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SMG - Q3 2016 Scotts Miracle-Gro Co Earnings Call

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OVERVIEW:

Co. reported 3Q16 sales of $994m and net income attributable to controlling interest of $213m or $3.44 per share. Expects 2016 sales growth to be 2% and adjusted EPS to be $3.75-3.95.

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PRESENTATION

Operator

Good day and welcome to the 2016 third-quarter earnings 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 IR & Corporate Affairs, Chief Communications Officer*

Thanks, Audra. Good morning, everyone, and welcome to The Scotts Miracle-Gro third-quarter conference call. With me this morning is our Chairman and CEO, Jim Hagedorn; our CFO, Randy Coleman; and also joining us for the Q&A session is Mike Lukemire, our President and Chief Operating Officer.

In a moment, Jim and Randy will share some prepared remarks. Afterwards, we will open the call for your questions. In the interest of time, we ask that you keep to one question and to one follow-up. I have already scheduled time with many of you later today to follow up and fill in any gaps, and anyone else who wants to set up some time can call me directly at 937-578-5622.

Before we begin, let me tend to a bit of housekeeping. Randy and I will be presenting on September 13 at the CL King conference in New York. We will also be conducting one-on-one meetings at that event for those who register. And for your planning purposes, we will not be holding an investor day event this year in December; rather, we will be likely to sponsor a more low-key event in February in Florida, as we have in the past, that will include briefer management presentations, as well as visits to lawn and garden centers.

So with that, let's move on with today's call. As always, we expect to make forward-looking statements, so I want to caution everyone that our actual results could differ materially from what we say today. Investors should familiarize themselves with the full range of risk factors that can impact our results, and those are filed with our Form 10-K with the SEC.

I want to remind everybody, as Audra said, that today's call is being recorded. An archived version of the call will be available on our website as well.

So with that, let's get things started and I will turn things over to Jim Hagedorn.

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

Thanks, Jim. Good morning, everyone.

As you can see from our press release, we have got quite a bit of news to share and discuss. Our performance in the quarter was solid, as we have been successfully navigating an unpredictable season that has had its fair shares of highs and lows. In addition to navigating the season, we have also been extremely busy implementing our long-term plan, which we are calling Project Focus.

Since our last conference call, we have completed or signed definitive agreements for two more acquisitions. We have continued to successfully integrate the transactions we've made in the past and we have begun to pivot toward more shareholder-friendly activities, like increasing our dividend and our share repurchase authorization.

As it relates to this year, we are making some revisions to our guidance. We are likely to wind up on the high end of our gross margin guidance, which will help us make up for lower-than-expected sales. And adjusted EPS, while likely in the lower half of our original guidance, is actually a pretty good result, given higher-than-expected dilution from the Scotts LawnService transaction and the impact of weather in the peak weeks of the year.

The other metric that I'm really pleased with is our operating margin. Randy will spend more time on this in a few minutes, but I wanted to add my own comments. The reason we call our plan Project Focus is because of focus we're putting on our North American business, which has an operating margin of roughly 20%. While we believe our European business is the best in the industry, we also know that it is significantly dilutive to our operating margin and that we are probably not the best long-term owner for this business.

Scotts LawnService had a high growth rate and a good track record, and service is a category that we really like over the long run. But to truly drive value, we needed more scale and the only way to get it was to find a partner -- or find a way to partner with TruGreen.

We would rather be a one-third owner of a fully integrated market leader than having to invest $1 billion and take on the integration risk ourselves. And, frankly, categories like live goods and hydroponics, which actually have more in common with our core than service is a better use of our time and resources.

In fiscal 2015, our Companywide operating margin, or EBIT margin, was less than 13%. On a pro forma basis, taking out SLS, it was 14%. And we are tracking for that rate to be 15.5% this year, with a goal of getting to 18% over the next several years.

An eventual exit of our European business would result in another jump, but it is our investment in faster-growing areas, like organics, live goods, and hydroponics, that will ultimately get us to our goal. These businesses, as well as deals like TOMCAT, diversify both our consumer base, as well as our retailer base.

Achieving our long-term goals requires more than just reconfiguring our portfolio. It requires the execution of our near-term business plans, so let me shift gears here. I will start by tipping my hat to Mike Lukemire and the entire operating team. They did an outstanding job preparing for the season and executing throughout the year. Consumer purchases entering the fourth quarter are up 2% on a year-to-date basis, as we saw strong consumer engagement after mid-May, when the weather finally started to cooperate.

Despite an extremely strong start to the season, year-to-date POS fell to a negative 2% shortly after our Q2 conference call in May. So the level of consumer engagement since then has been extremely strong. In fact, POS in June was up 13%.

At the start of Q4, we were in positive territory in every part of the country except the Southwest, which was due to terrible spring weather in Texas. But even the Southwest is down less than 1%. Our strongest region has been the Southeast, which is up 3%. The critical Northeast and Midwest are both up 2%. Pac West is also up 2%, thanks to a strong rebound in California.

In terms of retailers, we are seeing our best performance this year in the hardware channel, which aggressively supported our brands all season long. The home center channel also was above average. Where we have seen slippage has been in mass retail. Our discussions regarding 2017 season are well underway with all of our retail partners. We are optimistic about our initial plans, but we are extremely focused on mass retail.

From a product perspective in 2016, our gardening business continues to be strong. Consumer purchases of soils are up 6% entering the fourth quarter. We continue to be optimistic about the future of this business as we increase our commitment to organics and benefit from our new partnership with Bonnie Plants.

Entering Q4, grass seed is up 9%; cleaners are up 65%; mulch units are up 10%, excluding some commodity business that we walked away from. Our TOMCAT business is up 37% as we prepare for the peak of that season, and Roundup is up 3%.

In the constant back and forth with the insect control business, our Ortho insect products are down mid-single digits this year. Lawn fertilizers were down 5% year to date entering Q4. But behind the numbers, the story is better than it looks. The category got off to a strong start, but then slipped in April, our most important month for lawn fertilizer, as weather presented a series of challenges. You'll recall that POS of fertilizers was down 8% at the time of our last call.

Since then, the category has been strong, led by our Scotts Turf Builder Weed & Feed product. We also have good fall programs in place with our retail partners and we're optimistic that consumer purchases of Scotts WinterGuard product will help us close the year-to-date gap even further.

I want to stress that our adjusted gross margin rate is up 200 basis points year to date, despite the challenges with lawn fertilizer, which is our highest margin business.

While we have a number of good story lines, all of us are disappointed with our topline performance in the core business this year. In a nutshell, the six most critical weeks of the season were soft, largely due to weather. I don't want weather to be a crutch because categories like mulch, soil, and Roundup did better over the course of the season, but lawn fertilizer sales are concentrated in an earlier two-month window and it is a category that is more susceptible to the spring weather.

The difference between flat fertilizer sales and our current projection is probably worth $0.10 to the bottom line.

