category, we did not plan for a sudden spike in sales as a result of the introduction.

Before I turn things over to Dave, I want to give you some other high-level insights about how we are approaching 2012. We feel pretty good about the topline potential of the business next year. Between normalized weather, new product launches, improved marketing campaigns, and a modest price increase, we should have topline growth of somewhere north of 6%. I am not giving guidance today; I’m just saying that I think is a reasonable expectation.

Let me also give you an update on our approach to pricing next year. We have taken some pricing but have chosen to be more conservative than over the last couple of years. Our goal is to drive category growth and market share over the long term. We have been pretty aggressive in pricing in the recent years but given the increased economic uncertainty and consumer jitters, we just don’t think it is the right move for 2012.

So you will see some pressures on the gross margin line next year depending on where commodity prices go. I don’t see this as a long-term issue but rather a conscious short-term strategic decision.

Most of you already know that we will have some G&A headwinds as well. Given the shortfall on our business this year, variable comp has been effectively eliminated. So restoring that expense is something we will have to overcome next year.

While I am on the subject of SG&A, I want to spend a few minutes talking about a major initiative to change our expense structure. You’ll see in today’s press release that we took a $3 million restructuring charge in the quarter due to some severance. Typically we don’t treat severance as a restructuring charge and wouldn’t do it this quarter if there wasn’t more to come.

You have also heard me say repeatedly that we need to recalibrate our cost structure so we can invest more in advertising and innovation and spend less on the bureaucracy of running our business. To that end, we will be making other organizational changes over the next two months that will result in full-year restructuring charges of as much as $15 million to $20 million. These charges should result in annualized savings of approximately $25 million.

The team here have also been working on a significant effort to drive savings in both indirect purchasing as well as non-revenue-generating SG&A. Over time, these savings could equal the benefit we get from the restructuring effort. Nearly all of those savings will be reinvested back into the business to drive growth.

I want you to understand these actions are not a result of a challenging season this year. We have been working since last summer to identify the savings, understand the implications, and put a plan in place to capture them. And as I said at the beginning, we remain focused on our long-term goals and are not going to let the results from 2011 be an impediment to our progress.
In fact, quite the opposite is true. There are dozens of people walking around this place with a major chip on their shoulders right now and that includes me. But I see this as a huge positive. We are not accustomed to years like this. We are used to setting a goal, exceeding that goal, and then repeating the process and we are focused on getting back to that cadence.

With that, let me turn the call over to Dave.

**Dave Evans - The Scotts Miracle-Gro Company - EVP and CFO**

Thanks, Jim. Good morning, everyone. As I walk through our results this morning, I will focus primarily on third quarter adjusted results from continuing operations unless otherwise stated. And as I walk through the numbers, I will place extra focus on three areas.

First, the decline in gross margin rate is turning out to be greater than we expected. I will explain why and give you an update on our early thoughts for 2012.

Second, we closed on our new credit facility in the third quarter. I will provide color on what it means to our interest expense, capital structure, and priorities for uses of cash going forward.

Third, lower-than-expected earnings will adversely impact operating cash flow for 2011. While that does not alter our long-term expectations or our commitment to investing in the business and returning cash to shareholders, I will provide an update on our expectations for the year.

Before I begin my comments on the quarter, I would like to reiterate what Jim said relative to our dividend. The increase approved by our Board is consistent with the long-term capital structure strategy we have described before. It reflects our continued confidence in the structural competitive advantages of our business and the continued attractiveness of the overall category.

With that brief introduction, I will now begin with a quick look at our topline performance. Consumer purchases of our products at our largest retail partners in the US have clearly been softer than originally expected, down 6% for the quarter to 3% on a year-to-date basis. As a result, replenishment has been soft as well, leading to a 10% decline in Companywide net sales for Q3.

Global consumer sales declined 12% or 14% when excluding the impact of foreign exchange rates. Scotts LawnService increased by 1% and the corporate and other segment reported a third-quarter sales increase of $19 million. As a reminder, sales reported in the corporate and other segment relate to two activities, sales of professional seed in the US, which were excluded from the sale of the global core business, and sales of professional products supplied to ICO.

Both activities in the corporate and other segment have minimal margins which leads me to the next topic, gross margin rates.

Adjusted gross margin rate for the quarter was 37.9%, down 320 basis points from a year ago and for the first nine months, gross margin rate was 37.8%, down 60 basis points from a year ago. Explanations for the decline in rate for the quarter and year-to-date are substantially the same so their relative impacts vary.

For the quarter, just more than half of the decline was driven by unfavorable mix. The remaining decline was driven collectively by higher commodity costs, increased trade promotions, and reduced leverage on fixed manufacturing and storage costs. Cost productivity improvements planned and realized by our supply chain were a partial offset to the significant headwinds we saw in the quarter.

The negative impact of mix was significant as sales declines in the consumer business were disproportionately in higher margin lawn fertilizer and weed control products including Roundup. The impact of these declines was magnified by sales increases...
related to US proceed and sales to ICL, both at minimal margin. About 40% of the negative sales mix in Q3 is explained by the combined impact of reduced Roundup commissions and higher sales in corporate and other.

