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SMG - Q4 2013 The Scotts Miracle-Gro Company Earnings Conference Call

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OVERVIEW:

SMG reported 4Q13 sales of \$443m. Full-year GAAP earnings were \$161.1m or \$2.79 per share. 2014 sales growth (including Tomcat) to be about 2-3%.



CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Good day and welcome to The Scotts Miracle-Gro fourth-quarter conference call. Today's conference is being recorded. At this time, I would like to turn the conference over to Jim King. Please go ahead, sir.

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

Thank you. Good morning, everyone. Thanks for joining us for our year-end conference call. With me here in Marysville this morning are my colleagues, Jim Hagedorn, Chairman and CEO; Barry Sanders, our President and Chief Operating Officer; and Larry Hilsheimer, our CFO, as well as other members of the management team.

Jim is going to get started in a few moments with some brief remarks that put the results we announced this morning in context. He will also share some initial thoughts about 2014. Barry will then provide a more detailed look at the business performance for 2013, including a breakdown of consumer purchases by category.

Finally, Larry will walk through the numbers and will elaborate slightly on our early thoughts for 2014. We will then turn the call over to you for Q&A, but in the interest of time, we ask that you ask just one question and just one follow-up.

Before we get started, I want to remind everybody that we will be hosting our Analyst Day on December 13 in New York. Given the proximity of today's event to that meeting, we are going to keep our comments about 2014 to a minimum during today's call, so please keep that in mind during the Q&A session.

As far as Analyst Day, the event will once again be held at the Waldorf-Astoria in New York. We already have almost 90 people registered for the event. So if you haven't already done so, please register at investor@Scotts.com or by calling my assistant, Heather Scott, at 937-578-5968.

We will provide more details about the meeting in the weeks ahead, but this year's event will likely be shorter than in the past. We will probably get started around 9.30 am or 10.00 am. Presentations will conclude prior to lunch, and then we will conduct a Q&A session during the lunch.



As I said, we are still working on the details and will communicate more to you shortly before Thanksgiving.

Okay. Let's move on to the call. I want to remind everybody that our comments this morning will contain forward-looking statements, and as such, actual results may differ materially. Due to that risk, Scotts Miracle-Gro encourages investors to review the risk factors outlined in our Form 10-K, which is filed with the Securities and Exchange Commission.

As a reminder, this call is being recorded, and an archived version of the call will be available on our website. And if we make any comments related to non-GAAP financial measures not covered in the press release, we will provide those items on the website.

With that, let me turn the call over to Jim Hagedorn.

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

Good morning, everyone. Some years you know by the end of May whether you are going to hit your numbers or not. Other years you don't know until the very end. This year was the latter.

After a ridiculously late start to the season, we work like dogs all the way through the summer until the fall, and it wasn't until September that we could relax a bit and catch our breath. But in the end, even with lower topline growth than we originally expected, we accomplished what we set out to do. That is due to the work of the people sitting around the table with me here in Ohio, as well as thousands of others around the world.

I'm not going to go through the details of the business units; I will let Barry cover that in a few minutes. I want to use my time with you to provide some context around our performance and to begin to frame up how we are preparing for the future.

The headline today is that we delivered earnings of \$2.79 per share, slightly above the range we outlined at the beginning of the year. But the real story is the execution by the team and the focus we maintained on delivering on the commitments we made to you guys and our shareholders.

15 months ago we told shareholders we would budget conservatively in 2013 and focus on driving margin improvement and cash flow. We said we would delever the balance sheet and adopt a bias of returning 2/3 of our cash to shareholders. We said the remaining 1/3 would be used to grow the business, including acquisitions that were easily integrated into our existing operations, and we said we were striving to get the business back to record levels of profitability as quickly as possible, perhaps as quickly as two years. Every major action we took in fiscal 2013 was in keeping with those commitments.

In our core US business, we drove significant profit improvement in a flat category while maintaining overall market share. Barry will provide the details shortly.

In our international business, we successfully executed a restructuring effort in Europe that will result in higher profitability next year. And at Scotts LawnService, we continued to see mid-single digit sales growth and continued improvement in operating margins.

On a Companywide basis, we delivered gross margin improvement of 100 basis points; operating margin improvement of 260 basis points. Our leverage ratio of 2.05 times at September 30 was nearly a full turn improvement. Inventory at year-end was reduced by 22%. Our inventory management helped drive operating cash flow to \$340 million, which was better than we had expected. In terms of using cash, last quarter we announced a 35% increase in our quarterly dividend, and in recent weeks we began repurchasing shares under our existing \$300 million authorization.

Finally, in the first week of our new fiscal year, we announced the acquisition of Tomcat, a strong brand within the controls category that is immediately accretive to our business.

Like I said a moment ago, we were focused on making good on the commitments, and we did.

