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OVERVIEW:

Company Summary

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PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to SMG's First Quarter 2024 Earnings Presentation.

I would now like to hand it over to Aimee DeLuca, Head of Investor Relations. Please proceed.

Aimee DeLuca - *The Scotts Miracle-Gro Company - SVP of IR*

Good morning. I'm Aimee DeLuca, Head of Investor Relations at the Scotts Miracle-Gro Company. Welcome to our First Quarter 2024 Earnings Presentation and Business Update.

During our review, we will make forward-looking statements. Please be aware that our actual results could differ materially from what we share today. Please refer to our Form 10-K filed with the SEC for details of the full range of risk factors that could impact our results.

We will also discuss certain non-GAAP financial measures during our remarks. These measures should not be considered a replacement for and should be read together with our results under GAAP.

With me for this morning's webcast are Chairman, President and CEO, Jim Hagedorn; and Chief Financial and Administrative Officer, Matt Garth. Jim will provide an overall business update, followed by Matt with a brief review of our financial results through the first quarter and our outlook for the full year.

Following the webcast, Chief Operating Officer, Nate Baxter; and Hawthorne Division President, Chris Hagedorn, will join Jim and Matt for an audio-only Q&A session. To listen to the Q&A, simply remain on this webcast. If you wish to ask a question, please preregister via the audio link shared in our press release for call-in details and a unique pin.

Please note that today's session will be recorded. An archived version will be published on our website at investor.scotts.com. For further discussion after the call, you are invited to e-mail or call me directly.

With that, let's get started with Jim's business update.

James S. Hagedorn - *The Scotts Miracle-Gro Company - President, CEO & Chairman of the Board*

Welcome, everyone. Jim Hagedorn here. I'm in my office in Marysville, Ohio. We're opening our doors to let you see the people behind our company. We'll also share visuals and charts to help you gain a better understanding of what we're up to. We really love this company, and the better we communicate what we're all about, the better you can share our view.

Let me kick things off by expressing how pleased I am with the progress we've made and the direction we're headed in. We're in a different place from last year. We're running the business the way it should be operated, and that's a good thing. I want to give a lot of credit to the management team, which is entirely new from about a year ago.

The team has created a solid plan for '24 and is developing great strategies for '25 and beyond. They're coalescing and working together well, and that's a good thing, too. We're all aligned to driving top line growth, tightly controlling expenses and delivering on fiscal '24 goals that I outlined on our last call and Matt will discuss later.

Real progress is being made every day. And in fiscal '24, here's what we have to do: Make meaningful headway on gross margin improvement; increase investments in marketing, sales, R&D and our other most competitive advantages; continue to generate strong free cash flow; allocate the bulk of this cash flow to significant reduction in our debt and leverage ratios while paying the quarterly dividend.

The results of Q1 are an early indicator we're on the right path. POS was up over 8% in dollars and units, and we picked up 300 basis points of unit market share in key categories. The lift is due to conservative but favorable pricing actions, along with extended Fall promotions and media investment across Scotts and Tomcat.

SG&A was down 11%, the result of effectively balancing cost control with investments in high-value programs and initiatives. Free cash flow, gross margin and net sales were ahead of our operating plan, setting us up well into the peak of our Q2 load-in.

As for Q1 sales, I want to emphasize that last year's sales cadence is not a predictor of how retailer reloading will go this year. We're shifting back to a more normal load. Retailers are happy about this, and so are we. Inventories are in good shape and order flows are strong through Q2. We're where we need to be.

There's a lot to feel good about in our Consumer business. Everything is reaffirming our outlook for high single-digit growth. Much of this growth can be tied to a top-to-bottom relationship that we have with our retail partners. It's no secret that retailers have been pushing for vendors to reduce prices. We agree that, as commodities ease, prices for consumers should come down.

In fact, our fertilizer and grass seed products were getting pretty pricey last year. We didn't see people trading down because of our pricing. They instead walked away, adopting an attitude their lawns looked good enough.

Pricing does matter to consumers, and margins matter to us. We emerged from the post-COVID years with a margin decline. The best we can tell is retailers came out of this period with significantly higher margins, ours down by a similar amount. We're committed to significant margin recovery, starting with a minimum of 250 basis points this year. This limits our ability to reduce prices. We cannot participate in a lot of cost-outs until we get our margins back and the customer in the mid-30% range.

The good news is retailers understand our need to balance price reductions with margin improvement because of our investment in brands, sales and innovation are good for lawn and garden and the category's growth. This is the basis of the compromise we struck with them.

In exchange for price reductions on select high-margin fertilizer, grass seed and soil SKUs, they're giving us more merchandising opportunities with new listings and increased shelf space. These actions will contribute to incremental volume gains. Some of the growth will also come from price reductions, some of which we put into place last Fall and will expand in the Spring. We know lower pricing did drive incremental POS last Fall.

I'll shift to Spring. With durable sales and foot traffic being challenged at retailers, lawn and garden is critically important to their growth, and this is a space that we own. We'll invest heavily in our brands and sales support to drive engagement and takeaway. These include: High-impact programming and creative; highly focused engagement with our core consumers; messaging delivered by influential celebrities with consumer credibility; and lots of repetition starting in March on mass media, television, streaming platforms, cable, entertainment and radio around major sporting and news events. The impact of our spending and approach is substantial. Each brand will reach its target core consumer audience at least 17 times.

We've increased working media significantly over last year. Miracle-Gro will get 80% more marketing support. And through collaboration with Bayer, Roundup will spend 20% more.

With Scotts, we'll adjust the timing of our advertising and promotions for better lift. We'll allocate 33% more of our spend to peak weeks for Scotts. We are supporting the advertising blitz with powerful creative and celebrities.

Miracle-Gro has an exciting new partnership with home and garden icon, Martha Stewart. She is a multi-generational talent who epitomizes gardening and is the most authentic and influential personality in the space. Martha is an enthusiastic user for our products and is a true believer in Scotts Miracle-Gro.

In lawns, we'll build upon the success of our Scott for Scotts campaign starring Kristofer Hivju from Game of Thrones. Our data shows the creative approach drove strong levels of awareness and breakthrough that are keys for our seasonal business.

The significant build to this year's campaign includes the launch of Scotts Healthy Plus Lawn Food. It promotes overall lawn health through year-round preventive and curative disease control with fertilizer for deep greening. This product will replace SummerGuard, creating a wider application window and incremental POS opportunities.

On the sales front, there's no one better than us, period. To this end, we'll continue to invest in our field sales team and have 10% more merchandisers than last year. We've taken the power of our sales force and hooked it up with Bonnie's team to increase attachment.

Innovation gives us an opportunity for other incremental gains. Miracle-Gro this year is launching an important new organics line. And later in the season, we'll heavily promote the new healthy fertilizer.

Hawthorne was cash flow positive in fiscal '23 and will be again in '24. Over this 2-year period, it's on pace to be cash flow positive by more than $120 million. Hawthorne is a major contributor to our debt paydown.

We have a two-pronged strategy with this business. First is short-term profit improvement and cash flow generation. Hawthorne has the best collection of brands in the industry, and we continue to restructure its product line to focus on the higher-margin and more profitable Hawthorne-owned signature portfolio.