I realize we have moved the goal posts and gross margin rate twice since the spring. While the impact of higher trade promotion spending, commodities has remain substantially unchanged since our most recent update in June, mix and volume have continued to negatively influence our gross margin rate.

While I'm on the topic of gross margin rate, let me look briefly at 2012. We told you during the last call we expected inflation of about 10% to 13% on the one-third of our cost of goods sold that are commodity sensitive. Based on recent outlooks, that range still looks appropriate though we are clearly in an environment of higher volatility across many of our commodities. And global economic conditions could result in an easing of some of those costs.

We expect to offset the dollar value of currently forecasted commodity increases in 2012 through a combination of pricing, reduced trade promotion spending, and aggressive cost reduction initiatives within our supply chain. While we expect some tailwinds in 2012 from favorable mix driven by stronger lawn fertilizer and weed control sales, assuming more normal weather, it's unlikely we will hold gross margin rate flat in 2012 short of some easing in commodities from levels we have seen this summer.

After we have finalized pricing and programs with our retailer partners and get increased clarity on commodities, we will provide more color on this and the rest of the P&L in 2012.

Okay with that, let me get back to the 2011 results. SG&A declined $7.7 million in the quarter, down nearly 4% versus last year. While there are a number of puts and takes, the decline was primarily driven by lower variable compensation expense partially offset by modest increases in a number of other areas. For the full 12 months, we still expect SG&A to be essentially flat to last year.

I will now shift below the operating line and talk about interest expense, which is $14 million in the quarter, up $2.8 million from a year ago. We still expect interest expense for the fiscal year to be around $51 million, up about $8 million as higher rates attributable to our recent long-term financing activities offset the benefit of lower average debt outstanding.

The news here is our new credit facility, which we closed on at the end of June. This is a $1.7 billion facility priced at LIBOR plus 200 basis points through the end of this calendar year, reverting to a leverage based price grid in calendar 2012. At 2 to 2.5 times leverage, our rate remains at LIBOR plus 200 basis points. Below 2 times leverage, our rate will be 25 basis points lower.

The closure of our new revolving senior credit facility completes the reconfiguration of our long-term financing structure. We moved from a single source of financing, all bank debt, to a combination of bank debt and bonds. And we have moved from a single maturity date for all debt, staggered maturities that come due in 2016, 2018, and 2020. And including the interest rate swaps we have in place, we have fixed either the absolute rate or the underlying LIBOR rate and 60% to 70% of our average expected debt for the next four years.

With our financing needs now secured for the foreseeable future, I want to reiterate our philosophy on uses of cash. But first let me update you on our operating cash outlook for 2011.

Operating cash flow has historically been relatively steady and predictable. This year is an exception. We project operating cash flow of about $120 million for fiscal 2011. Adjusting for the sale of Global Pro, operating cash flow will be about $210 million. That represents a decline from what we originally expected, nearly $300 million, with the difference primarily attributable to the drop-off in earnings.

We expect next year's operating cash flow to return to trend plus some as cash payments for variable compensation, the bulk of which typically occur in our first fiscal quarter will be significantly less than the norm in Q1 of fiscal '12.
Despite the drop in earnings and operating cash flow this year, we like where we are at right now on debt leverage about 1.9 times at quarter end. And our go-forward objective is still to maintain leverage between 2 and 2.5 times. Based on this, we do not anticipate debt repayment as a significant priority for future use of cash.

As we think about future uses of operating cash flow, directionally about two-thirds will be targeted for growth equally divided between capital reinvestment and modest acquisitions. And the balance will be returned to shareholders. In the absence of attractive acquisitions, the amount returned to shareholders could be higher.

You are seeing our commitment to capital discipline through execution of our current share repurchase plan. We have remained active purchasers of SMG shares. During the third quarter, we repurchased 2.2 million shares, bringing our total repurchases to 4.5 million shares since this program was initiated in the fourth quarter of fiscal 2010. In fact, we increased our repurchase program this year by amount roughly equal to the after-tax proceeds from the sale of Global Pro.

We now expect to finish the year with a fully diluted weighted average share count slightly more than 66 million shares with a more dramatic decline in fully diluted share count next year when we get full credit for shares repurchased in fiscal 2011.

As a reference point, we expect to end fiscal 2011 with approximately 61 million shares outstanding before dilutive common share equivalents which will be the starting point for diluted EPS shares in fiscal ’12.

I will conclude my remarks by moving to one final item, some details regarding the difference between our adjusted earnings and our GAAP earnings. Adjusted earnings for the quarter were $126.7 million or $1.91 per share. That compares with $110.6 million or $1.67 per share on a GAAP basis.

During the quarter, we recorded about $8 million for product registration and recall matters. On a year-to-date basis, that number is now $12 million. The charges in the quarter reflect both ongoing costs and reserves established for the anticipated resolution of these matters.