I want to focus a few minutes on how we delivered the results, despite such a rocky start to the year. And it comes down to one word -- people.



Last year we had the strongest March in the history of the Company. This year the performance in March was atrocious. Weather kept the season at a standstill in every market, except the West Coast. We entered April with a year-to-date decline in consumer purchases of 28%. To say we were behind our internal plan entering the second half of the year would be a dramatic understatement. But to their credit, our team spent several weeks in the summer of 2012 wargaming various outcomes for the season. And so, when we got off to a slow start, no one panicked because they had confidence in their plans.

The sales team stayed focused on execution and keeping retailers engaged. The marketing team adjusted the timing of media buys so we weren't chasing near-term sales that were unlikely to materialize. The supply chain team adjusted production schedules that allowed us to manage the plants efficiently, to reduce our inventory and to make sure we continue to meet the needs of retailers. And the entire organization activated contingency plans that had been agreed upon months earlier.

Just about every week in the third quarter, year-to-date POS results improved. And by the time we hit Q3 conference call, POS on a year-to-date basis was flat. We finished the year with essentially flat POS, gross margins slightly below our original guidance and SG&A savings in excess of our guidance. That resulted in operating margins slightly better than we had anticipated.

We said entering Q4 that we were trending toward midpoint of our guidance of \$2.50 to \$2.75 per share. We updated that outlook during our investor conference in mid-September, saying likely we would finish on the high-end of our guidance range. We exceeded the high-end because the team kept focused on execution all the way through the fall season and because our associates managed SG&A just like it was their money.

So I am pleased with what we did, and I am pleased with how we did it. At the peak of our season, we have about 7000 associates. Every single one of them contributed to the success we had in 2013. I want our shareholders to know the importance of their contributions, and I want to thank them for a job well done. But I want to remind both shareholders and our associates that we still have work to do. So let me use that transition to discuss 2014.

I want to start by saying our view of the market really hasn't changed that much. While our core consumer remains highly engaged, category growth continues to be a challenge. So absent events beyond our control, we see 2014 playing out similar to 2013.

As a result, we are planning for the core business to be flat. We will drive for a better result. But just like 2013, we won't plan for it. So including the benefit of Tomcat acquisition, we are forecasting companywide sales growth of 2% to 3%.

In year two of Project Max, we continue to see gross margin improvement and the opportunity to further reduce inventory. As Larry will explain, SG&A will be a slight headwind. And so, as you saw in the press release, we expect to see EPS improvement in the range of 10% to 15% next year. If we are able to hit the high-end of that target, it would constitute nearly a 60% improvement in earnings per share over a two-year period.

All of us here believe there are significant opportunities to do even better in the long-term. So while our planning and guidance for 2014 will be conservative, we are aggressively working behind-the-scenes to put ourselves in a better position to drive category growth and market share improvements, starting in 2015 and beyond. With input from our executive team, as well as our Board, my focus is beginning to shift toward the longer-term. Relying on my love of aviation, I have told the team it's time we need to throttle up, and you will hear me talk about that more at our Analyst Day in December.

So what exactly does that mean? There is no doubt that we were caught by surprise when macroeconomic factors that seemed to pass us by in 2009 and 2010 begin to catch up with us in 2011 and 2012. While we made the right decisions not to chase near-term growth in 2013, we are convinced that longer-term growth is out there. And in terms of where that growth will come from, here are a few examples.

We like our Scotts LawnService business a lot. And not only do we see strong organic growth opportunities, but also the ability for high-margin acquired growth. The natural and organic market continues to grow quickly, and it is finally starting to feel like we can be players here. We have tests throughout the United States in 2014 with the new line of organic products under our Miracle-Gro business, and I am confident we will be even more aggressive in 2015.



The move from the suburbs into the city is real, and we stood up a team with the singular focus on urban gardening. This is a big opportunity.

Live goods is another area we continue to see potential, and we have expanded distribution this year with one of our partners in branded livegoods.

For those of you who don't know, grass seed is our oldest business, about 110-years-old. But the scientific advances we are making right now in grass seed are by far the best in the world, and we continue to see big opportunities here. And even in slower growing core businesses like lawn fertilizer, we are looking at exclusive formulation and active ingredient changes that would improve the consumer experience and provide an opportunity for new excitement in that category.

I can't tell you today how much each of these growth areas could generate, but I can tell you I am convinced that each of them is real. As we look ahead, it's with the realization that in order to fully leverage these and other growth opportunities we must maintain financial discipline. We will continue to focus on margins and reducing costs, but we will not starve our brands or existing businesses. We will continue to invest in innovation, and we will not walk away from our focus on driving total shareholder return in a way that includes returning cash to shareholders.

So that's what you will hear from me and other members of the team in December. As Jim King said, it's likely to be a shorter meeting in the past, but I think it will be very rich in content. So if you haven't registered yet, you should. I think you will find it time well spent.