Second is the long-term solution to recapture as much of our investment in Hawthorne as possible and unlock its future value as the market matures. We're exploring value-creating options and potential partnerships that we expect will happen in phases, especially as progress is made on the regulatory front.

The federal government is moving closer to rescheduling cannabis as a Schedule 3 drug to make justice system more fair and reduce taxes on plant-touching business by over 50%. This can be a major catalyst to cultivators reinvesting in their operations. Adoption of the Safer Banking Act is on the table as well, which would give the industry access to normal bank capital. These are potentially significant tailwinds for Hawthorne.

In the run-up to our Annual Shareholder Meeting last month, we reached out to shareholders on proxy issues and for general feedback. They indicated they are pleased with our progress. They want to know if we could accelerate our recovery by about 12 months.

Matt and I continue to evolve our multiyear financial strategy. There is agreement at corporate and among the operating teams as to what the financials should look like. Here's what to expect: 3% annual top line growth, gross margin in the mid-30% range and free cash flow directed to debt paydown that drives financial flexibility and shareholder-friendly actions. We'll share more about our long-term financial plans later this year.

Just as promising as the fact that consumers are engaged, based on recent surveys, they intend to participate at consistently high levels. I'll remind everyone that we outperformed the category in fiscal '23 and this last quarter. All the work we're doing now is the building block of the future and is the basis for our optimism.

In closing, I want to thank everyone for their support, commitment and hard work. Most importantly, I'm grateful for the collective belief in Scotts Miracle-Gro and our vision to help people of all ages express themselves on their own piece of the earth. It's a reminder that what we do matters to people, the environment and communities.

Thank you, and I'll turn it over to Matt.

Matthew E. Garth - *The Scotts Miracle-Gro Company - Executive VP, CFO & Chief Administrative Officer*

Thank you, Jim. And hello, everyone. I'd like to start by sharing some perspective on how the first quarter fits into our full year. Q1 typically represents less than 15% of our annual POS and sales. However, it is an early indicator of how well we're tracking our plan. It's the quarter that lays the foundation for the start of our season and provides important insight into how well our stores sets, load-in and advertising are coming together. Season readiness is our focus right now, and I can say that based on the execution of our marketing, sales and supply chain teams, we're in a good place.

Overall, first quarter 2024 exceeded our expectations, mostly due to the strength of the U.S. Consumer business, which more than offset a slower pace of Hawthorne sales. U.S. Consumer POS was 8% above last year in both dollars and units. This is a reflection of a strong Fall, along with the conservative but favorable price elasticity on key items, such as fertilizers and soils. The takeaway is consumer engagement is pacing well.

As for invoice sales, we were below Q1 of 2023, but this was expected and in line with projections that this first quarter would have shipment levels similar to pre-COVID historic patterns. Again, the aberration in shipments was last year, when we had a heavy early season load-in in cooperation with retailers. Bottom line, we are aggressively managing what is in our control, helping us to return to a more normal state of operating.

Now let's dive into the quarter. Net sales on a company-wide basis were down 22% versus Q1 last year, with a decline of 39% at Hawthorne and U.S. Consumer sales down 17%. Again, the reduction in U.S. Consumer sales is due to the change in shipping cadence. Retail inventories are well positioned for the second quarter load-in following the strong first quarter POS. Retailer inventory units ended down low double-digit percentage in Q1 versus the prior year, which is consistent with our plan.

Hawthorne sales pace has performed similarly to what we saw at the end of last year. While there is no uptick in underlying market conditions to point to, the team is executing on its strategy to narrow the product portfolio to fewer but more profitable brands. This lowers the top line but improves overall margins. So far, this initiative has improved Hawthorne's portfolio mix to 77% signature versus distributed brands from 65% a year ago.

Turning to the full year outlook. We are reaffirming our guidance of high single-digit growth in the core U.S. Consumer business. Our original guidance estimated Hawthorne net sales would be down low single-digit percentages for the full year. That outlook is under review.

To be clear, we will continue to make adjustments to target breakeven or better adjusted EBITDA for the segment. The adjustments are already having an impact. Jim talked about how the segment is cash flow positive. Additionally, the sales run rate for signature brands is outpacing distributed brands by 2x.

Here are a few other points from the first quarter. Gross margin improved 400 basis points year-over-year. Consumables mix increased 400 basis points versus durables mix and stands at 54%.

Given the rapid pace of change in the business and our ongoing actions, we are working on a guidance update to share with you. This includes an update on discussions with potential partners as part of our effort to redesign the business and create maximum shareholder value.

Now let's take a look at gross margins. The year-to-date adjusted gross margin rate for the total company ended the quarter at 13.7% of sales versus 20.1% last year. The reduction was driven by lower volumes and absorption in both operating segments, along with sales of higher-cost inventory.

We continue to expect the full year adjusted gross margin rate will improve by at least 250 basis points as we realize significant Project Springboard savings, lower our distribution costs and drive a favorable segment and product mix. Material costs and fixed cost leverage are also expected to improve slightly towards the back half of the year after we work through approximately $275 million of higher-cost inventories that are mainly in the U.S. Consumer business.

We will have further runway in fiscal 2025 to improve the total company gross margin rate when we are back to full production, driving fixed cost leverage and benefiting from lower-cost inventories. At this point, commodity-sensitive materials are about 65% locked for the year, and total cost of goods sold are about 70% locked, giving us fairly good visibility for the remainder of the year.

Turning to SG&A. The first quarter was down 11% versus Q1 last year and down 26% on a 2-year basis. This reflects Project Springboard progress and significant headcount and project spend reductions. We still expect company SG&A expenses between 15% and 16% of net sales for the current and future years.

As Jim said, we are redirecting some savings into activities that drive value. This includes U.S. Consumer investments directly focused on brand marketing, which will increase $10 million or 12% year-over-year in support of the media strategy.

Interest expense was flat to last year, and we continue to expect it to remain flat for the full year as the benefit of lower net debt is offset by higher interest rates. Interest rates are 72% fixed as of the end of the first quarter under a combination of long-term fixed rate notes and interest rate swap agreements. Note that $2.2 million in other income and expense is associated with the new accounts receivable sale facility. The adjusted effective tax rate in the quarter was 29.5%, and we anticipate full year ETR to be between 29% and 30%.

Finishing up the P&L. Our net loss for the quarter was $81 million or $1.42 per share on a GAAP basis compared to a loss of $65 million or $1.17 per share last year. On an adjusted basis, which excludes impairment, restructuring and other nonrecurring items, we reported a loss of $82 million or $1.45 per share compared with a loss of $56 million or $1.02 per share a year ago.

Non-GAAP adjusted EBITDA for the quarter was a loss of $26 million versus income of $21 million last year, primarily driven by lower volume and gross margin rates across both operating segments. The decline is primarily related to the phasing we have discussed. We are reaffirming our total company EBITDA target of $575 million for the full year.

Now continuing with the balance sheet. We ended the quarter with net leverage at 7.2x adjusted EBITDA, comfortably below the covenant maximum of 8.25x. As is typical with our seasonality, we expect working capital needs and associated leverage to peak at the end of the second quarter, when our covenant maximum will be 7.75x, followed by 6.5x for Q3 and 6x for Q4. Note that we expect to end the year comfortably below the maximum covenant and into the 4s.