There are two other charges excluded from adjusted earnings this quarter, impairment and other charges of $10.3 million related to our US proceeds business and $3.5 million for restructuring. The proceed charges are nonrecurring in nature and represent the termination of several contracts related to this business the most significant of which related to the settling and contingent purchase price element for a fiscal 2006 acquisition. We expect to be fully out of the US proceed business some time in 2012.

The restructuring charge relates to initial steps taken in the broader restructuring effort that Jim has already described, which we expect to conclude in our fiscal fourth quarter. We are currently projecting $15 million to $20 million in charges for the fiscal year as a result of this effort.

With that, let me turn the call back to our operator so we can take your questions. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Bill Chappell, SunTrust.
Bill Chappell - SunTrust Robinson Humphrey - Analyst

Good morning. I guess first just looking into what you are seeing at the mass retailer side and kind of what changes you're expecting going into next year, just trying to understand, are you permanently I guess impaired at some of that channel and focusing more of your efforts at more of the Home Depot, Lowes or how should we look at that?

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

I will talk for a bit and hand it over to Barry and he can pick it up from there. The answer is no. Mass is an important channel for us and we need to succeed there. The issues in the channel which I think probably you could say belong to both us and the retailers are something that we are in having good dialog on and making progress sort of the merchandising strategy for the channel. But it is something that we can't sort of walk away from and we don't want to. And the retailers don't want us to.

So I think we are making progress on it but we are disappointed in it for sure and I don't think that the channel is happy with the numbers either.

Barry Sanders - The Scotts Miracle-Gro Company - President

Bill, this is Barry. I would add two things. One, where -- that channel would have a higher proportion of economically distressed consumers, so we are evaluating our opening price point in our mid tier products to give them some better offerings. The other is differentiate merchandising strategy. They tend to be non-destination so better convenience items and a merchandising strategy the makes sense for the channel.

And then the third area is how to effectively promote in that channel given that it is a non-destination channel. So our relationship is good. They intend on winning and we are partnering with them and we expect that to turn around going forward.

Bill Chappell - SunTrust Robinson Humphrey - Analyst

Okay, switching gears to kind of gross margin and the outlook for next year, Dave, I understand that you can recover the penny profit but not the margin in terms of pricing. But just trying to understand why gross margins overall would be pressured because I would imagine some of this year had to do with the operating leverage and less volume going through, which presumably would be recovered with a 6% type growth next year in revenue.

Dave Evans - The Scotts Miracle-Gro Company - EVP and CFO

Bill, I'd say I agree that part of the sales mix issue we saw this year we should see some recovery on, assuming normal weather. But I think that where we are going to be more challenged next year is the commodity cost and because of the inflation that we are currently expecting, clearly it's pretty volatile right now. That will overwhelm the benefit we will get from the higher volume that will give us more leverage and the improved mix. It's just a matter of the scale of the numbers that will drive that conclusion.

Bill Chappell - SunTrust Robinson Humphrey - Analyst

And do you look -- I know you lock in your urea starting pretty soon but do you look in to kind of oil, diesel, some of the other things that are pulling back now that maybe lock in a little bit longer than you normally would?
Dave Evans - The Scotts Miracle-Gro Company - EVP and CFO

Yes, so we are fairly fluid on our strategy for locking in. We have been staying on the sidelines until just recently. And I would tell you that just in recent days, we have now been getting into diesel for next spring and within the last couple weeks, are starting to get in the market for urea.

So we have been standing down and I think that has proven to be a good strategy based on what I see today, but we are now engaging to try to get those locked in on a pace more consistent with where we have historically been.

Bill Chappell - SunTrust Robinson Humphrey - Analyst

Okay, then just one last one. I know you're not giving specific EPS guidance for next year but I thought somewhere variable comp kind of related to 10% earnings growth so if we are assuming that variable comp is coming back next year, should that be at least a floor?

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

Barry is nodding his head.

Bill Chappell - SunTrust Robinson Humphrey - Analyst

I hope he is nodding yes.

Barry Sanders - The Scotts Miracle-Gro Company - President

The answer is it doesn't assume things stay where they are, put it that way.

Bill Chappell - SunTrust Robinson Humphrey - Analyst

Thank you.

Operator

Olivia Tong, Bank of America.

Olivia Tong - Merrill Lynch - Analyst

Good morning, thanks. I was wondering if you could give more details on what is sort of going to that 6% plus sales number. How much you expect for the new products versus just a sort of normalized weather year and maybe some other things that go into that number? Thanks.

Dave Evans - The Scotts Miracle-Gro Company - EVP and CFO

Yes, Olivia, at this point we still feel good about our longer-term guidance of total growth over the course of the business cycle, 4% to 6% annually. Given the pressure we saw from weather this year, we feel confident that we're going to be at the high end or above the high end of that range next year. At this stage, though, it would be in August. We are not prepared to provide a
more detailed bridge of a clear range of volume growth for next year other than to say we think that we're going to be at the high end or slightly above the high end of that range next year.

Olivia Tong - Merrill Lynch - Analyst

Perfect. Fair to think then that any actions you may take in the mass channel will be more than offset by the easier comp relative to your -- to a normalized year?