So at this point, I will turn the call over to Barry to talk about the specifics of our performance, and then Larry will quickly run through the numbers. Barry?

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

Thanks, Jim, and hello, everyone. Since we have been so detailed in explaining the business throughout the year, I will try not to be redundant. I will talk about POS trends, market share trends, retailer support and inventory and my view of how we are positioned entering 2014.

On POS, as Jim said, it was all about the second half. Consumer purchases of our products were up 6% in the fourth quarter with improvements in nearly all areas of the business. From branded lawn fertilizer, POS was up 6% in the quarter and increased 1% for the year. Grass seed declined 8% in the quarter and was flat for the year, reflecting weakness in the overall category. In both of these categories, we believe we gained share against our largest competitors.

In our soils business, POS was up 6% in the quarter and was flat for the year. And excluding a few categories where we exited, our market share was down about 1 point in soils.

Mulch continued to be a good story for us. Market share increased several points in this category. POS was up 30% in the quarter and 11% for the year.

More importantly, we saw significant profit improvement in the business in 2013. By creating a more vertically integrated supply chain for mulch, we significantly improved our margins in about half of our manufacturing plants. We have opportunities to continue strengthening margins in mulch next year as we continue to evolve our supply chain.

It was an up-and-down year in the controls business. Recall that Ortho and Roundup were the two strongest businesses we had in 2012, a year in which they both improved more than 5%. In 2013 POS for Ortho declined 1% in the quarter and 6% for the year. And in Roundup, POS was up 17% in the quarter and flat for the year. In both businesses, our battery-operated applicator allowed us to gain share in the ready-to-use business. However, we saw some share erosion in the concentrate and ready to spray business, prompting both businesses to see modest share losses overall for the year.

In aggregate, market share in the US was essentially flat after a 200 basis point improvement last year, and that was our expectation entering this year. From a net sales perspective, the US business saw a sales increase of 15% in the quarter and down just less than 1% for the year.

We finished the year with retailer inventory just slightly ahead of the year ago, and as the season winds down through this month, retail inventory should continue to decline. That puts us in good shape as we prepare for a new season.

The story on the international consumer business was much like the US. They got off to a slow start, but rallied in the second half. Sales in the quarter were up 2%, and we finished the year up 1%, excluding FX.

More importantly, as Jim said, the European team successfully implemented a meaningful restructuring of the business. Our goal is to reduce SG&A in the European business by about 10%, and we have confidence we will hit that number over a two-year period. While the European market is hardly robust, we continue to believe we have hit the bottom and that we will continue to see slight improvement for our overall international business as we go into next year.

Finally, in Scotts LawnService, we continue to execute successfully against our plans. Sales in the quarter were up 7%, allowing for a 5% improvement for the year, perfectly in line with the guidance we've provided.

We continue to see improvement in customer account, in customer satisfaction, in retention rates and in market share. Operating margins in the business are now solidly above 11% compared to just 4% a few years ago.

In 2013 we begin testing in home pest control service in Florida, and we are pleased with what we saw. A few minutes ago, Jim said we remain committed to acquisitions that are easy to integrate in our existing business. I will elaborate further and say that SLS will likely be a focus of acquisitions in fiscal 2014.

Like Jim, I don't want to elaborate too much on 2014 today. I will save that for next month. But I do want to tell you I'm encouraged by the level of retailer support we continued to enjoy in both the US and our international business. Our line review discussions with retailers has gone well. They remain supportive of the category, and they are supportive of our brands.

As was true a year ago, I'm confident in the plans we've put together entering another season. We are taking a conservative approach to those things we can't control and taking a more aggressive approach to things that we can control.

As a result, I, like Jim, Larry and the other members of the team, believe we can continue to enhance shareholder value in 2014 and beyond.

With that, I will turn to Larry to walk through the numbers.

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

Thank you, Barry. I will cover a few topics this morning, beginning with our fourth-quarter and full-year results with additional details on adjusted gross margin rate improvement and SG&A savings.

In addition, I will provide an update on commodity costs and some high level comments on our outlook for 2014.

Fourth-quarter sales rose 10% to \$443 million, driven by the US consumer business, where sales were up 15% in the quarter. Outside the US, sales increased 2% in the quarter, excluding the impact of foreign exchange rates. Overall, sales in the Global Consumer segment increased 12% compared to the same quarter a year ago. Scotts LawnService sales rose 7% during the quarter. For the full year, sales in the Global Consumer segment were flat, while lawn service sales increased 5%, which, as Barry said, was in line with our external expectations.

Also as expected, gross margin was a good story for us in both the quarter and the full year. The adjusted gross margin rate improved 350 basis points in the quarter as a result of increased pricing, favorable commodity costs and other cost efficiencies, primarily related to Project Max, along with increased sales volume.