So I would say our legacy business has had a decent season, not a great season, but one that we can be proud of, given the rough patch we saw in April and early May.

In the Hawthorne Gardening Company, we continue to see a great story emerging. The business is up more than 300% from last year. While acquisitions are driving that performance, we are seeing strong levels of organic growth.

General Hydroponics continues to grow at a rate better than 20%. The growth at General Hydroponics consistently has been twice as high as the business case we used to justify the acquisition. More than just the performance of GH, we are benefiting from the knowledge as we continue to gain in the hydroponics space, and we are quickly putting that knowledge to work.

As many of you know, we also rolled out a new hydroponic offering this year called Black Magic that is sold exclusively at Home Depot. The products, which are liquid nutrients and high-quality growing media, are being tested in roughly 165 stores around the United States.

Even though it is just a test, we supported Black Magic with both online and television advertising that looks and sounds nothing like the type of marketing we use to support our legacy brands. The marketing is more gritty and reflecting of the demographics in the hydroponics space. The response to the product and marketing has been strong and we believe there is more upside from Black Magic as we look ahead.

As I mentioned earlier, we recently completed a second hydroponics transaction, and just this week we signed a definitive agreement on a third. The first deal is the purchase of a 75% stake in a Netherlands-based company named Gavita, which is the leading global provider of hydroponic lighting equipment and related hardware. With sales of roughly $100 million and more than a 20% EBIT margin, it is both a strong and extremely well-run company.

On Monday, we entered into a definitive agreement to purchase Arizona-based Botanicare, which is primarily focused on plant nutrients and supplements. They also have a leading line of hydroponic growing systems, including growing containers and other accessories. Botanicare has sales of roughly $40 million and margins consistent with the rest of our hydro portfolio.

Subject to normal closing conditions, we expect to close the deal by the end of the calendar year. Once we close Botanicare, our hydroponic business, including our investment in AeroGarden, will have annual sales of approximately $250 million. Like General Hydroponics, both Gavita and Botanicare are growing at double-digit rates and both own brands that are valued by growers in the hydroponics space.

So in less than 18 months, we have created what we hoped to, a complete product offering of hydroponic products for the benefit of both retailers and growers.

I know that many people listen to this call or read the transcript. So, to our new friends in the hydroponics space, I want you to know that we take seriously our responsibility as the industry leader. And since we are an outsider, I know a lot of people will be watching to see how we behave.

We have done more than just assemble a portfolio of the best brands within the various industry categories. Along the way, we have also assembled a great array of talent, entrepreneurs who have built strong companies from the ground floor. The goal was not simply to buy their businesses. The goal -- in fact, the obligation -- is to make them better. Whether it is through innovation, new products, improved technical support, improved packaging, or registered control products, our job is to be great stewards of these brands and partners with this industry.

For nearly 150 years, this Company has been committed to helping people grow things, and that commitment is now being extended into hydroponics. This is a core business for us. Because it is so critical, we have assembled a great internal team as well, from sales to marketing to finance to R&D and HR. We have put strong leaders in Hawthorne. They're off to a good start, and I want to thank them for their commitment and congratulate them for what they have accomplished so far.

Shareholders should know that once we get the Botanicare deal closed, our focus will shift to integrating these deals. We will begin to move away from any further significant M&A activity, just as we said we would. While we may still have a small tuck-in deal here or there, our use of cash will be for shareholder-friendly activities, like dividends and share repurchases.

I'm extremely confident that Project Focus, and I know my colleagues sitting here with me this morning share that optimism. Given our confidence in the ability to succeed with the portfolio we've assembled, we are going to invest in our own Company.

Clearly, we have the support of our Board of Directors, which this week raised our quarterly dividend by 6% and also improved the authorization to purchase $500 million of our shares. This new authorization is in addition to our existing plan, which still allows us to purchase another $400 million of shares.

So, there should be no doubt that we are putting our money where our mouths are. In fact, our focus on shareholder-friendly actions will result in changes to our short-term incentive compensation plan. Until now, management's incentives have been solely based on operating income. Beginning next year, we will add a free cash flow component to the mix as well. I have been a longtime believer that cash flow is what drives value and I want to make sure we emphasize that point within the organization.

We are also exploring some pretty dramatic changes to our long-term equity-based incentive plan. Those changes also will focus on making sure our incentive structure is clearly aligned with living up to the commitments we have made to our shareholders.

Before I turn things over to Randy, I want to emphasize one more point. I have asked Mike and the entire operating team to focus on finishing the year strong. Fall is an important season for us, and it is critical that we keep both our retail partners and consumers engaged all the way to the finish line.

While we are saying we will likely be in the lower half of our earnings range, it doesn't mean we won't push to do better than that. We will work hard to deliver every last dollar of sales and penny of earnings, but what we won't do is cut mission-critical investments that hurt us going into next year.

As you would expect, we have begun to turn the page from a planning perspective, and I like what I see right now about our prospects in 2017. Macroeconomic factors will continue to be a benefit. We will begin to see the cost savings from the Scotts LawnService joint venture with TruGreen. We will see EPS accretion from the hydroponics acquisitions we have made. We will see increased opportunities for a minority investment in Bonnie Plants, and we will supplement the natural earnings growth of the business through a share repurchase effort.

When we announced Project Focus, someone asked what the impetus was. To be more precise, someone asked if we had been pressured by an activist investor. The funny thing is the answer is yes, except I am the activist. So are the people here with me today. We know we can drive more value from this business. Each and every one of us is confident in the plans we're executing and believe we are on the right path to get that done.

I will cover more during Q&A, but right now let me turn things over to Randy to cover the financials.

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

Thank you, Jim, and good morning. I'm going to spend my time this morning focusing on three areas.

First, I am going to spend a fair amount of time walking through the third quarter and year-to-date P&L. We told you earlier in the year that the P&L would be complicated this year, due to the Scotts LawnService deal, our revised Roundup agreement, new acquisitions, and also new reporting segments. I want to make sure we are as clear as possible so that you can begin refining your models for next year and beyond.

Second, as I'm walking through the numbers I want to give you a more detailed look at how we see the full year coming together.

And third, I will address some potential questions related to 2017. We are not providing any specific guidance for next year at this time, but I will address some of the major themes. This includes an overview of the commodity environment, as well as some initial thoughts about returning cash to shareholders, as we now have the capacity to repurchase up to $900 million of our own stock.

Let's start by looking at the quarter, and I want to begin by reminding everyone about the impact of the shift in our fiscal calendar. Recall that our accounting convention is based on a 4, 4, 5 calendar. In other words, the first and second month of each quarter have four weeks and the third month has five weeks. This convention results in a six-day shift in our calendar every six years. So in years like 2016, there are six more days in Q1 and six fewer days in Q4. Q2 and Q3 both start and end six days later than a year ago.