Dave Evans - The Scotts Miracle-Gro Company - EVP and CFO

I'm not understanding.

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

Say again.

Olivia Tong - Merrill Lynch - Analyst

Sure, so is it fair to assume that anything that you do next year to sort of build up the mass channel again potentially hurting the mix on that side, that's more than -- the impact of poor weather versus a say normalized weather next year, that's enough of an offset?

Dave Evans - The Scotts Miracle-Gro Company - EVP and CFO

Olivia, I think there's an assumption in your question that what we would do would be lower margin to build that up and I think that's a wrong assumption. And so as we offer them merchandising and merchandising strategies, we need to do that effectively at what we would consider good margins for our business. So I don't think it would be an offset.

Olivia Tong - Merrill Lynch - Analyst

Got it, thanks. How do you think about spending next year again sort of thinking about the mass channel primarily? Do promo levels have to increase next year? Maybe you could give a little bit more color on some of the things that you are thinking about doing for next year, realizing that plans are not necessarily set yet.

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

Well, we are going to be taking costs out of -- sort of I think what we called the bureaucracy of the business, but call it Marysville, to fund more innovation work. I think completion of regionalization, although that's mostly done, and more marketing/advertising. That we are going to do.

What was the other part of the question? (multiple speakers) Listen, this is one of the areas that I would say we are not totally sure what we are seeing out there. For sure we believe in the lawn and garden business. There was a lot of promotional activity in fiscal year ’11 and that consumers were taking advantage of that.

I think one of the questions we have is how easy it is to wean? So I think what we are looking at saying, the level of promotional activity within the category needs to decline, that that money is better spent on I think what we would think is more sort of traditional brand building activities as opposed to discounting. And I think generally the retailers agree with that.
So I don't see a significant increase in the amount of promotional activity. I think particularly in mass, it has to be done better, more efficiently, and it has to be more impactful on driving volume, which in fiscal year ‘11, it was not. So I think there's a lot of work going into our -- at Scott's and within our BDTs and our retail partners in making that promotional spend more productive than it has been. And Barry?

Barry Sanders - The Scotts Miracle-Gro Company - President

Olivia, I would say we will be less promotional and like Jim said, we will put more money into building our brands. But I think as far as our partnership with our retailers, we're going to work hard at growing the category rather than trading footsteps, which was I think an issue this year.

Operator

Joe Altobello, Oppenheimer.

Joe Altobello - Oppenheimer & Co. - Analyst

Good morning, just a couple quick questions. First for Dave, in terms of the commodity costs you've locked in for next year, what percent of your raw materials need is locked in now and what did that number look like at this time last year?

Dave Evans - The Scotts Miracle-Gro Company - EVP and CFO

Joe, the percent we have locked in right now is south of 10%. The number at this time last year was probably hovering around 10%. So we are low single digits this year. We are just starting to begin buying in the urea and we literally just last week started buying into diesel. Last year at this time we were further ahead because the market looked very different last year, were much further ahead on urea than we are today.

Joe Altobello - Oppenheimer & Co. - Analyst

Okay, but it's not that much of a difference it sounds like versus last year.

Dave Evans - The Scotts Miracle-Gro Company - EVP and CFO

It's not that big. I mean, historically urea is the biggest item that we are buying ahead at this time of the year. We generally start with diesel in October, so we are actually starting earlier on diesel but later on urea.

Joe Altobello - Oppenheimer & Co. - Analyst

Okay, fair enough. And then in terms of the commodity headwinds for next year, it sounds like you are still implying about $60 million, $70 million, $80 million of headwinds next year. Is it fair to assume that about half of that is going to be offset by pricing?

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

$70 million, $80 million, based on what we see today. I think it's a combination of both direct and indirect pricing. It's pricing, and revisitation of some of our trade programs are going to cover more than half of that cost increase. And then the balance
of that cost increase will be coming from the cost productivity initiatives, which I think we’ve got a long track record delivering cost increases in our supply chain.

Those are being further accelerated this year as we are also exploring some of the other things that we are exploring in our broader SG&A cost structure.

Joe Altobello - Oppenheimer & Co. - Analyst
Okay, so more than half coming from pricing, it sounds like.

Jim Hagedorn - The Scotts Miracle-Gro Company - Chairman, President and CEO
There was a nodding of yes.

Joe Altobello - Oppenheimer & Co. - Analyst
Okay, and just one last one if I could. In terms of restructuring, could you give us a little more color on what you’re doing there and how quickly you might see that $25 million of savings?

Dave Evans - The Scotts Miracle-Gro Company - EVP and CFO
So we are currently underway with that. We will take actions this quarter and we would expect to get that value for next year.

Joe Altobello - Oppenheimer & Co. - Analyst
All of it for next year. Okay, great. Thank you.

Operator
Jeff Zekauskas, JPMorgan.

Jeff Zekauskas - JPMorgan - Analyst
Good morning. Urea is really up quite a lot and you spoke about 6% sales growth next year but to offset your urea costs, you are going to have to raise price about 6%, at least if urea costs stay where they are. So why isn’t your sales forecast much higher or are you banking on a decline in urea costs?