For the full year, there are a lot of moving pieces in the gross margin rate. Increased pricing was the primary driver of the 100 basis point improvement. Project Max efforts are also a good story. Going into the year, we said we expected product cost out efforts would contribute about \$15 million to \$20 million to gross profit. We actually slightly exceeded that target. These efforts provided cost benefits in the second half of the year, which offset expected higher material costs related to inventory in the first half.

During the quarter, SG&A decreased 6% to \$140 million. For the full year, we had SG&A reductions of \$44 million, a decrease of 6% compared to a year ago. The year-over-year savings in both the quarter and the full year were mostly due to benefits of our Project Max initiative. Decreases were partially offset by higher year-over-year costs for variable comp. Below the operating line, interest expense and tax rate were in line with what we expected in both the fourth quarter and the full year, and we ended the year with a diluted share count of 62.6 million shares.

Reflecting the seasonality of our business, the fourth quarter has historically been a lost quarter, and this year was no different. Adjusted loss from continuing operations was \$11.1 million in the quarter or \$0.18 per share compared to a loss of \$36.4 million or \$0.59 per share a year ago. For the full year, adjusted income from continuing operations increased 40% to \$174.4 million or \$2.79 per share, which compares with \$124.9 million a year ago or \$2.01 per share.

During the year, we've talked about restructuring charges related to our efforts to improve the profitability of our business in Europe. In total, we incurred about \$9 million in restructuring charges for the full year.

Separately, we recorded a non-cash adjustment resulting in a partial impairment of \$11.6 million as a result of our annual impairment review process of our Ortho business. When you include these one-time items, our GAAP earnings were \$161.1 million or \$2.58 per share compared with \$113.2 million or \$1.82 per share a year ago.

Now let me address a few balance sheet items. As we have already discussed, we are very pleased with the year-over-year change in inventory levels. While we don't expect to duplicate this level of reduction in 2014, we do expect to deliver a moderate decrease in inventory as we maintain our focus on working capital and a plan to return to a consistent inventory story going forward.

Cash from operations was about \$342 million in 2013, well above our original projections, primarily due to better-than-expected inventory management. As we previously noted, we recorded a nonrecurring cash benefit of \$37 million from the recovery of taxes overpaid in 2012, which also favorably impacted cash flow. In addition to strong operating cash flow, we reduced our leverage ratio during the year and increased our quarterly dividend by 35%. Our focus on shareholder-family actions will remain core to our near-term thinking as we continue to drive shareholder value.

I want to switch gears and talk a little bit about 2014. Like my colleagues, I will elaborate in December, but there are two items that I think need immediate attention. The first is gross margin.

We have seen some estimates in recent weeks that lower commodity costs, specifically from urea, could represent a \$0.25 benefit for us next year. Yes, it is true that urea prices have fallen sharply, but this impact is nowhere near the level that some have estimated.

To start, it is important to remember that we have a total of more than 30 commodity inputs. And as we have said many times over the years, urea represents only about 4% of the total cost of goods. Right now about 75% of our urea needs are locked for next year, and we will see some nice savings there.

However, those savings will be offset by higher prices for grass seed, sphagnum peat, packaging and a few other inputs. As it relates to the overall gross margin rate for next year, our thoughts right now are for improvements consistent with what we reported for 2013. That's still a great story as it will continue to give us some strong leverage for the P&L, and it keeps us moving forward on the path toward historic margin rates.

The other area I want to discuss related to next year's SG&A. Last quarter we were asked if our Project Max savings would be sustainable for 2014. We said that those savings would be sustainable, and that remains the case. However, the reduction in SG&A for the full year went beyond Project Max objectives, and some of those savings will likely reverse and result in some headwind for 2014.



Specifically, our advertising spending for the year was less than we had expected. As Jim said earlier, the slow start to the season resulted in pulling back in a number of areas that included advertising.

So, as we look into next year, we would expect to see advertising and marketing costs slightly higher. That fact, coupled with higher investments in other areas such as R&D and people development, means that SG&A will increase next year.

So roughly speaking, the 10% to 15% earnings growth is this -- about 2% to 3% sales growth, including Tomcat; gross margin improvement roughly in line with 2013; SG&A will most likely increase slightly higher than sales growth; and I want to stress that variable comp, which is embedded mostly in SG&A, would be roughly in line with 2013 if we hit the midpoint of the current earnings range.

We are not going to elaborate any further on our 2014 expectations today. However, in December I will share a much more detailed look at next year, including updates on capital structure and uses of cash. As I'm still getting to know many of you, I hope to see you in person in New York next month.

Now let me turn the call back to the operator to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Joseph Altobello, Oppenheimer.

Unidentified Participant

Hi, this is [Christina] on for Joe. I just had a question about the wide gap between POS and US sales this quarter and how you feel about inventory levels heading into the winter season?