Given the seasonal nature of our business, that shift was material to our results in both Q2 and Q3. In Q2, the shift added just under $105 million to sales. In Q3, the shift lowered sales by roughly $90 million.

That said, Companywide sales in the quarter were $994 million, compared with $1.1 billion in the third quarter last year. If you look at sales by segment, both the US and European consumer segments were down 13% in the quarter.

Aside from the calendar shift, there was simply a matter of lower shipments, primarily in April and early May, that were largely driven by weather. Jim has already told you we saw strong bounceback in consumer participation levels, but there simply won't be enough time left in the year to make up the ground on shipments.

On a year-to-date basis, sales are up 3% to $2.4 billion. When you exclude the calendar shift, year-to-date sales are up roughly 2%. Right now, I expect the US business to be roughly flat on the topline for the full year. Europe will likely decline mid-single digits, due to FX and the exit of a non-core business. Hawthorne has been performing strongly, as expected, and we will get another small incremental benefit in Q4 from the timing of the Gavita transaction.

As you know, acquisitions are the main driver for Hawthorne this year and will also be the primary driver on a Companywide basis, too. My current expectation is that sales will grow roughly 2% for the full year, with 3% attributed to M&A and with FX having a negative impact of roughly 1% for the year.

Before I move on, I want to briefly discuss the impact of weather on our business. It seems that almost every year we have weather challenges in certain areas of the country, but weather tends to normalize geographically by the end of our fiscal year. We benefit from the large landmass of the US with different climates and a product portfolio that complements diversity in weather patterns.

While I'm a bit disappointed in our sales results this year, I'm also very proud of the team's ability to navigate weather and consistently deliver earnings growth year after year after year.

Moving on from sales, I am highly encouraged by what I have seen on the gross margin line. Adjusted gross margins increased again in the quarter and are up 200 basis points year to date. Commodities have helped. The new Roundup agreement has helped. Distribution improvements have helped. Pricing has also helped.

But product mix has been a headwind, as mulch has again outperformed our expectations and lawn fertilizer sales were less than planned.

You might recall the midpoint of our original guidance for the gross margin rate was 125 basis points. Entering Q2, we raised the midpoint to a 150 basis-point improvement. And right now, I believe we'll be on the high end of our range, which was a 175 basis-point improvement on a full-year basis.

SG&A was down 2% in the quarter and is up 4% year to date. I'm expecting full-year SG&A to be up about 3% and the vast majority of the increase will come from acquisitions and related deal costs. In our core business and in corporate overhead functions, SG&A is essentially flat.

When you combine gross margin improvement, strong expense control, and the reconfiguration of our business, you see an impressive improvement in our operating margins. In his remarks, Jim talked about operating margin, and now I want to elaborate further.

Entering the year, I said I expected operating margin or EBIT margin to be 15.5% this year, compared to a pro forma rate of 14% a year ago. Right now, we are tracking to the goal I outlined. Whether we fall a little short or exceed our goal, it is a terrific outcome either way.

And I remain confident in the goal we outlined to improve our EBIT margin to 18% over the next few years.

Part of the benefit to this margin rate was the first step in the reconfiguration of our portfolio, specifically the contribution of Scotts LawnService into a joint venture with TruGreen. You'll recall that on a pro forma basis we said in December when we announced the transaction that we expected this deal to be dilutive by about $0.10 this year. I now believe that number will be at least $0.15, primarily due to delayed realization of synergies.

We continue to believe the combined business will achieve the $50 million in cost synergies we outlined back in December. But the closing of the deal occurred more than two full months later than expected, so the timing related to some of those savings will be delayed.

Interest expense and taxes are pretty much in line with what we expected, so when you look at the bottom line, pro forma adjusted income was $134 million in the quarter or $2.16 per share, compared with $167 million or $2.68 per share last year. Year to date, those numbers are $251 million or $4.04 per share, compared with $226 million or $3.65 per share a year ago.

The difference between the pro forma number and the GAAP number is significant and I want to make sure everyone understands them. In Q3, net income attributable to controlling interest was $213 million or $3.44 per share, compared with $133 million or $2.14 per share a year ago. On a year-to-date basis, the number is $342 million or $5.50 per share, compared with $183 million or $2.95 per share.

The year-over-year difference is primarily due to two factors. In last year's third quarter, we incurred significant costs related to our Bonus S product issue. We excluded those numbers from our adjusted EPS, but they obviously were included in the GAAP results.

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In addition, in 2016 we received and recognized as income the related insurance reimbursements associated with these costs. So the year-over-year differences in impairment, restructuring, and other line was an improvement of $111 million for this matter.

The other factor affecting the Q3 GAAP numbers relates to our divestiture of the SLS business in exchange for a 30% ownership in the newly combined TruGreen joint venture.

First, we recognized an $86 million gain on the contribution of the SLS business in exchange for our 30% ownership in the JV. This gain represents the excess of our fair value of our 30% ownership interest in the JV, less the book value of our lawn service business and related transaction costs. The gain on this transaction has been adjusted out of our pro forma results.

Second, we have begun to recognize and record our 30% share of the earnings on a new line on our income statement titled equity and income of unconsolidated affiliates. Going forward within our GAAP and adjusted earnings, we will be recognizing our share of the TruGreen earnings on this line. Consistent with our past non-GAAP practice, we will be adjusting the GAAP measure for nonrecurring unusual items recorded within this new line item.

For Q3, TruGreen recognized deal integration costs and restructuring costs and other non-cash transaction-related charges as it began the process of obtaining cost synergies. Our share of these expenses was $17 million, which has been adjusted out of our pro forma adjusted earnings, as we believe it provides a more accurate base off which to build your financial models.

We will continue to focus on pro forma adjusted results until the second quarter of fiscal 2017 because we believe it is the most accurate way for investors to look at the business on a comparable basis, looking both backward and forward. However, in the weeks ahead, we will be filing an 8-K that will provide two years of quarterly historical data on our new reporting segments, with Scotts LawnService out of the mix.

Also, assuming the Botanicare deal closes before we file our 10-K, we would expect to once again restate our segments within Hawthorne -- or with Hawthorne removed from the other segment to become its own reportable segment. This will provide a greater level of transparency on the progress of this business in the years to come.

So if I summarize the updated guidance, it looks like this. We expect sales to be up 2%, gross margin rate to be up roughly 175 basis points. SG&A should increase about 3%, due to acquisitions, and adjusted EPS will likely be on the bottom half of our range of $3.75 to $3.95, as the dilution from the TruGreen deal will likely be too large for us to reach the top end of the range.

Jim said earlier he believed 2016 will be a good year, not a great one, but one that we could be proud of, given the peak season challenges. As a 17-year Scotts veteran, I agree. He also said that we will push hard to the finish line, but we won't take any steps that impact 2017.