Liquidity is strong with over $1 billion of available capacity under our revolving credit and AR sales facilities as we head into Q2. Outstanding debt of $3 billion as of quarter end represents a $384 million reduction year-over-year from reduced working capital needs and reduction of previously purchased inventories. Planned CapEx for fiscal '24 is $70 million, a decrease of more than $20 million versus fiscal '23, with the majority of projects expected to generate favorable ROIC.

We are directing free cash flow to debt paydown and maintenance of our quarterly dividend. As mentioned, free cash flow is expected to meet or exceed $560 million, the balance of $1 billion over 2 years, driven by sustainable annual free cash flow of more than $300 million plus onetime improvements in net working capital balances.

I remind you that everything we're doing across Scotts Miracle-Gro is centered on driving value. This is grounded in our three 2024 objectives.

Generate $575 million in adjusted EBITDA through top line growth, 250 basis points of gross margin rate improvement and a continued tight rein on SG&A.

Deliver $560 million of free cash flow, the balance of our goal of $1 billion over 2 years. This includes managing total company inventory to fiscal 2019 levels of around $600 million. This cash will allow us to deleverage by $350 million or more, along with retaining our quarterly dividend.

And determining a solution for Hawthorne that will capitalize on the future potential of the industry and create maximum value for shareholders.

We are making meaningful progress on each of these objectives, and in doing so, laying the groundwork for sustainable shareholder value creation.

Two notes to finish up on. First, you will find a summary of our annual guidance in the appendix of today's presentation. And second, I look forward to providing you an update on our second quarter at the Raymond James 45th Annual Institutional Investors Conference, March 4 in Orlando, Florida.

And with that, we can move to questions. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Joe Altobello with Raymond James.

Joseph Nicholas Altobello - *Raymond James & Associates, Inc., Research Division - MD & Senior Analyst*

First question, I know it's a small quarter, but maybe talk about some of the drivers of that 8% POS growth. And I guess the follow-up on that, is the full year outlook still flattish? Or is that improving as well?

James S. Hagedorn - *The Scotts Miracle-Gro Company - President, CEO & Chairman of the Board*

Is the full year outlook for...

Matthew E. Garth - *The Scotts Miracle-Gro Company - Executive VP, CFO & Chief Administrative Officer*

POS.

Joseph Nicholas Altobello - *Raymond James & Associates, Inc., Research Division - MD & Senior Analyst*

POS, yes.

Nathan E. Baxter - *The Scotts Miracle-Gro Company - Executive VP & COO*

High-single digits, still...

James S. Hagedorn - *The Scotts Miracle-Gro Company - President, CEO & Chairman of the Board*

Yes. Look, here's the thing. I think I've been outspoken that I was really unhappy with our deployment of marketing support dollars in the fourth quarter. There is a view coming out of the Fall that it worked. I don't buy that.

I think, Joe, what happened is, we had started making deals with retailers and to get some cost out of particular lawn products, seed products and I guess some dirt products. Those prices went into effect in the Fall. The promotion for the Fall, I think, was extended in a good way, I think mostly the retailers. But the price adjustments really worked.

If somebody was to say what was driving that, I would say sort of good promotions at the retail level, our people doing their jobs to make sure the product's in and ready to go. But the price reductions were pretty immediate.

I think when you listen to Matt's words and my words, you heard this price elasticity, price adjustments. Those were negative price adjustments that were part of merchandising plans we were putting together for '24. Those prices went into effect at retail, and I think they worked really well. That's what happened.

Matthew E. Garth - *The Scotts Miracle-Gro Company - Executive VP, CFO & Chief Administrative Officer*

And then when you take a look, Joe, so specific movements year-over-year in the fourth quarter, that 8% lift on POS, as Jim said, driven by, yes, some elasticity that helped us. That was good. And then also the extended positions we had with our retail partners that began in the fourth quarter, you'll see that really pick up as we move into the second quarter.

For the full year, remember, what we said is high single-digit growth on the top line for the company, which is comprised of POS at the core Consumer level staying relatively flat year-over-year. The main drivers are those extended positions that we're getting of new listings and new promotions.

Price will be down, that continues, and we've seen that here in the first quarter. You saw that. But that's being offset by that elasticity. That still leaves us in the high single digits range.

James S. Hagedorn - *The Scotts Miracle-Gro Company - President, CEO & Chairman of the Board*

And still accreting our gross margins by at least 250 basis points. We actually feel pretty good about it. And I think if you look at the share in Q1, I think that's also a reflection of different merchandising programs at the retail level.

Joseph Nicholas Altobello - *Raymond James & Associates, Inc., Research Division - MD & Senior Analyst*

Got it. Very helpful. And maybe just to shift over to Hawthorne. Obviously, the revenue guidance is under review. But has your outlook on that segment's profitability changed since you left your EBITDA guide unchanged at $575 million?

James S. Hagedorn - *The Scotts Miracle-Gro Company - President, CEO & Chairman of the Board*

Here's what I would say. I think I saw your note this morning and we withdrew guidance. I'm sort of sorry about that because profitability will be higher, Margins will be better. And nobody has changed the cash flow targets. That's something we've been doing -- and that's what I focused on in my talk.

I'm not sure if you said profits are the same or higher. Cash flow is good and important for the business, and they're in the middle of sort of trying to figure out our go-to-market strategy. And if you look at what's happening with, I think, what they call our signature brands, which are our brands, the business is pretty good. I think it's the distributed brands that we're kind of moving from.

I think what you're seeing in those numbers is part just nonrecovery. I think we can't sort of hide that, I don't know, did I use those words? It was in my script there, that the market recovery is elusive or something. What may have been in the Annual Meeting script, is that the recovery in hydroponics remains elusive. But it's being accentuated by the fact that we're making choices in what we push and sell.

Anything you want to add, Chris?

Christopher J. Hagedorn - *The Hawthorne Gardening Company - Division President*

Yes, sure. Look, Jim already said it. But the revenue call down, as Jim mentioned, a result of us taking a hard look at the portfolio and making decisions, I think, that are important for our business to focus on brands and products that are just higher profit for us. And those are, in many or most cases, our signature products.

It's about really leaning out the offering, making sure that we're selling brands that we can make good money on and we can support properly, and looking at the health of the business through that lens.

James S. Hagedorn - *The Scotts Miracle-Gro Company - President, CEO & Chairman of the Board*

And Joe, I think that from my point of view, without a doubt, the operating team, Chris and Tom and the group of men and women who operate with them. They are enhancing the profitability of the business. And part of that is they're making choices then on being the best Hawthorne they can be based on where the business is at right now.

I continue to be optimistic about the business, and I think I talked about that, which is that there is a lot of our business or the biggest part of our business is lighting. When we talk about a move toward consumables, away from durables, that just means that there is just a drought of capital to improve these growth facilities.

And rescheduling to 3, let's just assume that happens. I think it's gone from HHS to DEA, the President supports it. I think that what you read, and I think the politics of it is, it seems to us it's likely to happen.

And it's not that it's perfect, the Schedule 3 is a perfect place. But what it does do is it solves the issue of 280E. And instead of having 80-plus percent tax rates, you go back down into sort of, I don't know, 20s, call it, at the federal level. That will significantly increase the profitability of legal growers. That's a lot of money.