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

You have to look year over year. When you go back to 2012, the replenishment was fairly conservative going into the month, and there was significantly more replenishment in October. And as we worked with the retailers, we said that's not the best approach to take. Unseasonal businesses you want to do more of a front-end load and work through the inventory. So there was more replenishment done in September in anticipation of the season, and the fall season is really a September-October, beginning of the November business.

So it was just shift in the replenishment. And like I said in my script, they are working through that inventory now, and we expect to be at the appropriate level of inventory sometime this month.

Unidentified Participant

Okay. And then just one other question -- for your topline growth of 2% to 3%, what are you factoring in for weather next year? Do you expect it to be similar or any improvement?

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

Well, I'm not sure how to answer that, except to say that at some point we have got to have a reasonable spring. To lose April in 2012, to lose March in 2013 -- and I mean just terrible weather. So I think we are sort of hoping for more normal, and this goes back to setting expectations. I think we



all believe we can do better than sort of beat the zero unit volume growth or call it 2% to 3% dollar. But I think we are planning conservatively and pretty helpful. I would hope that we wouldn't -- if we could get through March and April without disastrous weather, that would be pretty good.

So what are we planning on? We are planning on kind of conservatism and hoping for a lot better.

Operator

Olivia Tong, Bank of America Merrill Lynch.

Olivia Tong - BofA Merrill Lynch - Analyst

I wanted to see first on your 2% to 3% outlook, relative to your expectations last quarter, did anything change in your organic sales forecast, or is that all just the inclusion of the Tomcat acquisition?

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

No, I think, if you look at it, there's some pricing -- it's basically -- Olivia, is based on like zero unit volume growth in the core, plus pricing, plus Tomcat. That's effectively -- and you'll see higher -- if you actually were to get into people's heads here, you would see higher growth rates in lawn service, and I think we have some expectations of recovery in the European business. And that's kind of how we got to the number, but it's largely driven by an assumption, which, again, is a conservative planning number of 0% unit volume growth in the domestic business, excluding Tomcat.

And so I think we all hope it's not going to be that bad, but I think if you had talked to us a year ago, I think we would be talking like let's plan on like 2% unit volume growth plus pricing. I think we came out of 2013 and said, this is an environment where it's just, between the weather and the economy and everything else, it's just -- and I think this result we are having this year, which I think is really great, actually, considering, I think is all a result about conservative planning and not getting ahead of ourselves on expenses.

So I'm going to say I think Barry and the team are doing a really good job running the business, and I think if we took anything out of 2013, it's continued conservatism in our planning until we see that the world is better, and we don't get shot in the foot in April and March on weather.

So I think that those are the pieces that go into it, but it's mostly just planning conservatively and hoping for better. Does that make any sense?

Olivia Tong - BofA Merrill Lynch - Analyst

It does. And then just following up on that, if you think that your expectations are fairly conservative going into the year, to the extent that you have any EPS over deliveries, what is your plan in terms of how you are going to use that? Is it still 2/3-1/3 in terms of what gets dropped to the bottom line as opposed to what gets reinvested, or is there another algorithm should you overdeliver on EPS?

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

Now, listen, I think my next meeting is actually a meeting with Kura and the LawnService team and figuring out how much money they are going to get for acquisitions.

I think we have pretty reasonable visibility to ways to spend the money that I've allocated. And so the answer, I think the short answer is yes, we plan to be consistent with what we've told the Street and our investor community, which I think likes what they are hearing as far as shareholder friendly.



I think what I am saying is that, while I think there will be some competition for the money, I think that Barry and I and Larry would view, even if Brian Kura wouldn't, that we have sufficient money to make the acquisition.

So I think overdelivery -- we will stick with the ratio, and it depends on -- to be honest, it depends on share price as far as share repurchase versus special dividend. So we are just going to have to see how the year goes and if there's opportunities in the share price that we want to take advantage. But I think that the whole idea of special dividends is kind of yearend sweeps as we see where our leverage ratio is, what our cash position is and what's necessary. But the answer, again, is stick with what we told the Street.

Operator

David MacGregor, Longbow Research.

Josh Borstein - Longbow Research - Analyst

It's Josh Borstein in for David MacGregor. Thanks for taking my questions, and congratulations on the quarter. You saw some nice demand with your larger retailers, and I was hoping you can discuss what differences, if any, you saw in terms of demand in the various channels?

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

Well, look, Barry is shaking his head no, don't go there. What I will say is I would congratulate Blake and the team at Depot for, I think, doing a fabulous job this year. And I think for all the retailers, thank them for their support. But I think that Home Depot for sure has just really been doing a fabulous job, and I am super impressed with the guys in the lineup. So I think that there's -- Barry might say, oh, no, now you got me in trouble.