As I look ahead, I really like what I see. Our purchasing team continues to do an outstanding job of managing the [comartment] as we expect to see continued tailwinds from lower input costs. The TruGreen deal should be neutral to our EPS number in 2017 versus 2016, as cost synergies begin to offset higher interest expense and non-cash amortization.

Hawthorne's M&A activity will be accretive to EPS by $0.15 to $0.20 per share next year, and I would expect to invest at least $300 million in share repurchase activities before the end of next year, which will begin to enhance our EPS calculation as well.

I will provide a more detailed overview of our 2017 outlook during our next call, but I would expect to see EPS improvement of no less than 10%, and with a 6% increase in our dividend payment and share repurchases as well, I would expect to see solid double-digit improvement in total shareholder return.

As we have been executing our plans this year, I am more convinced than ever that our Project Focus initiative is absolutely the right plan at the right time. That belief has been reinforced in the dozens of face-to-face meetings we have had with shareholders. We are focusing on those areas that drive the highest returns and have the highest probability of success.

The combination of reconfiguring our business to focus on margins, along with a smart capital allocation strategy, gives me confidence in our ability to continue driving long-term shareholder value.

Thank you for your time today, and now let me turn the call back to the operator so we can take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Jon Andersen, William Blair.

Jon Andersen - *William Blair & Company - Analyst*

Good morning, everybody. I wanted to just ask about a couple of the businesses, which have been a little softer this season, both Ortho, which you mentioned down mid-single digit, and then fertilizer, just in general. Can you talk about any of the season-specific dynamics that you think has led to that performance and maybe plans or expectations for both of those businesses as you look ahead to 2017? Thanks.

Mike Lukemire - *The Scotts Miracle-Gro Company - President, COO*

Jon, this is Mike Lukemire. So on fertilizer, it is a series of micro seasons, so I would say the good news is our new Plus 2 product is up, but our early season with the Halts business was down, and then we had some problems in Texas on Bonus S.

But we started down minus 8; we are minus 4. I think what we have learned this year is with the micro seasons, also the call to action in being earlier, and also looking at our product assortment, where we are going to try to extend those seasons, so I am actually bullish on lawns.

On Ortho, we went out aggressive last year with pricing. We had some competitive pressures on the AccuShot that was expanded by Spec. However, we are reconfiguring the Ortho brand. We bought Roundup, and we're going to be introducing some new Roundup products next year and reconfiguring how Ortho plays with the combination of Roundup and RAID and the Off product.

And so, I think what you're going to see with Ortho is we really have a good strategy, but it has really been a transition year for us.

Jon Andersen - *William Blair & Company - Analyst*

Okay, thanks. The follow-up, on Hawthorne with the completion of the two deals that you have announced, it looks like that is a business now that you have got at about 10% of your overall consumer sales. Should we be thinking about Hawthorne going forward as a double-digit grower and, as a result, a mechanism to accelerate the underlying organic growth of the entire Company?

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

The answer -- that could be a simple yes. Maybe that's the easiest way to say it is yes.

What I would like to do is just go back a little bit on the lawns and pesticide. As we prepped for this meeting, one of the things I told Mike is there is sure to be questions on lawns and Ortho, so have your stuff together on that one.

I have asked the operating team to get back to me where -- if you look at just total pounds we have shipped over the last decade per year, it is down, and I was hopeful that we would have a great weather year this year. That seemed to start well and then not go as well. And the lawns business is the most impacted because it is a pretty short discrete window that happens in the April/early May, and it is pretty much across the entire country because the southern dormant grasses are coming out right when the northern dandelion rush is happening, so it is -- if you lose that part of the season, it is very impactful on a pretty high margin part of our business.

And so, I want to say it was just another one of those (expletive) weather years. On the other hand, I think it would be wrong to say should we be looking to see if there is a trend. And I think that the business and the operator community is eyes wide open on this issue, and we are really carefully evaluating it because we have a pretty outsized spend on the marketing side on our lawns business, and I just think we want to fully understand the embracing our reality of that business.

So I appreciate Mike's optimism. I just want to make sure that Randy and I on the corporate side can look at it and say, yes, fair enough, that the investment is related to what we think the opportunity is in the brand.

Jon Andersen - *William Blair & Company - Analyst*

Jim, I appreciate that comment and that's what I was getting at, and just to follow up on that. Are you seeing any -- how are your big retail customers, the home centers, thinking about that category, thinking about space allocation to lawn in light of what the trend has been over the past several years, putting weather aside?

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

I think they think it's important. It was in my script, which was mass, and so it is a relatively complicated story that we don't spend a lot of time on like these calls really going through, but I do think that what you saw this year was -- for those of us who live in the Northeast, just April and early May sucked. Texas just had huge amounts of rain and then the drought really didn't start to get better in California until the second half of the season. So I would argue that if you screw with California, Texas, and the Northeast, you can't have a good year in lawns.

I also think that if you look at the retail situation, I think the challenges in mass also had an outsized impact on it, so it is a slightly more complicated story that you can just touch at without really peeling back the onion, which we have done and are doing.

But I think we have action plans for all those things. But I would say largely if you say that most of our business is DIY and hardware, I think those businesses continue to be fully committed to the lawn fertilizer business.

Mike Lukemire - *The Scotts Miracle-Gro Company - President, COO*

I haven't seen any change in space, Jon. I think investment and call to action is really important in lawns, and we saw some decrease in that at the retailers, and the plan for 2017 is to re-up that.

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

Jon, this is Randy. The other comment I would make is if you look across our largest retailers, the ones that supported lawn fertilizers the most this year had the best years.

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

This is something, as we were building these scripts up, we spent a lot of time saying that people who were on the program, who drank the Scotts Kool-Aid, if you want to call it that, had by far the best result, and I think that's a message that Mike is going to be taking on the road next week as he meets a lot of our largest retailers, including retailers on the mass side.

On the pest side, I just wanted to add to what Mike said, which is the new Roundup deal that was my and Randy's deal I think is a big opportunity for Mike. So Mike's going to have new Roundup products that were really allowed to happen as a result of the new Roundup deal that we did.

And so if you basically say between our Roundup business and new products that Mike is bringing out in this coming fiscal year, reorientation as a much more competitive brand on the Ortho side, plus our SCJ partnership with Off and RAID, and I mean this with massive respect, but the opportunity that Zika presents in the United States, I think we feel really good about the portfolio of brands we have on pest and that there is a really good plan coming up for next year. So I guess I'd have to say it was a good question, since we spent a lot of time on it.

Jon Andersen - *William Blair & Company - Analyst*

Thanks for all the color. Appreciate it. I will pass it on.

Operator

Olivia Tong, Bank of America Merrill Lynch.

Olivia Tong - *BofA Merrill Lynch - Analyst*

First, can you talk about the comps as you close out the rest of the year in your main businesses? And then, really what I want to boil down to is Hawthorne. What level of investments do you think you need in the businesses that are already acquired? I've been trying to understand the comments around your ability to consolidate the area, and we saw in some of the press, and then also, obviously, your desire to return cash?