Dave Evans - The Scotts Miracle-Gro Company - EVP and CFO
Joe -- I’m sorry, Jeff, so right now we’re looking at the basket of our commodities going up in the range of $70 million to $80 million. So on sales of $3 billion, we would be looking at just north of 2% to 3% pricing. But what we have told you is that -- just in the last question -- we’re expecting to cover between pricing and programs something just north of that. I think it gives you a sense that the pricing we are looking at isn’t anything close to -- I think you might have used the number 6%. It’s low single-digit pricing.
Isn't urea up $200 a ton year over year?

Right now we are seeing urea in call it between $450 and $500 NOLA. So last year, as I recall, it was a moving average but we are probably in the lower $300s. So it's up, what, $100, $150 a ton.

Okay, thank you very much.

Alice Longley, Buckingham Research.

Good morning. Can you just clarify? This is fiscal '12. You are saying gross margins will probably be down and you are going to restore compensation I guess despite whatever the results are and your average (inaudible) ratio will go up. So am I assuming --?

What's the matter with you? You're just trying to pick a fight here. It's -- I think we told Bill that the answer was not no matter what the results are. No, I think we are looking to get back on what we around here call the CFO plan. And so there is an expectation of significant progress getting back to where we should have been. So the answer is no, the incentive is based on some relatively challenging goals.

Are operating margins going to be down next year? It sounds that way.

Operating margin rate down next year, is that what you're asking?

Yes, percentage of sales.
Dave Evans - The Scotts Miracle-Gro Company - EVP and CFO

It's going to be -- so we are going to see some pressure in the gross margin rate and we might see some leverage in the SG&A rate. So I'd say it's unlikely to see growth next year. I think it's too early to say how much -- what the range of any decline would be.

Alice Longley - Buckingham Research Group - Analyst

Probably down, but the SG&A ratio providing some positive leverage partly offsetting the gross margin decline?

Dave Evans - The Scotts Miracle-Gro Company - EVP and CFO

Yes.

Alice Longley - Buckingham Research Group - Analyst

Okay, and then I was unclear about what you were saying with shares outstanding. You said something about 56 million shares. What should we use for shares outstanding for next year? Because the number seemed quite different from what I've been using.

Dave Evans - The Scotts Miracle-Gro Company - EVP and CFO

Well the 66 million shares, what I said for was this year slightly more than 66 million. I didn't give a precise number for fully diluted share count for next year, so what I said was we start the year with around 61 million shares outstanding. Those are basic shares outstanding, Alice.

Alice Longley - Buckingham Research Group - Analyst

Okay, and then you add about one million for dilution, right?

Dave Evans - The Scotts Miracle-Gro Company - EVP and CFO

Well, there's common stock equivalents that get added back and then the other two parts are equity dilution, then we have an offset for continued share repurchases next year. So --

Alice Longley - Buckingham Research Group - Analyst

But some of the share repurchases offset the options -- you know -- is a good number for next year to use the 62 million diluted shares outstanding or something lower because the share repurchase will more than offset the option in exercising maybe?

Dave Evans - The Scotts Miracle-Gro Company - EVP and CFO

This would be very tentative because we are still making assumptions about a share repurchase program for next year. But tentatively I think a number 61.5 million to 62.5 million is probably a reasonable place to be at this early date.
Okay, and what will the interest expense line look like for next year? Because I know that's going up. I've been using 63 million. Is that still good?

Yes, so we really weren’t planning giving detailed line by line guidance on this call going down the P&L. Alice, I’m not sure if anything I've said in prior conversations when we gave longer-term guidance would change at this point. In February, the comments we made are probably still pretty good targets. We saved more this year because we deferred the facility later in the year. But it really doesn’t impact next year. The growth year over year is probably going to be a little bit bigger than what we said in February but the absolute number for next year, that’s a good place to start going back to what we said in February.

And I guess my last question is obviously we are all concerned about weak demand right now and yet weak demand is coming from -- is coming along with falling commodity prices. In making those comments about gross margins for next year probably being down, are you using all prices sort of where they are now or --? What is your assumption?

So I conditioned -- caveat in my comments. They have been moving fairly quickly. We have seen diesel for next spring move substantively just in the last three or four business days. The numbers we are using that we have been talking through are not up to date in terms of the last couple business days. But I'd also say it's a little premature to try to read longer-term trends into what has happened in the next two to three business days.

But what I did say was that global economic conditions could result in an easing of some of our commodities, and so that would be helpful, but we have not built that the last two to three days into these.

You’ve been working with sort of $90 oil?

Can you repeat the question?

Have you been assuming $90 oil?

Probably somewhat north of that, Alice.
Alice Longley - Buckingham Research Group - Analyst
Okay, and then you (multiple speakers)

Jim Hagedorn - The Scotts Miracle-Gro Company - Chairman, President and CEO
Well, well, stop, stop. I want to throw in there this idea of easing demand and maybe you are talking on commodities. I think on consumer demand, I think what's important for everybody to remember is how the business performed when the spring was behaving normally. And so I want to get back to consumer demand in regards to lawn and garden products. And to say we went into call it April 1 like almost up 15% POS. And I've got to say while gasoline prices went up and I think there was a fall in sort of peoples' attitude about the world and the economy in general, a lot of what we had expected to see we did see when the weather was good. And so our hope is that we are not seeing any sort of fundamental change in consumer demand or attitude toward lawn and garden.