And if Safe Banking, which I think the Senate side is good, the House is a little hard to predict now. But I think that it has passed the House numerous times. Safe Banking, where there's access to capital, to like real bank capital at proper prices, which is probably half of what today people in the alternative credit market are sort of -- that will be -- both of those things will be really positive. And we believe that there's years of capital investment in these growth facilities that's overdue. And I think this will be really good for the business.

What my concern, and this is that Chris and Tom and the teams down there, they want to be good citizens here. And they're not messing around when it comes to doing the things they think need to be done to enhance the profitability of the business.

And you might listen to that and say, "Well, of course, that's such a good thing." My concern is that we not let waste the things that are really important on the innovation side. And a lot of that is in lighting and nutrients, how to use these products, all the supplies that go into it, genetics, that these are really important parts of the future. And this business is in a very weird artificial sort of politically driven place where no one who's legal can make money. I think the future is very important to it.

This is the tension that exists between me and the operating team. I think Matt is somewhere in the middle.

Matthew E. Garth - *The Scotts Miracle-Gro Company - Executive VP, CFO & Chief Administrative Officer*

I have to tell you, actually, the way that you just went through that and the conversations we've been having internally, I think it's fair to share with everyone. We put out a long-term model for what Scotts Miracle-Gro is, right? 3% top line growth, we can get into that. Margins back into the 30s. We really didn't talk about Hawthorne.

It's because there's so much future potential that exists. And by and large, it's kind of being ignored today, and ignored in our equity, ignored in others' equities. And it's a construct of a very difficult environment to make money in. And like we said, the ability to apply capital in that marketplace is very difficult right now.

Opportunity abounds as you move forward, but it is hard to put into place right now what's right. But what we do know, whether it's the Scotts model or the Hawthorne model, investing in the future, the things that we know, innovation, marketing, our sales force, those pay off.

James S. Hagedorn - *The Scotts Miracle-Gro Company - President, CEO & Chairman of the Board*

And Joe, sorry for the long answer, but this is one that we have been talking about a lot. We had a Board meeting last week. We're sort of believers in the future. And what -- Chris and Tom are operating in today's world, which is a little more short term. And that's not meaning that, that's where they want to be. But I think they have to operate in our family here, in our community, and they want to add to it.

Now the part of the script where we talked about cash flow, which is over 2 years, more than $120 million of free cash flow coming out of Hawthorne, that is a major contributor. They aren't complete reprobates. And this business is going to get better. And we have a lot of -- I guess we'd call it deal-making. But we have a lot of stuff that we can't really talk about right now, but you're going to start to see.

I just don't want the business to become kind of what I keep telling them, is a circus curiosity, where we allow ourselves to become small enough that we're kind of irrelevant and the things that are going to drive value in the future, we let escape.

Christopher J. Hagedorn - *The Hawthorne Gardening Company - Division President*

One, I mean, we have this conversation in an earnings call, but here we are. So non-total reprobate speaking. Look, to be clear, the choices that Tom and the team and I are making to be good corporate citizens and to return a sort of requisite level of profitability into the enterprise. I think we've done it with a really high awareness of the things that have made Hawthorne unique and special and the most -- I think the most successful business in the hydroponics space to this point.

And we have no interest in losing those things. And I would say it's innovation, it's the investment we put in our brands and our sales force. It's the work that we've done in collaboration with Scotts on the government relations side to try to affect some of the change that Jim is talking about with rescheduling.

We're very sensitive to maintaining those aspects of the business that we do believe are unique and continue and have to be for Hawthorne to remain the business that it was, and I think still is, despite the results. So we're trying to make some very conscious and intentional choices.

But look, there is that tension and balance between -- I mean, it's healthy, between, again, just a baseline level of short-term profitability without sacrificing the future potential of the business. And that is really going to be achieved, as Jim mentioned, through partnerships that we can't quite talk about yet, but we think have a huge amount of potential to help us get through this period while, again, not becoming reprobates.

Operator

Our next question comes from William Carter with Stifel.

Unidentified Analyst

This is Andrew on for William. Just wanted to really quickly ask, and maybe I'm nitpicking here on the SG&A guidance that you said. I think you said 15% to 16%. I thought it was 14.5% to 15% last quarter. So was that a change through either some incremental marketing dollars or whatever and that would have to be a stronger U.S. Consumer profit performance that you've got modeled in there? And did that influence the higher advertising?

Matthew E. Garth - *The Scotts Miracle-Gro Company - Executive VP, CFO & Chief Administrative Officer*

Good catch. So we are going to be on the low end of that 15% to 16% range. And so that's -- it's kind of in the context of how we're building the long-term model for the company, which is 15% to 16% of sales, getting back to that normal rhythm of conversation. But you're right. It's going to be on the very low end of that range. And it does embed in it the things that we have talked about. Sales are going to be up this year, dollars in SG&A are going to be up this year.

The key drivers there are the 3 areas of focus that we have: marketing, innovation and our sales force. Everything else that exists in SG&A, we are working on maintaining or reducing. And so that is creating the room to keep that percent of sales low currently and long term and afford the increases in the areas that drive value for the company.

Unidentified Analyst

And second question I wanted to ask because you're now at, I think, you said 77% of Hawthorne is signature brands. I guess, first off, just to give a kind of help us with the road map of 30%, not sure if you'll break it out. Could you give us the margin differential between U.S. Consumer and Hawthorne and then also signature and distributed?

And then the second piece is, do you still see value in being in the third-party distribution business? I think when you bought something like in '18, a lot of that was due to visibility to get more scale, but is there still value with kind of how the category has changed over the last 6 years?

Matthew E. Garth - *The Scotts Miracle-Gro Company - Executive VP, CFO & Chief Administrative Officer*

Yes. And I think, Andrew, look, we don't break out a lot of that, that you just asked. But let me give some trajectory here. Right now, the overall margins for the company are by and large, reflective of U.S. Consumer business. And as we guide for the full year, that will be the case as well. Hawthorne coming through the period last year when you saw us with an EBITDA loss of about $48 million, moving to breakeven or profitability. And as Chris said, they're driving towards profitability.

That will create some positive gross margin that is going to be in the kind of, call it, mid-single digits. And that's not guidance, do not model that out. That is a waypoint on where that business should be, which is much closer to the overall corporate margins, but that will take time. So that's kind of the lay of the road on the margin side. You asked a lot of questions on some decisions that Chris and the team have made. So I'll let Chris speak about that.

Christopher J. Hagedorn - *The Hawthorne Gardening Company - Division President*

Yes, Andrew. Look, we are -- it's not that we are uninterested in being a distributor of third-party brands. We're interested in making money on the work that we do. And the reality is, there were a number of brands, there are a number of brands in the category, some of which we still distribute, some of which we are no longer distributing, that have been extremely low, 0 or even negative margin products for us.

Now there were products that when we did the Sunlight deal and through the explosive growth we saw through '20 and '21, they were products that they increased basket size, and they helped in some other ways. As the category shrunk, there's just -- there's -- those considerations have changed for us. So it's not so much that we are philosophically opposed to being a distributor of third-party products. It's that we have to have programs in place that allow us to make money on those products.