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

Olivia, this is Randy. So I will start on the question related to comps for the rest of the year. So last year, August was up low single digits and September was about flat, so it looks like pretty reasonable comps going forward for the next two months.

And then, regarding Hawthorne, you know, I'd --

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

Well, I would also add that in regard to relatively easy comps for the remainder of the fiscal year is that inventory levels are quite a bit lower than they were this time last year, so I think that there is no headwinds on that. If anything, there is a tailwind on the inventory at retail side. So, I think easy comps and lower inventory numbers in the trade than there was this time last year.

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

And then related to Hawthorne, so to answer your question about investments, I think about it two ways. So as far as significant outlays of capital, we're done for the most part when it comes to Hawthorne. There still may be some smaller tuck-ins that will make sense, but as far as significant uses of cash, we are done after the Botanicare deal.

As far as investments within the businesses we have purchased, part of the reason the operating margins are so attractive is there is not historically a lot of investment below gross margin. So going forward, we are going to look at R&D, look at marketing. We may be more aggressive than what these companies have done in the past, but they're growing at such a significant rate right now that a lot of this is just trying to keep up with the demand that we are seeing in the marketplace.

So right now in the short term, there is not a huge need to continue to drive consumer activity that way.

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

I would say, Olivia, relatively small sort of capital required for the consolidation and integration. I signed a par, I think last week or the week before, which is an appropriation request for SAP at GH, and I think that these are probably the biggest single numbers is going to be integrating our systems into Hawthorne's and their acquired companies so that we are all operating on the same system. It is probably the biggest single thing we do is probably integrating SAP in the various companies over time.

Olivia Tong - *BofA Merrill Lynch - Analyst*

Got it, that's helpful. So as we think about it, you are doing this one wave of consolidation, need some time to integrate it, bring it on board, so the capital requirements will be relatively low. But my sense is that there is still a significant amount of consolidation and that you're interested in doing that within this category.

So, does it return to be coming back into the spotlight at some point in the future? And how does that impact your ability to return cash to shareholders? And then, just generally speaking (multiple speakers), how is the M&A environment in the core DIY lawn and garden business?

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

I think we should be super-clear on this that, remember, what we are consolidating is hydroponics supply, okay? There may be opportunities for other people in that space to consolidate other areas. That is not of particular interest to us at the moment. Our interest is the hydroponics supply space.

And I think that what you see is if you look at that and say nutrients, growing media, pesticides, hydroponic systems, lighting, that we will have -- if you were to look at a pie chart of where a lot of the dollars are and a lot of the margin is, I think we will have the leading position in the spaces that we've found interesting. And at that point, other than I think what we have been calling small tuck-ins, and we tried to quantify that this morning as we were talking about it, which is plus or minus about $50 million, which would be for Mike's business including Hawthorne, so not exclusively for Hawthorne, that that's it, okay?

And the only other major M&A transaction we have would be the disposition of our European business. So that's it. And that's what we are -- at that point, we are done with the reconfiguration, and then beyond that virtually 100% of our free cash and our capacity will be used for shareholder-friendly actions.

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

Olivia, just to clarify on your question about P&L investments in Hawthorne, we would actually expect synergies going forward, so P&L improvement, not investments required to combine the businesses. So, certainly there will be some required investments to consolidate the three businesses, but there should be big significant synergies as a result of doing that work.

Olivia Tong - *BofA Merrill Lynch - Analyst*

Great, thank you very much. Appreciate it.

Operator

William Reuter, Bank of America.

Unidentified Participant

This is actually (inaudible) on for Bill today. Thanks for taking our questions. So, could you give us an update on your outlook for commodities for the remainder of the year, and can you quantify the benefit you expect to achieve from lower commodities?

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

Sure, this is Randy again. On commodities for the balance of the year, it is really a pretty small story, so we're about 95% purchased on our significant commodities that we track and that we talk about externally. So, essentially a done story for 2016.

For 2017, we expect commodities to be a tailwind again, perhaps not to the same level we saw in 2016, but we are expecting a double-digit number again for next year. So, again, more good news to come.

Unidentified Participant

Great. And then, you talked about mass retail being very weak and you are heavily focused on mass right now. Can you provide more details as to what drove that weakness and your plans you are focusing on to improve this going forward?

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

Okay, just in order to save myself from phone calls right after this from the retailers, I'm not sure I said very weak, okay? But I think that it was the poorest performance of our major retail partner categories was mass. Mike, do you want to pick up the other part of the question?

Mike Lukemire - *The Scotts Miracle-Gro Company - President, COO*

Yes, I think there was a change in philosophy around call to action. I think we have really good programs and we thought those programs would carry through, and so we're going to be working on reinstituting some of those call-to-action activities at mass. That is really the (multiple speakers)

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

What do you mean by call to action?

Mike Lukemire - *The Scotts Miracle-Gro Company - President, COO*

Like running tab support and those type of things, some early spring activities that we didn't repeat from the previous year. Those are the type of things that bring people in the store, and there was a movement just to be at everyday low price, and we had really great programs. We were confident we would -- actually, we thought we would do better there and it just didn't work. So, we're adjusting and we're going to be making some adjustments next year and we are working with them, and that is a focus for us.

Unidentified Participant

Great. And then, lastly for me, you mentioned that the timing of the $15 million in cost savings from the SLS-TruGreen joint venture will now be delayed. Can you just lay out the new timing of when you expect to achieve those savings?

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

Sure. The total cost savings is $50 million, just so to be clear, not $15 million, but that $50 million will be almost completely complete by the end of calendar 2017.

So, a little bit of slippage this year just because of the timing of the deal that closed six to eight weeks later than we expected. And on a calendar-year basis, we are really not seeing any slippage, but some of it that we would have expected earlier in the year will fall into October/November/December. But by the end of calendar 2017, the $50 million is still a really good number.

I can tell you Mike Lukemire and I are on the Board of TruGreen. We had our second Board meeting last week and we are really encouraged by the progress the team is making. Integration is on track. Given the timing of the close, the team is working hard to bring things together, and I couldn't be any more satisfied with the progress so far.

Unidentified Participant

Great. I will pass it along. Thanks.

Operator

Joe Altobello, Raymond James.

Joe Altobello - *Raymond James & Associates, Inc. - Analyst*

Jim, you mentioned Europe earlier. Obviously, you had a deal in place or thought you did and that fell through. So could you help us understand what's going on there? Is there anything that's going on in terms of timing of reconfiguring that business?

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

First, the business continues to perform well, okay? And so, I think what do we know coming out of the process we were part of is that we have got the best business in town and that business is performing pretty well. In fact, I think Phil was outspoken when we were preparing that it has outperformed the North American business. So, the business continues to get better.