In fact, our research shows that people continue to view lawn and garden as a kind of refuge and something they can do and cocoon and at home etc. And so it's just really difficult to read what's happening right now because you look at it all based on sort of the weather or at least what we think the major component was weather and sort of a channel issue.

Alice Longley - Buckingham Research Group - Analyst
Well, if that's true and POS is down 3% this year, why would you assume it's only up 6% next year? Why wouldn't you assume a stronger compound annual sales growth rate over two years?

Jim Hagedorn - The Scotts Miracle-Gro Company - Chairman, President and CEO
Because I'll tell you what, I remember riding around in a car with you somewhere out in the Rockies I think, where you said, never make the promise or never overpromise. Do you remember that? So I think this is a number we feel pretty comfortable with. And -- but listen, we came out of this feeling beat up pretty hard out of this year. And not used to seeing this --. And listen, we just got done with a Board meeting where we are trying to explain what happened. I think we feel pretty good about it that we understand it. But -- and I hope we do, but there's a lot going on in the economy right now and we are just not trying to sort of get ahead of ourselves.

Alice Longley - Buckingham Research Group - Analyst
Okay, and then just one final thing on the urea. Could you give us an update on this idea that more capacity is coming on stream so urea prices will at some point follow?

Dave Evans - The Scotts Miracle-Gro Company - EVP and CFO
Alice, so what we said to be in the past we still believe to be the case, which is we see starting later in 2012 more global capacity coming on line which holding all other variables constant is going to be a positive in putting some downward pressure on (multiple speakers) --

Alice Longley - Buckingham Research Group - Analyst
For fiscal '13?
Dave Evans - The Scotts Miracle-Gro Company - EVP and CFO

For fiscal ’13, because of the way we hedge and the terms we get as you are aware, we always see a delayed impact on that. So yes, it’s more realistic to expect that benefit in ’13.

Alice Longley - Buckingham Research Group - Analyst

Super, thanks a lot.

Operator

Jim Barrett, CL King & Associates.

Jim Barrett - CL King & Associates - Analyst

Good morning, everyone. Jim or Dave, could you even in broad strokes attempt to quantify the percentage contribution to the profit shortfall of the weather versus inefficient promotional spending versus your performance and mass merchandisers?

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

Yes. This is major, major swag, but I think we said that we think that slightly more than half of the miss is related to the weather. Of the remaining call it something less than 50%, probably split about 50-50 between sort of things we worked on that didn’t work out as well as we’d hoped, and this was — and my view on that, just so we’re clear, is the team was highly motivated to try to recapture sales. Had we seen the weather correct, we would have caught that back. It didn’t. And so we put it down as an error. But we tried.

And I’d say about the other — so if that was about half of the half, I’d say the channel was probably the other half or call it about 25% of the miss.

Jim Barrett - CL King & Associates - Analyst

And the follow-up, Jim, within mass merchandisers, could you rank order the promotional intensity by category in terms of where the opening price point competition is impacting your business?

Barry Sanders - The Scotts Miracle-Gro Company - President

Jim, this is Barry Sanders. I would say really the primary area would be the bug and the weed area and then a whole different scenario with what happened with grass seed this year.

Jim Barrett - CL King & Associates - Analyst

Okay, Barry, Jim, thank you very much.

Operator

Connie Maneaty, BMO Capital Markets.
Connie Maneaty - BMO Capital Markets - Analyst

Good morning. I also have questions about the SG&A and restructuring savings. They seem like very big dollar amounts, but there still isn't a whole lot of detail. So what are the projects in the restructuring that you are doing?

And secondly, you said you were saving $20 million to $25 million in SG&A but that's separate from the restructuring. So what's happening there and what is the timeframe on those savings?

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

Let me just -- I'll deal with the first part of the question, which is what is the detail on the first part? We've been working really hard I would say with Denise, Barry, and Dave Evans, who is responsible for the strategy group now, on what we call spans and layers. And as we have simplified the business and gotten rid of things that we didn't think were sort of core to us, we've also taken a look at how many bosses do we need around here and so what is the span of control? So how many layers do we have and what's the span that each sort of call it director and up has?

So the first component, which was the approximately $25 million, taking the charge in this quarter, that's a headcount and that is certain and it's really just related to the project of what we would call spans and layers here. So we think it's important to making the business sort of more controllable and putting -- I'm going to say the senior folks including myself and Barry closer to the action. And so we think the business can be made simpler. We think we can make decisions faster and that agility we think is good for all kinds of reasons and free up money to invest in things that we think are more productive.

The other part of that is what we would call indirect savings and, Dave, if you want to take that one.