And we've had challenges there. Now obviously, when able, I think our #1 preferred course of action is to work with third-party vendors to establish programs that there's enough profitability for obviously the vendor, the manufacturer, for us and the retailer ultimately and to remain competitive. But as things have compressed, they forced some tough choices for us. So again, we are just -- we are focused on profitability. And without getting into detail, obviously, our signature portfolio is significantly more profitable than the vast majority of our distributable.

James S. Hagedorn - *The Scotts Miracle-Gro Company - President, CEO & Chairman of the Board*

Andrew, Jim here. I -- first of all, I think that was a really good question, okay? I'm not sure we're completely ready to answer that. And I think as we hopefully soon announce new relationships that it sort of starts to make sense. But as we have been searching for partnerships for Hawthorne for sort of strategic scale -- and we've talked to, I would say, the usual suspects. The thing is everybody is looking to do the same thing. It's not like everybody is like, oh, we need to be -- we need even more SKUs.

I think everybody we talk to is basically interested in the same thing, sort of fewer SKUs, higher gross margins, less inventory. And I think -- so what I'd say is it was a real good question. And I think you'll probably hear a lot more of this in maybe the next call or the call after that, where it starts to become clear.

As we prepared for this, we've been pretty explicit about what we're looking to do. And I don't want people to sort of misread what we said and where we are. But what's clear to me right now is that this structure or this Hawthorne is an important piece of this cannabis business, particularly on the supply side. And that the solutions for us and for other people we would partner with, it's a puzzle.

And it seems like it's more complicated. Part of what I would say is I don't want people to say, you say some, and then you take it back and you say, you take it back. No, it's not like that. What it is, it is this Rubik's cube is we're still messing around with it with other important people in the space trying to figure out how to do things that works for everybody. But there is a lot of progress.

I would just tell you that we can't announce right now. And I think that -- we have leaf touching parts of our business, at least through our relationship with RIV. And I think there's progress on both sides of the business in ways that I think people will find interesting and impressive.

But it just -- and some of those things, we're still dealing with the puzzle pieces and trying to do it. And we're not operating a puzzle by ourselves. We're operating puzzles with other people, and it has to solve for them as well. I'd say good progress, and Chris and Tom and Matt and Dimiter are all doing really good work right now, and impressive. And I get to play a little bit with them on it on the kind of the vision side.

And I don't know, it's hard. It's like speed dating sometimes. but we know what Hawthorne is. And I think if we kind of look back a little bit to kind of the decisions on distribution, it is sort of dealing with the short term and profitability that -- in the Rubik's cube, Hawthorne profitability matters a lot when you're in sort of dating -- dowry -- dowries are always important.

That's also driving some of this stuff, which is that -- live in today's world because when you're dealing with the Rubik's cube puzzle, the other people on the other side, they are absolutely living in the same world that everybody else is. People are interested in when you talk about something, it's a positive as opposed to like scratch your head and say, what? Lots of good work happening, and just good question.

Operator

Our next question comes from Jon Andersen with William Blair.

Jon Robert Andersen - *William Blair & Company L.L.C., Research Division - Partner & Research Analyst*

I want to shift gears back to the consumer business, U.S. Consumer. Were sales in line with plan in the first quarter relative to your plan? And I had a ton of questions about the full year guide, which calls for 10% or so volume growth. And that volume growth, I understand, is based on new listings. But why should we think that new listings say, a fourth phasing of the same item be as incremental as listings you had a year ago? So can you just talk about kind of how you progressed through the first quarter relative to budget? And then why the volume guidance makes sense in terms of incrementality if it's just listings driven?

James S. Hagedorn - *The Scotts Miracle-Gro Company - President, CEO & Chairman of the Board*

Okay. I'll start, and then I think Nate can sort of pick it up and Matt can clean up anything we said wrong. North America, first quarter outperformed. So that's an easy one. They beat their numbers pretty well. So that's good. The sort of believability in the numbers -- first of all, I'm not sure we're using double digits. I think we're saying high single digits. But we don't need to quibble on -- I don't know what the numbers are 8, 9, something that is probably what I think the numbers are.

I'd start, Jon, by saying -- because we know exactly what we're taking over, So new listings aren't really new listings. There are new listings people had before that we got that we knew exactly what the volume was. There's no guessing really on that. This is just what it was worth. Now it's ours, It's not just new listings because it's additional promotional support of stuff that wasn't promoted before, and we have products like that where they advertise something else that they don't advertise it.

You get promotional support, which is their own advertising plus discounts and promotional periods where we had none before or it's incremental on top of what we did have before. If we did have promotion, it's more. I know that people say, what? But our view is that, that's just meat and potatoes translation. That's not -- nobody is, I think, being super -- I think if anything, they're probably conservative. But I don't know, Baxter?

Nathan E. Baxter - *The Scotts Miracle-Gro Company - Executive VP & COO*

Yes. So Jon, just to comment on Q1, that 300 bps of growth we saw was really focused in 3 key areas. It was rodents, it was birds and it was some selective weed. We had a good extension on the Fall. I know Jim was unhappy with the first part of the Fall, But like magic on October 1, between some of the promo, media and weather, that's really where we saw the lift.

Talking about the growth we expect over the year, the depth of new listings, aside from additional shelf space with existing listings, we've got healthy, we've got Miracle-Gro Organics. We've got full distribution of buyers' new dual action Roundup. We have pretty significant increase in private label soils, and then we have our new MAX fertilizer line.

So beyond just additional shelf space of existing listings, we actually have a pretty healthy pipeline of new innovation that's coming into the market. I'll turn it over to Matt just to make any final comments. But I think we're feeling very comfortable. And by the way, just to repeat what Jim said, our plans were built bottoms up with the retailers. So this is not a gas. It's a partnership with our retail partners.

Matthew E. Garth - *The Scotts Miracle-Gro Company - Executive VP, CFO & Chief Administrative Officer*

That's a great emphasis on that last point. Thanks, Nate. From a modeling perspective for everyone, let's base ourselves on a few things. We expect the POS, that plan question to be about plus 5%. In Q1, we actually came in plus 8%. So that's good, right? That's the beat that both Jim and Nate are talking about. As you build up the full year, let's get through the nuance that's happening, which is volume up 10%, yes, sales up high single digits. The difference being, the price down that we guided you to, which is going to be about -- well, we said low single digits, but I say that is 1% to 3%, so call it, 2%.

Let's build this bridge. We are expecting no difference in the activity of the U.S. Consumer year-over-year. That's on the positions we held last year or the positions that we are taking and share this year. You build on top of that price down 2%, elasticity and some other small growth areas that are on existing brands of about 2%. Those 2 things offset. What Nate and Jim talked about between listings, new products and new promotional activity and expanded promotional activity, that's plus 8%. If you think high single digits is kind of 7% to 9%.

Jon Robert Andersen - *William Blair & Company L.L.C., Research Division - Partner & Research Analyst*

Okay. That's helpful. I have got 2 more. One is just clean up. On the retail inventories, I think you commented that units are down double digits as of the end of the quarter. Does that get you back to a more normal level? Or is that lower than historical norm? I'm just thinking about the implications for the seasonal build here in the fiscal second quarter.

And if I can just tag on a final 1 around the leverage. The covenant does step down from 8 1/4 to 7 3/4 during what is your seasonal working capital peak. So what needs to happen in 2Q here from a working capital perspective, cash gen, EBITDA in order to stay within the boundaries of that covenant?