That said, it is still dilutive to our margin, and I think we would argue that we got lots of opportunities to take advantage of, including investing in our own Company, which is more North American centric.

So, I think that the answer is the business continues to perform better than it has been and probably historically good. That said, is there action and are we evaluating our choices here? The answer is yes. And I think we're pretty comfortable about that. I don't know, Randy -- it is really Randy's project. You want to talk about it at all?

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

No, Jim is right on. We are exploring a lot of ideas with potential partners and making progress, and I think at some point we will have something to announce. Nothing imminent at this point, but we are focused on it.

Joe Altobello - *Raymond James & Associates, Inc. - Analyst*

Okay. There has been some chatter about some changes in the regulatory environment in Europe. Does that complicate your plans?

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

Look, the business in Europe for everyone is very pesticidal, okay? And, so, if you look at where the margin is for us, Syngenta, everybody who has got consumer businesses, I mean, sort of the old Syngenta, [Compo], pesticides matter, okay? And if you are seeing more activity on -- Canadian-like activity on green actives, you could either say it is a big issue, and I think Mike and I have talked about this before, or you could say it is a big opportunity.

And I think it has turned into a big opportunity for us in Canada, but you got to start by saying, yo, I was going to use some bad language, you MF, embrace your reality and stop hoping you can change the green motion and some of these regulatory environments, like Europe or Canada, and start saying we need to have unique and interesting actives.

A lot of the actives today are pretty much commodities, okay? The ability to have actives that work in these environments tends to offer the people who do it a much more unique and proprietary opportunity to exploit margin, and Mike and I think his R&D community have made a tremendous amount of progress in identifying actives that we could use that give consumers a reasonable response.

The Roundup deal that we did was a very significant contributor toward that sort of opportunity. In the past, you'd have -- look, first of all, I believe glyphosate is a superb and safe active, okay? I don't really understand the criticisms of it when there has been repeated evaluations of the active by both the German and Canadian government that have said it is a clean active.

And I think if you look and say relative to the arsenic-based herbicides that existed in the world of agriculture prior to it, a very good and low-impact active ingredient glyphosate continues to be.

But it doesn't change the fact that there is pressure within Europe on glyphosate, unfortunately. But that said, part of our new agreement that Randy and I worked out with our partners in St. Louis was not just making it a safer agreement for us, but also giving us the opportunities to substitute actives beyond -- besides glyphosate and use the Roundup mark.

And we are very deep in that process and I think -- so I think that we are in a really good spot, to be honest. I think that we have got alternative actives. The agreement with Roundup made it very simple to substitute natural actives, which we have, for those products, and Mike's work with some of our big ag suppliers on natural or low-impact actives I think look really good for the future. So, Randy?

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

Yes, the only thing I would add, Joe, is it is an obvious question that comes up in conversation, so we are obviously transparent from the very start on this.

But we have been investing a couple million dollars in R&D and regulatory in Europe over the last couple years just to prepare for the inevitable, so we feel like we have been proactive. We are ahead of the curve, and even though there is some bans that are coming in, I will call it, 2019/2020, what we have actually seen is a lot of those transitions we are making at retail today. So by the time we get to the point where there is an official ban, we will have already gone through these transitions and substitutions.

So, we feel like we are being proactive and we are ahead of the game, and we haven't received a whole lot of pushback on that from exploratory discussions that we have had because I think it is a sincere point of view.

Joe Altobello - *Raymond James & Associates, Inc. - Analyst*

Great, that's very helpful. Just one quick one for me. The $900 million in incremental share repo, it is a pretty big number. It is about 20% of your market cap. What is the timing on that? Is that the next three years or so you expect to do that?

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

I think that's a fair timeline. Next year, we are targeting around $300 million, and as we continue to grow and generate more cash and continue to maintain leverage around 3.5 times, it will provide 2018/2019 similar numbers, if not larger.

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

But you know, Joe, we talked about this in regards to long-term comp plans, which we have a meeting -- I go right into a comp and org meeting, because we are at a Board meeting right now, right out of this meeting.

This Project Focus plan for us is the longest -- I think it is the most clear and obvious strategic plan we have ever had. I think our Board agrees with that and I think a lot of our big investors do as well. But it is beyond a five-year plan.

So I think if you say this $900 million, it is -- part of what we are trying to drive with this incentive is that once we close the M&A book, and let's just make the assumption that includes Europe, now we are totally focused on the shareholder-friendly side of this.

And I think we have been pretty clear that, all things being equal, we would like to see a very significant reduction in our share count, without getting to the point where we deal with more independence issues and stuff like that. And I think that's pretty clear that we don't drive the Hagedorns over 50%, which is a residual and alive part of the merger agreement that would force Hagedorns to make an offer to buy the whole Company, which I don't think we are looking to push toward that and I think everybody is happy about that, the family and the Board.

So we're looking at a pretty significant reduction, but not so far that it would drive that, and to do that within the leverage and cash flow, which are the two limits that would drive that, limits that we have. It is probably something less than 10 years and probably something more than five years.

So the $900 million really is an authority to get it on, but we are not looking to stop there. We are looking to continue, and so what we are trying to do is align our long-term plan where somebody would say, well, how exciting is it really being at Scotts if what you're doing is a [beck] at trying to run your business like a private-equity player would run it?

Part of it is I have got some gray-haired people around the table with me here, and they either are or would be over the period of the plan retirement eligible, and so part of our long-term plan is to keep them engaged, make it exciting, and get people to the finish line. But the finish line is beyond the scope of what we generally have been talking about, which we tend to talk in three-year terms. So this will be a multiple of that, and this authorization from the Board for $900 million really is just the beginning of that process.

Joe Altobello - *Raymond James & Associates, Inc. - Analyst*

Great. Thank you, guys.

Operator

Jeff Zekauskas, JPMorgan.

Jeff Zekauskas - *JPMorgan - Analyst*

I think some of the pricing you got in your products this year had to do with raw material cost inflation that happened a few years ago, and obviously raw materials have come down this year and they will come down next year. As a base case, do you expect your product prices to fall in 2017 in the US or do you think it will be 2018 before you feel the price pressure?

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

Listen, our belief is that we need to be picking up about 0.5 points of gross margin accretion per year, and we think that's reasonable. And that's across the entire -- it is not by product, but it would be across the entire matrix of products that we sell.

I do think that we are seeing more -- I am not -- so the idea of prices going down with us, definitely not, okay? So I can answer that one easily, and I'm sure Mike will pick up the pieces here and help with that, but definitely do not see our taking our prices down.

I think we see a little more pressure and pushback at the retailer level, which is -- we haven't seen in a while, which is more consumer oriented. And that, I think that's fine, and so that's not -- I wouldn't take that as a negative. I would view that as retailers up until, call it, maybe this year or last year have been, whatever you guys want to do is okay. They are now pushing back a little bit, and I view this as this is what you're seeing with Wal-Mart and Craig Menear at Depot.