Dave Evans - The Scotts Miracle-Gro Company - EVP and CFO

Yes, so the indirect savings are something that what Jim talked about earlier was that is not something we are expecting to realize entirely in 2012. That is going to be more of I'd say over a two- to three-year period. We expect to realize an amount up to or equivalent in value to the restructuring side.

An example of the type of activity we are looking at there is trying to streamline the number of vendors we use across a variety of spending areas, where if we do an analysis for spend, we will find we have bifurcated the spending across a very large population of vendors. It's a simple process of trying to consolidate those, leverage our scale, and competitively bid out the product or service that we're purchasing.

And so it's been a detailed process going through all of our spending, quantifying and prioritizing those efforts, and then examining where -- how long the current duration of commitments we have are today, which is what allows us to schedule out what we can expect to realize in '12, '13, and what may take even into '14 to get in that area.

Connie Maneaty - BMO Capital Markets - Analyst

Okay, and on reducing the complexity, how many layers of management did you have? What are you going to and what's the either headcount reduction number or percentage that you are going to?

Barry Sanders - The Scotts Miracle-Gro Company - President

Connie, this is Barry Sanders. I would say as we looked at the layers, we were up to nine layers. We have taken steps to take that down one or two immediately and we're going to continue to reevaluate that going forward.
What I would also say is it tends to be skewed to the higher-level people in our organization, so I'm not going to go through a specific headcount reduction but it tends to be the more highly compensated people, as Jim has said, that as we have streamlined our business model and our portfolio, we don't need as many director level and above to manage our organization.

Connie Maneaty - BMO Capital Markets - Analyst

If I could ask one different question. On Snap, the spreader price of $29, it seemed to me that when you put it in tests you were looking at price points of $39 to $79 for the spreader. So at this lower price point, did you need to redesign it? Are there fewer features or do you take a loss on the spreader and make it up on bags I guess put into it?

Barry Sanders - The Scotts Miracle-Gro Company - President

I'm going to add a little bit. Then I'm going to ask Jim Lyski to clarify what I'm going to say is -- we did go out of those higher price points, Connie, and what we discovered was that the spreader itself as we spoke with consumers was following more of a durable lifecycle replacement than a new product introduction on other products that we've had. And what we found is that when the consumer buys the product, that we are getting phenomenal scores on the satisfaction with what the consumer is actually using the product and we found that they tend to buy and put down more applications of product than on our traditional bag.

So what we have said is we need to accelerate getting the number of spreaders out there. It puts them in our franchise. It's a proprietary interface and it will allow us to accelerate the lifecycle of the product and ultimately be -- ramp up the sales much faster than keeping it at that $39 or $49 price point.

Jim Lyski - The Scotts Miracle-Gro Company - EVP and CMO

Barry, I think that's spot on. I'd only add that the reason we did test it was to test multiple price points to identify how to maximize the value of the consumer in this franchise. And the number came out to be if we could get to a net $29.99 number via promotion, that is the number that maximizes our total return over the lifetime of the product.

Connie Maneaty - BMO Capital Markets - Analyst

Okay, thank you.

Operator

Mark Rupe, Longbow Research.

Mark Rupe - Longbow Research - Analyst

A follow-up on the Snap system. I know that when you are testing it, it's obviously a different SKU and the retailer has to probably position a little bit differently on the floor I guess different shelf space and the like. How did the stores in the markets that you tested this year, how did they manage the inventory? Was it any different than your regular business? Then just expectations on kind of the inventory management of that product as you roll it out nationwide next year?
Jim Lyski - The Scotts Miracle-Gro Company - EVP and CMO

This is Jim Lyski again. We saw a whole range of ways to merchandise this product and that was another benefit of conducting the test. What we saw was that we merchandised everything from just putting it onto the shelf to an end cap to a total kind of on floor full-in merchandising display and we saw different takeaway rates at the different display types. So we've identified that there is a couple good places to have this, i.e., like an end cap or kind of an on floor display where the uptake is much, much stronger. And we have worked with our salesforce now to identify those best practices and push those out during the 2012 season.

Mark Rupe - Longbow Research - Analyst

Okay, and then on Expand 'n Gro, any learnings on the test that you had in the select markets this year?

Jim Lyski - The Scotts Miracle-Gro Company - EVP and CMO

Yes, we also had learnings on that, too. The first one was once again, merchandising matters. It's a competitive advantage that we have and when we merchandise effectively, we have a good takeaway rate with that product.

The second one is that we are expanding the Expand 'n Gro test to the state of Texas this year. As you guys probably all know, that have had a very difficult weather year with 100-year drought and when Expand 'n Gro is added to the soil in gardens, we see a tremendous performance benefit and so we are going to be positioning the product to be much more oriented towards a soil amendment or just a flat-out garden soil next year the state of Texas and we'll see how that test goes. But all indications are it will be a smash hit in that positioning.

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

Yes, I just want add sort of my two cents. One, I think we were using the product in Europe and saw pretty good results. Second, from an R&D point of view, we have never seen sort of grow and [media] results this good particularly as a soil amendment.