James S. Hagedorn - *The Scotts Miracle-Gro Company - President, CEO & Chairman of the Board*

Let's reverse that. I put this as a little bit of cheating, my man. You put like the big Mondo question sort of hitting at the end thing saying just 1 more thing. Why don't we get that off first, which is the pinch point for leverage at the end of Q2.

Matthew E. Garth - *The Scotts Miracle-Gro Company - Executive VP, CFO & Chief Administrative Officer*

And you detailed it perfectly, which is, right, it does step down from 8 1/4 to 7.75%. We said this is going to be our tightest across the leverage profile for the next couple of years here in the second quarter of 2024. What does that mean? It means that we are in our working capital build, you are right. Inventories go out. We are creating AR. We don't necessarily get paid here in the second quarter, so working capital is high.

EBITDA is also growing. We've talked about, the difference in phasing that we are experiencing year-over-year. Last year, if you recall, the first half of the year was kind of mid-50s, high 50 percentages. This year, it will be closer to 50%. You have some shifts between the first half of last year, the first half of this year.

But what that does mean is that second quarter here in 2024, you're going to have a good EBITDA trajectory, and that will help you with the room. But the room, as we've said, is the tightest. Across the period, across the horizon, we've given ourselves about a half to a full turn in every period in working with our banking partners. That gets tighter in the second quarter because of the needs for that working capital and also the change in trajectory that we have coming from last year into where we want to be this year.

It is manageable. We have multiple levers in place that extend anywhere from additional efficiencies that we're driving, additional spend controls that we have in place and additional partnering that we can do with our retailers on the timing of shipments and where and how we are promoting. And so that is work that is being done and we'll manage that as we get closer to the end of the quarter. But right now, we are feeling good about maintaining compliance and we have good space to maintain compliance here this quarter. And then as we've said, that broadens out pretty significantly as we move through the rest of the year and expecting peak to end this year in the 4s.

James S. Hagedorn - *The Scotts Miracle-Gro Company - President, CEO & Chairman of the Board*

Let me just throw in just on that. The discussions with our banking partners that delivered that touch point or that squeeze point or that kind of square corner, that was not accidental. I think that was a commitment they wanted us to make. We knew that going in, they're saying this is what you need to do. We know that. When I say in the script that we're not running the business to what we did last year, this is not a sort of weekly, monthly managing leverage, which is the world we lived in last year. This is really this 1 point we're dealing with.

Inventories at retail are very healthy. And we have not been in kind of deal mode to push product in the store. There are opportunities and contingencies we have to solve. We went into the year knowing that was going to be our closest point, we built a plan that people are comfortable with. We have outperformed that plan, and we have contingencies in place if we need to move. I think that -- it doesn't get much better, but it is kind of an artificial square corner in the aviation world. People don't like square corners and curves. But it was, I think, imposed a little bit. And we're absolutely capable of managing around it.

Nathan E. Baxter - *The Scotts Miracle-Gro Company - Executive VP & COO*

Yes. I'll just comment on the first question. Jon, on retailer inventories, we're right on plan. I thought I heard you say down 10%, but we're down 5%, which is exactly where we want to be. It's aligned with the retailers. Remember, we've got a target hitting final year-end inventory of around $600 million. We are going to, in partnership with our retailers and our supply chain team, focus on making sure that we've got the inventory ready for load-in. I think the retailers are in a good place. We're looking at probably 150 million units that we need to ship in Q2, and we are right on track with that.

Matthew E. Garth - *The Scotts Miracle-Gro Company - Executive VP, CFO & Chief Administrative Officer*

And just to put a final emphasis on that. The way we've talked about retailer inventories over the past year, they are high. They're higher than they like to have, and they are working down those positions, and that is reflective in everything that we've been doing last year in terms of lower production and this year in terms of keeping that production low. We do expect that they will normalize their inventories back to what they usually do is some percentage of POS, it's around 15% of POS. Currently, it's around 16%, 17%. There will be a natural drawdown on retailer inventories as we make it through the year. That is built into our plan. That is why we are saying it's healthy, and that's where we get the drive to say inventories are going to be reduced this year, the Scotts inventories. Retail inventories will also be reduced this year.

Jon Robert Andersen - *William Blair & Company L.L.C., Research Division - Partner & Research Analyst*

That's all super helpful. I'll squeeze 1 more in.

James S. Hagedorn - *The Scotts Miracle-Gro Company - President, CEO & Chairman of the Board*

1 more?

Jon Robert Andersen - *William Blair & Company L.L.C., Research Division - Partner & Research Analyst*

Yes, sorry. 2Q. So again, it's difficult because there are so many puts and takes. But are we looking at a quarter where EBITDA could be up year-over-year than in the second quarter in order to work through the leverage capital?

Matthew E. Garth - *The Scotts Miracle-Gro Company - Executive VP, CFO & Chief Administrative Officer*

Yes. We don't guide to that kind of stuff. Here's what I'm going to do. The phasing here is really important, right? If you look at U.S. Consumer, so last year in the first quarter, we did about 13% of our sales for the year. This year, we did about 10%. In the second quarter of last year of '23, we did about 48% of our sales for the year. This year, it will be between 40% and 43%. That should help you because incremental margins are staying roughly the same, plus a small benefit as we're phasing that across the year, you'll get your normal SG&A moves that we phase in with sales. The answer is, potentially.

But the real way that this plan is built is on EBITDA dollar expansions in the second half of the year, when you'll see higher shipments, higher sales and also the realization of the activities that we have on margin expansion and the beginning of the lower cost inventories, that will dip into towards the end of the year.

Operator

Our next question comes from Chris Carey with Wells Fargo Securities.

Christopher Michael Carey - *Wells Fargo Securities, LLC, Research Division - Senior Equity Analyst*

I told myself, I dare not ask more than 1 question on this call, but I think I'm about to ask one...

James S. Hagedorn - *The Scotts Miracle-Gro Company - President, CEO & Chairman of the Board*

After Andersen, you could ask 20 at this point.

Christopher Michael Carey - *Wells Fargo Securities, LLC, Research Division - Senior Equity Analyst*

I think I want to ask negative questions now.

Unidentified Company Representative

Okay, come on. Let's go, Chris.

Christopher Michael Carey - *Wells Fargo Securities, LLC, Research Division - Senior Equity Analyst*

Just how about this? Just quickly on the balance sheet. So obviously, you're going to be running tight in the fiscal Q2. Can you talk about contingencies if you run tighter than expected? And really what I'm just asking here is, I think you have an accounts receivable facility. How much is on that? And is that included in your leverage calculation? So that hopefully is a relatively quick question.

I think the sort of maybe broader question is, what's your visibility on mix in your U.S. Consumer business for this year? Mix was a real headwind to the business, both top line and margins last year as your lawn care, growing media really underperformed. And so you're talking about visibility with shelf space and POS, and I hear you there. What's your visibility of the mix is going to come in as you expect? Do we need to be worrying about weather? Or does the shelf space gains that you've had give you some confidence that again, mix won't be this volatile factor in the model of what we saw last year? So thanks for that broader question and the confirmation (inaudible).