But what do I think? I think the retailers are doing a pretty good job, and even guys that performed less well last year, last fiscal year -- a lot of them have been here in the building in the last couple of weeks. I've participated in those conversations, and I think everybody has got their head on straight. I think the plans for next year are good. People that performed less well than we had hoped -- I think they have got really good plans going forward, and the relationships that Barry is sort of stewarding are good.

So I don't know. Barry, if you could open there?

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

When you look specifically at last quarter, I would say we were happy with all of our customers. There was consistent execution. We followed the plans, and we got the desired results.

So what that does is leading into 2014, as we've said, we have good plans, consistent with what those retailers' strategies are, and we have high expectations for all the big retailers next year.

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

Look, I mean I would just add one more thing just because I think it's important. I think when retailers executed according to the plans as well as when we executed according to plans, the results were good across the board, even in kind of a crappy weather here.

So I think that at the end of the day, what did we learn from this year? It's all about execution, and what did retailers learn? Because everybody did pretty well in the second half of the year. It's all about execution.



And I think the answer is, even when you wonder about, is the consumer really vibrant, the weather sucked. The bottom line is it all comes down to like getting the stuff on the shelf and promoting it off the shelf, and it kind of all works.

Josh Borstein - *Longbow Research - Analyst*

And just one follow-up -- on raw materials for the year, what was the raw material delta between 2013 and 2012?

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

It was basically flat.

Josh Borstein - *Longbow Research - Analyst*

And then given you are, I think, around 50% locked in for 2014 and given where current spot prices are, what does that number look like in 2014?

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

On our overall commodities, it is basically flat again.

Operator

Patrick Trucchio, BMO Capital Markets.

Patrick Trucchio - *BMO Capital Markets - Analyst*

What has changed in your internal planning that you are able to offset the weakness in a season where sales are so highly concentrated? And then related to that, should we look forward to years where sales are more evenly spread throughout the quarters?

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

Well, I think let's start with the latter part. I think the answer is no. But what I would say is that, all things being equal, I think this is -- if you ever watch these like MIT planning exercises where the professors mess with demand and then everybody goes crazy and builds a bunch of inventory and then they have too much inventory and then they try -- you know, it's just -- I think if you sort of -- the lesson in that is that there's a lot more smoothness than you think. This does not mean the quarters are all even, but what it means is that, if you look at this season, this season was pretty much flat and in spite of a crappy year. And so I think what it means is the distribution of sales changes a little bit, but it's not that different, really.

And so I think that it's probably somewhat more predictable than you think, although it's still highly concentrated in those quarters, the spring and the fall, and a little bit of pesticide business in the summer.

So what do I think? I think that sometimes we overreact, and I think this is true with these MIT studies is that most management teams and supply chains and sales force tend to overreact to good news and get suicidal when there's bad news. At the end of the day, the business is kind of the business and it kind of flows. If anything, the more retailers try to pull business out, the more concentrated it makes our sales as -- because we are a really good performer on just-in-time.

So I think over time, since I've been here, our business has become more concentrated in those peak weeks, almost, really, that represent lawn and garden and then the fall.



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

Just some numbers to reflect on what Jim would say. Historically between our first half and second half, the numbers are 50-50, 50% in the first half, 50% in the second half. This year it was 45% in the first half and 55%. So we saw a 5% swing. And I think the business relative to the weather can move four to six weeks, depending on how that spring breaks. And as we look back over the last 10 years, exactly what Jim is saying -- you see these fairly large swings month to month or even on the quarter splits, but overall in the business, it tends to work its way out. So you don't want to react too violently, just as Jim was saying, to any one thing that is happening last week or last month. And that's how we ran the business this year. And I think with the plans that we have going into 2014, if you go into it with a conservative plan, it gives you a lot more flexibility to manage as you see those swings and make sure you are going to deliver for the total year.

Operator

Jeff Zekauskas, JPMorgan.

Jeff Zekauskas - *JPMorgan Securities Inc. - Analyst*

How much potash do you buy relative to the amount of urea you buy?

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

There's folks looking. I'm amazed they are prepared.

Jeff Zekauskas - *JPMorgan Securities Inc. - Analyst*

And maybe while you are looking, I can ask a second question. Why haven't you locked in more urea? I think you said you were 75% bought, but with the way prices have trended, wouldn't it be better to be higher, or are you limited?

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

Well, first off, we don't speculate. We have a pretty consistent approach to what we do in our hedging program. That said, we have actually slowed down slightly on what we have done because our forward look would say there might be even a slight bit more opportunity. But we don't do this to speculate. We do it to provide consistency. So we stay with our program, and that's our standard progress.

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

The urea is 6 to 1.

Jeff Zekauskas - *JPMorgan Securities Inc. - Analyst*

And then lastly, how does the Tomcat acquisition affect the top line next year? Is it 0.5% or 0.25%?