And so this Texas work we're going to do next year, which is to really focus the product a little more on being a soil amendment is sort of reducing the confusion as to what is this product? It's just important to remember, this is a product we have seen crazy good results from sort of how plants grow in this product when it's used correctly. And so this is a major innovation in sort of home lawn and garden agronomy, call it. And we are just spending a lot of time trying to understand and make sure the consumer understands what the product does and then price it accordingly, because it's a major innovation.

Mark Rupe - Longbow Research - Analyst

And then just lastly, how are you guys or how are the retailers approaching the fall business given the difficult summer?

Barry Sanders - The Scotts Miracle-Gro Company - President

From the fall business, it's a brand-new season. The weather has taken its toll on the lawns and I would say that they're going to approach it the same as they have in the past and we expect that the business will be up this fall again the way it has been in the past previous years.

Part of the advantage of the fall is relative to spring business, it's always been a much lower sized business and so there's tremendous upside and the consumer gets the best results if they fertilize in the fall. And so we're going to go out with normal promotional activity and I expect our retailers are going to do the same.
Mark Rupe - Longbow Research - Analyst

Perfect. Thank you, guys. Good luck.

Operator

Jason Gere, RBC Capital Markets.

Jason Gere - RBC Capital Markets - Analyst

Good morning. I just wanted to talk a little bit more about regionalization. Just where you kind of need to keep tweaking the model. It's still in its infancy. Talk about the best practices from some of the regions performing better. I guess the way to look at it is the last couple of years the weather has obviously been in favor and regionalization certainly has played out well. And this year obviously the weather was adversely playing with you. So regionalization, I just wanted -- I guess give a more bigger color like is there bigger tweaks or do you think it's broadly on line with what you set out a couple years ago?

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

Let me start, only because I've got a sort of big attitude on this one. You know, I would say that the biggest thing that is going to happen/needs to happen is that the regional presence are -- this was a year where we just had terrible weather and everybody was just working really hard to sort of survive. The changes that have to happen as we streamline Marysville and continue to push up the regions gets back to regional products or maybe you could change the words to local products designed for local consumer needs. That is really just beginning to happen now. And if you looked at sort of what Jim Lyski and R&D are working on on products or within sort of the M&A side that Dave and his group are working on, what you are seeing is much more of a focus on meeting those needs. And that ultimately is when you are going to see regionalization really work or not is when we have products in the Southeast that are different than in the Northwest.

And that really hasn't happened yet, so I would say we need a little more ornery dudes who are not fighting for their life and actually able to demand the products that they need. But that Marysville has to change as well to be responsive to those products. And that the work that happens in the regions and the work that's going to happen in our marketing group as we recommit money out of sort of call it the bureaucracy of spans and layers into sort of consumer intelligence, which is an area where we are going to spend more money, is getting smarter on the consumer and both doing that locally and out of Marysville marketing.

I think that's when you are really going to see the difference and that's hugely important. But I don't know what you would add. I think that was a pretty good answer.

Barry Sanders - The Scotts Miracle-Gro Company - President

Maybe I will just add a little, Jim. So I would say regionalization is in itself a change to our business model going from a centralized organization to a decentralized organization. Two of the five regions in the US were brand new this year and so they really got their learnings in a really bad business condition. So I think the weather, to Jim's point, set us back as far as getting to the model and the behaviors that we want.

But if you go back to the original business case of what we are trying to accomplish of getting closer to the local consumer, better retailer relationships with the people that are region retailers, and then responsiveness and deploying the ability to manage out into the field, all of those things we remain committed to plus the original business case of those market share opportunities that are out in the region are still there and we are building that business -- the business model to be able to do that.
And so I could go through a list of things that were good this year, much better relationships with the local communities, the local influencers. We are building regional capability to better partner with the states and their regulatory agencies as well as some specific wins across all of the regions with some local retailers.

And then to Jim's point, the flow of product ideas that are coming in here, it's a matter of how much capacity do we have because they are so big of opportunities coming through that we need to prioritize those. So we remain committed. The business case is still there and we had some learnings this year and we will move on and make it better next year.

Jason Gere - RBC Capital Markets - Analyst
Okay, that sounds good. Thanks for the answers, guys.

Operator
Reza Vahabzadeh, Barclays Capital.

Reza Vahabzadeh - Barclays Capital - Analyst
Actually my questions have been asked and answered. Thank you.

Jim Hagedorn - The Scotts Miracle-Gro Company - Chairman, President and CEO
You're welcome.

Jim King - The Scotts Miracle-Gro Company - VP of IR
You want to do one more?

Jim Hagedorn - The Scotts Miracle-Gro Company - Chairman, President and CEO
That was actually the best way to end.

Jim King - The Scotts Miracle-Gro Company - VP of IR
All right. So thanks, everybody, for being with us this morning. If there are follow-up questions or things we didn't get to, you can feel free to give me a call directly. This is Jim King at 937-578-5622. Otherwise we will talk to you again when we report our year-end results in early November. Thanks and have a great day.

Operator
Thank you, ladies and gentlemen. This does conclude today's conference call. You may now disconnect.
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