James S. Hagedorn - *The Scotts Miracle-Gro Company - President, CEO & Chairman of the Board*

I'll take the beginning and then probably leave it to Matt. But I think if you said Q2, it is probably an execution question more than anything. It's not really a POS issue. This is really deployment of inventory into the field for the second half, which is when consumers are buying products. And just to put into context, we haven't asked retailers to do anything, okay? If we needed to, just to put it into context, you're dealing with maybe a couple of days of sales. That's it. That's the solution to stuff is like a couple of days of sales move into Q2 if we need help. We're trying not to like actually in sight like additional discounting.

But seriously, the sales at that point of the year are so high at the end of the quarter that it's -- when you say contingencies involve what. There's probably some internal stuff that we can do. But it's a couple of days of sales. It's not asking really a lot. That's all you have to do, is move a couple of days of sales and pull it forward and you cover that.

Before everybody gets all weird, it's like this is a couple of days of sales. And the issue is just if you get a giant snowstorm or something like that where you're not able to deliver, that's the kind of stuff that would set you back that has to be corrected for. I think this is not like anything that's hard to understand. It's just moving the product into the field. And if the numbers get big enough and you have a blizzard in the Northeast, what do you do about it? Nate and his teams, without a doubt, have this under control.

Matthew E. Garth - *The Scotts Miracle-Gro Company - Executive VP, CFO & Chief Administrative Officer*

I think the big picture view is, as Jim did, the appropriate place to start on it, which is as we forecast right now, we've got a quarter to 0.5 a turn of room. And the reason that we're telling everyone, it's the most acute period -- it's the tightest period, it's because we've had kind of 3 quarters to a full turn in every quarter over the past couple of quarters. So that's really what we're alerting you to. Jim has it spot on.

We're talking about it. It's the beginning of February. We're managing it. And everything that Nate and his organization are doing is geared up to execute against the forecast we have, and we'll manage the unknowns. To say that we're comfortable, I feel comfortable. It is a risk. We're being transparent as always, and that is the Scotts way. Feel really good about managing the covenant, feel good about executing in the quarter, feel good about being able to capture the margin. As Jim said, the first half is largely us. It's the second half where the consumer comes into play, and it's probably a good point to transition over to Nate because that's where you can talk about some of the mix, some of the weather and some of the insights that you've been driving that are different from where we've been previously.

James S. Hagedorn - *The Scotts Miracle-Gro Company - President, CEO & Chairman of the Board*

Look, I just want to talk just really briefly about team. This is a new team. This is their first full season together, and from my point of view, 1 of the things that makes me feel really good about this is that Matt and Nate are like all over this. What they're telling me is we got this. I think you can believe that. I think that's the right answer for us, is we got this. You all know how we lived last year. The fact that we're dealing with like tightness at the end of the quarter as opposed to for an entire year, and that we don't really have to sort of talk about leverage.

We're making leverage a major part of our strategic planning. When I said we want to accelerate leverage reduction 12 months, we're not joking around. This is more right now discussion talks with our Board, development of incentive plans for '24 and '25 that say how much do we need to do to take leverage down, call it by a turn within our strategic planning period, call it, 3 years. And we're working really seriously on this.

Matthew E. Garth - *The Scotts Miracle-Gro Company - Executive VP, CFO & Chief Administrative Officer*

An additional turn.

James S. Hagedorn - *The Scotts Miracle-Gro Company - President, CEO & Chairman of the Board*

Additional turn. Yes. When they say they got it, I'm actually very confident and it makes me feel good about these 2 gentlemen working together is that this is not some stressed out conversation. They are working through it. Sales is a big part of that. Supply chain is a big part of that. I think it's very important that you guys not overreact to sort of a 1-day period that we lived through for every day last year. I'm going to say we got this.

Nathan E. Baxter - *The Scotts Miracle-Gro Company - Executive VP & COO*

Yes, Chris, let me comment real quick. Q1 mix was favorable from a core perspective, and we do attribute that to the October, November sort of extended Fall. The sales team's mandate is to make sure that we're constantly working the mix to be more favorable. But let me take a step even further back, just to talk a little bit about what we're doing differently. Jim mentioned it in his prepared remarks, but Matt and I, I mean, this company is being run totally differently.

So let me give you a few examples. We're delivering these results with a supply chain that has about 2.5 million less square feet of distribution and warehouse space. How are we managing to that? We're leaning into data analytics. We're using a lot of predictive modeling to help us understand not only week to week, but quarter-to-quarter and from a full year outlook, what the highest probability factors are. And I know we always talk about weather, and it is important, but it's not the most important. There are a lot of other factors, including consumer sentiment, promos. Again, what Jim talked about, we're feeling really good about the load in the season. we are feeling even better about our media and creative that's going to bring consumers into the stores. We're making good investments, and we're making smart investments. And I won't go back to the numbers that Jim talked about on the prepared remarks, but we feel very, very comfortable that we're going to be able to deliver to that full year forecast based on that.

And the other thing I'll leave you with is because we're using these type of predictive analytics, our ability to make adjustments real time is on a totally different level than it was a year ago. And we are constantly doing that. So again, a day or 2, yes, we're praying for no snow late March, but we've got contingencies and we've got a supply chain and the sales team that's ready to flex with that.

Matthew E. Garth - *The Scotts Miracle-Gro Company - Executive VP, CFO & Chief Administrative Officer*

Chris, also the Treasurer just ran in and handed me something because I didn't finish the answer to your question, which was, we sat in the room and then he traded it around the front of people to be fully transparent, which is the Scotts way. We had $140 million drawn on the AR facility. It's a $600 million facility. We have $460 million left that we could draw on in Q2. Remember, that is treated as cash collections. It is not treated as debt. It is off balance sheet. And so that is all formative to helping us on a net leverage basis.

Operator

Our next question comes from Peter Grom with UBS.

Peter K. Grom - *UBS Investment Bank, Research Division - Director of Equity Research & Analyst*

So maybe just 1 clarification to 1 of Jon's questions just on the phasing. So the 40% to 43% of full year sales in 2Q in U.S. Consumer, does that kind of imply like a mid- to kind of high single-digit decline? I just want to make sure I heard that right. And then just kind of bigger picture, the mid-30% gross margin target, just in the context of where we've been, it's a pretty remarkable improvement. Can you maybe provide some guardrails or thoughts on an appropriate time line and on kind of when that can be achieved?

Matthew E. Garth - *The Scotts Miracle-Gro Company - Executive VP, CFO & Chief Administrative Officer*

Phasing first. First half of this year, we'll do kind of 52%. First half of last year, we did 61%. I gave the breakdowns on Q1 versus Q2 this year and last year. So yes, that, and you heard it in our prepared remarks, you've seen it in the press release, was the driver of the volumes down year-over-year in the first quarter. They will be year-over-year in the first half. You have that right.

The margin build is, as Jim said, something we discuss almost every single day. There is a heavy discussion and emphasis right now on scenario planning around what the future of Scotts can be. And you saw us today put some markers into place as to what that looks like, 3% top line annual growth. We'll get into what that 3% really is probably at our Investor Day later this year. The margin build is actually a little more pedantic. It's a little less exciting, frankly, because we will have some natural releases from where we stand today on a raw material basis and on a fixed cost leverage basis.