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

Slightly over 1%.



Operator

Bill Chappell, SunTrust.

Sarah Miller - *SunTrust Robinson Humphrey - Analyst*

This is the Sarah Miller on for Bill. My question is on pricing. Have you already taken the pricing that is going to be in the market in 2014? I don't think you said it. Can you just give a little bit more color around the time period you are expecting that? Is it in certain categories? Is it across the board?

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

Barry, you can -- the answer is yes, we have taken pricing. I'm not sure that what we are going to do is get into the issue, but I am going to say slightly over 100 basis points of pricing.

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

Yes, it's a slightly over 100, and it's not spread across the board. It is relative to price increases and our ability to take pricing and so forth.

So Sarah, we don't just do a blanket price increase. It is category by category, SKU by SKU, to make sure that we are delivering on what the expectations are.

Operator

(Operator Instructions). Alice Longley, Buckingham Research.

Alice Longley - *Buckingham Research Group - Analyst*

A follow-up on pricing. Can you remind us what your sales growth for the US was this year in terms of volume and pricing? Was it zero volume and 1% pricing in fiscal 2013 as you were saying it is going to be in fiscal 2014?

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

I'm going to try to get these numbers right. I think pricing for US in 2012 -- I'm sorry, for 2013, 2012 to 2013, was around 2%, and we finish the year down about 1% in unit volume. And so --

Alice Longley - *Buckingham Research Group - Analyst*

In volume. And you are saying that really all the gross margin expansion -- or you didn't say that. Most of the gross margin expansion in both years is coming from pricing. Is that correct?



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

Well, when you work through all the puts and takes, it ends up being equivalent to the pricing increase. But there were some material prices that went up. There were some distribution cost shifts. I mean there were E&O changes. But at the end of the day, it all netted to where you can say it was attributable to pricing.

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

So I'm going to slightly talk to the group here, okay, which is that the team did a good job, Alice, this year. I think we would have expected -- I would have expected more gross margin to fall to the bottom line than did. So I think if you looked at E&O, and there's other areas that I would view as not necessarily sloppy. But as people are making changes to product lines, as we had a couple seed issues -- it was just a bunch of little things that just sort of -- next thing you know, it ate more than I would have liked to have seen.

Now the result for the year, as far as I'm concerned, was good. This means screwup a little less next year, Barry, and you ought to be able to harvest more of that. So this is really me talking to the team, Alice. But I think it answers the question, which is that I think we would have expected more. I'm a little disappointed we didn't get it, but we know where it is and we know what happened and we know how not to repeat that.

Alice Longley - *Buckingham Research Group - Analyst*

What about your Project Max stuff? Didn't that play into helping gross margins, too?

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

No, the answer is absolutely, and I think this is where you can sort of say what -- the answer is yes. Had we not done Max, the result would have been less good. But I think that -- did we get all the benefits of pricing and Max combined? No, we lost more than I would have hoped. And I am requesting my team to be a little more diligent in making sure we don't do that, which it should be favorable for us next year.

So the bottom line is the answer is I think we at least delivered on the Project Max the savings that we expected. We got the pricing that we expected. Did we bring it all to bottom line? No. But I'm actually positive about that because it means, like I said, just screw up a little less, and that's always kind of true with us.

Alice Longley - *Buckingham Research Group - Analyst*

And so for this year where you are guiding to the same gross margin expansion, I guess we have the same Project Max, we have similar flat commodity costs, and you maybe we'll screwup less. On the other hand, it looks like you have less pricing.

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

Well, Alice, what I would say is that we just got through getting our budget approved by the Board. We are going to sit down with you guys in December. And I think the experience this year for us is not -- and I think I remember driving around somewhere in the middle of the United States with you probably a decade ago, and you said key number one, do not overpromise. I think that was you. Like I'm certain it was you.

Alice Longley - *Buckingham Research Group - Analyst*

Sounds like me.

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

And I would say that's where we are headed now. So I just wouldn't work too hard to try to make the math work because not only will we provide more guidance next month with you guys, but we are also working pretty hard to underpromise and produce a good result. And I think we did that this year, and I think, all things being equal, we will next year.

Alice Longley - *Buckingham Research Group - Analyst*

The last part of this question is product mix. Are you seeing any sign of this lackluster consumer in terms of product mix in any of your categories? Like within fertilizer, are people buying Snap as much as you thought, or is there any shift to private label in any of your categories, some of the private label that you make? So maybe mix is a factor in this gross margin outlook as well. Could you comment on that?

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

Well, look, what do we know? We know that mulch continues to do really well, and that, in spite of a lot of work that Barry and his group have done on getting better margins on multi-products, and they have succeeded at that, it's still a lower margin business than our average margin.