And I view that as not challenging or negative at all, except to say they are more outspoken, I think, about distribution costs and how to share opportunities that we can jointly find. But that does not mean we don't see pricing for next year; we do. But I do think that there is some tension in the discussion and I think that's generally healthy.

And so, I am not concerned about our goal of 50 basis points of accretion. I see that as important to us, but it is the jet fuel it takes to invest in our business, and I think our retailers need to understand that healthy margins within our business allow us to invest in our business and grow these categories. And I think without growth, it is a whole (expletive), (expletive) place to be and I'm not okay with that, okay?

So I do think we need -- we are the leaders in this business and we can't just say we are happy with flat. We are not. I think we had the discussion earlier on lawns, and we are looking very hard at saying what truly is happening in our lawns business? We also talked about the pesticide business, which I feel really good that Mike has got a plan on.

So, I don't think gross margins are a bad story. While I think we are seeing some tailwinds, we're still taking pricing. It is just smaller than we were back in the day when we were taking 3%, 4% per year, but we still intend to take pricing this -- this coming year, in 2017. Everybody wants to talk on this one.

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

This is Randy again. So just for a little context, in my 17 years here I can only recall one instance where we reduced pricing on a branded product and it wasn't tied to commodities; it was due to a competitive situation a couple years ago, which we have talked about at length. So, that's really not the dynamic that we see in our category.

And the other thing is our pricing capability's improved a lot over recent years, so in years past where we may have taken a peanut butter price increase on invoice sales, now it is much more targeted. It is done in a way that both the retailer and we can win, and it doesn't price the consumer out of a particular place.

And the other thing I would add is pricing can take various forms, so there's ways to enhance margin without having to just take a price increase on a product. There is resizing and different ways to get to the same answer, and we are thinking through all those types of approaches.

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

Trade, promotion, so all those got to be effective, and the reinvestment is to go back to drive category growth. As the category leader, we need to drive growth, so a lot of this is repurposed to drive more growth.

Jeff Zekauskas - *JPMorgan - Analyst*

Okay, and for my follow-up, you have bought Gavita. In rough terms, how do the sales split between Europe and the US? And my impression is these are relatively expensive grow lights or that is the main thing that they do. Is there a negative price dynamic or a positive price dynamic, or do you worry about prices for these lights over time?

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

It is probably say -- I worry about everything. Right now, I would say they can't make things fast enough, okay? And they don't sell themselves.

First, I think I have said this a bunch of times, which the people we have met in the businesses we've purchased or bought large shares of, these are not the dregs. These are the top-of-the-line business leaders in this space is the companies we have been investing in.

And the Gavita team, and I want to call them out specifically, these are extremely professional operators, okay? And so to the first part, I think 80%-plus of their business is US-based, okay? They make no bones that they operate at the high end of the market and that their lights are better. So I don't think they operate that.

We are looking at that and saying, who is the competitors? This is part of what we can add is let's look at the entire category, and do we need to play just in the premium space or are there opportunities to play in the mid-tier prices as well? I am not sure we have any desire to participate at the commodity and opening price-point side, which I think generally are reserved for our distributors. They are selling appliances, I will call them that for the moment, in that space.

But I think on the mid-tier, there are opportunities that we are looking at, and when we talk about within Hawthorne, some of the money that Mike has before the M&A book closes this year is focused on Hawthorne, and we are looking at opportunities on that mid-tier lighting side. But I think probably we would want to participate in mid-tier and high end.

Jeff Zekauskas - *JPMorgan - Analyst*

Okay, thank you so much.

Operator

Eric Bosshard, Cleveland Research Company.

Eric Bosshard - *Cleveland Research Company - Analyst*

A couple things. First of all, I wasn't totally clear within the guide on the US growth, the up 2% that I think you reported through June, and then you talked about August and September. Can you give us a sense of what that up 2% you are expecting by the end of the year, and within that what happened in July?

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

Sure, Eric, this is Randy. The 2% year to date we are expecting to be closer to flat by the end of the year. The primary reason is the timing of how our calendar works, so we're going to lose about 1 point of growth or more than that, actually, for the whole Company over the fourth quarter, and the rest of that is just trying to end the season in a good place, so make sure that we have plenty of inventory in the stores to match POS, but we don't want to do anything dramatic and make sure we're in good shape going into next year as well.

Eric Bosshard - *Cleveland Research Company - Analyst*

And then July, any insight? I know the month is over now. Any insight on July?

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

Yes, June is about twice the size of July and June was up 13%. July was about flat, so when you average it out, the summer has done well. Sometimes you say the spring moves into June. Halfway through June, you're talking summer. But we are pleased with the outlook over the next two months and we think we're going to finish the year strongly.

Eric Bosshard - *Cleveland Research Company - Analyst*

And then (multiple speakers)

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

And when he says about flat, it is not negative about flat. It is positive about flat, so maybe we are arguing over nothing, but we're not trying to hide something here.

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

Exactly.

Eric Bosshard - *Cleveland Research Company - Analyst*

Okay. And then, secondly, I think 40% of the business is fertilizer and controls and now it sounds like 10% is Hawthorne. Two separate questions, on the 40%, and I appreciate the bullishness about the fertilizer business, but it seems like there has been some market challenges in growing fertilizer for a while, and more recently there has been pricing challenges, it feels like, in the controls business.

And so I guess as you look out over the next three or four years, what is the vision for the growth profile of that 40%? I know the 10% is interesting, but in terms of that big piece of the Company, where do you see that going and what is the driver (multiple speakers) for better sustained performance there?

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

I think on fertilizer, if I can get 1%, I'd be happy. I think there is some other -- trying to get out of the micro season of having one application and depending on those micro seasons is very tough for us, and so Halts would be an example. I would say we doubled down on that. I would still make that same bet, but the season cut off and then you miss the season, because we were up 15%.

So, if there is things we can do with the product to extend it and make it a more full solution, which we are working on, I'm actually bullish on that. I also think the number of apps and our new summer product will actually drive activity, which is actually related more to water.

On the controls, I am really excited about the Roundup extensions, and I think what you're going to see there is premium products and so I look at tremendous growth there in the category and using Ortho. And we're repositioning Ortho that it has a true meaning on bug, and using it as a fighter in weed, use of RAID and the Off brand.

So you're going to see that whole -- I actually think that we're going to actually do very, very well there, so projection of growth, I would be throwing out a number, but it is mid-single digits, okay, how about that? They are all looking at me.

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

(multiple speakers). I wasn't actually looking at you, dude.

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

But I am really bull in that change, but it was something we needed to do, and then we got some natural products in that category and also natural products for the lawn category that will be game-changing. So, I am bullish about where we're going with that.