Let me give you the big blocks here. 23.7% last year, we said up 250 basis points. I say up 250 basis points, Jim says, up 250 basis points plus. Don't read into that, he just wants more, which we all agree we're going to drive for more. That leaves you around 26%. You guys can do the final math. Therefore, to get back into that mid-30s for the company, you need to see that fixed cost leverage piece, which includes everything from distribution to absorption, to just being much more efficient across every single facet of the operation, that will be roughly half of the closure to bridging that gap.

The other piece is really the raw material release. And you've heard Jim talk about it in his prepared remarks. We have been able to, over the past few years through COVID, price for raw materials, but we haven't priced for the margin that we typically have. That's in itself been margin dilutive to the company. As those raw materials are now declining, we are going to maintain as much pricing as possible so that we can accrete back as much of that margin as possible. And that's the other gap closure to getting back to where our target margins are.

Operator

Our next question comes from William Reuter with Bank of America.

William Michael Reuter - *BofA Securities, Research Division - MD & Research Analyst*

I just have 2 quick ones. Hopefully. The first is in terms of the -- your long-term leverage target, I don't think I heard the number 3.5x on this call. Does that continue to be that target? And what is the timing of when you think that you could achieve that goal? That's it.

James S. Hagedorn - *The Scotts Miracle-Gro Company - President, CEO & Chairman of the Board*

Look, I'll let Matt correct. It's the (inaudible) about being a CEO, at our Board meeting last week, I asked Matt -- there's a lot of really good things happening in the American business. There's a lot of change coming sort of in the Hawthorne and the cannabis side. There's a lot of hours of conversation right there that are engaging in real with the Board. And we use January as kind of a prep session for August where we kind of present a renewed 3-year strategic plan. Remember the 3-year part because that will matter here.

I asked Matt, when I looked at the first version of the agenda, it just sounded like a regular Board meeting, and I wanted it to be more than that. I wanted it to be a real discussion about the things that we're going to be doing over that 3-year period. And some of it has changed. We got a brand-new guy running the Consumer business. We got a lot of stuff happening on the Hawthorne side. But Matt's been here, like, I don't know, a year, call it. And I said this is time for you to present your version of what our financials need to look like over -- probably more than a 3-year plan.

It needs to be 1 that the operating team isn't like making faces and giving him the finger. It needs to be a cooperative plan that people buy, but it's really Matt starting to put his fingerprints on our financial strategy. And for the first time, having been at the company long enough to know where he's at and know the team. And he did a really good job, by the way.

It was really important to this discussion we're having. My knowledge of this subject is a little keener than normal just because we've been talking about it so much. And I don't want to get sort of ahead. But I think at the end of sort of the 3-year period, I think notionally, the numbers would have been about 3.5, something like that. If you've been listening, this idea of accelerating it by 12 months, you could sort of read that as an additional turn out of the leverage from where the sort of current plan rolls up to about 3.5 to 2.5.

And what needs to happen to do that? And this is 1 where I have to look both at all the business operators and Matt and say, what is this going to require of us? I don't know, it's somewhere between $60 million and $100 million of additional incremental EBIT. And I said, do not tell me unless it's achievable, and we can develop plans around it. And I think the team has not shied away from this. That does not mean we have all the plans in place.

But I think this does answer to your question, which is where we were at the end of our sort of current plan and then my challenge to them to go faster, which is, in part, we heard from our shareholders and my family wouldn't say anything different, which is hurry up, I think, a theme that we're trying to be responsive to.

And in addition, we're having very significant conversations right now, live, like today, with our comp and org committee about developing long-term incentives that are tied to achieving these goals. I don't know, Matt, where you would take it from there?

Matthew E. Garth - *The Scotts Miracle-Gro Company - Executive VP, CFO & Chief Administrative Officer*

Which everything is aligned. This is a big statement -- with how we see driving shareholder value into the future and getting to our net leverage target which, yes, it used to be 3.5. Jim and I have kicked around, given the volatility of the environment, given the risk that is in inflation rates, given how we want to manage this company going forward? Would 2.5 to 3 be better? Of course, it would be better. So putting plans into place to not only accelerate deleveraging and also look at getting to a lower target level, let's say, 3 to 3.5 is where we ended up. That's the mission.

But what does that allow us to do? This is not just the financial strategy. This is the Scotts model that is so super exciting. And Jim and I have been saying to Nate and his team we're going to sustainably give you pockets of expense so that we reinvest in what is Scotts Miracle-Gro. What is our purpose? Grow more good, make everybody feel great about their own piece of the earth and be able to enjoy it to the maximum level. That requires innovation. That requires marketing. That requires a sales force that's differentiated. Those are our moats. And strategically, that's what drives an extremely high free cash flow yield that Scotts Miracle-Gro can deliver.

Now what we do with that cash, what we've said is we delever in the short term, and then we return to shareholder-friendly activities and investments to sustainably grow that free cash flow into the future, which will, in turn, be used for higher shareholder-friendly actions. We feel really good about the near term. And we feel exceptional around the future for Scotts Miracle-Gro and for what we can deliver to shareholders and creating value both for our consumers and for our shareholders. And that's what this long-term plan is about. And so everyone here in this room is shaking their head up and down. Well, nodding their head up and down.

James S. Hagedorn - *The Scotts Miracle-Gro Company - President, CEO & Chairman of the Board*

Look, and part of this which is included in here is very strategic investment in the business. For instance, within the plan we're developing, the assumption is at least a 50% increase in brand support, at least a 50% increase in innovation support. And so these are big numbers. This is not acting short term. This is long term. And by the way, mid-30s is historically where we ought to be. This is not reinventing anything. This is just coming out of COVID. And demand was a little squirrely, particularly on the cannabis side, but cost of goods pressures were really significant. Where we're seeing that recovery, we will naturally unwind that.

But it gets back to the math that Matt threw out there, you're dealing with kind of 900 basis points of margin we're at while making these investments. And again, not everything is solved for, but I think people understand the major buckets that they're going after, and nobody is hiding. And this is a really good thing for this team. The team is working together really well. And I was really sad about Mike moving on and Denise. I didn't know like how it was going to be.

But the team has really come together well. You guys -- I'm sort of desperate to get you guys out to show off to people here. And it's not just the people around this table right now, there's a whole level down of people who came out of last year, beaten up pretty bad, dude. Incentives weren't paying out, the equity was in the frigging toilet. You know what I mean. And we made a lot of personnel changes, particularly at the senior level.

King used to say a spring in their step or something. It would show up in my scripts a lot. But I think there is a kind of hoity attitude developing in the business kind of everywhere. It's a pretty good feeling place right now. And the plans we're talking about, which will go back to value creation guys, at the end of the day, nobody wants the thought price here. And I think we know what we have to do. And if the markets are rational, we will recover a lot of share price. And that's kind of how we get paid. And I think what you guys ought to want from us. But we're doing this in a way while if you look at the things that drive value, our ability to execute in the field, our sales force, our relationships with the retailers all the way up to the CEO level. We have the crazy brands. We're going to be investing in all that stuff.

I think Matt sort of said it, which is if you want 1 of those things, you probably have challenges on spending less. But I think a lot of that work has already happened. And people have sort of gotten used to their Ozempic diet, but we're investing in the future.

Operator

Ladies and gentlemen, this does conclude the Q&A portion of today's conference, and it also concludes the conference call itself. We thank you for your participation. You may all disconnect, and have a wonderful day.