So we see, I think, some negativity in mix just because a lot of our organic products are -- that includes mulch -- are selling really well. So I think mix generally is -- now, on the other hand, you have these new power sprayers that we are using like in Ortho and Roundup, and they did really well.

I think if I was to say, what else do we need to do, we cannot just do the upper end or the commodities side. There's the middle of the line -- and Barry talked about that with concentrates like Ortho, concentrates and what we call ready to spray, which would be you hook right up to a hose and put the product down.

I think that's a little bit we took our eye off the ball there. I know that we had a retailer in this week here in Marysville, a big retailer. And we spent a lot of time talking about that kind of certain demographics that are more challenged and how do we create products that are really designed for that demographic because it seems like there's an opportunity there, and I think we all agreed to that, and Lyski and his team are doing a ton of work on trying to hit various price points with our branded products and I think, I'm going to say, doing a good job.

So I think the answer is probably yes, that there is -- and I think that this is like DeBlasio in New York, I sort of can't believe.

But what do I think? I think there is like a lot of wealthy people in New York, and they continue to buy nice apartments and live nicely. And there's opportunities on the low end, and I think -- and that's commodities, and those businesses continue to do okay. And there's a lot in the middle.

So I think we've got to balance our offering so that we are offering everything up. And I think if you look at our share data this year, you can see that there are some opportunities to solidify in the center, and I think we can do that.

So I think the answer is yes, there is some shift in mix. It's margin dilutive, although I think some of our high-end stuff -- and by the way, Snap did well. So I think it's managing all parts of the business because we play pretty hard in this space, and we don't want to give up anything that we don't have to -- consistent, though, with our approach toward must make money.

Operator

Stewart Scharf, S&P Capital IQ.



Stewart Scharf - *S&P Capital IQ - Analyst*

Could you expand a little on your new products and what percent of sales comes from recent product over the last couple of years? And also you have targeted -- in the past, you mentioned 50% of organic mix from overall products. And I was wondering where you stand on that, and just over on the Snap sales in Europe, how that has gone this year and what you are looking for in fiscal 2014?

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

Jim, why don't you talk about what products are coming, and then I will take the backend of that question.

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

I would just say on this year's results things like Snap has been alluded to. We continue to see that deliver at least 20% of all spreader sales. But more importantly, we see the number of bags per Snap units to continue to increase substantially.

So that has been a big hit for us. I would say that we expect to derive a significant portion of our organic growth via innovation. This coming year I think you will see the retailers firmly behind our involvement in the acquisition of Tomcat. Year two of our repellent line app will be a significant expansion this year nationally with our major retailers. And then probably the other one we did have very high hopes for, for this year, will be Roundup 365. It will be a major launch for us and has been taken with enthusiasm by the retailer community.

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

I want to throw in there because unfortunately we didn't bring it up, which is that in addition our relationship with SCJ continues to evolve in a much bigger way. So if you look at the -- you can call it grow and kill or the controls category, I think, is a nicer way to say it. But Tomcat and our expanding relationship with SCJ on Raid and Off!, I think, really changes the paradigm in the controls categories.

So I think this is very positive, and I think if SC Johnson was on the phone, they would say, good job.

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

Just a quick add, Jim, to Alice's question. We have a low-priced lineup that we introduced with SCJ with a lot of our -- with our houseplant lineup and some other activities. Every SCJ account that they manage for us took that lineup, and I think that -- like you said, it's a low price point, under \$5 at good margin.

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

Yes, that is designed for food and drug, which is where they distribute our products. Anything else, Barry?

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

I would say expectation on revenue -- we have publicly stated that we would like 25% of our revenue to come from products that were in the last three years. I would tell you, Stewart, that we are probably exceeding that goal now with the SKUs that we are replacing. And as we look forward into the pipeline, we have some bigger SKUs in products that are coming out that we will deliver consistent with that 25%.



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

And 50% naturals, that was a challenge I offered to the team probably a decade ago and said I want it to be 50% naturally derived within I think it was five years at the time. So Barry has well missed that target, and I continue to be interested in trying to get there.

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

Yes, we are going with that. I would say the overall market for the natural and organic is about 15% to 20%. It is growing nicely, but we have a lot of effort behind that. We will continue to support Miracle-Gro Organic Choice, and we are testing this year a new Miracle-Gro Nature's Care with all of our major retailers, and we have high expectations for that.

Operator

And that concludes the question and answer session. I would now like to turn the conference back over to Jim King for any closing comments.

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

Thanks, everybody, for joining. If there are follow-up questions or items that we didn't address in the call or the Q&A, call me directly sometime later this week. My number is 937-578-5968. And again, please call that same number, if you haven't already, to register for our Analyst Day on December 13. We will see you then.

Thanks. Have a great day.

Operator

And that concludes today's conference. We thank you for your participation.

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