Randy Coleman - *The Scotts Miracle-Gro Company - EVP, CFO*

I know you want to go negative on this, and, look, I would start by saying of our entire analyst community, I think you are super tight, and so while I may not always agree with you, I think you are a really good analyst. And so, I know when I am talking that you know what I am talking about, which is that this season for lawns almost could not have been worse, okay? And so, I don't want to get too crazed over -- like I said before, you mess up Texas, California, and New York, you can't have a good season, okay?

And that's part of what's going on here. I think we said that mass did less well. That has a lot to do with the numbers, so if you were to pull apart and you had our numbers, I think you would say, well, there is a story there, okay? And it is what it is. And we are working on that, and I know our retail partners are engaged in trying to do better as well where there is opportunity to do that.

In addition, there is more activity in R&D. This new, I think, [weed] stick or something we call it technology, which is a brand-new granule that gives 40% better performance on the same level of active on the granule, that's a brand-new product that happened in 2016, so major improvement in how the product works occurred the year now.

There are new products and combos that say, you know what, if we -- to me, in lawns, there is people who apply one bag and then there is people who apply five bags, okay, and that equates to a number we have not moved the number -- the needle very much on, which is how many bags per year do people put down? I think we have talked about a lot. We haven't made a lot of progress on getting people to apply more bags.

I would make the argument that if, to some extent, we can embrace -- if you say there is a one-bag person and then there is a five-bag step person, that one-bag person, let's sell him a better product. Let's sell him something that can do crab and dandelion in the same application, and we have got -- made a ton of progress on being able to do that. And I think Mike has got a plan to introduce that probably in 2018. There is just registration stuff to do.

Plus improved actives in our southern product, which is to continue to look for actives beyond just atrazine for our southern braced weed killers.

So what do I think? I don't think the story is like all glum, and if Mike is especially, which is I'm a big believer in embrace your reality, saying, look, if I get 1% on lawns, I am okay, I think we can easily do that.

And so, I am fairly confident and I think Mike explained well the pesticide area. He's got a good pesticide program, and we tend to see a lot of progress and then fighting back from a strong competitor like Spec where it is like, (expletive), we should have killed them when we could have, when they weren't bankrupt, and Mike has got a new program.

And so, I think we tend to be in a little bit of a tit-for-tat period, but I think we have got a way better program with Ortho, Roundup, non-glyphosate products, and RAID and Off. I just think we have got a really complete program, and Mike wants to jihad with it, so I am pretty happy with that.

Eric Bosshard - *Cleveland Research Company - Analyst*

Okay. And then, last thing, within the Hawthorne portfolio, just a bit of clarity on where you look at creating value within this. Is this buying into a fast-growing business or do you think there are things you can do in expanding their distribution or increasing product investment? Just trying to understand the case for creating value with this portfolio that you have now built?

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

Dude, see, I think of you as a smart dude. It is both. First of all, this is a business that everyone we have invested in is growing, call it, roughly 25% per year. I don't see that stopping, and if you look at the medicinal laws that are taking place in the United States, I think they enhance that. You are now over more than half the states. Now Ohio went medicinal.

So I think the opportunities, there is good runway ahead of us just on outsized growth relative to our existing core business, and that makes it attractive.

In addition, these are good businesses to begin with. I think we have a good vision for where we want to go with that, which means how do we put it together into a singular business a little bit like we did with Scotts North America back in the day because, remember, Scotts was a bunch of businesses much like these businesses and I think we have done a really good job of being an essential partner with our retailers and consumers on our conventional lawn and garden business. And I think we can do that here and tie it all together with a little bit more of a professional bent, which would include technical sales support, high levels of R&D spend, much more professional supply-chain management.

So I think really on both sides of just, do we think the integrated business has higher growth rates that are just systemic to a fast-growing business? Yes. And I think we have a good vision on where we want to go with it that doesn't freak out my Board or my lawyers. And I am really pleased with that.

But I think it is both. I think it is both we have ideas on how we can be good stewards of these businesses and really become essential partners to the community of people who use these products, one, and, two, just take advantage of something that is high margin, high growth. And I had this debate with Mike Porter when Mike was a Board member here that basically was this does so much for us. It is a younger community compared to a much grayer community on our conventional lawn and garden.

It diversifies us on the retailer side. This is a much more independent-based business then our conventional lawn and garden businesses. It is much more West Coast than this is. It is not very suburban. It is more urban and rural. So I think that in so many ways this is a very interesting opportunity for us.

Eric Bosshard - *Cleveland Research Company - Analyst*

That's helpful. Thank you.

Jim King - *The Scotts Miracle-Gro Company - SVP IR & Corporate Affairs, Chief Communications Officer*

Let me jump in here real quick. In the interest of time, I think we're going to take one more question, so let's move forward.

Operator

Jim Barrett, CL King & Associates.

Jim Barrett - *CL King & Associates - Analyst*

Jim, to follow up on your last point, would you compare and contrast Botanicare and GH in terms of franchise quality, financial performance? Is management sticking around with Botanicare? And was it an auction process?

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

No, not an auction process, okay? Without getting into, I think, private details, we have an employment agreement that has been pre-negotiated and agreed to with the CEO, so the answer is yes. And we want the management to continue to stay. So the answer is yes on that.

Was there a part of the question I missed?

Jim Barrett - *CL King & Associates - Analyst*

Talk about the brands and the financial performance relative to GH, please?

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

So I think that both GH and Botanicare are very focused on the nutrient side. Botanicare also has a plastics side of the business that is very interesting for us, so I'd call it hydroponics systems that helps us further expand the line of products.

GH had a very important part as the center of our catalyst for our first acquisition in the space, and I am really grateful for Larry Brooke and his family to have entrusted the business to us. It was a much more informally managed business, I think, than Botanicare, so I think Botanicare has very robust financial systems and management systems that actually make this an easier integration for us than -- but I would say similar businesses in the product line. Although Botanicare a little more on the hydroponics systems -- not maybe a little more, a lot more on hydroponic systems than GH, and probably from financial metrics, probably pretty similar, I would say, as percentages.

But I think we expect a much easier integration than we had with Botanicare than we had with GH. And so, my hat is off to the Botanicare folks for running a real tight business.

Jim Barrett - *CL King & Associates - Analyst*

Great. Thank you and good luck.

Operator

That does conclude today's question-and-answer session. At this time, I will turn the conference back over to Mr. King for any closing remarks.

Jim King - *The Scotts Miracle-Gro Company - SVP IR & Corporate Affairs, Chief Communications Officer*

Okay, thanks. Since Jim Barrett was the last person to ask a question, I will just remind everybody that Randy and I will be at his conference, I think, September 18 in New York, so you can see us there. And I think there were some people who were in the queue that we didn't get to, so feel free to give me a call directly. That is 937-578-5622.

Thanks for joining us and have a good day. Otherwise, we will talk to you all during our Q4 conference call in early November. Bye now.

Operator

And that does conclude today's conference. Again, thank you for your participation.